



# IMF POLICY PAPER

## REVIEW OF THE METHOD OF VALUATION OF THE SDR—PROPOSED EXTENSION OF THE VALUATION OF THE SDR BASKET AND MODIFICATION OF THE DATE OF EFFECT OF A NEW BASKET

March 2021

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- The **Staff Report**, prepared by IMF staff and completed on February 24, 2021. The proposed decision in the paper was approved by the Executive Board on March 5<sup>th</sup>, 2021.
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**International Monetary Fund**  
**Washington, D.C.**



February 24, 2021

## REVIEW OF THE METHOD OF VALUATION OF THE SDR— PROPOSED EXTENSION OF THE VALUATION OF THE SDR BASKET AND MODIFICATION OF THE DATE OF EFFECT OF A NEW BASKET

### EXECUTIVE SUMMARY

**This paper proposes that the Executive Board extend the valuation of the Special Drawing Right (SDR), and change the effectiveness date of the next SDR valuation basket.** The current SDR valuation basket will expire on September 30, 2021, and the Board is expected to conclude the next review of the SDR valuation in time for the next SDR valuation basket to take effect on October 1, 2021. Staff proposes that the current basket be extended from September 30, 2021 through July 31, 2022, and the effectiveness date of the next SDR valuation basket changed from October 1, 2021 to August 1, 2022, allowing for a postponement of the review of the SDR valuation. This proposal would require the Executive Board's approval by a 70 percent majority of the total voting power.

Staff sees merit in the proposed changes for a number of reasons:

- A proposed postponement of the review would contribute to ongoing efforts to prioritize work during the COVID-19 crisis, considering that there is a parallel quinquennial SDR workstream (the case for a general SDR allocation), which, unlike the SDR valuation review, has an end-June 2021 deadline set in accordance with the Articles of Agreement. This postponement is not expected to have major downsides or materially affect the outcome of the next review and would also avoid the bunching of these workstreams in the future.
- The proposed postponement also offers an opportunity to select a more suitable effectiveness date for a new valuation basket taking into account feedback from SDR users who face portfolio rebalancing difficulties as financial markets in China are closed on October 1, the date of effect of a new basket under current Board decisions.

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## INTRODUCTION

**1. The method of valuation of the Special Drawing Right (SDR) is reviewed every five years.** Under the current framework for SDR valuation, this SDR valuation review covers the size of the SDR valuation basket (i.e., the number of currencies in the basket), the specific currencies to be included in the basket, and the respective weights of those currencies. At the same time the Board reviews the financial instruments to be included in the SDR interest basket.<sup>1</sup> On the last business day before a new SDR valuation basket becomes effective (transition date), the amounts of each currency in the SDR basket are determined such that they correspond to the currency weights determined by the Executive Board when completing the review. The currency amounts remain fixed over the five-year SDR valuation period.

**2. Under current Executive Board decisions<sup>2</sup>, the next SDR valuation review will decide on the SDR valuation basket that would come into effect on October 1, 2021.** The Executive Board completed the last SDR valuation review in November 2015. This followed the Board discussion of initial considerations for the review in August 2015. As part of the review decision, the Board approved an extension of the four-currency SDR basket in place at the time beyond December 31, 2015 through September 30, 2016. The Board decided that, effective October 1, 2016, the *renminbi* (RMB) be determined a freely usable currency and that, effective that date, it would be included in the SDR basket as the fifth currency along with the US dollar, the euro, the yen, and the British pound. The Board further decided that the SDR basket should be revised effective October 1, 2021 and thereafter on the first day of each subsequent period of five years.

**3. This paper proposes to change the date for the effectiveness of the next SDR valuation basket from October 1, 2021 to August 1, 2022, effectively postponing the next SDR valuation review to 2022.** With two major five-yearly SDR-related workstreams expected in 2021—i.e., the SDR valuation review and the case for a general allocation or cancellation of SDRs<sup>3</sup>—the proposal to postpone the SDR valuation review would contribute to broader efforts to prioritize work during the COVID-19 crisis and also phase work pressures in the future by eliminating the overlap of these

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<sup>1</sup> The daily valuation of the SDR exchange rate, including the currency amounts that enter its calculation, can be found at [https://www.imf.org/external/np/fin/data/rms\\_sdrv.aspx](https://www.imf.org/external/np/fin/data/rms_sdrv.aspx). The weekly calculation of the SDR interest rate can be found at [https://www.imf.org/external/np/fin/data/sdr\\_ir.aspx](https://www.imf.org/external/np/fin/data/sdr_ir.aspx).

<sup>2</sup> See Executive Board Decision No. 15891-(15/109), adopted November 30, 2015 and Executive Board Decision No. 16061-(16/91), adopted September 30, 2016.

<sup>3</sup> The Articles of Agreement provide for periodic consideration and decisions on SDR allocations or cancellations in the context of consecutive basic periods of normally five years (Article XVIII, Section 2(a)). Pursuant to Article XVIII, Section 4(c), the Managing Director (MD) is required to submit a report on her proposal to the Board of Governors (BoG) regarding a general allocation or cancellation of SDRs for the Twelfth Basic Period no later than end-June 2021. Staff work to assess whether there is a case for an SDR allocation, which will inform the MD's proposal, will thus need to be completed in the first half of 2021.

workstreams. Postponing the review is not expected to have a material impact and the new effectiveness date will improve portfolio rebalancing by SDR users.<sup>4</sup>

**4. The paper is organized as follows.** The next section puts the challenge of conducting the SDR valuation review in 2021 into context and considers the merits of postponing the review to 2022. The subsequent section proposes a specific date of effect of a new basket and discusses other practical and legal considerations. The paper concludes with a draft decision, which may be adopted by the Executive Board by a seventy percent majority of the total voting power.

## CONTEXT AND THE CASE FOR POSTPONING THE SDR VALUATION REVIEW TO 2022

**5. Postponing the review would allow separating the timing of the two important SDR workstreams, thereby helping to alleviate work pressures.** Due to the extension of the then prevailing SDR basket from December 31, 2015 through end-September 2016 and the corresponding reset of the five-year review cycle thereafter (¶2), the work on the SDR valuation review cycle would, going forward, coincide with the work on the SDR allocation—assuming the standard five-yearly cycle of the SDR allocation workstream. A postponement of the SDR valuation review would separate the two workstreams, thereby helping to alleviate work pressures (for staff in affected departments and the Board), not only during the COVID-19 crisis but also in future five-yearly cycles.

**6. Postponing the SDR valuation review would facilitate work prioritization without any major downsides.** It is not expected to materially affect the outcome of the next review given that the methodology used relies on five-year averages of Board-approved indicators to derive the weights of currencies in the basket. There are also no operational concerns for the SDR interest rate.<sup>5</sup>

**7. The SDR valuation review can be postponed by extending the current valuation basket.** The Executive Board may extend the valuation of the SDR basket through an Executive Board decision. In contrast, the timing for the Managing Director to make a recommendation on a general allocation or cancellation of SDRs for the next basic period is established under the Articles, leaving no flexibility to adjust the work program in this area.

**8. Postponing the review would also allow for a more suitable effectiveness date for a new valuation basket while facilitating planning.** October 1 coincides with the beginning of the

<sup>4</sup> The term “SDR user” refers to both the participants in the SDR Department, the IMF and its members, and 15 prescribed holders regarding their use of official SDRs, and to third parties in their use of the SDR as a unit of account or other reference, for example, deposits denominated in SDR or investment products based on the SDR basket composition.

<sup>5</sup> The SDR interest rate would continue to be determined weekly based on a weighted average of representative interest rates on short-term government debt instruments in the money markets of the SDR basket currencies, with a floor of 5 basis points (Rule T-1). As usual, the next SDR valuation review will cover also the review of the financial instruments included in the SDR interest rate basket.

Chinese Golden Week holiday during which financial markets in China are closed. SDR users have therefore indicated, based on their experience in 2016, that October 1 is not a suitable date of entry into effect of a new basket as it complicates portfolio rebalancing. They have suggested that it would be best to avoid changes on dates around which markets are closed or trading is thin in major markets and a change in the effectiveness date is an opportunity to take these constraints into account.

## PROPOSED CHANGES

### 9. **Staff proposes to extend the current SDR valuation basket from September 30, 2021 through July 31, 2022 and change the effectiveness date of a new basket to August 1, 2022.**

The proposed extension of the current SDR valuation basket would permit a Board discussion of the SDR valuation review in late spring of 2022, leaving sufficient time between the two major SDR-related workstreams to conduct the analysis.<sup>6</sup> The selection of the proposed effectiveness date of a new SDR valuation basket takes into account practical accounting considerations. In particular, it appears desirable to have SDR basket changes enter into effect at the beginning of a month consistent with the standard market practice of rebalancing portfolios at month beginnings. There is no timing limit on the effectiveness of the related SDR interest rate basket, which has been determined in accordance with Article XX, Section 3.<sup>7</sup>

**10. The proposed decision on extension of the current SDR basket may be adopted by a 70 percent majority of the total voting power.** The special majority is required as the extension of the current SDR basket to July 31, 2022 and the establishment of a new effective date for the next SDR basket would deviate from the periodicity of SDR valuation, which constitutes part of the current valuation method (Article XV, Section 2). If the proposed changes are approved, the SDR valuation basket that would be decided at the conclusion of the next SDR valuation review would take effect from August 1, 2022.

**11. The delay of the new basket effectively resets the five-yearly cycle of the SDR valuation reviews.** The current SDR valuation basket would be extended to July 31, 2022 and the next SDR valuation review should take place in time to allow for the new basket to take effect on August 1, 2022. Thereafter, the five-yearly revisions of the SDR basket would be taking effect on August 1. In line with previous practice, it is expected that the Executive Board's decisions regarding SDR basket revisions would be adopted well in advance of the August 1 date in order to provide sufficient notice to allow adequate time to make necessary changes and to complete any consultations that might be required.

<sup>6</sup> If the proposed changes are approved, a press release will be issued to inform interested parties.

<sup>7</sup> The SDR interest basket consists of the following representative interest rates for the five SDR basket currencies: three-month benchmark yield for China Treasury bonds as published by China Central Depository and Clearing Co; three-month spot rate for euro area central government bonds with a rating of AA and above published by the European Central Bank; three-month Japanese Treasury Discount bills; and three-month UK Treasury bills; and three-month US Treasury bills.

## Proposed Decision

The following decision, which may be adopted by a 70 percent majority of the total voting power, is proposed for adoption of the Executive Board:

“Notwithstanding Paragraphs 2 and 4 of Executive Board Decision No. 15891-(15/109), adopted November 30, 2015, the SDR valuation basket determined under Executive Board Decisions No. 15891-(15/109), adopted November 30, 2015 (as amended), and No. 16061-(16/91), adopted September 30, 2016, shall remain in effect through July 31, 2022.”