



IMF POLICY PAPER

USE OF SDRS IN THE ACQUISITION OF HYBRID CAPITAL INSTRUMENTS OF THE PRESCRIBED HOLDERS

May 2024

IMF staff regularly produces papers proposing new IMF policies, exploring options for reform, or reviewing existing IMF policies and operations. The following documents have been released and are included in this package:

- A **Press Release** summarizing the views of the Executive Board as expressed during its May 10, 2024 consideration of the staff report.
- The **Staff Report**, prepared by IMF staff and completed on April 15, 2024 for the Executive Board's consideration on May 10, 2024.

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International Monetary Fund
Washington, D.C.



IMF Executive Board Approves the Use of SDRs for the Acquisition of Hybrid Capital Instruments Issued by Prescribed Holders

FOR IMMEDIATE RELEASE

Washington, DC –May 15 2024: The Executive Board of the International Monetary Fund (IMF) authorized on May 10 the use of [Special Drawing Rights](#) (SDRs) by IMF members for the acquisition of hybrid capital instruments issued by prescribed holders (official entities approved by the IMF to hold SDRs). A hybrid capital instrument is a financial instrument with perpetual maturity that has both equity and debt properties.

The use of SDRs to acquire hybrid capital instruments adds to seven SDR prescribed operations already authorized (see background below). The new SDR use will be subject to:

- a cumulative limit of SDR 15 billion, and
- the expectation that IMF members channeling SDRs to prescribed holders under such capital contributions have [Voluntary Trading Arrangements](#) (VTAs) in place to help ensure sufficient liquidity and an equitable distribution of potential SDR exchanges into currencies in the VTA market.

A review of the new SDR use is expected to be conducted when cumulative hybrid capital contributions surpass SDR 10 billion or two years after the authorization, whichever comes first.

The authorization provides members with the possibility to consider the use of SDRs in the acquisition of hybrid capital instruments issued by prescribed holders. The decision whether to use SDRs to acquire hybrid capital instruments rests solely with each member country. Some member countries are impeded to engage in this type of operations due to domestic constraints.

Executive Board Assessment¹

Executive Directors approved the decision to expand permitted use of SDRs by authorizing the use of SDRs in the acquisition of hybrid capital issued by prescribed holders, adding to the seven currently authorized financial

¹ At the conclusion of the discussion, the Deputy Managing Director, as Chairman of the Board, summarizes the views of Executive Directors, and this summary is transmitted to the country's authorities. An explanation of any qualifiers used in summings up can be found here: <http://www.IMF.org/external/np/sec/misc/qualifiers.htm>.

operations which are (i) the settlement of obligations, (ii) loans, (iii) pledges, (iv) transfers as a security for performance of financial obligations, (v) swaps, (vi) forward operations, and (vii) donations.

Most Directors agreed that the authorization could help broaden the use of SDRs and increase the attractiveness of the SDR as a reserve asset. However, a number of Directors did not share this assessment and some would have preferred a broader principles based review to have taken place before taking any decisions. Most Directors agreed that the proposed use of SDRs is consistent with the Articles of Agreement, as well as with the policy motivations of previous authorizations of SDR uses. Many Directors however raised varying reservations about the use of SDRs as hybrid capital, with a number of Directors having remaining questions about consistency of the proposal with the intended purpose of SDRs and the role of the IMF.

Directors also emphasized that while the decision creates an option for members to use their SDRs to acquire hybrid capital instruments of prescribed holders, it is the sole decision of individual members whether to use their SDRs in this way. They also noted that many members will not in practice be able to channel SDRs in this manner due to domestic constraints.

Directors agreed that the expansion of permitted use, in the form of a general decision, should be subject to ex ante risk mitigation measures. In this context, they supported the proposal that authorization be subject to a cumulative limit of SDR 15 billion on the use of SDRs for hybrid capital acquisition, with the limit designed to minimize any possible liquidity risks while providing room for participants in the SDR Department to channel SDRs to multilateral development banks (MDBs) by acquiring hybrid capital instruments issued by these banks. A number of Directors expressed evenhandedness concerns from the “first come, first served” basis implicit in the limit for any prescribed holder wishing to channel SDRs into hybrid capital instruments.

Directors supported the proposal to conduct a review of the proposed use when cumulative hybrid capital contributions surpass SDR 10 billion or two years after the authorization, whichever comes first. This review would assess experience with the proposed SDR use and encompass the other already authorized uses, thereby providing the Executive Board with an opportunity to discuss the scope of SDR operations by prescribed holders in a holistic manner.

To address concerns over SDR market liquidity risks and equitable burden sharing of potential SDR exchanges into currencies in the VTA market, Directors expressed the strong expectation that participants availing themselves of the new use participate in the Voluntary Trading Arrangements (VTAs). However, a few Directors would have preferred a requirement for an explicit commitment to participate in the VTA market.

Directors called on staff to closely monitor the operations related to the use of SDRs for the acquisition of hybrid capital instruments and to bring any issues that could affect the functioning of the SDR Department to the attention of the Executive Board. They also called for a careful communication strategy concerning the new authorized SDR use that appropriately manages external expectations.

Background

The SDR is an international reserve asset created by the IMF to meet the long-term global need to supplement the existing reserve assets of IMF members. SDRs are allocated only to IMF members participating in the SDR Department. SDRs can be used by holders in spot transactions for exchanges into currencies and in financial operations authorized by the IMF. With the objective of making the SDR the principal reserve asset of the international monetary system, between 1978-1980 the Executive Board adopted decisions allowing SDR Department participants (currently all IMF members) and prescribed holders to use SDRs for seven operations: (i) the settlement of obligations; (ii) loans; (iii) pledges; (iv) transfers as a security for performance of financial obligations; (v) swaps; (vi) forward operations; and (vii) donations. The IMF has authorized [20 official entities](#) as prescribed holders of SDRs.

Related links

FAQ: [Hybrid Capital Instruments](#)



April 15, 2024

USE OF SDRS IN THE ACQUISITION OF HYBRID CAPITAL INSTRUMENTS OF THE PRESCRIBED HOLDERS

EXECUTIVE SUMMARY

The Special Drawing Right (SDR) is an international reserve asset created by the IMF to meet the long-term global need to supplement the existing reserve assets of IMF members. SDRs are allocated to IMF members participating in the SDR Department, in proportion to their IMF quotas.

SDRs can be used by holders for spot exchanges into currencies and several other authorized financial operations. With the objective of making the SDR the principal reserve asset of the international monetary system, between 1978-1980 the Executive Board adopted decisions allowing SDR Department participants (currently all Fund members) and prescribed holders (official entities that are approved as holders of SDRs) to use SDRs for: (i) the settlement of obligations; (ii) loans; (iii) pledges; (iv) transfers as a security for performance of financial obligations; (v) swaps; (vi) forward operations; and (vii) donations.

This paper discusses the authorization of the use of SDRs in the context of SDR Department participants' acquisition of hybrid capital instruments issued by prescribed holders. A hybrid capital instrument is a financial instrument with perpetual maturity that has both equity and debt properties. Following the 2021 general SDR allocation, some multilateral development banks (MDBs) have developed a proposal under which they could receive SDRs channeled by member countries as hybrid capital contributions. Since the use of SDRs for the acquisition of hybrid capital instruments does not fall into any of the already prescribed SDR operations, Executive Board authorization of this new use would be required. Pursuant to Article XVII, Section 3, such a decision could be adopted by a majority of votes cast.

Staff recommends such authorization, subject to risk mitigations. The authorization would help broaden the use of SDRs and increase the attractiveness of the SDR as a reserve asset. By facilitating SDR channeling to prescribed holders in the circumstances specified in the proposal, it would also support the ambition of the international community to further enhance the impact of the 2021 allocation to benefit countries most in need, doing so in a manner consistent with the Fund's mandate. Staff assesses that the proposed use of SDRs is consistent with the Articles of Agreement and proposes Board authorization subject to (i) a safeguard in the form of a cumulative limit of SDR 15 billion to address possible liquidity risks, (ii) the establishment of a strong

expectation that contributors channeling SDRs to prescribed holders under such capital contributions will have Voluntary Trading Arrangements (VTAs) in place to ensure fair burden sharing, and (iii) a review of the use of SDRs for the acquisition of hybrid capital instruments when the channeled amounts surpass SDR 10 billion or two years after the authorization, whichever is earlier. With these measures in place, staff assesses that the proposed use of SDRs would be in line with the effective functioning of the SDR Department.

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INTRODUCTION

1. The Special Drawing Right (SDR) is an international reserve asset created to meet the long-term global need to supplement the existing reserve assets of IMF members. SDRs are allocated to IMF members participating in the SDR Department in proportion to their IMF quotas.¹ Pursuant to Article XVII of the Articles of Agreement, SDRs can be held only by the official sector, i.e., Fund members that are participants in the SDR Department (currently all Fund members), the Fund itself (through the General Resource Account, GRA), and other official entities authorized by the Fund (referred to as “prescribed holders”). Prescribed holders and participants can hold SDRs, and by agreement either enter into spot transactions to exchange SDRs for currencies or acquire and use SDRs in prescribed operations authorized by the Fund (Annex I and II).²

2. There are seven prescribed SDR operations currently authorized by the Fund. With the objective of making the SDR the principal reserve asset of the international monetary system, between 1978-1980 the Executive Board adopted decisions allowing prescribed holders and participants to use SDRs in seven specific operations, including: (i) settlement of obligations; (ii) loans; (iii) pledges; (iv) transfers as a security for performance of financial obligations; (v) swaps; (vi) forward operations; and (vii) donations. These prescribed operations apply both to participants and prescribed holders in the SDR Department.³ The most frequently used prescribed SDR operations between participants or between participants and prescribed holders include loans and the settlement of financial obligations, including payment of capital subscriptions (Box 1).

Box 1. Experience with SDR Operations

Participants in the SDR Department and prescribed holders can use their SDR holdings unconditionally. Upon allocation, SDR Department participants (currently all Fund members) receive SDRs as a foreign-currency asset (the SDR holding), with a corresponding liability (the SDR allocation). Some participants hold SDRs to boost their reserves. Others may buy or sell SDRs for currencies or use them for other financial operations authorized by the IMF Executive Board, including with prescribed holders.

Most SDR transactions consist of exchanges of SDRs for currencies through Voluntary Trading Agreements (VTAs), with a few exchanges being conducted bilaterally between participants or prescribed holders. The VTAs remain the primary vehicle for the exchanges of SDRs, having supported the

¹ According to the Articles of Agreement, general allocations of SDRs are distributed to participants in proportion to their quota shares at the Fund.

² See the definitions of “transactions” and “operations” in SDRs in [Articles of Agreement](#), Article XXX(i).

³ Participants are authorized to use SDRs in accordance with the terms and conditions under the relevant decisions which prescribe specific SDR operations. See Decision No. 6000-(79/1) S, December 28, 1978, as amended; Decision No. 6001-(79/1) S, December 28, 1978; Decision No. 6053-(79/34) S, February 26, 1979, as amended; Decision No. 6054-(79/34) S, February 26, 1979, as amended; Decision No. 6336-(79/178) S, November 28, 1979; Decision No. 6337-(79/178) S, November 28, 1979; and Decision No. 6437-(80/37) S, March 5, 1980. For prescribed holders, the Board adopted a decision granting them the rights to conduct SDR transactions and operations on the same basis as participants. See Decision No. 6467-(80/71) S, April 14, 1980.

Box 1. Experience with SDR Operations (concluded)

conversion of over SDR 238.7 billion since the inception of the SDR Department, and SDR 54 billion since the 2021 SDR allocation as of end-March 2024 (Box 4). Bilateral transactions among participants or with prescribed holders are generally arranged with minimal involvement of the Fund and have been much more sporadic, amounting to about SDR 8.3 billion over the lifetime of the SDR Department (SDR 714.6 million since the 2021 allocation).

Unlike SDR transactions (i.e., currency exchanges for SDRs), SDR operations have been relatively limited. Since inception of the SDR Department through end-March 2024, SDR operations amounted to about SDR 36.5 billion or 10.8 percent of total SDR transactions. The most frequently used operations include SDR loans (SDR 16.2 billion) and the settlement of financial obligations (SDR 18.2 billion), including payment of capital subscriptions. Other operations include swaps (SDR 1.5 billion) and forward operations (SDR 481.6 million), although these date back more than 20 years, and donations (SDR 79 million).

3. Following the historic 2021 general SDR allocation, the international community embraced the ambition of voluntarily channeling SDRs to benefit countries most in need.⁴ In the wake of the 2021 allocation, the Fund has engaged with its membership to identify viable options for the voluntary channeling of SDRs from countries with strong external positions to weaker and more vulnerable countries, including through the Poverty Reduction and Growth Trust (PRGT) and the Resilience and Sustainability Trust (RST). In addition, the G-20 and the Fund’s Managing Director in her 2021 Global Policy Agenda have supported the exploration of options to channel SDRs to multilateral development banks (MDBs), while the International Monetary and Financial Committee (IMFC) has called on Fund staff to provide technical support for this purpose.⁵

4. The African Development Bank (AfDB) and the Inter-American Development Bank (IDB) have developed a proposal under which member countries may channel SDRs as hybrid capital contributions to help expand their lending capacity. These two MDBs—which are prescribed holders of SDRs—have designed the technical and operational features of their proposed instrument in consultation with Fund staff. The AfDB/IDB proposal envisages a mechanism that would allow participants in the SDR Department to channel SDRs to MDBs in the form of loans with perpetual maturity that meet rating agency criteria and accounting standards for their classification as equity (a form of hybrid capital with features of subordinated debt which can be used to absorb losses, see also Box 2). The proposal incorporates experience from the design of the PRGT and RST, including regarding mechanisms to ensure reserve asset status under applicable statistical guidelines of the claims resulting from SDR channeling, and takes into account the operational features of the SDR Department.

⁴ A general SDR allocation is a way of supplementing Fund member countries’ foreign exchange reserves, allowing members to reduce their reliance on more expensive domestic or external debt for building reserves. Such a decision, which is taken by the Board of Governors, requires a finding by the Fund that there is a long-term global need to supplement existing reserve assets.

⁵ See [Communique G20 Finance Ministers and Central Bank Governors Meeting \(October 2021\)](#); [The Managing Director’s Global Policy Agenda \(October 2021\)](#); and [Communique of the Forty-Fourth Meeting of the IMFC \(October 2021\)](#).

5. This paper discusses the possible expansion of authorized SDR uses to encompass participants' acquisition of hybrid capital instruments issued by prescribed holders. As this new use of SDRs does not fall into any of the seven currently prescribed SDR operations, a decision by the Executive Board adopted by a majority of the votes cast would be required to approve such use. Staff recommends the adoption of such a decision.

6. The paper is organized as follows. The first section describes the proposed use of SDRs in the acquisition of hybrid capital of prescribed holders. The next section covers the legal framework and requirements for authorizing a new SDR operation. The following section discusses staff's assessment as to whether this new SDR operation meets the relevant requirements under the Articles of Agreement for prescription, followed by a discussion on implications for enterprise risks. The last section details staff's proposal to prescribe the use of SDRs in the acquisition of hybrid capital instruments issued by prescribed holders.

THE PROPOSED NEW SDR OPERATION

7. This paper proposes that the Executive Board authorize the use of SDRs held by participants in the SDR Department in the acquisition of hybrid capital instruments issued by prescribed holders. A hybrid capital instrument is a financial instrument with perpetual maturity that has both debt and equity properties. Such instruments are specifically designed to be subordinated to other types of debt issued by prescribed holders and may be written off to absorb losses. The specific form of such instruments could vary across channeling schemes, depending on applicable accounting standards (e.g., IFRS, US GAAP), prescribed holders' own internal risk capital models, and the methodology of credit rating agencies for recording the instrument as equity on the balance sheet of a prescribed holder of SDRs. For example, in the proposal of the AfDB and IDB, the hybrid capital would be structured as a perpetual SDR-denominated loan instrument issued by MDBs to members of the Fund (contributors) with strong external positions (Box 2). Upon receiving SDRs as proceeds from their sale of hybrid capital instruments, prescribed holders could either hold the SDRs on their balance sheet or exchange them for currencies, including through the Voluntary Trading Arrangements (VTAs), which are bilateral arrangements between the Fund and SDR Department participants or prescribed holders.⁶

8. The proposed use of SDRs for the acquisition of hybrid capital instruments issued by prescribed holders would not be subject to any requirement that the claims under these instruments have or maintain reserve asset quality. The quality of any claims arising from the use of SDRs is conceptually separate from the reserve asset quality of the SDRs. While any underlying claim resulting from the use of SDRs may have reserve asset quality, this is not a requirement under the Articles of Agreement or the Fund's decisions authorizing current uses of SDRs. For instance, in the case of SDR loans, there is no requirement that the resulting claims of the lender have reserve

⁶ In their VTAs, SDR Department participants and prescribed holders agree to buy and sell SDRs within certain limits. The trading range for VTAs with participants is expressed in terms of upper and lower limits for SDR holdings as a percentage of the SDR allocation, while for prescribed holders the trading range is fixed in nominal SDR terms (currently, the European Central Bank is the only prescribed holder with a VTA).

asset characteristics, and such loans could be made with or without an encashment regime, resulting in claims that may or may not have reserve asset status.⁷

Box 2. Summary of the AfDB/IDB Proposal on SDR Channeling

The AfDB/IDB channeling proposal envisages the issuance of an SDR-denominated and settled hybrid capital instrument. The instrument would constitute subordinated debt that can be accounted for as equity on the MDBs' balance sheet based on applicable accounting standards, internal risk capital models, and the methodology of major credit rating agencies. Under the proposal, hybrid capital would be structured as a perpetual SDR-denominated loan issued to Fund members (contributors) with strong external positions. The two MDBs would initially not expect to exchange the SDRs received for another currency but would hold them in their accounts in the IMF's SDR Department.

The hybrid capital instrument would be callable under some conditions, would be junior to other debt, and its interest could be cancelled in tail scenarios of portfolio losses. The hybrid capital instruments would rank junior to subordinated and unsubordinated debt of the MDB, but it would be senior to the paid-in capital provided by shareholders. It would pay the SDR interest rate plus potentially a spread to compensate contributors for incurred SDR interest charges on their allocation. The MDBs would have a discretionary right to cancel interest payments and a mandatory right to cancel interest payments in the remote case of significant losses across their loan portfolios.^{1/} Should a trigger event be reached and the MDB be in such severe financial distress that it can no longer service its debt or honor its guarantees and therefore has to resort to calling its callable capital, the principal of the SDR loan would be written off right before the capital call.^{2/} This would be a remote scenario based on the past experience as the AfDB and IDB have AAA credit ratings and have never made a capital call.^{3/} The MDBs would have a discretionary right to prepay the loan instrument at par following a "non-call" period of 10 years after issuance and on agreed subsequent dates thereafter, provided a financial trigger event has not occurred.^{4/}

The proposal is underpinned by a liquidity support agreement (LSA) broadly modelled after the encashment regimes of the PRGT and RST.^{5/} The LSA establishes an obligation of contributing countries to provide on demand the needed liquidity to assume another contributor's hybrid capital claim if the latter faces a balance of payments (BoP) need. Other (non-contributing) countries would also be able to participate in the LSA by providing a liquidity guarantee to the contributors that would be triggered once the primary liquidity arrangement is exhausted.

The two MDBs would expand their lending by leveraging the additional capital through borrowing in international financial markets. Thus, the additional capital would allow for a more-than-proportional expansion of lending. By increasing their equity, the AfDB and the IDB would have additional capacity to make loans to their member countries through their existing lending facilities.

The AfDB/IDB hybrid capital instrument would meet reserve asset quality requirements conditional on sufficient participation by contributors with strong external positions. Based on the design of the proposal, staff judges that the claims of the hybrid capital instruments would meet reserve asset status, subject to confirmation of the final terms and provided that the LSA include a minimum number of contributors (depending on the relative size of the contributions) with strong external positions (e.g., participants in the Fund's Financial Transaction Plan).^{6/} The minimum number ensures that, if any contributor were to face a BoP need, a sufficient number of remaining contributors stand ready to exchange the claim for freely usable currencies on demand. Contributors receiving a disbursement from the LSA because of a

⁷ The use of SDRs in donations is another example. This use is currently authorized, even though it does not result in any claim for the holder making the donation.

Box 2. Summary of the AfDB/IDB Proposal on SDR Channeling (concluded)

BoP need are expected to reimburse the funds as soon as the BoP need is resolved by repurchasing their initial hybrid capital holdings. A second layer of the liquidity arrangement is being developed, which would allow non-contributing members to provide a liquidity guarantee denominated in any of the currencies of the SDR basket (USD, EUR, CNY, JPY and GBP) or SDRs, should the resources in the first layer be exhausted. The LSA would thus support the encashability of the hybrid capital instruments and, together with the MDBs' multilayered-credit-risk management framework, ensure the reserve asset quality of the resulting claims.^{7/}

^{1/} This is a requirement from rating agencies and IFRS/US GAAP accounting rules for the hybrid instrument to qualify as "equity." An MDB has a fiduciary duty to act in the best interest of all its stakeholders. As the cancellation of interest payments would not on its own materially strengthen capitalization, MDBs would be expected to cancel interest only if they face extraordinary events and are unable to address those through other means.

^{2/} A financial trigger event will depend on the issuer's asset-to-paid-in-capital-and-reserve ratio. For example, under the specific proposal of the AfDB and IDB, the trigger event occurs when the asset-to-paid-in-capital-and-reserve ratio is larger than 7.5, in which case there would be a mandatory cancellation of interest payments until the ratio falls below 7.5.

^{3/} See [Boosting MDB's Investing capacity - An Independent Review of multilateral Development Banks' Capital Adequacy Frameworks](#). (2022) In the case of AfDB and IDB proposal, the institutions would need to lose more than 40 percent of their equity for the trigger event to be reached. This is equivalent to the full default of the AfDB's top ten credit exposures. In the case of IDB, this scenario would require the full default of 100 percent of IDB's sovereign-guaranteed credit exposure.

^{4/} An early call would be possible upon certain accounting or ratings events (i.e., if the hybrid capital structure no longer meets the IFRS/GAAP or credit rating agency requirements to be accounted for as equity, the relevant MDB can prepay the instrument during the "non-call" period).

^{5/} See International Monetary Fund, [Proposal to Establish a Resilience and Sustainability Trust](#) (2022).

^{6/} The fact that under Union law SDR channeling by European Union (EU) national central banks to MDBs is incompatible with the prohibition of monetary financing significantly reduces the pool of potentially available contributors among MDB shareholders.

^{7/} The Balance of Payments and International Investment Position Manual (BPM6) stipulates that "reserve assets must be readily available in the most unconditional form. A reserve asset is liquid in that the asset can be bought, sold, and liquidated for foreign currency (cash) with minimum cost and time, and without unduly affecting the value of the asset. No time limit is provided, but to qualify as reserves, an asset should be available in a very short period of time given the speed at which experience suggests a foreign exchange need can arise in adverse circumstances." The Fund's definition of reserve assets is based on BPM6, which serves as the relevant statistical standard.

LEGAL FRAMEWORK

9. The use of SDRs in the acquisition of hybrid capital instruments, as envisaged under the AfDB/IDB proposal, can be viewed as essentially combining two existing prescribed uses of SDRs into a single operation, thereby falling outside the scope of the currently authorized uses of SDRs. The use of SDRs for this purpose could be viewed first as a loan and then as a donation (i.e., loan being written down in the case of credit loss by the issuer of the hybrid capital instrument). While SDR loans and donations are both prescribed operations in their own right that

can be effected at any time, past Board decisions have been understood by staff as not allowing for a combination of two or more authorized operations without a new Board approval.⁸

10. Authorization by the Executive Board in accordance with Article XVII of the Articles of Agreement would therefore be required to enable the proposed use of SDRs for the acquisition of hybrid capital instruments issued by prescribed holders. Under Article XVII, Section 3, the Fund may prescribe the terms and conditions for the use of SDRs in operations and transactions between participants and prescribed holders and among prescribed holders (see Annex II). In approving prescribed operations, the Executive Board has broad discretion provided, however, that the terms and conditions are consistent with the requirement under the Articles of Agreement and the effective functioning of the SDR Department.⁹ The Executive Board decision to approve the use of SDRs for the acquisition of hybrid capital instruments issued by prescribed holders may be taken with a majority of the votes cast.

11. The standard of being consistent with the provisions of the Articles of Agreement and the effective functioning of the SDR Department has intentionally been defined in general terms to safeguard the SDR system while not being overly prescriptive and thus allowing for flexibility. This clause has been in the Articles of Agreement since the First Amendment, when SDRs were created. The legislative history shows that flexibility in the design of the new SDR system was a key theme, and it was not thought necessary or feasible to be more prescriptive. The standard was designed as a general “safeguards” clause that the Fund would be able to rely upon to object, in cases where there were uses of SDRs that “abuse” the express provisions of the Articles, or “evade” the proper working of the SDR Department. To quote Joseph Gold, the General Counsel at the time of the Second Amendment, describing the situation at the First Amendment: *“It did not seem possible to make the language more specific, and the Fund would therefore have to rely on good faith and practice in the future as it has in the past.* This general posture of flexibility to allow evolution in the use of SDRs became even more of a consideration at the time of the Second Amendment, when the Fund’s Articles of Agreement were amended extensively to reflect the realities of the post-Bretton Woods system. The Second Amendment reforms not only reduced the central role of gold

⁸ In 1983, staff proposed to broaden and simplify SDR operations with the objective of making the SDR a more attractive reserve asset. Under this proposal, the Board was asked to adopt a single decision authorizing participants and prescribed holders to enter into SDR transactions and operations by mutual agreement, subject only to limitations imposed by the Articles of Agreement. If approved, this proposal would have allowed the use of SDRs in all operations beyond the seven previously authorized operations, subject to much less reporting requirements to the Fund and with the elimination of the required use of the SDR exchange rate in these operations (i.e., the “equal value principle”). As then noted by staff, “most if not all, of [new SDR operations under this proposal] are likely to be closely related to or to combine different elements of the [operations already] permitted by the Fund. See *Simplification of Operations in SDRs* (SM/83/187, 08/15/1983). When the Executive Board discussed the proposal, there was some significant concern about the proposed change relating to the elimination of the application of the equal value principle. The Executive Board ultimately did not act on the proposal.

⁹ Under Article XVII, Section 3, “The Fund may prescribe: ... (ii) the terms and conditions on which prescribed holders may be permitted to hold special drawing rights and may accept and use them in operations and transactions with participants and other prescribed holders; and (iii) the terms and conditions on which participants and the Fund through the General Resources Account may enter into operations and transactions in special drawing rights with prescribed holders... The terms and conditions prescribed by the Fund shall be consistent with the provisions of this Agreement and the effective functioning of the Special Drawing Rights Department.”

in the international monetary system but also included the ambition (which is still enshrined in the Articles of Agreement) to make the SDR “the principal reserve asset in the international monetary system.”¹⁰ It was in this spirit, after the Second Amendment, that the Executive Board considered and adopted the core set of decisions that continue to govern what participants and prescribed holders can do with their SDRs, including decisions authorizing the use of SDRs in the settlement of financial obligations, loans, pledges, transfers as security for the performance of financial obligations, swap and forward operations, and even donations.¹¹ The policy position in those discussions was on providing broad degrees of freedom regarding the use of SDRs.¹²

12. This backdrop explains the relative flexibility for the current uses of SDRs as authorized under the long-standing Executive Board decisions and pursuant to the related understandings and practices to date. For example, while the Fund can only engage in balance of payments (BoP) related lending, there is no requirement under the Articles of Agreement or any of the Fund’s current decisions that a participant can only engage in SDR operations if those are BoP related. Thus, while using the designation mechanism to exchange SDRs for currency requires representation of a BoP need, no such requirement is established under the Articles of Agreement or existing Board decisions for voluntary exchanges—even by members—of SDRs into currency outside the designation mechanism. Similarly, in authorizing other voluntary SDR operations, such as loans, the Executive Board has not established any requirements for either the user or recipient of SDRs to have a BoP need before using SDRs.¹³ Rather, participants or prescribed holders today can rely on the Fund’s existing decisions to make loans of SDRs to other participants or prescribed holders with broad freedom regarding the purpose and conditions of the loans and with no limits on key terms such as maximum amounts or maturities—a policy choice made in the context of the Second Amendment as discussed earlier. There are similarly no restrictions under the current framework—quantitative or otherwise—regarding voluntary exchanges of SDRs among participants or prescribed holders for currency.

13. Under the standard, the Fund can regulate a participant’s or prescribed holder’s use of SDRs under a prescription to ensure that participant comply with their obligations under the Articles of Agreement. For instance, if participants use SDRs in pledges, they must still pay their

¹⁰ See Articles of Agreement: Article VIII, Section 7, Article XXII.

¹¹ See Decision No. 6000-(79/1) S, December 28, 1978, as amended; Decision No. 6001-(79/1) S, December 28, 1978; Decision No. 6053-(79/34) S, February 26, 1979, as amended; Decision No. 6054-(79/34) S, February 26, 1979, as amended; Decision No. 6336-(79/178) S, November 28, 1979; Decision No. 6337-(79/178) S, November 28, 1979; Decision No. 6437-(80/37) S, March 5, 1980; and Decision No. 6467-(80/71) S, April 14, 1980.

¹² See, e.g., *Additional Types of SDR Use* (SM/78/79, 03/16/1978), noting that, while some operations such as swaps and borrowing of SDRs could have “undesirable” effects on the total of international reserves, the particular uses could be conducted with other reserve assets and therefore “it seems desirable to provide participants, as far as possible, with a similar degree of freedom to use and receive SDRs.”

¹³ See Decision No. 6001-(79/1) S, adopted December 28, 1978, which is the Fund’s decision authorizing the use of SDRs in loans.

charges on any pledged amounts.¹⁴ With respect to the functioning of the SDR Department, past discussions have highlighted that the use of SDRs should not undermine the SDR designation mechanism that is the ultimate backstop for the SDR system. The same would apply if reconstitution were to be introduced or in the event of SDR cancellations (Box 3).

14. The Executive Board further has the ability to terminate or modify the terms and conditions governing the existing uses of SDRs, including with respect to prescribed holders, if it assesses ex post that an approved use could pose or is posing difficulties for the effective functioning of the SDR Department. The Articles of Agreement contain an ex post mechanism in the event participants were to enter into transactions and authorized operations that—in the judgment of the Fund—would be prejudicial to the process of designation or otherwise inconsistent with the obligation of members under Article XXII.¹⁵ The Fund may make representations to a participant that enters into such transactions and operations and if the participant persists, pursuant to Article XIX, Section 2(d) and Article XXIII, the Fund may suspend the participant’s right to use SDRs acquired after the suspension. Regarding prescribed holders, the Executive Board decision setting out the terms and conditions on which prescribed holders may accept, hold and use SDRs contains an obligation for prescribed holders to cooperate with the Fund, participants and other prescribed holders to facilitate the effective functioning of the SDR Department and the proper use of SDRs. This decision provides, and thus prescribed holders are also on notice, that the Fund may terminate the prescription of a holder (Annex II). As the Fund is permitted under the Articles to authorize and prescribe the terms and conditions of SDR operations among participants and prescribed holders, the Fund can also terminate the authorization, or modify the terms and conditions, of these SDR operations.

15. Consistent with the approach for all other prescribed uses, staff proposes to authorize the use of SDRs for the acquisition of hybrid capital instruments issued by prescribed holders in a general form, as opposed to a prescribed holder-specific authorization. A general decision would cover the use of SDR for hybrid capital instruments by any prescribed holder based on general criteria rather than an authorization that is specific to a single prescribed holder, for example an MDB. Such a decision would mirror the approach for authorizations provided for already prescribed SDR operations and provide maximum flexibility for the use of SDRs while minimizing demands on staff and Executive Board resources. While a decision that is circumscribed to specific prescribed holders, for example the AfDB and IDB, would give the Executive Board more control

¹⁴ In prescribing the use of SDRs in pledges, it was proposed that the prescription be consistent with the requirement under the Articles of Agreement that participants pay charges and assessments to the SDR Department and therefore that pledged SDRs in a member’s account may be debited to meet these obligations, notwithstanding the pledge. Accordingly, Decision No. 6053-(79/34) S, February 26, 1979, as amended, provides that “The amount of SDRs to be pledged shall be set aside and shall not be used... except... in order to discharge an obligation of the pledgor under the Articles of Agreement”. Under this decision, a pledgor’s obligations under the Articles of Agreement would include, e.g., an obligation to pay charges on the net accumulative allocation of SDRs to the pledgor.

¹⁵ Article XXII on General Obligations of Participants provides: “In addition to the obligations assumed with respect to special drawing rights under other articles under this Agreement, each participant undertakes to collaborate with the Fund and with other participants in order to facilitate the effective functioning of the Special Drawing Rights Department and the proper use of SDRs in accordance with this Agreement and with the objective of making the special drawing right the principal reserve asset in the international monetary system.”

over this use of SDRs, it would not only create higher administrative burden, but also constitute a fundamental shift in the Fund's approach to authorization which has always been premised on creating uniform conditions for all participants and prescribed holders. An institution-specific authorization could lead to concerns about evenhandedness if approvals are granted selectively to prescribed holders, and it would be difficult to envisage a rationale justifying Fund approval for certain requests but not all, even though they meet the same criteria. Overall, in light of its benefits, staff would propose maintaining the existing practice of approving SDR uses in a decision of general applicability, and in a context where potential risks will be monitored and managed through the envisaged risk mitigation measures.

ASSESSMENT OF THE PROPOSED USE OF SDRS

16. Allowing the use of SDRs in the acquisition of hybrid capital instruments issued by prescribed holders would be consistent with the policy motivations in the past authorizations of SDR uses. The purpose of the SDR is to supplement existing reserve assets, with the Second Amendment of the Articles of Agreement establishing the objective of making the SDR the principal reserve asset of the international monetary system.¹⁶ This objective has guided the Board in authorizing the current seven different uses of SDRs, as well as the collaboration of participants in the SDR Department. The main policy consideration in the decisions to authorize the currently authorized SDR operations was that the additional uses would bring the characteristics of SDRs closer to those of reserve currencies, enhancing the attractiveness of SDRs as a reserve asset. The Board considered that it was preferable for the Fund to take a fairly broad view of the advantages of permitting additional uses of SDRs, as in any event, the operations would remain within the effective control of the Fund. Authorizing the proposed use of SDRs would further broaden the possible uses of the SDR by holders and thus be consistent with increasing the attractiveness of the SDR as a reserve asset.

17. Any recommendation to authorize a new use of SDRs must be grounded in a comprehensive assessment of the possible implications for the functioning of the SDR Department. This includes an assessment of possible financial and non-financial risks. Currently, participants and prescribed holders are already permitted to use SDRs in loans, such as to the PRGT or RST. With the proposed prescription, participants could use their SDRs in connection with making hybrid capital contributions. Subject to the measures discussed below, staff does not expect any negative implications for the functioning of the SDR Department from the proposed use and considers the proposed new use as consistent with the Articles of Agreement.

18. Staff recognizes that the proposed new use could potentially result in a significant increase in SDR operations by prescribed holders. The authorization of the proposed additional use could encourage more SDR operations and transactions and lead to higher SDR holdings by prescribed holders compared to the experience so far (Box 1), especially if the hybrid capital instruments have characteristics that fulfill the criteria as reserve assets. The main risk would concern

¹⁶ See Article XVIII, Section 1(a) and Article XXII of the *Articles of Agreement*.

the liquidity of the SDR market, particularly from possible (i) long-term holdings of SDRs by prescribed holders and (ii) large and disruptive currency conversions by prescribed holders.¹⁷ Channeling SDRs to prescribed holders could also impact burden-sharing in the VTA market, which is an important principle underlying its operation.

19. Long-term holdings of larger amounts of SDRs on prescribed holders' balance sheet could affect SDR liquidity in two ways:

- **SDRs in circulation could be insufficient to meet members' demand to acquire SDRs.** Long-term immobilization of very large volumes of SDRs compared to allocated SDRs could have a negative impact on the market if prescribed holders were not willing to sell SDRs at a time where demand for SDR is very high, for example by participants to replenish their SDR holdings or to meet SDR obligations, such as for charges. Compared to total SDR allocations, staff expects that holdings by prescribed holders, including from hybrid capital contributions, will remain limited, but the Fund would need to monitor the level of holdings closely. Should a shortage of SDRs arise, the Executive Board could amend decisions on prescribed holders and prescribed operations to ensure proper circulation of SDRs.
- **Large and prolonged holdings of SDRs by prescribed holders could complicate the (very unlikely) reinstatement of a reconstitution requirement and/or SDR cancellations.**¹⁸ While reconstitution was abolished in 1981 and the Fund has never cancelled SDRs, in the event of a renewed reconstitution requirement, the Fund would have to ascertain that SDRs held by prescribed holders do not prevent participants from reconstituting their SDR holdings to the required level. Similarly, in case of a decision to cancel SDRs, the Fund would have to be satisfied that participants with relatively low SDR holdings can acquire additional SDRs so that the intended cancellation can take place (Box 3).¹⁹ The liquidity risk in either case would likely be low as long as the amount of SDRs channeled into hybrid capital instruments remains relatively contained.

¹⁷ The main risk in the SDR Department in relation to the use under consideration is liquidity risk. Credit risk is remote because the debtor positions do not have maturity dates and could be held until the participant's withdrawal from the Department or the liquidation of the SDR Department.

¹⁸ Until 1981, SDR Department participants were required to maintain minimum average daily holdings of SDRs (specified as a percentage of their net cumulative allocation) over successive five-year periods ending each calendar quarter. Initially set at 30 percent, this specified percentage was lowered to 15 percent two years before the requirement was abolished. The requirement reflected the desire to ensure that SDRs would not be used to finance prolonged balance of payments deficits, generating a permanent transfer of resources from countries that accumulate SDRs to countries that use them on a net basis. This concern was more acute in the past because the SDR interest rate was set below market interest rates.

¹⁹ The purpose of the SDR cancellation is to reduce the excess global reserve assets and the SDRs are allocated to members, and members have to replenish the SDR holdings at least to the level of the cancelled amount before the cancellation takes place. See [Proposal For a General Allocation of Special Drawing Rights](#).

Box 3. SDR Cancellation and Reconstitution

The Articles of Agreement authorize the Fund to cancel SDRs and to adopt rules requiring participants to reconstitute their SDR holdings. To date there have been no SDR cancellations. However, if the Fund were to cancel SDRs, the cancellation rate would be based on net cumulative allocations of SDRs, and if the amount of SDRs held by a participant is lower than the share of the SDRs to be cancelled, that participant is required to eliminate its negative balance as promptly as its gross reserve position permits.¹ Reconstitution was implemented by the Fund from 1969 until it was abrogated in 1981. During this period, each participant was required to maintain its average daily holdings of SDRs at no less than a specified percentage of its net cumulative allocation, initially set at 30 percent and later lowered to 15 percent, over a five-year period ending each quarter.²

If the Fund were to cancel SDRs or reintroduce rules on reconstitution, very large SDR holdings by prescribed holders could potentially become an issue if these prescribed holders are unable or unwilling to exchange their SDRs. This issue may arise as participants which have significant negative SDR balances would need to acquire additional SDRs to meet the cancellation or the reconstitution requirement and neither the VTA market nor other voluntary bilateral transaction could generate the required SDRs (including from GRA SDR holdings), imposing the liquidity pressure on the SDR Department. This potential risk is, however, not unique to SDR holdings by prescribed holders that originate from hybrid capital contributions. Rather, any large SDR holdings by prescribed holders (originating through any of the existing authorized uses of SDRs) or any large concentration of SDRs among a few participants would potentially raise similar liquidity concerns. This risk would be mitigated if relevant measures are implemented to limit very large holdings of SDRs by prescribed holders or concentration of SDR holdings in a few participants. Further, if there were such liquidity concern, it would be expected that the Fund would adopt proper steps for the implementation of SDR cancellation or reconstitution, and work closely with participants and prescribed holders to help facilitating SDR acquisitions by participants with negative balances.

^{1/} See Article XVIII, Section 2(b) and (f).

^{2/} See Article XIX, Section 6. With respect to the previous rules on reconstitution, see Schedule G of the Articles of Agreement, Decision No. 5936 – (78/168) S, adopted October 25, 1978, and Decision No. 6063 - (79/43) S, adopted March 14, 1979. With respect to abrogation, see Decision No. 6832-(81/65) S, adopted April 22, 1981, and Rules R of the Fund's Rules and Regulations.

20. Very large and sudden SDR conversions by prescribed holders could in principle put pressure on the SDR trading market, even though the VTA market currently has a healthy absorption capacity (Box 4). A key design feature of the SDR Department is that all transactions and operations by prescribed holders are voluntary and depend on bilateral agreements, meaning that prescribed holders do not have an assured mechanism to convert SDRs for currency. While it appears unlikely at this stage, should prescribed holders potentially undertake to convert large volumes of SDRs that cannot be absorbed by the VTAs without disrupting the market, this could lead to a situation of illiquidity. An illiquid VTA market would not impact the Fund's balance sheet but it could limit the attractiveness of the SDR as a reserve asset and raise reputational risks for the SDR Department and the Fund. Overall, materialization of these scenarios would be very unlikely if the channeled amount of SDRs is relatively modest.

21. Liquidity problems would mainly affect prescribed holders. In practice, should VTAs be unable to accommodate exchange requests by prescribed holders, they could seek conversion of SDRs through bilateral transactions by agreement with other participants or prescribed holders.

Ultimately, the risk of non-conversion would be borne by the involved prescribed holders as they cannot enforce the conversion of their SDRs into currency through the designation mechanism provided in the Articles.²⁰ In this scenario, it would be accurate to assume that other SDR transactions between participants and those between participants and other prescribed holders would not be affected.

22. Risks to the liquidity in the voluntary SDR market are assessed to be low unless the conversions by prescribed holders become very large and concentrated in time. Should large conversions of SDRs for usable currencies by prescribed holders in the voluntary market or through bilateral transactions result in participants in the VTA market not being willing to absorb further SDRs in exchange for currency, the Fund would have to revert to the mandatory designation mechanism if participants requested exchange of SDRs for a freely usable currency upon representation of a BoP need. However, the designation mechanism has not been used in decades. Furthermore, this type of liquidity risk is not limited to the channeling of SDRs into hybrid capital instruments but is inherently associated with any large SDR transactions in the voluntary market, whether by prescribed holders or participants, as discussed recently.²¹ In general, prescribed holders' use of the VTA market has been limited. Hybrid capital instruments could in principle boost the expected SDR channeling volumes relative to the absorptive capacity of the VTA market, thereby increasing the potential risk from disruptive SDR conversions. Currently, this risk can be assessed as low given that, under current conditions, the VTA market has ample absorptive capacity.

23. Operationally, the impact on the burden sharing among VTAs will depend on whether contributors have VTAs and whether prescribed holders want to convert received SDRs.²² If they convert SDRs into currencies, all VTAs would be considered for such conversions as the nature of the VTA market is to draw on participants in this market within their agreed trading bands independently of where a specific SDR transaction originated. VTA members would be called upon depending on their SDR positions (i.e., SDR holdings-to-allocation ratios) and in line with other operating modalities. If contributors do not have VTAs, the burden of providing such currencies would be borne by all VTA members. If contributors have VTAs, and their SDR positions drop vis-à-vis other VTAs, they would be asked to participate in more SDR exchanges, bearing a greater burden of providing currencies to the SDR market until their SDR positions return to being more closely aligned with those of non-contributor VTAs (Box 4). Hence, over time, contributors would be

²⁰ The Articles of Agreement and Fund policies do not provide any mechanism to ensure that prescribed holders can exchange their SDRs for currencies. The designation mechanism is not available to prescribed holders, though it should also be noted that prescribed holders could transfer SDRs to members with a BoP need that would be able to resort to designation.

²¹ See [Applications To Become Holders of SDRs](#) (2023).

²² The "burden" in the VTA system refers to the commitment of participants to provide currency in exchange for SDRs when requested by another member. The SDR holdings-to-allocation ratio provides a stock measure of the cumulative amount of currency that a member has provided on a net basis against SDRs. This ratio typically exceeds 100 percent for VTA participants.

expected to buy most of the channeled SDRs.²³ If prescribed holders held on to channeled SDRs, everything else being equal, there would be no need for VTA members to provide currencies and the average SDR position of VTA members would consequently decline.

24. The proposed new SDR operation would have limited operational implications. One-off implementation costs would include changes to IT configurations and financial reporting. Recurrent costs would include administrative resources to support a higher volume of SDR transactions. Overall, the resource implications could be expected to be relatively modest and the GRA would be reimbursed through higher annual SDR assessments.

Box 4. Voluntary Trading Arrangements and SDR Channeling

The liquidity of the SDR has for over thirty years been supported by Voluntary Trading Arrangements (VTAs). VTAs are arrangements between the Fund and participants in the SDR Department and prescribed holders who have agreed to buy and sell SDRs within set trading limits.^{1/} The designation mechanism serves as a backstop to the VTA market to ensure the reserve asset quality of the SDR for participating members in the SDR Department with a balance of payments need, but this mechanism (which imposes an obligation on participants in the designation plan to provide freely usable currency to participants having a balance of payments need) has not been needed or used since 1987. Following the 2021 SDR allocation, the IMF initiated a broad engagement with the membership to expand and strengthen the voluntary market given the key role of VTAs in supporting the attractiveness of the SDR as a reserve asset, which derives its value from the commitments of members to exchange SDRs for freely usable currencies.

Generally, VTA members channeling SDRs should be prepared to participate more frequently in transactions and hold more SDR-denominated assets. In determining burden sharing, i.e., distributing sale and purchase requests across VTAs, staff considers a range of factors that aim at an equitable use amongst VTA participants over time. These factors include the SDR position (i.e., the level of SDR holdings relative to allocations) and the level of SDR holdings within the trading range specified in the participant's VTA. From an operational perspective, it does not follow that a member channeling SDRs would be asked to reacquire them immediately on a one-for-one basis. Rather, participants should expect to be asked to participate in more transactions if their SDR holdings relative to allocation are lower compared to other VTA participants' holdings. SDR channeling and any other actions that reduce a participant's SDR holdings thus increase the likelihood that a participant will be asked to participate in future VTA exchanges.

Since the 2021 General SDR allocation, the volume of SDR trading through the VTA market has been dominated by SDR sales.^{2/} From September 2021–March 2024, the SDR Department recorded total VTA sales amounting to SDR 45.4 billion (about 10 percent of the total 2021 SDR allocation). This is comprised of exchanges by (i) participants (SDR 29.9 billion), (ii) the Poverty Reduction and Growth Trust (PRGT) and the Resilience and Sustainability Trust (RST) (SDR 12.9 billion), and (iii) prescribed holders (SDR 2.6 billion). On the SDR acquisition side, during the same period, the Fund assisted 50 participants and two prescribed holders in purchase transactions through VTAs amounting to SDR 8.6 billion.

²³ The Executive Board has supported this approach for the conversion of channeled SDRs in the context of the PRGT (and more recently the RST).

Box 4. Voluntary Trading Arrangements and SDR Channeling (concluded)

Going forward, SDR sales are generally expected to remain somewhat higher than before the 2021 allocation. The PRGT and RST transactions are expected to continue as deposit contributions are made effective and loan contributions are gradually drawn under Fund financial arrangements. The possible additional impact on the VTA market from the proposed SDR channeling into hybrid capital instruments issued by prescribed holders will depend on whether the latter decide to hold on to their SDRs or exchange them. Considering the relatively low cumulative cap proposed for such operations, staff expects the VTA market to continue to operate smoothly, with future demand for SDR exchanges expected to remain significantly below the current absorptive capacity of VTAs, which stands at about SDR 200 billion. Market liquidity will continue to be protected by the strong expectation that contributors channeling SDRs have VTAs in place. This approach reflects longstanding modalities and principles guiding SDR operations, which largely rely on the members' close and willing cooperation with the Fund.

^{1/} While the VTA market is the primary means of exchange, participants and prescribed holders can also exchange SDRs for currencies in bilateral transactions by agreement.

^{2/} Please also see more details in [2021 Special Drawing Rights Allocation—Ex-Post Assessment Report](#)

25. Overall, staff does not anticipate a material impact on the functioning of the SDR Department from authorizing the proposed use of SDRs for the acquisition of hybrid capital instruments. Risks from potential long-term holdings of SDRs by prescribed holders on the VTA market are expected to be relatively contained if amounts of channeled SDRs remain limited.

26. The authorization of the proposed use of SDRs is likely to increase SDR holdings and transactions by prescribed holders but it is too early to establish how significant such increase will be over the longer run. As noted earlier, historically, SDR transactions and operations by prescribed holders have been relatively modest, especially for MDBs (Box 4). In the current context, staff expects the SDR amounts to be channeled into hybrid capital instruments to remain limited. The AfDB and IDB hope to initially receive hybrid capital contributions amounting jointly to SDR 4-5 billion, which is less than 1 percent of total cumulative SDR allocations and 3 percent of the VTA buying capacity (currently about SDR 205 billion).²⁴ While other MDBs could introduce similar schemes, their channeling volumes would also be expected to be constrained by financial considerations and regulatory factors such as the inability of EU countries to channel SDRs to MDBs due to legal restrictions (Box 2). This said, against the backdrop of limited experience with SDR transactions and holdings by prescribed holders thus far, there is some residual risk that channeled SDR amounts could rise more than currently expected.

27. The authorization could be made subject to a cumulative cap of SDR 15 billion for SDRs channeled into hybrid capital instruments, which would address the above-described

²⁴ The current SDR holdings of members not in the Financial Transaction Plan, i.e., those most likely to exchange SDRs for currencies, stands at SDR 85 billion at end-December.

residual risks. Such a cap would constitute an ex-ante safeguard that would strike a balance between supply and demand considerations, including:²⁵

- Supply-side: Limiting the possible accumulation of large SDR holdings on prescribed holders' balance sheets to a level that would not create material liquidity risks. The cap of SDR 15 billion would represent a moderate volume relative to the current VTA buying capacity (about 7 percent) and cumulative SDR allocations (less than 3 percent), suggesting that related transactions could be expected to be absorbed comfortably by the voluntary SDR market.
- Demand-side: Ensuring that the proposed limit would be sufficient to accommodate declared channeling intentions of the AfDB/IDB of about SDR 4-5 billion, while leaving room for several other prescribed holders to use the instrument if they decide to do so.

28. The total authorized amount could be made available on a “first come, first served” basis to any prescribed holder wishing to channel SDRs into hybrid capital instruments. While caps have not been used in the past for any of the other prescribed operations, including with prescribed holders, staff considers them a useful tool to address potential concerns about overuse of the proposed new SDR operation while monitoring its implications on the functioning of the SDR Department. Evenhandedness risks from the “first come, first served” would be limited. The cap would be transparent, giving prescribed holders equal access to information ex-ante, enabling evenhanded and uniform treatment. Furthermore, the proposed cap of SDR 15 billion would provide room for several institutions to issue hybrid capital instruments at a significant scale, and is not likely to be binding soon.²⁶ If the cap were to be reached, the Executive Board could consider increasing the cap or moving to an unrestricted authorization, subject to a favorable review of the experience and a careful assessment of any risks for the effective functioning of the SDR Department associated with such an increase.

29. A strong expectation that SDR channeling members have VTAs in place would also be useful. This presumption, which has already been endorsed by the Executive Board for SDR channeling to the PRGT and RST, is contemplated in the AfDB/IDB proposal.²⁷ The Executive Board, in providing the proposed authorization, could make clear that channeling members are expected to support the smooth functioning of the SDR Department, including through buying SDRs from prescribed holders if necessary to help ensure sufficient liquidity and fair burden sharing within the cooperative framework of the VTA market.

²⁵ For reference, SDR 15 billion of hybrid capital could support additional lending by multilateral development institutions of about SDR 45-60 billion (assuming a leverage ratio between three and four).

²⁶ Setting caps at the level of individual institutions would not be desirable as liquidity risks to the SDR Department depend in part on the aggregate amount of channeled SDRs (which would not be constrained by individual caps) and the absorptive capacity for hybrid capital varies widely across prescribed holders depending on their size and other financial characteristics.

²⁷ See Proposal to Establish a Resilience and Sustainability Trust (2022), paragraphs 110 and 111 .

30. Staff suggests a review of the proposed use when cumulative hybrid capital contributions surpass SDR 10 billion or two years after the authorization, whichever comes first. The review would aim to identify potential issues associated with the proposed SDR use and also encompass the other already authorized uses, thereby providing the Executive Board' with an opportunity to discuss the scope of SDR operations in a holistic manner.

31. Beyond these specific measures, staff would closely monitor the operations related to the proposed SDR use and propose corrective actions if needed. Staff regularly assesses the operation of the SDR Department and reports on activities in the [Annual Update on SDR Trading Operations](#). If warranted, staff would bring any operational issues arising from the use of SDRs for the acquisition of hybrid capital instruments to the attention of the Executive Board. The Fund would retain its ultimate authority to amend decisions on prescribed holders and prescribed operations, including operations with participants in the SDR Department. Prescribed holders have accepted all the terms and conditions.

32. Staff further assesses the proposed use of SDR in hybrid capital contributions to be fully consistent with the legal requirements under the Articles of Agreement. This determination is informed by the applicable legal standards, legislative history, existing Executive Board decisions, and historical practices concerning similar SDR authorizations that have been in place for over four decades discussed above, as well as the analysis in this section on the liquidity impact and other implications for the functioning of the SDR Department, taking into account the proposed safeguards. Based on staff's assessment, there are no factors that suggest the hybrid capital proposal would abuse, evade or otherwise be inconsistent with the requirements of the Articles of Agreement or undermine the effective functioning of the SDR Department.

ENTERPRISE RISK

33. Approving the use of SDR to acquire hybrid capital instruments of prescribed holders would entail the following enterprise risks for the Fund.

- **Liquidity risks and burden sharing in the VTA market.** As discussed, risks include liquidity risks from long-term holdings and large and sudden conversions of SDRs by prescribed holders, which would be substantially mitigated by the proposed cap for SDRs channeled into hybrid capital instruments. Risks to fair burden sharing in the VTA market would also be modest as the ex-ante risk mitigations ensure that SDR channeling members will be available to provide currencies and, over time, replenish their SDR holdings. Both risks would be further mitigated by the review of the proposed use of SDR.
- **Operational risks.** The potential increase in VTA transactions could put pressure on the infrastructure supporting the financial operations and reporting, creating human-capital and process-related operational risks. These risks are modest, both in terms of expected likelihood and impact, and could be mitigated through timely engagement with the Executive Board in the context of the annual budget exercise to ensure the availability of sufficient resources. Staff will prepare operational guidance for the proposed new operation to mitigate the risk of human

capital error, execute in a timely manner changes to IT systems' configurations and financial reporting, and onboard potential users, as needed. The review of the proposed use of SDR would provide further opportunity to address potential operational issues if needed.

- **Reputational risks.** Credibility risks could result if the outlined liquidity and operational risks materialize—despite mitigations—and, more broadly, from any negative impact of the authorization on the effective functioning of the SDR Department. Effective external communications are expected to mitigate these risks. Evenhandedness risks arising from the proposed SDR 15 billion cap on contributions would be limited and can be mitigated through careful communication.

34. Not approving the current proposal may entail business and reputational risks. Given the international community's strong call for expanding SDR channeling, not approving the proposed new SDR operation could increase member engagement risk, as the Fund could be perceived as not responding adequately to the needs of members. Not approving the new SDR operation could also have reputational implications to the extent that it would be perceived as intentionally limiting the attractiveness of the SDR as an international reserve asset. In both cases, however, it should be feasible to mitigate these risks with a strong communications plan that clearly explains the concerns underpinning the non-approval.

STAFF RECOMMENDATION

35. For the reasons discussed above, staff recommends the approval of the proposed use of SDRs in the acquisition of hybrid capital of prescribed holders in the form of a general decision, subject to ex-ante risk mitigation through specific measures. The proposed prescription would be general, allowing SDRs held by participants in the SDR Department to be used in the acquisition of hybrid capital instruments issued by prescribed holders, i.e., the approval would not be institution-specific. For these purposes, hybrid capital instruments are defined as financial instruments with perpetual maturity, junior to other types of debt issued by the prescribed holder, and which may be written off against losses experienced by the prescribed holder. Approval is proposed subject to three specific measures: (i) a safeguard in the form of a cumulative cap of SDR 15 billion for SDRs channeled into hybrid capital instruments to limit the possible accumulation of large SDR holdings on prescribed holders' balance sheets and thus contain liquidity risks and (ii) the strong expectation that members channeling SDRs into hybrid capital instruments have VTAs in place to ensure fair burden sharing and underpin the smooth functioning of the VTA market. In addition, staff proposes to conduct a review of the proposed use of SDRs when the channeled amount surpasses SDR 10 billion or two years after the authorization, whichever is earlier.

36. Approving this new SDR operation would help broaden the use of SDRs and enhance its attractiveness as a reserve asset. With the proposed cap in place to mitigate potential liquidity risks, staff expects no impact on the effective functioning of the SDR Department. Pursuant to Article XVII, Section 3, the prescription of the Fund for the use of SDRs as hybrid capital contribution to prescribed holders can be approved by a majority of votes cast.

Proposed Decision

The following decision, which may be adopted by a majority of votes cast, is proposed for adoption by the Executive Board:

- A. In accordance with Article XVII, Section 3 of the Articles of Agreement, the Fund prescribes that:
1. A participant may use SDRs to acquire a Hybrid Capital Instrument issued by a prescribed holder which may accept these SDRs in exchange for its Hybrid Capital Instrument, provided however that the amount of SDRs used for acquiring Hybrid Capital Instruments for all operations under this prescription shall not exceed SDR 15 billion on a cumulative basis. For the purposes of this prescription, a “Hybrid Capital Instrument” issued by a prescribed holder means a financial instrument with perpetual maturity that is junior to other types of debt issued by the prescribed holder and may be written off against losses experienced by the prescribed holder in accordance with the terms of the instrument.
 2. The denomination, value and repayment of the contribution by a participant to a prescribed holder through the acquisition of a Hybrid Capital Instrument issued by the prescribed holder shall be subject to the following requirements:
 - a. the contribution is denominated in:
 - i. SDRs; or
 - ii. The currency of a member; or
 - iii. The currency of a nonmember or another unit of account that is composed of currencies and is applied under an intergovernmental agreement, in respect of which arrangements have been completed for determination by

- the Fund of equal value in terms of the SDR on the basis of Article XIX, Section 7(a) and Rule O-2; and
- b. the amount of SDRs to be used in a contribution referred to in (a)(ii) or (a)(iii) above is equal in value, in terms of the SDR, at the time of contribution, to the amount of the contribution; and
 - c. for part or all of the contribution (or its remaining value) to be repaid by the prescribed holder to the contributing party in accordance with the terms of the Hybrid Capital Instrument, the prescribed holder has undertaken the following obligations:
 - i. if the contribution is denominated in SDRs, to repay with the same amount of SDRs, or the equivalent, at the time of repayment, in the currency of a member on the basis of Article XIX, Section 7(a) and Rule O-2, or in the currency of a nonmember or another unit of account under (a)(iii) above in accordance with the arrangements for valuation referred to therein; or
 - ii. if the contribution is denominated in the currency of a member and is to be repaid in SDRs, to repay with the equivalent in SDRs, at the time of repayment, on the basis of Article XIX, Section 7(a) and Rule O-2; or
 - iii. if the contribution is under (a)(iii) above and is to be repaid in SDRs, to repay with the equivalent in SDRs, at the time of repayment, in accordance with the arrangements for valuation referred to in (a)(iii) above.

3. The calculations under 2(b) and 2(c) above shall be made at the exchange rate of the third business day preceding the value date or of the second business day preceding the value date if agreed between the parties.
 4. A participant and a prescribed holder intending to use SDRs under this prescription shall provide the Fund with a copy of the Hybrid Capital Instrument and any amendment thereof and inform the Fund of the denomination and amount of the contribution, the value date of the contribution, and the reduction in the value of the contribution as a result of any write-off against losses under A.1 above. As required by Rule P-7, the parties shall declare that the intended use of SDRs will be in accordance with this prescription.
 5. Transfers of SDRs under this prescription shall be made only upon receipt by the Fund of instructions from the relevant participant and prescribed holder.
- B. The Fund shall record operations under this prescription in accordance with Rule P-9.
- C. The Fund shall review this decision when the amount of SDRs used for acquiring Hybrid Capital Instruments in accordance with this decision exceeds SDR 10 billion on cumulative basis, or two years after the approval of this decision, whichever is earlier.

Annex I. Prescribed Holders of SDRs

This annex provides information on official institutions prescribed as holders of SDRs, qualifications for becoming a prescribed holder, as well as the terms and conditions to hold and use SDRs by prescribed holders.

1. **Currently prescribed holders of SDRs.** The Fund has so far prescribed 20 official institutions as holders of SDRs. The prescribed holders are four central banks, three intergovernmental monetary institutions, and thirteen multilateral financial institutions. Most prescribed holders were approved in the 1980s. In the early stages of development of the SDR market, the Fund reached out to other international financial institutions to inquire about their interest in becoming holders of SDRs under Article XVII and subsequently several of them applied. Following the adoption of the euro, the European Central Bank (ECB) was approved as a prescribed holder by the Executive Board in 2000. Following the 2021 SDR allocation, five additional institutions were prescribed in February 2023, namely, the Caribbean Development Bank (CDB), the Development Bank of Latin America (known as Corporación Andina de Fomento or CAF), the European Bank for Reconstruction and Development (EBRD), the European Investment Bank (EIB), and the Inter-American Development Bank (IADB).
2. **The Fund's authority to prescribe holders of SDRs.** Under Article XVII, Section 3 (i) of the Articles of Agreement, the Fund has broad authority to prescribe as holders of SDRs: non-members, members that are not participants in the SDR Department, institutions that perform functions of a central bank for one or more than one member, and other official entities.
3. **Terms and conditions to hold and use SDRs.** Article XVII, Section 3(ii) and (iii) also authorize the Fund to establish the terms and conditions under which a prescribed holder may accept, hold, and use SDRs. In 1980, the Executive Board adopted a decision establishing these terms and conditions, which have consistently been applied to all prescribed holders and their activities in the SDR Department (Annex II).
4. **Use of SDRs by prescribed holders.** Most of the SDR transactions and operations of prescribed holders have been between regional central banks or intergovernmental monetary institutions and their member states. Transactions by these entities consist mostly of exchanges of SDRs for freely usable currencies through bilateral transactions by agreement or through the VTA. The Bank for International Settlements (BIS), as the most active prescribed holder, plays an important role in conducting sales on behalf of the trusts and administered accounts managed by the Fund, including to facilitate the disbursement of loans in currencies funded with resources in SDRs. Use of SDRs by MDBs and other multilateral financial institutions has been more sporadic. Most of the transactions and operations by these non-monetary institutions consist of exchanges of SDRs for currency by bilateral agreement or through VTAs, and settlement of financial obligations.

Table I.1. IMF Prescribed Holders and Year of Approval of Prescribed Holder Status**Central banks (4)**

European Central Bank (ECB)	November 15, 2000
Bank of Central African States (BEAC)	February 26, 1982
Central Bank of West African States (BCEAO)	June 29, 1981
Eastern Caribbean Central Bank (ECCB)	May 17, 1984

Intergovernmental monetary institutions (3)

Bank for International Settlements (BIS)	January 21, 1974
Latin American Reserve Fund (FLAR) - Former Andean Reserve Fund	April 18, 1980
Arab Monetary Fund (AMF)	August 26, 1980

Development and other multilateral institutions (13)

African Development Bank (AFDB)	June 25, 1986
African Development Fund (ADF)	June 25, 1986
Caribbean Development Bank (CDB)	February 21, 2023
Asian Development Bank (ADB)	October 15, 1982
International Bank for Reconstruction and Development (IBRD)	December 23, 1980
Development Bank of Latin America (CAF)	February 21, 2023
European Bank for Reconstruction and Development (EBRD)	February 21, 2023
European Investment Bank (EIB)	February 21, 2023
Inter-American Development Bank (IDB)	February 21, 2023
International Development Association (IDA)	December 23, 1980
Islamic Development Bank	April 5, 1982
Nordic Investment Bank	April 18, 1980
International Fund for Agricultural Development	April 18, 1980

Annex II. Terms and Conditions for Acceptance, Holding, and Use of Special Drawing Rights by Other Holders

The terms and conditions on which other holders prescribed by the Fund may accept, hold, or use SDRs are described under *Decision No. 6467-(80/71), April 14, 1980*:

1. Acceptance, Holding, and Use by Prescribed Holders

(a) Acceptance and use

A prescribed holder may accept or use special drawing rights (i) in exchange for an equivalent amount of a monetary asset other than gold in a transaction entered into by agreement with a participant, or another prescribed holder, or (ii) in an operation entered into by agreement with a participant or another prescribed holder in accordance with and on the same terms and conditions established at that time for participants by decisions of the Fund under Article XIX, Section 2(c).

(b) Holding

A prescribed holder may hold special drawing rights, subject to the provisions of this decision, accepted in accordance with (a) above or received as interest paid on its holdings of special drawing rights in accordance with Article XX, Section 1.

2. Acceptance and Use by Participants in Transactions and Operations with Prescribed Holders

Participants may enter into transactions and operations by agreement with a prescribed holder in accordance with the prescriptions in paragraph 1(a) of this decision.

3. Application of General Provisions

The holding of special drawing rights and the acceptance and use of them in transactions and operations by a prescribed holder shall be governed by the provisions of the Articles, By-Laws, Rules and Regulations, and decisions of the Fund that apply from time to time to all holders of special drawing rights.

4. Exchange Rates

The Rules and Regulations and decisions of the Fund that determine the exchange rates applicable at the time of each use or acceptance of special drawing rights by a participant shall apply to each use or acceptance of them by a prescribed holder. A prescribed holder shall not levy any charge or commission in respect of a transaction involving special drawing rights.

5. Information and Recording

The Fund shall inform prescribed holders of matters relevant to the acceptance, holding, and use of special drawing rights by them. A prescribed holder shall inform the Fund promptly of the facts necessary to record any transactions or operations in which a prescribed holder accepts or uses special drawing rights.

6. Consultation and Review

(a) Consultation between the Fund and a prescribed holder shall be held at the request of the Fund or the prescribed holder with respect to the application of this decision or the decision prescribing the holder or with respect to transactions or operations entered into involving special drawing rights.

(b) The Executive Board shall review periodically this decision and decisions prescribing holders.

7. General Undertaking

Each prescribed holder shall collaborate with the Fund, participants, and other prescribed holders with respect to its acceptance, holding, and use of special drawing rights in order to facilitate the effective functioning of the Special Drawing Rights Department and the proper use of special drawing rights in accordance with the Articles and the terms and conditions prescribed by the Fund now or in the future for the acceptance, holding, and use of special drawing rights by prescribed holders.

8. Suspension

During any period in which a suspension is in effect under Article XXIII, Section 1 with respect to participants, the suspension shall apply to the same extent to prescribed holders.

9. Termination

(a) The prescription of a holder of special drawing rights may be terminated by the Fund by a decision of the Executive Board or by a notice from the prescribed holder in writing to the Fund at its principal office. Termination shall become effective on the date specified in the decision of the Executive Board but not earlier than the date of the decision, or when notice from the prescribed holder is received by the Fund at its principal office.

(b) A prescribed holder whose status as such has been terminated may continue to hold the special drawing rights it held on termination and to receive special drawing rights as interest on its holdings and may continue to use special drawing rights to dispose of them in transactions or operations in accordance with paragraph 1(a) above. A prescribed holder whose status has been terminated shall make arrangements, with the concurrence of the Fund, to dispose of its holdings of special drawing rights as expeditiously as possible and shall exchange special drawing rights for a freely usable currency selected by the prescribed holder when requested by the Fund.