Finance for Development Lab

SDR Rechanneling and ECB Rules

Why rechanneling SDRs to Multilateral Development Banks is not *always* and *everywhere* monetary financing.

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Executive summary

Eurozone countries are financially and politically pivotal to the Special Drawing Rights (SDRs) rechannelling agenda.[1] Collectively, they hold $200bn in SDRs (just over 20% of all SDRs), and the Eurozone countries which are G-20 members hold $120bn in SDRs (just under 20% of the G-20's SDRs). These countries are also the most ambitious and proactive members of the SDR system, with France being the first advocate of SDR rechanneling and Spain being the first to rechannel (to the IMF Resilience and Sustainability Trust - RST). However, the Eurozone's capacity to lead on and participate in SDR rechanneling has been complicated by the European Central Bank (ECB). President Lagarde has expressed that SDR rechanneling to Multilateral Development Banks (MDBs) may not preserve the reserve asset characteristic of the SDR and may violate the prohibition on monetary financing.

Building on Paduano and Maret (2023), this paper demonstrates that certain forms of SDR rechanneling can clearly satisfy the ECB's concerns — and, more importantly, that the rechanneling of reserve assets to multilateral development banks *already occurs*. The paper makes the following four core arguments:

1. SDRs fall under the "Agreement of Net Financial Assets" (ANFA holdings) of eurosystem National Central Banks (NCBs), which affords the NCBs greater sovereignty over how they use their SDRs. This means that the ECB's jurisdiction over SDRs is limited to enforcing the prohibition on monetary financing — so long as the prohibition on monetary financing is not violated, eurosystem NCBs can use SDRs at their discretion.

2. The prohibition on monetary financing is not violated by the purchase of SDR bonds given the rulings of the Court of Justice of the European Union and the ECB underlying the ECB's Public Sector Purchase Programme (part of the Asset Purchase Programmes). The Public Sector Purchase Programme explicitly included the purchase of supranational bonds, including those of multilateral development banks, and eurosystem NCBs now hold EUR 288bn in supranational bonds. By extension, the Court of Justice of the European Union and the ECB have already ruled affirmatively on the purchase of an SDR bond.

3. The European Investment Bank (EIB)'s access to the ECB's repo facility and its EUR 13bn in borrowings from eurosystem NCBs further demonstrate that the ECB and eurosystem NCBs already rechannel reserve assets to MDBs. This funding arrangement can be altered with respect to denomination, tenor, and collateralization structure without legal complication, thereby serving as precedent for future forms of SDR rechanneling.

4. The primary regulation of concern to the ECB — EC3603/93, Article 7 — does not limit the rechanneling of reserve assets to the International Monetary Fund (IMF). Instead, it highlights the IMF as one entity onto which public obligations may fall. This is demonstrated both by reference to existing forms of reserve asset rechanneling to entities other than the IMF (the public sector purchase programme and the EIB's repo access), and by evaluating past ECB rulings on SDR rechanneling arrangements. Past rulings make clear that the ECB rules not on the basis of which entity receives financing, but whether that financing preserves the reserve asset characteristic of the SDR and honours the prohibition on monetary financing.

[1] This paper is also published under the same title as *LSE Global Economic Governance Commission — Working Paper #3*. Thank you to Martin Kessler, who first brought the EIB's access to the ECB's repo facility to my attention. This work builds off of "The ECB and SDRs" co-authored with Theo Maret and "How an SDR Denominated Bond Could Work" with Brad Setser.

1. Context

In 2021, the G-20 committed to rechanneling $100 billion in Special Drawing Rights (SDRs) to vulnerable countries. SDRs are the reserve asset of the IMF which can be converted into dollars, euros, pound sterling, yen, and yuan. In effect, SDRs allow any IMF member to borrow the official reserves of any other IMF member, at very low interest rates (currently 3.7%), and for any reason the IMF member deems fit (i.e., SDRs are uniquely 'unconditional'). The G-20 countries committed to rechannel $100bn in SDRs because of how SDRs are allocated: in line with IMF members' quotas, which are themselves largely a function of the size of each IMF member's economy. This means that the richest and largest economies least likely to need or use their SDRs hold the vast majority of SDRs — the G-20 holds $608bn of the world's $935bn — while the low- and middle-income countries with the greatest need for sustainable financing and buttressing their official reserves receive a much smaller share.

The G-20's rechanneling commitment was a drop in the bucket of the global total of SDRs — just north of 10% — but a promising initiative to make SDRs a more helpful feature of the global financial architecture. What has been less promising, however, are the political, technical, and legal obstacles to SDR rechanneling that immediately emerged. The international community has been able to work through many of the political and technical obstacles. Many G-20 countries have come forward with rechanneling commitments, and countries such as Japan and France have stepped up with commitments to rechannel 40% of what they received in the last allocation — double what was initially expected of them. Pressure is continuing to build on these countries to convert their commitments into disbursements.

Solutions have also risen for the technical obstacles to facilitate SDR rechanneling. The IMF rolled out a new $19 billion funding strategy for the Poverty Reduction & Growth Trust (PRGT and created the climate-focused Resilience & Sustainability Trust (RST) with an initial funding target of $44 billion. With the RST and PRGT only able to rechannel $63 billion in SDRs, more rechanneling mechanisms were needed to make use of the remaining $37 billion of the G-20's commitment. Unfortunately, the simple solution — to scale up both trusts to reach $100bn total — is not so simple. The PRGT requires SDR contributions to the loan account to be matched with grant contributions to the subsidy account, which IMF members are less eager to provide. For the PRGT to be scaled up, subsidy contributions must be scaled up even more (given the 300 basis point rise in the SDR interest rate over the past two years, which subsidy contributions must offset), which makes scaling up the PRGT seriously unlikely in the near-term.

The RST, having pushed the IMF into the foreign terrain of climate issues and requiring high levels of coordination with the World Bank (in particular around Country Climate and Development Reports (CCDRs)), **has also been slow to operationalize fully.** The RST has already nearly hit its full funding goal, which indicates that a lack of funds is not the limiting factor for the disbursement of RST funds. For the RST to be scaled up, the IMF will need to develop greater coordination with the World Bank, greater internal institutional capacity around climate issues, and greater familiarity with how to develop RST programs — all of which require time, more so than money.

In the long-term, it would be good for the PRGT and RST to be larger and faster-acting trusts. In the near-term, this is not possible, and the IMF is right to keep funding targets low and achievable.

Given the limitations on the IMF's rechanneling trusts, there has been a push to rechannel SDRs to multilateral development banks. Two proposals have been put forward: the "hybrid capital proposal"

proposed by the African Development Bank (AfDB) and Inter-American Development Bank (IDB) and the "SDR bond" proposed by Brad Setser and myself.

MDB rechanneling will be key to delivering on the G-20's $100bn commitment, and G-20 countries have engaged in good faith on both proposals. However, while the SDR rechanneling agenda has made great progress since the 2021 allocation, one issue remains outstanding: the concern of the ECB that SDR rechanneling to MDBs would constitute "monetary financing."

2. Why is the ECB so central?

1. The Financial and Political Leadership of Eurozone Countries

The importance of the ECB lies in a few interconnected facts. While the first, second, and third largest SDR holders are not Eurozone countries—being the United States, Japan, and China—the Eurozone collectively holds the world's largest stock of SDRs: $200 billion, over 21% of the world's SDRs. Moreover, the Eurozone contains the most eager and progressive members of the SDR system. In particular, France was the first country to call for SDR rechanneling and Spain was the first country to do so, as the first contributor to the RST. Of the 24 countries that have pledged to rechannel some portion of their SDRs, fully half—12 countries—are Eurozone countries (though this includes Germany, which has pledged to do so in euros, which is not quite SDR rechanneling). On these two scores, Eurozone countries bring both the financial resources and the political resources that are needed for any SDR rechanneling effort.

SDR pledges

Country	SDR Allocation (USD billion)	Pledged (USD billion)	Pledged (%)	Sources	PRGT (hover)	RST (hover)
Australia	8.92	3.44	39%	Source Source 2	Yes	Yes
Belgium	8.69	0.35	4%			Yes
Canada	14.96	2.69	18%	Source	Yes	Yes
China	41.36	14.15	34%	Source		Yes
Denmark	4.67	0.21	5%		Yes	
Estonia	0.33	0.04	11%	Source		Yes
France	27.35	8.20	30%	Source Source 2	Yes	Yes
Germany	36.13	7.30	20%	Source		Yes
Greece	3.30	0.50	15%		Yes	Yes
Italy	20.44	4.09	20%	Source	Yes	Yes
Japan	41.81	16.73	40%	Source Source 2	Yes	Yes
Lithuania	0.59	0.12	20%	Source		Yes
Luxembourg	1.80	0.36	20%	Source Source 2		Yes
Malta	0.23	0.03	14%	Source		Yes
Netherlands	11.85	2.41	20%	Source	Yes	Yes
Oman	0.74	0.06	7%	Source		Yes
Portugal	2.79	0.37	13%	Source Source 2	Yes	
Saudi Arabia	13.56	3.96	29%	Source	Yes	
Singapore	5.28	0.99	20%	Source		Yes
South Korea	11.65	1.91	16%	Source	Yes	Yes
Spain	12.94	2.59	20%	Source	Yes	Yes
Sweden	6.02	0.21	4%		Yes	
United Kingdom	27.35	5.47	20%	Source Source 2	Yes	
United States	112.59	21.23	19%	Source		
Total	**302.73**	**76.19**	**25%**			

Note: This table is based on a SDR-USD exchange rate from Oct. 29, 2021 • The table totals do not include the United States, due to Congress not authorising the US pledge.
This research is compiled by The ONE Campaign, using the latest available data that can be found. However, the G20 does not disclose this data directly.

Source: ONE Campaign

2. The ECB's constraints on Eurozone countries

Yet while SDR rechanneling is a national decision, decisions around SDR utilization appear to be partially under the jurisdiction of the ECB. This is owed to the fact that the SDR is a reserve asset and Eurozone countries' SDRs are held by their national central banks (NCBs). The creation of the Eurosystem formally folded most, though not all, NCB operations under the ECB's mandate. In order for NCBs to rechannel SDRs to the PRGT and RST, they must first get an ECB ruling—as they have successfully done in the past. Some efforts to make use of SDRs, such as Ireland's attempt to use SDRs for debt relief to Sudan and Somalia, were shot down by the ECB, and the ECB encouraged Ireland's Finance Ministry to take "corrective action in the form of the reimbursement" for the Central Bank of Ireland's use of SDRs.

The ECB has not yet issued a ruling on SDR rechanneling to MDBs, however ECB President Christine Lagarde has stated on two occasions that SDR rechanneling to MDBs would likely "not be compatible

with the EU's legal framework." In prior comments, Lagarde said that the specific problem was that SDR rechanneling to MDBs likely "is not compatible with the monetary financing prohibition." Although these statements are not binding, they do indicate the ECB's belief that SDR rechanneling falls under its mandate.

3. Three Demonstrations of the Viability of SDR Rechanneling Under EU/ECB Rules

1. ANFA and the ECB's Jurisdictional Limits: How SDRs fall outside the jurisdiction of the ECB

Nonetheless, it is likely that certain use cases of SDR do not in fact fall under ECB jurisdiction. Pursuant to the Agreement on Net Financial Assets (ANFA), NCBs hold "net financial assets" that are outside of the ECB's jurisdiction as they do not affect the "single monetary policy of the eurosystem." The January 2023 "Consolidated opening financial statement of the Eurosystem" indicated that ANFA holdings include EUR 1.758bn in assets and EUR 2.393bn in liabilities — leaving the eurosystem's "net financial assets" at EUR -667.58m. **Crucially, the ECB's own demarcation of eurosystem's balance sheet demonstrates that SDRs, held as both assets ("receivables from the IMF") and liabilities ("special drawing rights allocated by the IMF"), form part of the "net financial assets" out of the eurosystem NCBs.**

	Assets (EUR millions)	Balance
1	Gold and gold receivables	593,004
2	Claims on non-euro area residents denominated in foreign currency	526,929
2.1	Receivables from the IMF	229,731
2.2	Balances with banks and security investments, external loans and other external assets	297,198
3	Claims on euro area residents denominated in foreign currency	20,994
4	Claims on non-euro area residents denominated in euro	16,891
4.1	Balances with banks, security investments and loans	16,891
4.2	Claims arising from the credit facility under ERM II	0
5	Lending to euro area credit institutions related to monetary policy operations denominated in euro	1,324,347
5.1	Main refinancing operations	2,406
5.2	Longer-term refinancing operations	1,321,422
5.3	Fine-tuning reverse operations	0
5.4	Structural reverse operations	0
5.5	Marginal lending facility	519
5.6	Credits related to margin calls	0
6	Other claims on euro area credit institutions denominated in euro	37,400
7	Securities of euro area residents denominated in euro	5,119,252
7.1	Securities held for monetary policy purposes	4,937,199
7.2	Other securities	182,053
8	General government debt denominated in euro	21,589
9	Other assets	327,028
	Total assets	7,987,435

	Liabilities (EUR millions)	Balance
1	Banknotes in circulation	1,576,419
2	Liabilities to euro area credit institutions related to monetary policy operations denominated in euro	4,017,551
2.1	Current accounts (covering the minimum reserve system)	237,545
2.2	Deposit facility	3,778,787
2.3	Fixed-term deposits	0
2.4	Fine-tuning reverse operations	0
2.5	Deposits related to margin calls	1,219
3	Other liabilities to euro area credit institutions denominated in euro	81,610
4	Debt certificates issued	0
5	Liabilities to other euro area residents denominated in euro	568,309
5.1	General government	439,618
5.2	Other liabilities	128,692
6	Liabilities to non-euro area residents denominated in euro	538,279
7	Liabilities to euro area residents denominated in foreign currency	11,895
8	Liabilities to non-euro area residents denominated in foreign currency	4,719
8.1	Deposits, balances and other liabilities	4,719
8.2	Liabilities arising from the credit facility under ERM II	0
9	Counterpart of special drawing rights allocated by the IMF	182,361
10	Other liabilities	303,716
11	Revaluation accounts	587,532
12	Capital and reserves	115,045
	Total liabilities	7,987,435

Source: ECB

As we can see, eurosystem NCBs hold a very large quantity of assets not for monetary policy purposes. They are free to buy and sell these without ECB engagement, in certain cases (as in the case of the Banque de France) not using ECB accounting rules for them. So long as ANFA holdings and

transactions do not affect the single monetary policy of the eurosystem and do not compromise the EU's prohibition on monetary financing, eurosystem NCBs can manage their ANFA holdings freely.

As demonstrated by the ECB, everything involving SDRs falls into this category of ANFA holdings. **The purchase of an SDR bond, for example, would not fall under the jurisdiction of the ECB.** Nevertheless, the ECB would still theoretically have standing to block forms of SDR rechanneling if it can demonstrate that the form of rechanneling in question violated the EU's prohibition on monetary financing. It is understandable that some use-cases of SDRs may not pass this test, as in Ireland's experience with HIPC in 2022. However, as we shall turn to now, the ECB would not be able to claim that the purchase of an SDR bond violates the prohibition on monetary financing *given that the ECB and the Court of Justice of the European Union have already established that the purchase of supranational bonds is not monetary financing*.

2. The Prohibition on Monetary Financing and the Public Sector Purchase Programme: Why NCBs Can Already Purchase SDR Bonds

Article 123 of the Treaty on the Functioning of the European Union establishes the EU's prohibition on monetary financing. "Monetary financing" conventionally refers to a central bank lending directly to its government or buying its debt in the primary market. The rationale for the prohibition is that monetary financing contravenes the modern norm of central bank independence, potentially promoting macro-fiscal imprudence, and perhaps spurring inflation.

In the years of the "liquidity trap" — when conventional monetary policy operations proved incapable of getting advanced economies out of their disinflationary slump — central bankers came to adopt certain "unorthodox" monetary policies which legally and normatively tested interpretations of monetary financing. The purchase of long-dated government bonds, needed to bring down long-term interest rates, became a key monetary policy tool. Although it was universally understood that such purchases were *not* being conducted to finance governments, it was important for the Court of Justice of the European Union to establish that such asset purchase programmes (quantitative easing) would be compatible with the Treaty on the Functioning of the European Union.

Concluding in 2018, the Court of Justice of the European Union held that the ECB's Asset Purchase Programmes, including its Public Sector Purchase Programme (PSPP), does not infringe on the prohibition on monetary financing. Following this, it became acceptable to purchase a range of public sector securities, including bonds issued by supranational entities.

The ECJ's ruling on QE was smart as both a matter of law and policy. Despite surface-level similarities, easing monetary conditions is not the same as financing a government. The Court of Justice of the European Union's "purposive" interpretation of Article 123 honoured the spirit of the monetary financing rule, rather than allowing "monetary financing" to be defined in a way well beyond its original intention. It is worth noting that such an interpretation made for good policy, too. The approval of quantitative easing proved to be a critical step in ending the Eurozone crisis, and it was of great value that the Court of the Justice of the European Union affirmed it without legalistic complication—such as suggesting that the Treaty on the Functioning of the European Union would have to be opened up and re-worded for QE to be viable.

> **"It is clear that the purchase of an SDR bond would not constitute monetary financing given that the bonds of supranationals have been purchased routinely, with the express authorization of the ECB and the Court of Justice of the European Union, throughout the past decade."**

As of March 2023, the ECB and eurosystem NCBs hold EUR 2.5 trillion in public sector securities. Of this, the ECB and eurosystem NCBs hold EUR 288bn in bonds issued by supranationals. As a result, it

is clear that the purchase of an SDR bond would not constitute monetary financing given that the bonds of supranationals have been purchased routinely, with the express authorization of the ECB and the Court of Justice of the European Union, throughout the past decade.

3. The EIB and the ECB: How the ECB and Eurosystem NCBs already Rechannel Reserve Assets to MDBs

Given that SDRs and SDR rechanneling fall within the ANFA holdings of eurosystem NCBs, and that the purchase of bonds issued by MDBs has been fully established to be compatible with the EU's prohibition on monetary financing, it is clear that 1) eurosystem NCBs are independently capable of using their SDRs to purchase SDR bonds and 2) that doing so would not be monetary financing.

We can also go one step further in demonstrating that the ECB and eurosystem NCBs can rechannel reserve assets to MDBs by inspecting another case — that is, in addition to the Public Sector Purchase Program — in which this already occurs: the case of the European Investment Bank (EIB).

The EIB was established by the Treaty of Rome in 1958. It has a similar shareholder structure as other MDBs and offers a similar range of products and services: public and private sector lending, equity financing (specifically venture debt, investments in infrastructure and environmental funds, and investments in SME and mid-cap funds), guarantees, and advisory services. As with other MDBs with higher-income shareholders (such as the EBRD, ADB, and AIIB), the EIB operates both in Europe and elsewhere—Africa, Latin America, the Middle East, South Asia, and East Asia. This is all to say that while the EIB is held in special esteem by European policymakers, the EIB is an MDB like any other.

One well-known factor that distinguishes the EIB from other MDBs is its size. The EIB is perhaps the world's largest MDB. Total assets for the EIB amount to €565bn — more than the €494bn of the IBRD and IDA combined (€293bn and €201bn, respectively).

A more important distinguishing factor of the EIB is its funding structure. In December 2008, the ECOFIN council approved EIB access to ECB liquidity. The stated purposes of this decision was to provide "a fast track answer by the EIB to the impact of the financial crisis on the real economy of Member States, with increased lending to priority and/or particularly vulnerable sectors and regions, additional support for SMEs and a comprehensive package for energy and climate change." The EIB added at the time of the announcement:

> *"Access by EIB to central bank liquidity via the ECB constitutes a natural complement to the financing initiatives taken and will facilitate it for the EIB to accommodate the additional demand for its lending programme currently foreseen. At present, this additional demand is estimated to be EUR 10bn in 2009. With the new access to central bank liquidity, it is envisaged that EIB loan signatures would amount to EUR 70bn this year."*

According to the EIB's 2021 financial report, the EIB is "an eligible counterparty in the Eurosystem's monetary policy operations… [and] benefits from access to the monetary policy operations of the European Central Bank (ECB)." It is perhaps notable that this access comes via a national central bank, the Banque Centrale du Luxembourg (BCL). More specifically, this arrangement gives the EIB the "ability to repo ECB-eligible collateral… add[ing] substantially to the operational liquidity resilience of the EIB."

At present, the EIB holds €28.7bn in securities "eligible to be reused with the Eurosystem at the BCL." As a result of this, the EIB lists €13 billion in "borrowings from central banks," (pg. 71) which is a function

of its participation in ECB monetary operations. It should be noted that it does not matter in which way this funding comes. Borrowing from the ECB via the marginal lending facility — paying the marginal lending facility rate and providing overnight collateral — is not legally distinct from or superior to receiving other debt financing from the ECB or an NCB. The Treaty on the Functioning of the European Union of course makes no comment on tenor, collateralization, or any element of financing structures at this level.

> **"If a financing arrangement of any sort between the ECB, an NCB, and the EIB is viable, then rechanneling SDRs to MDBs should be viable.** Put in negative terms, if the ECB and NCBs cannot rechannel SDRs to MDBs due to the prohibition on monetary financing, then the ECB is in violation of its own rules by establishing a funding arrangement with the EIB."

However, collateralized borrowing for overnight repo transactions does comport with the ECB's emphasis on preserving the reserve asset characteristic in order to satisfy the prohibition on monetary financing. ECB and BCL financing for the EIB demonstrates that entities other than the IMF are eligible to receive central bank financing, and that their eligibility is a function of preserving the reserve asset characteristic and satisfying the prohibition on monetary financing. Again, it does not matter how this is done: a tradable AAA-rated security that mirrors any other reserve asset, the encashment regimes of the PRGT and RST, and collateralized borrowing in the form of repo transactions all evidently satisfy ECB rules.

This is important, and interesting, because it raises questions about the ECB's informal position against rechanneling SDRs to MDBs. In theory, rechanneling SDRs to MDBs is not viable because SDRs are reserve assets held by central banks and they are not meant to be lent to quasi-fiscal MDBs. In addition to the substantive problems with this logic, there now appears to be a precedent issue with this logic: the EIB, which is an MDB, is financed by the ECB and NCBs (e.g., the BCL). By definition, this financing arrangement engages reserve assets that the ECB considers equivalent to SDRs. If a financing arrangement of any sort between the ECB, an NCB, and the EIB is viable, then rechanneling SDRs to MDBs should be viable. Put in negative terms, if the ECB and NCBs cannot rechannel SDRs to MDBs due to the prohibition on monetary financing, then the ECB is in violation of its own rules by establishing a funding arrangement with the EIB.

There is no evident way around the precedent of the EIB. The EIB is an MDB like any other, and SDRs are a reserve asset like any other. The ECB's informal position against SDR rechanneling would suggest that it would not be possible to fund the EIB with reserve assets. There are at present €13 billion to suggest that this is not the case—and a total of €28.7 billion in ECB-eligible securities that would further testify to the ability of the EIB to be funded with reserve assets by the ECB and NCBs.

4. Implications for the ECB's Concerns about Rechanneling SDRs to MDBs: Unpacking EC3603/93

By establishing that SDRs are part of the ANFA holdings of eurosystem NCBs, that the purchase of MDB bonds is not monetary financing, and that the ECB and eurosystem NCBs already rechannel reserve assets to an MDB (the EIB), we have established multiple reasons why eurosystem NCBs would be able to rechannel SDRs to MDBs — specifically through the purchase of SDR bonds.

Nevertheless, it is worth addressing one specific concern that the ECB has communicated: EC3603/93, Article 7. This article would appear to limit the possibility of rechanneling reserve assets to any entity besides the IMF:

Interestingly, this refers not to Article 123 of the Treaty on the Functioning of the European Union (the prohibition on monetary financing) but instead to Article 104 of the Treaty Establishing the European Community, with specific reference to avoiding "excessive deficits." Nonetheless, it is clear that EC3603 is in dialogue with Article 123: when the ECB has exempted IMF trusts from the prohibition on monetary financing in the past, they have done so on the authority of EC3603/93. The question is essentially how it is in dialogue with Article 123: does it *constrain* monetary financing exemptions to the IMF, or does it provide the IMF *as just one example* of something which may be exempt?

The question is essentially how it is in dialogue with Article 123: does it constrain monetary financing exemptions to the IMF, or does it provide the IMF as just one example of something which may be exempt?

There is no EU treaty, EC regulation, or ECB ruling that would indicate an answer one way or the other.

There is no EU treaty, EC regulation, or ECB ruling that would indicate an answer one way or the other. One prevailing "hunch" is that the IMF gets exempted while MDBs do not because the IMF performs essentially monetary operations, while MDBs perform essentially fiscal operations.

If this is the case, it is a weak case. First and foremost, whatever the "fiscal" or "monetary" nature of MDBs may be, MDBs are not governments. Financing them is not "monetary financing" for an even stronger reason than that quantitative easing was not "monetary financing": no conventional definition of monetary financing — the financing of the government by its central bank — is being breached. Buying an MDB's bonds, as in the case of the Public Sector Purchase Programme or lending to the MDB directly, as in the case of the EIB's repo facility access, has evidently less to do with monetary financing than buying a government's securities.

Secondarily, IMF and World Bank operations can function in identical ways, particularly when the World Bank's functions are performed by IBRD and IDA (rather than MIGA and IFC, which are not in fact prescribed holders and are thus unrelated to the SDR rechanneling conversation). This has become particularly clear with the RST, which has thrust the IMF into climate-related lending and which necessitates high levels of World Bank engagement. If EC3603 draws an intentional distinction between the two — which, again, it is unclear it does — that distinction is not grounded in fact.

The lack of a clear substantive rationale for EC3603 makes the regulation confusing, and the question remains whether it permits and constrains monetary financing exemptions to the IMF, or whether it just provides the IMF as one example. Past ECB rulings on SDR rechanneling would indicate the latter.

If EC3603 could "permit and constrain" — i.e., if it were to be read literally as blanket approval for rechanneling to the IMF, *but only to the IMF* — there would have been no need for the ECB to rule on the permissibility of IMF operations. Seeking ECB approval for the RST, for example, should not have been as difficult as it reportedly was. All such IMF trusts simply should have been waived through. More pressingly, there would have been no potential for the ECB to reject certain IMF operations, as the ECB did with Sudan/Somalia HIPC relief (going so far as to compel Ireland's finance ministry to reimburse its central bank for being in violation of the prohibition on monetary financing). Despite the language of EC 3603, it is clearly the case that *not all* ECB/NCB financing of the IMF are "not regarded as a credit facility."

Rather than ruling on the basis of EC3603 — that is, whether or not the trust in question is an IMF trust — the ECB appears to rule on the underlying issues of the **reserve asset characteristic** and the **prohibition on monetary financing.** When Lagarde has commented on the issue of SDR rechanneling, these are indeed what she cites, not EC3603. We should therefore understand EC3603 as a regulation that does not constrain monetary financing exemptions to the IMF, but instead provides the IMF as one example of a *potentially* acceptable conduit for SDR rechanneling.

Paduano and Maret (2023) already explored the ways in which an SDR-denominated, cash-settled bond preserve the reserve asset characteristic of the SDR in accordance with past ECB rulings, as well as how the AfDB-IDB hybrid capital proposal's "liquidity support agreement" mirrors the encashment regime of the RST, which has already been approved by the ECB. Nevertheless, it is possible for questions to linger about the reserve asset status of "hybrid capital" itself, given that hybrid capital would be junior to the AfDB and IDB's senior and subordinated debt. It is also possible for monetary financing questions to linger about lending directly to the AfDB and IDB, given that the EIB's overnight repo precedent — which does involve direct lending — is materially, if not legally, different from the structure of the hybrid capital proposal. As it relates specifically to the AfDB-IDB hybrid capital proposal, there is a need for further inspection.

Yet as this article further demonstrates through the example of the Public Sector Purchase Programme and the EIB's repo facility, rechanneling reserve assets to MDBs does not always and everywhere constitute monetary financing. As a result, the underlying issues for the ECB's ruling — the reserve asset characteristic and the prohibition on monetary financing — can be firmly demonstrated to be satisfied by the SDR bond.

5. Going Forward: The ECB and SDR Agenda

The intersection of ECB policy and SDR policy remains largely unexplored. This is unfortunate for the sequence of reasons we have already covered:

1. Financing global development priorities at a time of rising interest rates and falling ODA budgets will increasingly rely on creative solutions such as SDRs;
2. The IMF's capacity to support the rechanneling of SDRs is constrained at $63bn – the combined funding targets of the PRGT and RST – which is $37bn below the G-20's rechanneling target;
3. The successful rechanneling of SDRs will rely on the financial resources and political leadership of large and ambitious IMF members to establish and participate in alternative methods of SDR rechanneling – namely, rechanneling to MDBs;

4. The ECB, with its current claim to the eurozone's $200 billion in SDRs, presides over both the largest pool of SDRs and the most IMF members that are supportive of SDR rechanneling;
5. However, the ability of Eurozone countries to lead the SDR rechanneling agenda is currently constrained by the ECB's *informal* opposition to rechanneling SDRs to MDBs.

This paper, building on Paduano and Maret (2023), has highlighted four core reasons why eurozone countries can rechannel reserve assets to MDBs, specifically through the purchase of an SDR-denominated bond:

1. First, **SDRs are part of the ANFA holdings of eurosystem NCBs**, which affords the NCBs greater sovereignty over how they use their SDRs — and means that the ECB's jurisdiction over SDRs is limited to enforcing the prohibition on monetary financing.
2. Second, the **ECB's Public Sector Purchase Programme (part of the Asset Purchase Programmes) explicitly included the purchase of supranational bonds, including those of multilateral development banks**. Given that the Court of Justice of the European Union and the ECB have confirmed that Public Sector Purchase Programme honours the prohibition on monetary financing, and that the eurosystem now holds EUR 288bn in supranational bonds, it is clear that the purchase of an SDR bond would be compatible with the EU's prohibition on monetary financing.
3. Third, the **EIB's access to the ECB's repo facility and its EUR 13bn in borrowings from eurosystem NCBs further demonstrate that the ECB and eurosystem NCBs already rechannel reserve assets to MDBs**. This funding arrangement can legally be altered with respect to denomination, tenor, and collateralization structure without complication, thereby serving as precedent for future forms of SDR rechanneling.
4. Fourth, the **primary EC regulation of concern to the ECB — EC3603/93, Article 7 — does not limit the rechanneling of reserve assets to the IMF**. Instead, it highlights the IMF as one entity onto which public obligations may fall. This is demonstrated both by reference to existing forms of reserve asset rechanneling to entities other than the IMF (the public sector purchase programme and the EIB's borrowings), and by evaluating past ECB rulings on monetary financing. These past rulings make clear that the ECB rules not on the basis of which entity receives financing, but whether that financing preserves the reserve asset characteristic of the SDR and honours the prohibition on monetary financing.

The world's development challenges are building at the precise moment that the developing world's official and private sector resources are retreating. Creative and ambitious thinking is required to break the impasse and use the SDR system as a tool for global development. At no point have we argued that it is the mandate of the ECB to tend to global development challenges and spearhead global economic governance. What we have endeavoured to show is why it is within the rights of the ECB and NCBs to *allow* SDR rechanneling to happen. Nevertheless, we hope that the severity of the world's development crises, the opportunity of SDR rechanneling, and the need for European leadership are taken into consideration by the ECB, and that productive discourse and policymaking will follow.

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