



# IMF POLICY PAPER

## REVIEW OF THE FUND'S INCOME POSITION FOR FY 2017 AND FY 2018

MAY 2017

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**.
- The **Staff Report** on the Review of the Fund's Income Position for FY 2017 and FY 2018 was prepared by IMF staff and completed on April 4, 2017 for the Executive Board's consideration on April 26, 2017.

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**International Monetary Fund**  
**Washington, D.C.**



INTERNATIONAL MONETARY FUND



Press Release No. 17/197  
FOR IMMEDIATE RELEASE  
May 30, 2017

International Monetary Fund  
Washington, D.C. 20431 USA

## **IMF Executive Board Reviews the Fund's Income Position for Financial Years 2017–18**

The Executive Board of the International Monetary Fund (IMF) completed its [annual review](#) of the Fund's income position for the financial years ending April 30, 2017 (FY 2017) and FY 2018, on April 26, 2017.

### **FY 2017 Income Position**

Total FY 2017 net income, including income from surcharges applied to higher access borrowing from the IMF, is estimated at SDR 1.7 billion (US\$2.3 billion). Net income excluding the retained earnings of the gold endowment, will be added to the IMF's precautionary balances which are projected to reach SDR 16.4 billion (US\$22.5 billion) at end-FY 2017. The net income position for FY 2017 is higher than estimated a year earlier. This reflects the amended IAS (International Accounting Standard) 19 adjustment, relating to reporting of employee benefits, and higher investment income.

### **FY 2018 Income Position**

Net income of SDR 0.7 billion (US\$1 billion) is projected for FY 2018. This projection is sensitive to the timing and amounts of disbursements under approved arrangements included in the projections, possible new arrangements, the performance of the Fund's investment portfolio, and the annual pension expense as determined under IAS 19. The projected net income will allow the IMF to continue to add to its precautionary balances.

The IMF charges member countries a basic rate of charge on the use of IMF credit, which is determined as the SDR interest rate plus a margin expressed in basis points. In April 2016, the Executive Board set the margin for this rate of charge at 100 basis points for financial years FY 2017 and FY 2018. In the context of this year's comprehensive review of the Fund's income position at the midpoint of this two year period, the Executive Board concluded that the margin should remain unchanged.



April 4, 2017

## REVIEW OF THE FUND'S INCOME POSITION FOR FY 2017 AND FY 2018

### EXECUTIVE SUMMARY

The Fund's total net income for FY 2017, including surcharges, is projected at about SDR 1.7 billion or some SDR 0.7 billion higher than expected in April 2016. This mainly reflects the IAS 19 adjustment (relating to reporting of employee benefits), which is expected to contribute about SDR 0.4 billion to net income, and higher investment income. Lending income is expected to be modestly lower than the April 2016 estimates.

The paper recommends that GRA net income of SDR 1.2 billion for FY 2017 (which excludes projected income of the gold endowment), be placed equally to the special and general reserve. After the placement of GRA FY 2017 net income to reserves, precautionary balances are projected to reach SDR 16.4 billion at the end of FY 2017. The paper further proposes to transfer currencies equivalent to the increase in the Fund's reserves from the GRA to the Investment Account.

In April 2016, the margin for the rate of charge was set at 100 basis points for the two years FY 2017 and FY 2018. The margin may be adjusted before the end of the first year of this two-year period (i.e., FY 2017) but only if warranted by fundamental changes in the underlying factors relevant for the establishment of the margin at the start of the two-year period. Staff does not propose a change in the margin.

The projections for FY 2018 point to a net income position of SDR 0.7 billion. These projections are subject to considerable uncertainty and are sensitive to a number of assumptions.

Approved By  
**Andrew Tweedie**

Prepared by the Finance Department in consultation with the Legal  
Department and the Office of Budget and Planning

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## INTRODUCTION<sup>1</sup>

**1. This paper reviews the Fund's income position for FY 2017 and FY 2018.** The paper updates projections provided in April 2016, and proposes decisions for the current year. The paper includes a comprehensive review of the Fund's income position as required under Rule I-6(4). No change is proposed in the margin for the rate of charge that was established under this rule in April 2016 for the period FY 2017-18.<sup>2</sup>

**2. The paper is structured as follows:** The first section reviews the FY 2017 income position and the main changes from the previous projections; the second section makes proposals on the disposition of FY 2017 net income and placement to reserves; the third section discusses the margin on the rate of charge for FY 2018, updates the income projections for that period, and reviews the projected burden sharing adjustments; and the last section reviews special charges.

## REVIEW OF THE FY 2017 INCOME POSITION

**3. FY 2017 net income is now projected at SDR 1.7 billion compared with an initial estimate of SDR 1 billion (see Table 1).**<sup>3</sup> This mainly reflects the IAS 19 adjustment (relating to reporting of employee benefits), which is expected to contribute about SDR 0.4 billion to net income, and higher investment income.

**Total lending income is projected to be modestly lower than the earlier estimates.** Operational lending income (from the margin, service charges, and commitment fees) is projected at SDR 0.85 billion compared with the earlier estimate of SDR 0.9 billion. Surcharge income is projected to be about SDR 0.58 billion or about 9 percent below the previous estimate:

- *Margin income* is slightly lower than projected in April 2016 as disbursements under new arrangements were offset by delays in disbursements in existing arrangements and earlier than anticipated advance repurchases;
- *Service charges* are higher by about SDR 16 million than the previous estimate due to new arrangements in the GRA;
- *Commitment fees* are lower by about SDR 55 million following the early cancellation of FCLs by Colombia and Mexico in June and May 2016, respectively;<sup>4</sup> and

<sup>1</sup> Prepared by a team comprising Alexander Attie, Sonja Davidovic, Mohammad Hasnain, Heikki Hatanpaa, Mary Hoare, Janne Akseli Hukka, Farhan Khawaja, Elena Liu, Donal McGettigan, Diviesh Nana (lead), Breno Oliveira, Sergio Rodriguez-Apolinar, Vidhya Rustaman, Yan Sun-Wang, Charles Xie, and Vera Zolotarskaya, under the guidance of David Andrews (all FIN)

<sup>2</sup> [A New Rule for Setting the Margin for the Basic Rate of Charge \(11/23/11\)](#), was adopted by the Executive Board in December 2011 and was first applied in setting the margin for the rate of charge for FY 2013–2014.

<sup>3</sup> See [Review of the Fund's Income Position for FY 2016 and FY 2017-2018 \(04/08/16\)](#).

<sup>4</sup> Commitment fee income is only recognized at the expiration or cancellation of an arrangement in accordance with accounting principles.

- *Surcharge income* in FY 2017 is about SDR 55 million lower than in the April 2016 projections mainly due to delays in large disbursements and earlier than expected advance repurchases.

**Investment income is estimated to be SDR 297 million higher than projected, reflecting mainly the stronger performance of the endowment:**

- *The Fixed-Income Subaccount (FI)*: Full year returns from the subaccount are now projected at about SDR 75 million compared with SDR 41 million projected a year ago. The difference mainly reflected the reversal of valuation losses recorded at the end of FY 2016;<sup>5</sup> and
- *The Endowment Subaccount*: Investment income for the year is now projected at SDR 461 million, more than double the original projection, mainly reflecting the strong performance of the equity allocation.<sup>6</sup> Pending the establishment of a payout policy for the endowment, which is to be considered as part of the upcoming review of the Investment Account, this investment income is retained in the endowment and therefore not included in the Fund's operating income.<sup>7</sup>

**Interest free resources:** Implicit earnings on the Fund's interest free resources were lower than projected and remained at a very low level. This reflected a lower than projected SDR interest rate, which is now expected to average 21 basis points in FY 2017 compared with a previous estimate of about 32 basis points. The marginal impact of the change in the SDR basket, including the addition of the RMB as the fifth currency, was 9 basis points at the time of its first interest rate determination on October 7, 2016.<sup>8</sup>

**Reimbursements to the General Resources Account (GRA):** The GRA is reimbursed annually for the expenses of conducting the business of the SDR Department, of administering the PRG Trust, and of administering Special Disbursement Account (SDA) resources in the CCR Trust.<sup>9</sup>

<sup>5</sup> A large difference in the exchange rates used to determine the SDR rate and the yen cross rate against the SDR caused an unusually large currency valuation impact on the portfolios at end-April 2016. As a result, the valuation of the FI declined by 32 bp in April 2016. The valuation impact was reversed at the beginning of May.

<sup>6</sup> The three-year funding period of the passively-managed portion of the endowment was completed in December 2016, and one-half of the actively managed portion was allocated to an external manager in August 2016 so that 98 percent of the endowment is now invested under the broadened mandate.

<sup>7</sup> The Fund shall decide on the use of the IA's income for each financial year, including whether any portion of such income will be transferred to the GRA for use in meeting the expenses of conducting the business of the Fund. See [Rules and Regulations for the Investment Account](#), adopted on January 23, 2013 and amended on March 12, 2014, August 31, 2015, and July 29, 2016 by the Executive Board.

<sup>8</sup> This was lower than earlier staff estimates, partly reflecting the impact of the SDR interest rate floor of 5 basis points specified in Rule T-1, as the weighted average of the representative interest rates based on the old basket was negative at the time.

<sup>9</sup> Reimbursement to the GRA from the CCR Trust is for expenses not already attributable to other accounts or trusts administered by the Fund, or to the GRA.

- The expenses of conducting the business of the SDR Department in FY 2017 are estimated at SDR 6.049 million (proposed Decision 1).<sup>10</sup>
- The expenses for administering SDA resources in the CCR Trust are estimated at SDR 0.105 million (proposed Decision 2).
- The proposed reimbursement from the PRGT to the GRA in FY 2017 is SDR 69.68 million (proposed Decision 3), consisting of the estimated cost of administering the PRGT in FY 2017 of SDR 62.71 million, and an adjustment for an underestimate of the costs of administering the PRGT in FY 2016 (Table 1, Text Table). The cost of administering the PRGT in FY 2016 was underestimated by SDR 6.97 million, resulting in a correspondingly lower reimbursement to the GRA in FY 2016 (SDR 50 million rather than SDR 57 million). Staff has identified the source of the underestimate and will review and strengthen the methodology and controls going forward. The increase in the costs of administering the PRGT in FY 2017, from the revised estimate of SDR 57 million in FY 2016 to SDR 62.71 million, reflects the rising costs of conducting the business of the PRGT with more countries in or near-program status.<sup>11</sup>

**Text Table. PRG Trust Reimbursements - FY 2017**  
(In millions of SDRs)

	FY 2017 reimbursements	
	Initial projection	Current estimate
	<i>(In millions of SDRs)</i>	
PRG Trust reimbursements per Table 1 comprises:		
- Reimbursement for FY17 costs	50	63
- Adjustment for underestimate of FY16 costs		7
	50	70

**Total expenses are estimated to be about SDR 3 million lower than expected in April 2016.**

This is largely attributable to the depreciation charge which is expected to be lower reflecting delays in HQ1 renewal project. In U.S. dollar terms, net administrative expenditures in FY 2017 are projected to be about US\$12 million lower than budgeted. However, expenses would be modestly higher in SDR terms, as a result of an appreciation of the dollar to an average rate of US\$1.38 per SDR compared with a rate of US\$1.40 per SDR assumed in the earlier projection.

**The IAS 19 adjustment is expected to contribute about SDR 447 million to net income in FY 2017.** IAS 19 "Employee Benefits" is the International Financial Reporting Standard (IFRS) that deals with accounting for pension and other employee benefits (Annex III). For financial reporting purposes under IAS 19, the actuarial assumptions are set by management, but the practice has been to establish consistency between the actuarial assumptions for funding and accounting purposes.<sup>12</sup> The expected gain for the IAS 19 adjustment is comprised of two elements:

<sup>10</sup> Consistent with paragraph 5(b) of Schedule M to the Articles of Agreement, the SDRs taken into account for purposes of calculating the assessment do not include SDR 20 million that, due to the overdue financial obligations of certain members, are being held in an escrow account pursuant to paragraph 5(a) of Schedule M.

<sup>11</sup> Starting in FY 2013, the practice of reimbursing the GRA for the expenses of conducting the business of the PRG Trust was resumed. The reimbursement is an important element of the Fund's new income model endorsed in 2008. See [Review of the Fund's Income Position for FY 2013 and FY 2014 \(04/15/13\)](#).

<sup>12</sup> In FY 2016, the Fund undertook a 5-yearly review of the demographic and financial assumptions to determine if the assumptions selected are consistent with the actual experience underlying the pension obligations being valued and to establish the actuarially determined contribution rate for its pension plans.



- Net actuarial gains projected at SDR 605 million that are immediately recognized in the Fund's income statement. These gains stem mainly from a decline in the defined benefit obligation since the beginning of the year. Approximately half of this decline reflects the increase in the discount rate from 3.75 percent at the end of the previous financial year to 3.96 percent at end-February.<sup>13</sup> In addition, the fair value of plan assets experienced strong growth for the 10 months ended February, reflecting a broad based rally across most asset classes in the portfolio; and
- This gain is partly offset by an adjustment of SDR 158 million representing the difference between (i) the actuarially determined annual IAS 19 expense (the increase in obligations under the staff retirement plan stemming from an additional year of staff service) of SDR 292 million; and (ii) the funding (cash appropriation) for the year projected at SDR 134 million.

	<b>FY 2017</b>
	<b>Projected</b>
<b>A Accounting vs. Funding</b>	<b>-158</b>
Pension cost (accrual basis)	-292
Pension funding (cash basis)	134
<b>B Actuarial gains</b>	<b>605</b>
<b>C Total IAS 19 timing adjustment (A+B)</b>	<b>447</b>

Source: Willis Towers Watson and IMF Finance Department

<sup>13</sup> Under IAS 19, the discount rate should be determined by reference to market yields at the end of the reporting period on "high quality corporate bonds". Recent trends in market interest rates have translated into significant volatility in the discount rate, serving to further highlight the sensitivity of the defined benefit obligation, and by extension the funded status of the pension plan, to the discount rate.

**Table 1. Projected Income and Expenditures—FY 2017**  
(in millions of SDRs)

	FY2017	
	Initial Projections 1/	Current Projections
<b>A. Operational income</b>	<b>1,014</b>	<b>1,017</b>
Lending income	<b>901</b>	<b>855</b>
Margin for the rate of charge	494	487
Service charges	19	35
Commitment fees 2/	388	333
Investment income	<b>41</b>	<b>75</b>
Fixed-Income Subaccount (Reserves)	41	75
Interest free resources 3/	<b>17</b>	<b>11</b>
SCA-1 and other	17	11
Reimbursements	<b>55</b>	<b>76</b>
CCR Trust and SDR Department	5	6
PRG Trust 4/	50	70
<b>B. Expenses</b>	<b>833</b>	<b>830</b>
Net administrative expenditures	766	768
Capital budget items expensed	30	32
Depreciation	37	30
<b>C. Net operational income position (A-B)</b>	<b>181</b>	<b>187</b>
Surcharges 2/	639	584
IAS 19 timing adjustment 5/	---	447
Endowment Subaccount (gold profits) investment income	198	461
<b>Net income position 6/</b>	<b>1,018</b>	<b>1,679</b>
<u>Memorandum Items:</u>		
Fund credit (average stock, SDR billions)	49.4	48.7
SDR interest rate (average, in percent)	0.3	0.2
US\$/SDR exchange rate (average)	1.40	1.38
Precautionary balances (end of period, SDR billions)	16.1	16.4

Source: Finance Department and Office of Budget and Planning

<sup>1/</sup> [Review of the Fund's Income Position for FY 2016 and FY 2017-2018 \(04/08/16\)](#).

<sup>2/</sup> For current projections, surcharges and commitment fees are projected on the basis of quota increases following the 14<sup>th</sup> General Review of Quotas and new time and level-based surcharge thresholds and commitment fee thresholds. See [Review of Access Limits and Surcharge Policies \(01/20/2016\)](#).

<sup>3/</sup> Interest free resources reduce the Fund's costs and therefore provide implicit returns. Since the Fund invests its reserves in the IA to earn a higher return, the interest free resources retained in the GRA are mainly attributable to the SCA-1, unremunerated reserve tranche positions not represented by gold holdings, and GRA income for the year not transferred to the IA. These resources reduce members' reserve tranche positions and the Fund's remuneration expense resulting in implicit income for the Fund.

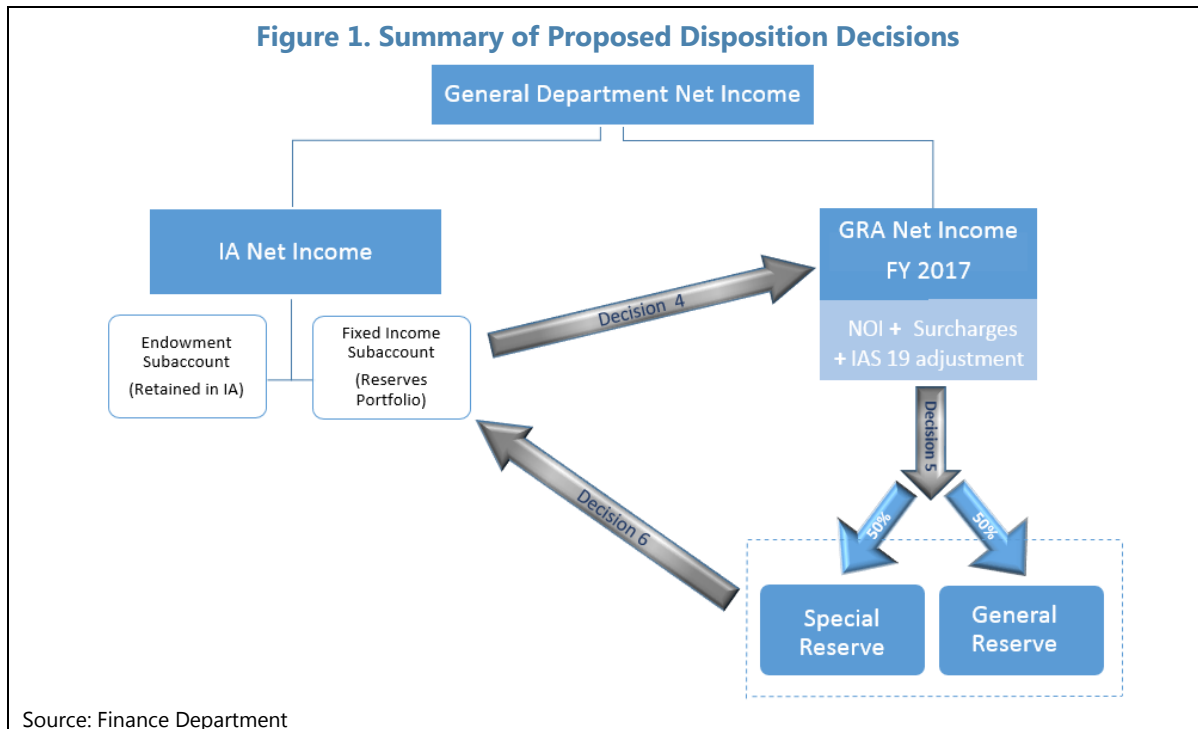
<sup>4/</sup> The current estimate of the PRG Trust reimbursement includes SDR 7 million related to the cost of administering the Trust in FY 2016.

<sup>5/</sup> IAS 19 is the accounting standard that prescribes the accounting treatment of pensions and employee benefit expenses, and involves actuarial valuations. An estimate is only provided for the current year under review (FY 2017).

<sup>6/</sup> Net income on the basis presented in the Fund's IFRS annual financial statements.

## DISPOSITION DECISIONS

4. As in previous years, the Executive Board needs to consider a number of decisions on the disposition of income for FY 2017. These cover the use of IA investment income earned in FY 2017, which impacts the determination of GRA net operational income in FY 2017; the placement of net income to reserves; and the transfer of currencies from the GRA. These elements are discussed below, and presented in Figure 1, beginning with the disposition of IA investment income.



5. **The use of IA income is guided by the Fund's Articles.** Under the Articles, investment income from the IA may be invested, held in the IA, or used for meeting the expenses of conducting the business of the Fund.<sup>14</sup> Article XII, Section 6(f)(ii), permits the transfer of additional GRA currencies to the IA if, at the time of the decision to make such transfer, the Fund's reserves are above the cumulative amount of previous transfers of currencies from the GRA to the IA.<sup>15</sup>

6. **Staff proposes that income in the subaccounts of the IA be used as follows:**

- **Fixed-Income Subaccount:** Consistent with past practice, staff proposes that the estimated FY 2017 income of SDR 75 million be transferred to the GRA to be used towards meeting the expenses of the Fund (proposed Decision 4). By so doing the IA income will

<sup>14</sup> Article XII, Section 6 (f)(iv). The Board could also, by a 70 percent majority of the total voting power, decide to reduce the amount of the investment in the IA (Article XII, Section 6 (f)(vi)).

<sup>15</sup> The cumulative amount is derived net of transfers out of the IA. In the past windfall gold sales profits of SDR 2.45 billion had been transferred to the IA but these were subsequently transferred out during FY 2013 and FY 2014, following a distribution of the general reserve to the membership, as part of the strategy for the creation of a self-sustained PRGT.

contribute to the GRA net income, which will be placed to the Fund's reserves as indicated in Figure 1; and

- **Endowment Subaccount:** As noted earlier, pending the establishment of a payout policy, the projected gain of SDR 461 million for FY 2017 will be added to retained earnings, raising cumulative retained earnings of the IA to about SDR 651 million.<sup>16,17</sup> No Board decision is required for the reinvestment of these earnings.

**7. The Articles permit the Fund's net income of the GRA to be either distributed to members or placed to the general or special reserve (see Box 1).** At the last biennial review of the Fund's precautionary balances, Directors stressed the importance of maintaining an adequate level of precautionary balances and supported retaining the current indicative medium-term target of SDR 20 billion.<sup>18</sup> As discussed below, under the staff's baseline medium-term projection and assuming an unchanged margin for the rate of charge of 100 basis points, this target would be reached in FY 2022. Placing all FY 2017 net income, other than the retained earnings of the endowment, to reserves would increase precautionary balances by SDR 1.2 billion to SDR 16.4 billion at the end of FY 2017.

**8. Last April, Directors approved a decision in line with staff's recommendation to place equal amounts of FY 2016 net income to the special and general reserves.** This represented a change from the previous practice of placing operational income to the special reserve and surcharge income to the general reserve, which originated under the old system for setting the rate of charge.<sup>19</sup> Staff proposed updating the allocation methodology to be more consistent with the approach to setting the rate of charge under the new income model.<sup>20</sup> The proposal for an equal allocation between the special and general reserves took account of Directors' views at an earlier

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<sup>16</sup> The retention of gold endowment investment income in the IA is in keeping with the Rules and Regulations for the IA, and consistent with the presentation in the Fund's annual IFRS financial statements. Retained earnings totaled SDR 190 million at end-FY 2016.

<sup>17</sup> As per the Rules and Regulations of the Investment Account, the Fund shall decide on the use of the IA's income for each financial year, including whether any portion of such income will be transferred to the GRA for use in meeting the expenses of conducting the business of the Fund.

<sup>18</sup> See the [Review of the Adequacy of the Fund's Precautionary Balances \(1/26/16\) and The Acting Chair's Summing Up \(02/25/16\)](#).

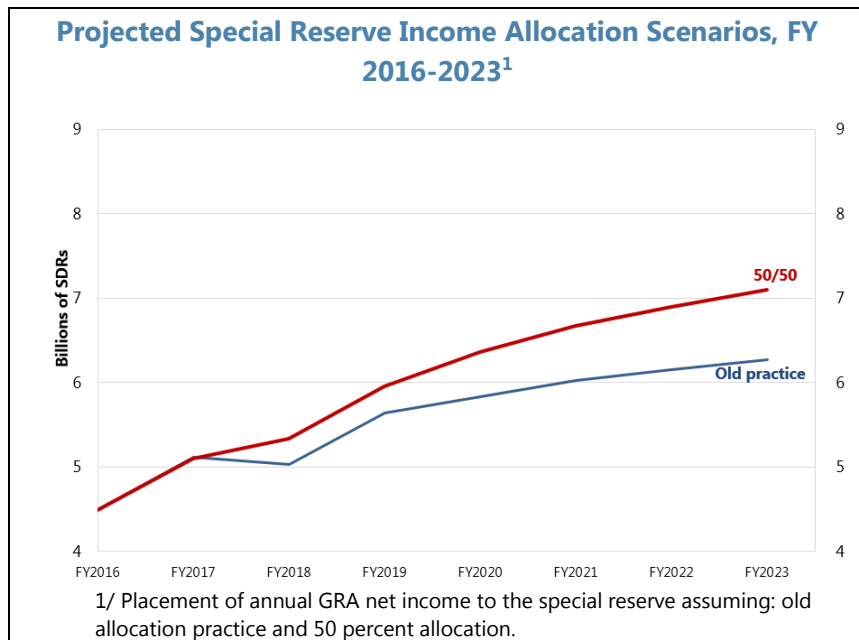
<sup>19</sup> Under the old system, the margin for the rate of charge was set annually to achieve a net income target that would cover the Fund's expenses and allow for an increase in reserves of 5 percent, which would be placed to the special reserve. Surcharge income, which was expected to be temporary and volatile, was not taken into account in setting the rate of charge, recognizing that its inclusion could significantly distort the rate of charge and result in large fluctuations in any given year.

<sup>20</sup> Under the amended Rule I-6(4), the margin of the rate of charge is set for a two-year period to cover intermediation costs and contribute to reserve accumulation; the assessment of reserve accumulation called for in setting the margin takes into account accumulation from surcharges as well as the margin itself.

discussion.<sup>21,22</sup> While Directors supported the proposed approach for FY 2016, a range of views were expressed. Many saw the new approach as a reasonable compromise consistent with the Fund's longstanding practice of allocating part of its net income to the special reserve, while noting the need to review the allocation periodically. Others would have preferred a higher or lower allocation to the special reserve, or were not convinced about the need for a new approach and called for further work.

**9. Staff proposes that net income again be allocated equally to the general and special reserve in FY 2017 (proposed Decision 5).** Maintaining an equal allocation of net income (including surcharge income) to the two reserves in FY 2017 would increase the special reserve by just over SDR 0.6 billion to SDR 5.1 billion,<sup>23</sup> while the general reserve would also rise by SDR 0.6 billion to SDR 10.1 billion. Reverting to the previous practice of allocating net operational income to the special reserve and surcharge income to the general reserve would result in a very similar outcome in FY 2017. Looking ahead, however, the allocation is projected to diverge under the two approaches, as allocating net income equally between the two reserves would allow the special reserve to rise to about SDR

7 billion by FY 2023, compared with only about SDR 6.3 billion under the old allocation practice as net operational income is projected to be modest or negative in some periods going forward (Text chart). Staff proposes to revisit the allocation of net income between the two reserves at the next annual income review, which would also allow it to benefit from the outcomes of the reviews of precautionary balances and the Investment Account in early 2018.



<sup>21</sup> See the [Review of the Adequacy of the Fund's Precautionary Balances \(1/26/16\)](#) and [The Acting Chair's Summing Up \(2/25/16\)](#).

<sup>22</sup> Precautionary balances comprise SCA-1 balances of about SDR 1.2 billion and the general and special reserves, except for amounts in the special reserve attributed to profits from the 2009-2010 gold sales of SDR 4.4 billion corresponding to the initial resources of the endowment.

<sup>23</sup> This does not include the part of the special reserve attributable to gold sales for the establishment of the endowment which is not considered to be part of the Fund's precautionary balances.

### Box 1. The Fund's Reserves

Article XII, Section 6(a) requires the Fund's net income to be distributed to members or placed to the general or special reserve.

**Special Reserve.** This reserve—established in 1957—was initially funded by the proceeds from a gold investment program set up to address the deficits accumulated from annual losses the Fund suffered from its inception to April 1956. Income from the investment program was placed to the special reserve each year until the program was terminated in 1972. The Board also decided in 1957 when the reserve was established that any administrative losses would first be written off against the special reserve. The special reserve is therefore the first line of defense against income losses. In symmetric fashion, it has been the Fund's practice to place its annual net operational income (not attributable to surcharge income) to the special reserve since the termination of the gold investment program. Under the Fund's Articles, no distributions (dividends) can be made from the special reserve.

**General Reserve.** In 1958, it was decided that the reserve contemplated in Article XII, Section 6(a) of the Articles, prior to the Second Amendment, would be referred to as the general reserve to distinguish it from the special reserve. Net operational income was placed to this reserve while the gold investment program was active, i.e., during FY 1958–72, as the Fund had returned to profitability from its operations. The general reserve can be used to absorb capital losses, to meet administrative losses or for distribution. Placements of Fund net income were made to the general reserve in FY 1998 to FY 2006 as follows: (i) net operational income generated under the Supplemental Reserve Facility (SRF), after meeting the cost of administering the PRGF Trust (FY 1998–2001); and (ii) surcharges on purchases under the SRF, credit tranches and EFF (FY 2002 to FY 2006). During FY 2007–2008, the Fund experienced net income shortfalls and subsequently, the Board agreed to resume the practice of placing net income equivalent to surcharge income in the general reserve in FY 2011. In FY 2016 the Board agreed to place net income equally to the general and special reserve. Pursuant to Article XII, Section 6(d) of the Articles, reserves accumulated in the general reserve may be distributed to members, in proportion to their quota, if the Board approves such decision by a 70 percent majority of the total voting power.

**10. The placement of FY 2017 GRA net income to the special and general reserve provides scope for further transfer of currencies to the Fixed-Income Subaccount.** Article XII, Section 6(f)(ii) provides that the transfer of currencies from the GRA to the IA shall not, at the time of the decision, exceed the total amount of the general and special reserves. After the above placement, the combined balance in the special reserve and the general reserve would total SDR 19.6 billion. This would remain above the net cumulative amount of transfers made thus far to the IA from the GRA of SDR 18.4 billion.<sup>24</sup>

**11. Accordingly, staff proposes to transfer currencies equivalent to the increase in the general and special reserves of SDR 1.2 billion from the GRA to the IA for investment in the Fixed-Income Subaccount (proposed Decision 6).** This amount comprises currencies equivalent to net income of SDR 1.2 billion for FY 2017, the maximum amount permitted under the Articles. The objective of the FI subaccount is to achieve investment returns that exceed the 3-month SDR

<sup>24</sup> These totals include special reserves attributed to profits from the 2009–2010 gold sales of SDR 4.4 billion, which are not part of the Fund's precautionary balances, and corresponding transfers to establish the gold endowment.

interest rate over time while minimizing the frequency and extent of negative returns and underperformance over an investment horizon of three to four years. It is also consistent with the assumption of the new income model that the IA will over time achieve a higher return than the SDR interest rate.<sup>25</sup> While risks of under-performance remain under the current rising interest rate environment (see Annex IV), staff proposes to transfer the maximum amount permitted under the Articles, currently estimated at SDR 1.2 billion to the IA for investment (proposed Decision 6).

## FY 2018 INCOME OUTLOOK

**12. The income outlook for FY 2018 remains positive.** Despite a decline in commitment fee income, projected net income, comprised of net operational income together with surcharge income and retained earnings in the gold endowment, is projected at SDR 0.7 billion for FY 2018 (Table 2). This projection assumes that the margin for the rate of charge is maintained at the level of 100 basis points in place since 2008 (see below) and is also sensitive to a number of factors including the level of global interest rates; the timing of purchases and repurchases under existing arrangements; possible new arrangements; the U.S. dollar/SDR exchange rate, the payout policy and the annual pension expense as determined under the amended IAS 19.<sup>26</sup>

### A. Review of the Margin for the Rate of Charge

**13. In April 2016, the Executive Board set the margin for the basic rate of charge for financial years 2017-2018.** Based on amended Rule I-6(4), which came into effect on May 1, 2012, the Executive Board set the margin to cover the Fund's intermediation costs and help build up reserves. The rule provides for a cross-check of the alignment of the margin to long-term credit market conditions (see Box 2). The rule also permits that, in exceptional circumstances, the margin may be set at a level other than that which is adequate to cover estimated intermediation expenses of the Fund and to generate an amount of net income for placement to reserves and for the accumulation of precautionary balances ("exceptional circumstances clause").

<sup>25</sup> Since the inception of the IA, the IA returns have exceeded the three month SDR interest rate by 117 basis points on an annualized basis. Over the past three years the excess return was 47 basis points (annualized).

<sup>26</sup> Consistent with past practice, the projections only take account of arrangements approved through end-March 2017 and not possible new arrangements.

<b>Table 2. Projected Income Sources and Uses - FY 2017–2018</b> (in millions of SDRs)		
	FY2017	FY2018
<b>A. Operational income 1/</b>	<b>1,017</b>	<b>789</b>
Lending income	<b>855</b>	<b>590</b>
Margin for the rate of charge	487	532
Service charges	35	54
Commitment fees 2/	333	4
Investment income	<b>75</b>	<b>98</b>
Fixed-Income Subaccount (Reserves)	75	98
Interest free resources 3/	<b>11</b>	<b>32</b>
SCA-1 and other	11	32
Reimbursements	<b>76</b>	<b>69</b>
CCR Trust and SDR Department	6	4
PRG Trust 4/	70	65
<b>B. Expenses</b>	<b>830</b>	<b>873</b>
Net administrative expenditures	768	806
Capital budget items expensed	32	30
Depreciation	30	37
<b>C. Net operational income position (A-B)</b>	<b>187</b>	<b>-84</b>
Surcharges 2/	584	568
IAS 19 timing adjustment 5/	447	---
Endowment Subaccount (gold profits) investment income 6/	461	253
<b>Net income position 7/</b>	<b>1,679</b>	<b>737</b>
<u>Memorandum Items:</u>		
Fund credit (average stock, SDR billions)	48.7	53.2
SDR interest rate (average, in percent)	0.2	0.6
US\$/SDR exchange rate (average)	1.38	1.37
Precautionary balances (end of period, SDR billions)	16.4	16.9
Source: Finance Department and Office of Budget and Planning		
1/ Surcharges are excluded from operational income.		
2/ Surcharges and commitment fees are projected on the basis of quota increases following the 14 <sup>th</sup> General Review of Quotas and new time and level-based surcharge thresholds and commitment fee thresholds. See <a href="#">Review of Access Limits and Surcharge Policies (01/20/2016)</a> .		
3/ Interest free resources reduce the Fund's costs and therefore provide implicit returns. Since the Fund invests its reserves in the IA to earn a higher return, the interest free resources retained in the GRA are mainly attributable to the SCA-1, unremunerated reserve tranche positions not represented by gold holdings, and GRA income for the year not transferred to the IA. These resources reduce members' reserve tranche positions and the Fund's remuneration expense resulting in implicit income for the Fund.		
4/ The current estimate of the PRG Trust reimbursement for FY 2017 includes SDR 7 million related to the cost of administering the Trust in FY 2016.		
5/ The IAS 19 timing adjustment is actuarially determined and is finalized shortly after the end of the financial year. An estimate is only provided for the current year under review (FY 2017).		
6/ Payouts from the endowment to the GRA are assumed to commence in FY 2019.		
7/ Net income on the basis presented in the Fund's IFRS annual financial statements.		



### Box 2. The Rule for Setting the Margin for the Basic Rate of Charge

Effective May 1, 2012, Rule I-6(4) reads as follows:

"(4) The rate of charge on holdings (i) acquired as a result of a purchase under a policy that has been the subject of an exclusion under Article XXX(c), or (ii) that exceed the amount of the member's quota after excluding any balances referred to in (i), shall be determined in accordance with (a) and (b) below.

(a) The rate of charge shall be determined as the SDR interest rate under Rule T-1 plus a margin expressed in basis points. The margin shall be set at a level that is adequate (i) to cover the estimated intermediation expense of the Fund for the period under; (b) below, taking into account income from service charges; and (ii) to generate an amount of net income for placement to reserves. The appropriate amount for reserve contribution shall be assessed taking into account, in particular, the current level of precautionary balances, any floor or target for precautionary balances, and the expected contribution from surcharges and commitment fees to precautionary balances; provided, however, that the margin shall not be set at a level at which the basic rate of charge would result in the cost of Fund credit becoming too high or too low in relation to long-term credit market conditions as measured by appropriate benchmarks. Notwithstanding the above, in exceptional circumstances, the margin may be set at a level other than that which is adequate to cover estimated intermediation expenses of the Fund and to generate an amount of net income for placement to reserves.

(b) The margin shall be set for a period of two financial years. A comprehensive review of the Fund's income position shall be held before the end of the first year of each such two-year period and the margin may be adjusted in the context of such a review, but only if this is warranted in view of fundamental changes in the underlying factors relevant for the establishment of the margin at the start of the two-year period."

**14. Since amended Rule I-6(4) was first implemented, the Executive Board has consistently set the margin under the exceptional circumstances clause.** The new Rule I-6(4), which was amended as part of the Fund's New Income Model, was designed to move away from the reliance on lending income for the financing of the Fund's non-lending activities i.e., non-lending income was expected to cover non-lending activities of the Fund while lending income was to cover intermediation costs and contribute to a build-up of reserves.<sup>27</sup> However, investment income, the main source of the Fund's non-lending income, remains constrained by the historically low level of global interest rates. Over the longer term, the gold profits-funded endowment is also expected to contribute more to Fund income, following the establishment of a payout policy, but in the near term lending income is expected to continue to cover a significant portion of the Fund's non-lending operating costs.

**15. Against this background, the margin for FY 2017–2018 was again set under the exceptional circumstances clause.**<sup>28</sup> Although non-lending income is projected to rise moderately, as in the last two years, it would only cover about one-fifth of the Fund's non-lending activities. As such, an important implication of the use of the exceptional circumstances clause is that the contribution of the margin to reserve accumulation is significantly less than it would be if non-

<sup>27</sup> Annex II provides an update on the Implementation of the New Income Model.

<sup>28</sup> The margin for the basic rate of charge for the period FY 2017 and FY 2018 was adopted under the exceptional circumstances clause (see [Review of the Fund's Income Position for FY 2016 and FY 2017–2018 \(4/8/16\)](#)).

lending activities were covered by non-lending income, i.e., income from the margin will also be required to cover a significant part of the costs of the Fund's non-lending activities.

**16. While the margin is set for a two-year period under Rule I-6(4), a comprehensive review of the Fund's income position must be held before the end of the first year of each two-year period** (for this period, the end of FY 2017). The margin may be adjusted by the Board in the context of such a review but, to provide for stability and predictability, only if an adjustment is warranted in view of fundamental changes in the underlying factors relevant for the establishment of the margin at the start of the two-year period. As discussed in greater detail below, staff is of the view that there has been no fundamental change in the underlying factors relevant for the establishment of the current margin and therefore no change is proposed for FY 2018.

### Coverage of intermediation costs

**17. Intermediation costs are estimated at US\$92 million in FY 2017 (Table 3).** Fund-wide intermediation costs related to generally available facilities (GAF) are derived in consultation with departments using the Fund's Analytic Costing and Estimation System (ACES). They cover direct personnel, travel and other administrative expenses, as well as indirect support and governance costs. FY 2017 costs are lower compared with FY 2016 estimates, reflecting reduced spending (and FTEs) on GAF.

**18. Income is expected to remain substantially in excess of intermediation costs in FY 2018.**<sup>29</sup> The income from service charges at US\$74 million (Table 3, row B) is projected to cover a portion of the intermediation costs in FY 2018. An unchanged margin of 100 basis points would provide further income of about US\$729 million (SDR 532 million) in FY 2018.

**19. In addition to the margin and service charges on purchases, commitment fees for non-drawing arrangements and surcharges contribute to the Fund's income.**

Income from commitment fees is estimated at about US\$460 million (SDR 333 million) in FY 2017. This includes commitment fees that were recognized following the cancellation of FCLs by Colombia and Mexico in FY 2017. In FY 2018, commitment fee income is projected to fall back sharply, as the two-year commitment fees on three new FCL arrangements and a PLL arrangement approved in FY 2017, would be recognized only in FY 2019. (Table 3, row E); and

Surcharge income is projected at about US\$778 million (SDR 568 million) in FY 2018, lower than previously projected. (Table 3, row F).

### Reserve accumulation

**20. Reserve accumulation is projected to remain relatively strong in FY 2018, though somewhat lower than estimated in April 2016.** Table 3 first illustrates the potential reserve accumulation that would result if lending income were required solely to cover intermediation costs and provide for additional reserves (Rows G and H). In this hypothetical scenario, potential reserve

<sup>29</sup> Commitment fees are included in the analysis as a source of income that contributes to reserve accumulation. Under this approach, the analysis in setting the margin is insulated from the unpredictability of commitment fees.

accumulation with a margin of 100 basis points would fall to 6.6 percent in FY 2018. Projected actual reserve accumulation (after taking into account the need to cover non-lending expenditures while investment income is constrained by low interest rates) would be 3 percent of reserves in FY 2018 (Rows I and J). Precautionary balances are projected to reach SDR 16.9 billion by end-FY 2018, slightly higher than estimated previously, reflecting the stronger-than-projected outcome for FY 2017. Table 3 further simulates reserve accumulation at alternative margins of 80 and 120 basis points, respectively.

**Table 3. Income from the Margin and Reserve Accumulation<sup>1</sup>**  
**(in millions of U.S. Dollars, unless otherwise indicated)**

	Actual			Projected	
	FY 2014	FY 2015	FY 2016	FY 2017	FY 2018
A. Intermediation costs 2/ <i>Less</i>	96	96	97	92	94
B. Service charges	90	88	32	48	74
C. Costs to be covered by income from margin (A-B)	6	7	65	44	20
D. Income from margin 3/ 80 basis points	...	...	...	538	583
100 basis points	1,297	1,091	716	672	729
120 basis points	...	...	...	806	875
E. Commitment fees 4/ E.1 FCL/PLL	44	742	133	460	5
E.2 Other	29	726	25	460	-
	15	16	108	-	5
F. Surcharges 5/	2,125	2,151	1,094	806	778
G. Potential reserve accumulation 6/ (D+E+F-C) 80 basis points	...	...	...	1,760	1,347
100 basis points	3,460	3,977	1,878	1,894	1,493
120 basis points	...	...	...	2,028	1,639
H. Potential reserve accumulation (as a percent) 7/ 80 basis points	...	...	...	8.4%	6.0%
100 basis points	19.8%	21.3%	9.5%	9.0%	6.6%
120 basis points	...	...	...	9.6%	7.3%
I. Actual reserve accumulation 8/ 80 basis points	...	...	...	1,547	517
100 basis points	4,005	2,142	1,440	1,681	663
120 basis points	...	...	...	1,815	809
J. Actual reserve accumulation (as a percent) 8/ 80 basis points	...	...	...	7.4%	2.3%
100 basis points	22.9%	11.5%	7.3%	8.0%	3.0%
120 basis points	...	...	...	8.6%	3.6%
K. Precautionary balances at the end of FY (in SDR billions) 9/ 80 basis points	...	...	...	16.3	16.8
100 basis points	12.7	14.2	15.2	16.4	16.9
120 basis points	...	...	...	16.5	17.0
<u>Memorandum items</u>					
Average Fund credit outstanding (in SDR billions)	85.3	74.2	51.5	48.7	53.2
Number of active arrangements (average) 10/	13	13	15	19	...
Average exchange rate US\$/SDR	1.52	1.47	1.39	1.38	1.37

Source: Finance Department and Office of Budget and Planning

1/ For analytical purposes, surcharges and commitments fees are considered for reserve accumulation only.

2/ Costs related to the Fund's "generally available facilities."

3/ Derived by applying the margin against average Fund credit outstanding at the average US\$/SDR rate.

4/ Includes commitment fees for expired or cancelled arrangements.

5/ Surcharges are projected on the basis of current quotas and surcharge thresholds.

6/ Potential reserve accumulation is derived by assuming other sources of income are sufficient to cover non-intermediation costs.

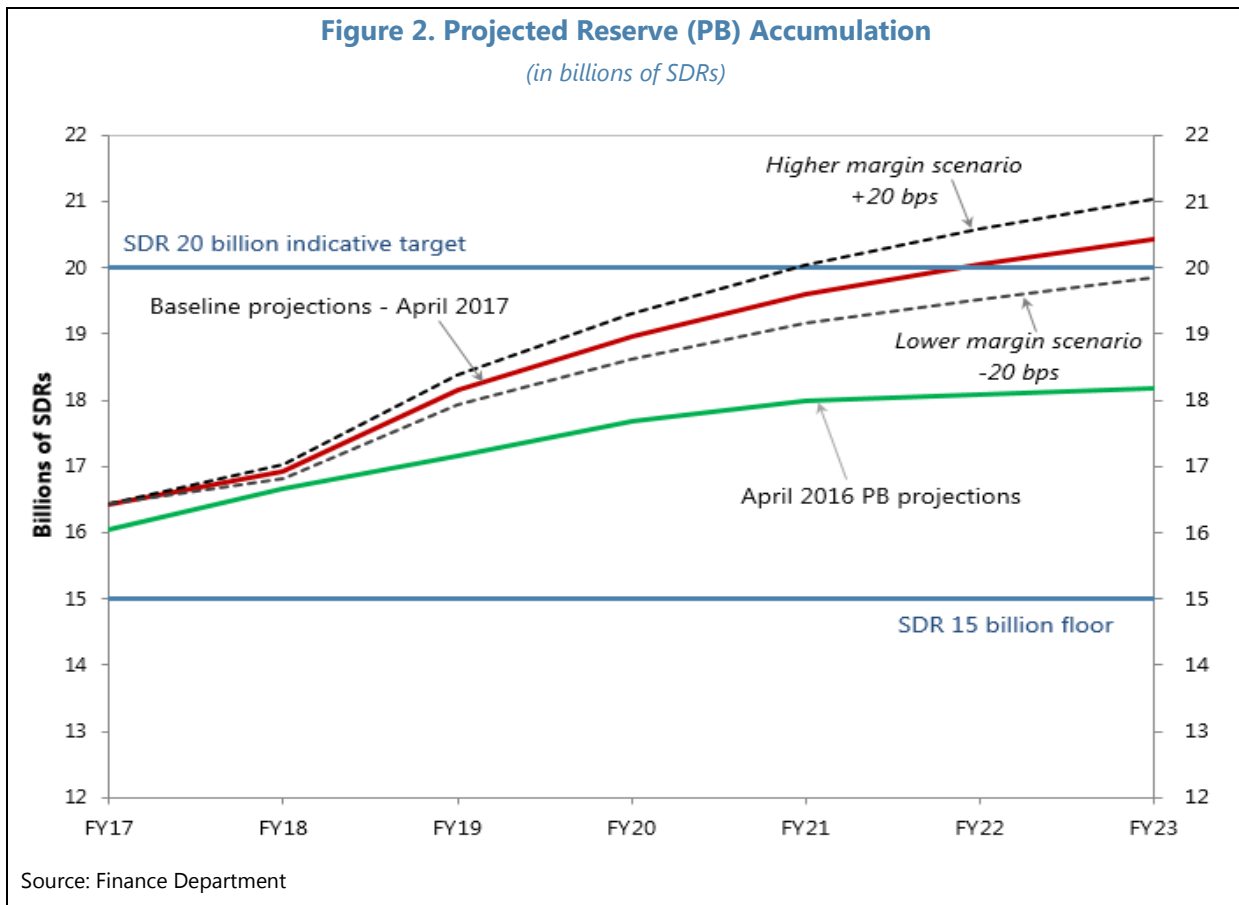
7/ Potential reserve accumulation as a percent of precautionary balances at the beginning of the financial year.

8/ Additions to reserves based on net income for the year (excluding retained gold endowment investment income).

9/ Precautionary balances include the Fund's reserves and SCA-1 balance less the gold endowment of SDR 4.4 billion.

10/ Excludes FCL and PLL arrangements.

**21. The medium-term outlook for Fund income and reserve accumulation has improved (Figure 2).**<sup>30</sup> The most recent projections, which incorporate a number of new arrangements approved in FY 2017 and a modest upward revision in the interest rate path over the medium term, suggest that precautionary balances would reach their current indicative target of SDR 20 billion by end-FY 2022, based on an unchanged margin of 100 basis points. At the time of the April 2016 income review, precautionary balances were expected to reach only about SDR 18 billion by FY 2022. Despite this, achieving the target of SDR 20 billion remains subject to considerable uncertainty as, only as recently as 2014, the target was expected to be reached by mid-FY 2018.<sup>31</sup> A more comprehensive review of the pace of reserve accumulation will be conducted as part of the forthcoming review of adequacy of precautionary balances scheduled for January 2018.



<sup>30</sup> For an update of the medium-term income and expenditure table see Table 5 in *FY2018-FY2020 Medium-Term Budget* (03/29/17).

<sup>31</sup> See [Review of the Fund's Income Position for FY 2014 and FY 2015–2016 \(04/07/14\)](#).

## Alignment of Fund borrowing costs with market conditions

**22. Rule I-6(4) provides for a cross-check to ensure that the margin maintains a reasonable alignment with long-term credit market conditions.**<sup>32</sup> This aims to ensure that the cost of borrowing from the Fund is not too high or low in relation to the cost of market funding. Benchmarks developed by staff for this purpose provide a useful guide but should not be applied mechanistically and require judgment particularly on the global financial context and future developments. As in the past, staff employs EMBI spreads as the main basis for the comparison with market borrowing rates.<sup>33</sup> Typically two adjustments are made to the metric measuring long-term market conditions:

*Risk premium adjustment*—an adjustment to take account of the lower credit risks the Fund faces as a cooperative public policy institution. The Fund's preferred creditor status and its lending policies are key factors in reducing these risks. To reflect this, the measure compares the margin to market borrowing spreads applying for the most creditworthy Fund members, approximated by the lowest quartile of EMBI spreads; and

*Term premium adjustment*—an adjustment is made to account for the difference between the SDR interest rate (based on a floating rate composed of three-month instruments) and the comparator EMBI measure (based on five year fixed interest rate instruments).

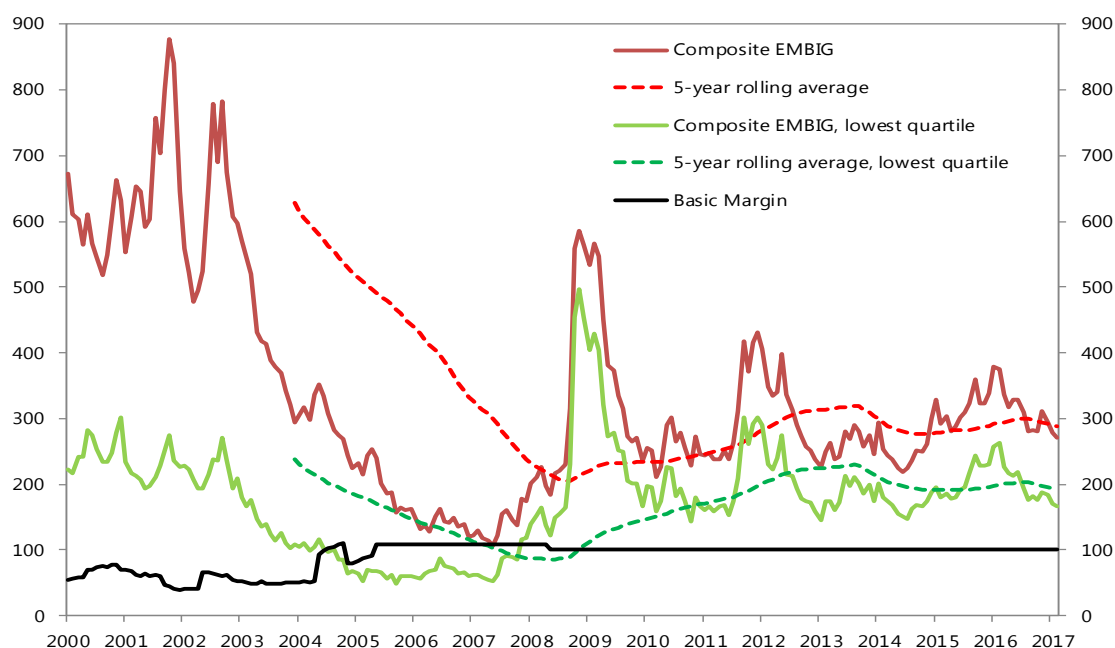
**23. The updated staff benchmarks suggest that the cost of Fund credit at the current margin remains broadly aligned with the long-term credit market conditions.** While EMBI spreads have narrowed since the last review, the 5-year rolling average spread remains at a broadly comparable level to recent reviews (Figure 3). In the most recent five-year period ending in February 2017, the lowest quartile of the EMBI adjusted for the term premium was about 72 basis points above the current margin (Table 4). As such this differential has remained close to the levels seen since the global financial crisis and staff therefore does not see a basis to conclude that the cost of Fund credit has become too high or too low relative to long-term market conditions.

**24. Based on the foregoing analysis, staff's view is that there are no fundamental changes that would warrant an adjustment to the margin for the rate of charge set at 100 basis points for FY 2018 (proposed Decision 7).** At this level, the margin will cover intermediation costs, generate a substantial contribution to reserves, and is not significantly out of line with long-term market conditions. While the overall outlook for reserve accumulation has improved relative to last year, the SDR 20 billion target would only be reached by end-FY 2022 and these projections remain subject to substantial uncertainty, including over the future course of Fund lending and interest rates.

<sup>32</sup> See [A New Rule for Setting the Margin for the Basic Rate of Charge \(11/23/2011\)](#).

<sup>33</sup> EMBI spreads do not include data for advanced countries, some of which have outstanding credit to the Fund. (55 percent of total GRA credit outstanding relative to 66 percent in April 2016). However, based on currently available measures, staff continues to view the EMBI-based measure as the most appropriate metric of long-term market conditions (see Annex II, [Review of the Fund's Income Position for FY 2014 and FY 2015-2016 \(04/07/14\)](#)).

**Figure 3. EMBIG Spreads: Total Composite and Bottom Quartile  
(in basis points)<sup>1</sup>**



Source: Bloomberg and Staff calculations.

1/ SDR-equivalent rates are calculated using the currency weights in the SDR basket.

**Table 4. Long-Term Credit Market and Comparator Spreads  
(in basis points)**

	2006 - 2010	2011 - 2015	Mar 2012 - Feb 2017
(Median spread, in SDR-equivalent basis points) 1/			
<u>Country risk spread--EMBI-based measures 2/</u>			
Composite EMBI	219	277	281
Risk adjusted (lowest quartile)	153	180	185
Term premium 3/	16	15	14
<u>Term-premium adjusted country risk spread</u>			
Composite EMBI	203	262	268
Countries in the lowest quartile	<b>137</b>	<b>165</b>	<b>172</b>
<i>Memorandum item</i>			
Past users of Fund resources 4/	217	270	274
Margin on the basic rate of charge 5/	104	100	100

Source: Bloomberg, JP Morgan and Fund staff calculations.

1/ SDR-equivalent rates are calculated using the currency weights in the SDR basket.

2/ Table reports linear combination of spreads in EMBIG-U.S. dollar and EMBIG-Euro composites. Series were combined using the weights of the U.S. dollar and Euro in the SDR basket (normalized to 100). During the sample period, the combined EMBIG indices contained spreads for a total of 40 countries.

3/ Difference in yields between a five-year fixed-rate SDR bond and the five-year average 3-month SDR interest rate as implied in futures market contracts, adjusted for the higher risk premium of instruments in future markets. Starting October 2016, these calculations account for the Chinese renminbi inclusion in the SDR basket.

4/ Median level of the SDR weighted U.S. dollar and euro EMBIG spreads for the members with Fund arrangements between 2000 and 2016, excluding advanced countries.

5/ Margin reduced to 100 bps from 108 bps in May 2008. The margin is defined in absolute basis points over the SDR interest rate.

## B. Key FY 2018 Income Outlook Factors

**25. Key factors that affect the FY 2018 income outlook are discussed below and presented in Table 2.** A sensitivity analysis on the income effects of changes in some of the assumptions is also presented in Table 5.

**Lending income.** Despite the large number of new arrangements approved in the GRA in FY 2017 and the resulting increase in projected average Fund credit outstanding in FY 2018 to SDR 53.2 billion, lending income is projected to decline by almost a third in FY 2018, reflecting a sharp decline in commitment fee income. Following the replacement of four large precautionary arrangements cancelled early in FY 2017, the bulk of commitment fee income is now projected to be recognized in FY 2019.

### IA investment income:

- **Fixed-Income Subaccount:** As in April 2016, income projections over the medium term remain conservative incorporating the broadened investment mandate that began in FY 2017 thus maintaining the gradual rise in returns from this subaccount. In FY 2018 the subaccount is projected to yield about 64 basis points broadly in line with the SDR interest rate, and is expected to realize gains of about SDR 98 million. However, a rise in interest rates beyond current market expectations could reduce these gains.<sup>34</sup> Annex IV provides further discussion on the sensitivity of the returns in this portfolio to changes in global interest rates;
- **Endowment Subaccount:** As noted, following the recent completion of the phasing-in of the passively managed portion and partial funding of the actively managed portion during the year, the endowment is now 98 percent invested, with the remaining gold sales profits temporarily held in USD denominated short-term fixed deposits. The projected income for the endowment amounts to about SDR 253 million in FY 2018, broadly in line with prior year estimates.<sup>35</sup> During the funding period, investment income earned from the subaccount is assumed to be retained in the endowment in accordance with the Rules and Regulations of the Investment Account (IA) and is therefore not included in the Fund's operating income. The payout policy for the endowment will be addressed in the context of the next review of the IA Rules and conflict of interest policies, scheduled to take place by January 2018. For now, the projections maintain the illustrative assumption of annual payouts of 3 percent, which are assumed to commence in FY 2019, one year later than projected in prior years;<sup>36</sup>

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<sup>34</sup> The balance of the Fixed-Income Subaccount corresponds to the investment of the Fund's reserves except for the gold profits and any currencies retained in the GRA.

<sup>35</sup> Payouts from the endowment are expected to be based on U.S. dollar returns which are likely to differ from returns in SDR terms.

<sup>36</sup> See [Press Release No. 13/37](#) on the new rules and regulations of the Investment Account.



**Interest-free resources and reimbursements.** Income from interest-free resources is projected to be higher reflecting the expected uptick in interest rates. Projected reimbursements are based on the FY 2017 estimates;

**Expenditures.** Net administrative and capital expenditures are consistent with those set in the medium-term budget paper;<sup>37</sup>

**Surcharges.** Surcharges are projected to decline to SDR 568 million in FY 2018 following delays in expected disbursements and earlier than projected advance repayments, partly offset by new arrangements; and

**Sensitivity.** Projected income and expenses remain susceptible to changes in the underlying assumptions. The effect of changes in key assumptions is summarized in Table 5.

Change in:	
SDR interest rate by 50 basis points	
Implicit returns 1/	27
Credit tranche purchases (non-FCL) by SDR 10 billion 2/	275
U.S. dollar exchange vis-à-vis SDR by five percent	38
Investment income margin by 50 basis points	102

1/ Implicit returns on GRA interest-free resources.  
2/ Assumes May 1 transaction with full drawing of SDR 10 billion and access of 500 percent of quotas. Includes service charges, margin on the basic rate of charge and level based surcharges (commitment fees are excluded).

**26. In October 2014, Rule T-1 and the burden sharing mechanism were amended as the SDR interest rate fell below the minimum required for the mechanism to operate.**<sup>38</sup> Notably, a 5 basis point floor on the SDR interest rate was set, the rounding rules on the SDR interest rate and the burden sharing adjustment were changed, and the 1 basis point minimum of the burden sharing adjustment, introduced in FY 2010, was reduced to 0.1 basis point. These measures aim to preserve a minimal capacity of equal burden sharing for protecting the Fund's balance sheet, while limiting potential departures of the SDR interest rate from market interest rates.

<sup>37</sup> See *FY 2018–FY 2020 Medium-Term Budget* (03/29/17).

<sup>38</sup> Under the burden sharing mechanism, where creditors and debtors as a group generate equal amounts to cover deferred charges, a minimum positive SDR interest rate is required for the mechanism to operate. During FY 2015 the SDR interest rate hit historical lows, falling below that minimum level, affecting the functioning of the burden sharing mechanism for deferred charges. See [Recent fall in the SDR Interest Rate – Implications and Proposed Amendments to Rule T-1 \(10/16/2014\)](#).

**27. Given current levels of overdue obligations and lending, and the moderate rise in interest rates, burden sharing adjustments remain at low levels.** The burden sharing decision allows for a “carry-forward” of excess amounts generated from a minimum adjustment to the rate of charge and the rate of remuneration.<sup>39</sup> If the amounts brought forward are sufficient to offset deferred charges in subsequent quarter(s), no adjustments are necessary for such quarters. This was the case for adjustments to the rate of charge in FY 2015 and FY 2016, and the first two quarters in FY 2017 (see Table 6).

**Table 6. Recent Burden Sharing Adjustment Rates**  
(in basis points, unless otherwise stated)

	FY10	FY11	FY12	FY13	FY14	FY15 <sup>3</sup>	FY16	FY17 Projected
Rate of Remuneration 1/ Deferred charges	1	– <sup>2</sup>	– <sup>2</sup>	– <sup>2</sup>	– <sup>2</sup>	0.300	0.575	0.375
Rate of Charge 1/ Deferred charges	1	– <sup>2</sup>	– <sup>2</sup>	– <sup>2</sup>	– <sup>2</sup>	–	–	0.175
Average SDR interest rate (in percent)	0.29	0.35	0.30	0.09	0.09	0.061	0.051	0.205
Average basic rate of charge (in percent)	1.29	1.35	1.30	1.09	1.10	1.061	1.051	1.205

1/ The average rates have been calculated using the quarterly burden sharing rates and SDR interest rates.  
2/ Annual average rate less than 0.5 basis points. Based on minimum burden sharing adjustment rate of 1 basis point.  
3/ In October 2014 (FY 2015), the minimum for the quarterly burden sharing rate adjustment of 1 basis point was reduced to 0.1 basis point.

## REVIEW OF SPECIAL CHARGES

**28. The decision on special charges on overdue financial obligations in the GRA and the Trust Fund calls for an annual review.** Under the decision, special charges equal to the SDR interest rate apply to charges that are in arrears for more than 10 days but not beyond six months.<sup>40</sup> While the decision also includes a regime for special charges on overdue repurchase obligations, such charges can only arise in circumstances where the basic rate of charge is below the SDR interest rate. Since, under the current system for setting the basic rate of charge, that rate is always in excess of the SDR interest rate, members are not subject to special charges on their overdue repurchases.<sup>41</sup> At this stage, no changes are proposed to the current system (proposed Decision 8), but staff could revisit this issue at a later date if warranted by developments.

<sup>39</sup> See [The Fund's Income Position for FY 2010—Midyear Review \(12/8/2009\)](#), paragraphs 8–10.

<sup>40</sup> Special charges were established to provide members with an incentive to settle their financial obligations to the Fund in a timely manner. It was also recognized that these charges may complicate the efforts of a member in protracted arrears and those of its donors and creditors to resolve its arrears problem, by increasing the financing needs and making it more difficult for the member to make payments to the Fund equivalent to obligations falling due.

<sup>41</sup> For overdue repurchases, the special rate of charge is set to equal the excess, if any, of the SDR interest rate over the basic rate of charge. Pursuant to Rule I-6(4), the basic rate of charge “shall be determined at the beginning of

(continued)

## Proposed Decisions

### Decisions Pertaining to FY 2017

- Decision 1 provides for the assessment on SDR Department participants for the reimbursement of the General Department for the expenses of conducting the business of the SDR Department in FY 2017.
- Decision 2 provides for the reimbursement to the General Resources Account for the cost of administering SDA resources in the CCR Trust in FY 2017.
- Decision 3 provides for the reimbursement to the General Resources Account for a total amount of the cost of administering the PRGT in FY 2017 and the adjustment for the underestimate of the cost of administering PRGT in FY 2016.
- Decision 4 provides for the transfer of income from the Fixed-Income Subaccount of the Investment Account to the General Resources Account for use in meeting FY 2017 administrative expenses.
- Decision 5 provides for the placement of FY 2017 General Resources Account net income to the Fund's Special Reserve and the General Reserve.
- Decision 6 provides for the transfer of currencies from the GRA to the Investment Account equivalent to the increase of the special and general reserves following the placement of FY 2017 net income.

### Decisions Pertaining to FY 2018

- Decision 7 completes the review of the Fund's income position and concludes that there are no fundamental changes that warrant adjustment to the current rate of charge at 100 basis points over the SDR interest rate for FY 2018.
- Decision 8 reviews the system of special charges.

Decisions 1, 2, 3, 4, 5, 7, and 8 may be adopted by a majority of the votes cast. Decision 6 may be adopted by a 70 percent majority of the total voting power.

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each financial year as the SDR interest rate under Rule T-1 plus a margin expressed in basis points". As such, the basic rate of charge would always be in excess of, or at least equal to, the SDR interest rate. Hence, members with overdue obligations are currently not subject to an additional special charge on their overdue repurchases.

**Decision 1. Assessment under Article XX, Section 4 for FY 2017**

Pursuant to Article XVI, Section 2 and Article XX, Section 4 of the Articles of Agreement and Rule T-2 of the Fund's Rules and Regulations, it is decided that:

- (i) The General Department shall be reimbursed for the expenses of conducting the business of the SDR Department for the period of May 1, 2016 through April 30, 2017; and
- (ii) An assessment shall be levied on all participants in the SDR Department. The special drawing right holdings accounts of participants shall be debited on April 30, 2017 with an amount equal to 0.00296311 percent of their net cumulative allocations of special drawing rights. The total assessment shall be paid into the General Department.

**Decision 2. CCR Trust Reimbursement for FY 2017**

In accordance with paragraph 3 of Decision No. 14649-(10/64), adopted June 25, 2010, as amended, the General Resources Account shall be reimbursed an amount equivalent to SDR 0.105 million by the CCR Trust in respect of the expenses of administering SDA resources in the CCR Trust during FY 2017.

**Decision 3. PRG Trust Reimbursement for FY 2017 and adjustment for FY 2016**

In accordance with paragraph 3 of Decision No. 8760-(87/176), adopted on December 18, 1987, an amount equivalent to SDR 69.68 million shall be transferred from the Reserve Account of the PRGT (through the Special Disbursement Account) to the General Resources Account, of which an amount equivalent to SDR 62.71 is to cover the cost of administering the Poverty Reduction and Growth Trust (PRGT) for FY 2017 and an amount equivalent to SDR 6.97 million is to cover the underestimate of the cost of administering PRGT in FY 2016.

**Decision 4. Transfer of Investment Income for FY 2017 to General Resources Account**

The income of the Fixed-Income Subaccount of the Investment Account for FY 2017 shall be transferred to the General Resources Account for use in meeting the expenses of conducting the business of the Fund during FY 2017.

**Decision 5. Placement of FY 2017 net income of the General Resources Account to the Special Reserve and General Reserve**

The net income of the General Resources Account for FY 2017 shall be placed in equal parts to the Fund's Special Reserve and General Reserve.

**Decision 6. Transfer of Currencies to the Investment Account for FY 2017**

Pursuant to Article XII, Section 6(f)(ii) of the Articles of Agreement, the Fund shall transfer from the General Resources Account to the Investment Account currencies in an amount equivalent to the difference between the Fund's general and special reserves as of April 30, 2017 and the cumulative amount of previous transfers of currencies from the General Resources Account to the Investment Account. This transfer of currencies to the Investment Account shall be effected in the context of the Financial Transactions Plan covering the period August- October 2017. The currencies transferred to the Investment Account pursuant to this decision shall be used for immediate investment in the Fixed Income Subaccount in accordance with the Rules and Regulations for the Investment Account.

**Decision 7. The Rate of Charge on the Use of Fund Resources for FY 2018**

Pursuant to Rule I-6(4)(a), the Fund has completed the review of the Fund's income position and concluded that for FY 2018 there are no fundamental changes to warrant any adjustment to the margin for the basic the rate of charge as determined by Decision No. 15980-(16/33), adopted April 22, 2016.

**Decision 8. Review of the System of Special Charges**

The Fund has reviewed Decision No. 8165-(85/189) G/TR, adopted December 30, 1985, effective February 1, 1986, as amended, on Special Charges on Overdue Financial Obligations to the Fund.

## Annex I. Decisions in Effect Related to the FY 2017 Income Position

### Decisions in Effect

The Executive Board has taken the following decisions affecting the Fund's income position for FY 2017:

#### *Rate of Charge*

The margin for calculating the basic rate of charge in FY 2017 was set in 2016 at 100 basis points for a period of two years (FY 2017-18). This decision was adopted under the *exceptional circumstances* clause of Rule I-6(4), which allows the margin for calculating the basic rate of charge to be set at a level other than that which is adequate to cover the estimated intermediation expenses of the Fund and to generate an amount of net income for placement to reserves.

#### *Burden Sharing for Deferred Charges*

Income losses resulting from unpaid charges are shared equally between debtor and creditor members under the burden sharing mechanism largely pursuant to decisions taken in 2000 and 2009. Unless amended by the Board, this mechanism will continue for as long as overdue obligations to the Fund persist.<sup>1</sup>

#### *Special Charges*

For overdue repurchases, the special rate of charge is set to equal the excess, if any, of the SDR interest rate over the basic rate of charge. Pursuant to Rule I-6(4), the basic rate of charge "shall be determined at the beginning of each financial year as the SDR interest rate under Rule T-1 plus a margin expressed in basis points". Since under the current system for setting the basic rate of charge, that rate is always in excess of the SDR interest rate, members are not subject to special charges on their overdue repurchases.

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<sup>1</sup> See [Recent fall in the SDR Interest Rate – Implications and Proposed Amendments to Rule T-1 \(10/16/2014\)](#).

<sup>1</sup> See [Review of the Fund's Income Position for FY 2016 and FY 2017-2018 \(4/8/16\)](#).

## Annex II. Implementation of the New Income Model

In April 2008, the Executive Board endorsed a New Income Model (NIM) aimed at diversifying the Fund's sources of income and reducing the institution's overreliance on income from lending to finance its diverse activities. The NIM reflected many of the measures that had been proposed in early 2007 by the Committee of Eminent Persons chaired by Andrew Crockett, and was designed to develop broader and more sustainable income sources in recognition of the public good aspects of many of the Fund's activities.<sup>1</sup> Adoption of the NIM would require an intensive work program for the Fund over several years. The table below summarizes the main elements of the NIM and the status of their implementation.<sup>2</sup>

Completed	In progress	Not started
Main Element	Implementation	Status
An amendment to the Articles of Agreement to broaden the Fund's investment authority.	The amendment to the Articles came into effect in February 2011 following ratification by three-fifths of IMF members representing 85 percent of the total voting power. The amendment aimed at providing the Fund with flexibility to enhance the expected return on its investments and adapt its investment strategy over time.	
Creation of an endowment funded with profits from the sale of 403.3 metric tons of the Fund's gold holdings.	Gold sales required an 85 percent majority vote of the Executive Board. The gold sales were completed in December 2010 and realized total profits of SDR 6.85 billion. <sup>3</sup> Initial sales were conducted through off-market transactions with central banks and official holders followed by on-market sales.	
Adoption of new rules and regulations for the Investment Account (IA)—a requirement for the Fund to exercise its expanded investment authority under the amended Articles.	In January 2013, the Executive Board approved new rules and regulations for the IA.	
Full implementation of the endowment	The Executive Board has established the strategic asset allocation (SAA) for the endowment and agreed that the investment into this SAA will be phased over three years (funding started in March 2014). During FY 2018, the Executive Board will return to the payout policy for the endowment to determine how much of the endowment's returns will be made available to help cover the Fund's administrative expenses.	
Adopting a new rule for the margin for the basic rate of charge. Previously, the margin was set to generate sufficient income for the Fund to cover all of its administrative expenses and to meet a specific net income target.	In December 2011, the Fund adopted a new rule for setting the margin on the rate of charge. Under the new rule, the margin should be set to cover only the Fund's intermediation (lending) costs and help build-up reserves. However, given the low interest rate environment and phasing of the endowment, the margin has so far been set under the exceptional circumstances clause.	
Reimbursement of PRG Trust expenses.	In FY 2013, the practice of reimbursing the Fund for the expenses of conducting the business of the PRG Trust was resumed.	



Review of the investment mandate for the reserves portfolio

The staff paper Review of Investment Strategy for the Fixed-Income Subaccount of the Investment Account issued on August 5, 2015 reviewed the investment strategy of the IA-FI. The scope for setting a specific numerical target, as envisaged under the NIM, is to be revisited at a later stage.




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Significant progress has been made in implementing the NIM and many of the main elements are now in place. In the meantime, however, the global economic and market environment has changed dramatically. The global financial crisis has increased the Fund's lending income, but non-lending income has been highly constrained by very low global interest rates in recent years. In 2008, projected FY 2014 income from investment of the Fund's reserves and interest free resources was expected to be around SDR 386 million (equal to over 60 percent of expenditures). In contrast, actual FY 2014 income from these sources was only about one-tenth of this estimate, largely reflecting an average SDR interest rate of about 0.1 percent compared with a projected rate of 3.5 percent. In FY 2015 and FY 2016, income from the investment of reserves and interest free resources (excluding profits retained in the Endowment Subaccount) covered about 12 percent and 3 percent of expenditures, respectively. Notwithstanding the above, the current income projections indicate that following the full implementation of the NIM, and assuming that global interest rates revert towards more normal historical levels, broad objectives of the NIM remain within reach.

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<sup>1</sup> [Final Report of the Committee to Study Long-Term Financing of the Fund \(1/31/07\)](#).

<sup>2</sup> In addition to these elements geared to broadening the Fund's income, the NIM envisioned that in the event the Fund's precautionary balances are considered to be adequate, the Executive Board could consider making dividend payments to members. The Fund is still accumulating precautionary balances towards the current agreed target of SDR 20 billion. As such, this issue will need to be revisited at a later date.

<sup>3</sup> SDR 4.4 billion of the gold profits was used to fund the endowment. In accordance with two decisions adopted by the Board, the remaining profits of SDR 2.45 billion were distributed to members to help finance concessional lending to low-income countries in October 2012 and October 2013.

## Annex III. IAS 19 Accounting for Employee Benefits

IAS 19 is the International Financial Reporting Standard (IFRS) that deals with accounting for pension and other employee benefits, including the timing adjustment, in the financial statements of the Employer. Under IAS 19, an employer's balance sheet, *inter alia*, shows the funded status of the defined benefit pension plan. The funded status, which is either a net pension asset (or liability), is the difference between the fair value of plan assets and the net present value of the defined benefit obligation. The change in the funded status from one period to the next is a function of demographic and financial assumptions underpinning the defined benefit obligation, as well as changes in the fair value of plan assets.

### Background

Since the adoption of IFRS in FY 2000, the Fund has followed IAS 19 in accounting for employee benefits. The objective of IAS 19 is to ensure that the liability associated with services provided by employees in exchange for benefits to be paid in the future and the related annual expense is properly recognized by the employer in its financial statements. IAS 19 prescribes the accounting by employers for (i) short-term employee benefits (e.g., salaries and wages); and (ii) post-employment benefits (e.g., pension, post-retirement health benefits, and termination grants). The employer recognizes an expense for short-term employee benefits in the period in which an employee has rendered services. Cash outflows associated with long-term benefits are subject to a high degree of uncertainty and are actuarially determined.

### Accounting for post-employment and long-term benefits

To meet the benefit obligations associated with post-employment and long-term benefits, the Fund has sponsored a defined benefit plan (Staff Retirement Plan) and a separate Retired Staff Benefits Investment Account. The Fund reports on the balance sheet a net asset or liability equal to the difference between the fair value of plan assets and the net present value of the defined benefit obligation. To determine the present value of the defined benefit obligation, the Fund discounts projected future cash outflows by applying demographic assumptions (e.g., mortality and employee turnover), and financial assumptions (e.g., the discount rate, inflation rate, salary increases, inflation rate, and future medical costs). Changes in underlying assumptions from year to year give rise to actuarial gains or losses (e.g., a reduction in the discount rate, and all else being equal, would result in a higher defined benefit obligation and an actuarial loss). The change in the net asset (or liability), after taking into account the employer's contributions to the plans and actuarial gains and losses, determines the IAS 19 expense for the year. The full impact of actuarial gains and losses incurred during the year is reflected in the annual IAS 19 adjustment.

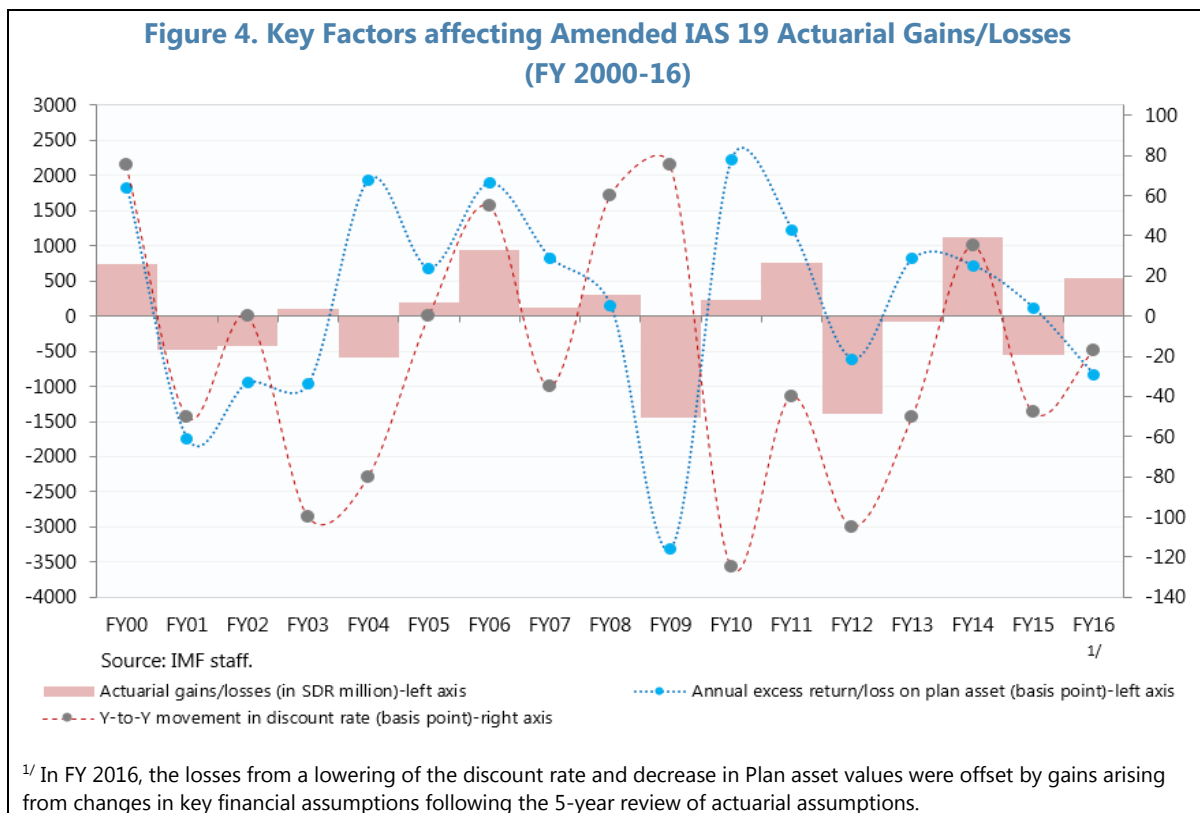
### Accounting vs. funding basis

The actuarial methods under IAS 19 to measure the IAS 19 expense in the Fund's financial statements are different from the actuarial method used to determine the Fund's annual contribution for the pension plans (i.e., the funding requirement). Therefore, the accounting for employee benefits differs between the Fund's financial statements (accrual basis) and the administrative budget (cash basis for employer's contributions). The resulting timing differences can

be substantial but should net to zero over the life of the pension and benefit plans, as from an accounting perspective the IAS 19 adjustments necessarily equal the employer's funding over time.

**Additional volatility in Fund income**

The amended IAS 19 has introduced an additional source of volatility to Fund income.<sup>1</sup> Historically, variances in the discount rate used to derive the net present value of pension obligations and movements in the fair value of pension assets have had the largest impact on changes in the funded status of the defined benefit pension plan. Figure 4 illustrates the Fund's actuarial gains and losses for FY 2000-16 (restated retrospectively under Amended IAS 19 for FY 2000-13). Going forward, the timing adjustment is expected to remain unpredictable and any volatility in the underlying actuarial assumptions would translate into volatility in the Fund's income and reserves. As such, the IAS 19 timing adjustment has not been projected beyond FY 2017.



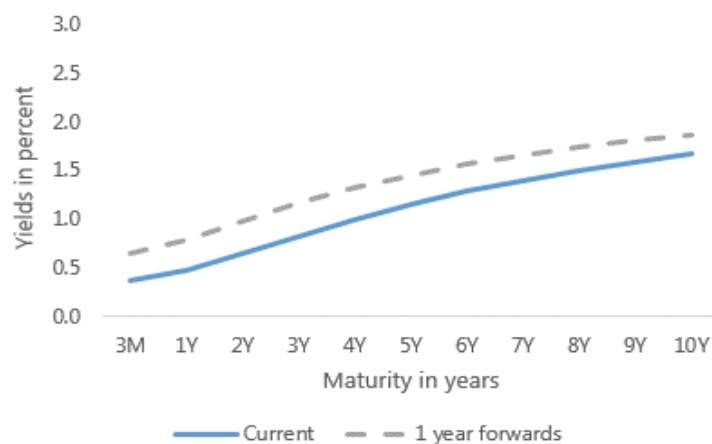
<sup>1</sup> In FY 2014 the Fund implemented the amended IAS 19 thereby eliminating the "corridor method." As a result, all gains and losses arising from changes in actuarial assumptions are recognized in the year incurred. The amended IAS 19 was implemented retrospectively such that a one-time adjustment for the cumulative unrealized actuarial losses was charged against the reserves on May 1, 2013 (start of the financial year), bringing the Fund's net asset (or liability) and reserves to the same level as if the Fund had never chosen to apply the "corridor method." From FY 2014 onwards, the full impact of actuarial gains and losses incurred during the year is reflected in the annual IAS 19 adjustment.

## Annex IV. Investment Account (IA) Performance Scenarios

### Fixed-Income Subaccount (FI)<sup>1</sup>

Government bond yields in markets of the SDR basket remained volatile during FY 2017. Despite starting the year on a downward path, developed market government bond yields rose sharply in the second half of the year, especially at the long end, in response to rising inflation expectations, as well as concerns of an imminent tightening cycle in the US. Towards the end of FY 2017, government bond yields in SDR were marginally higher compared to last year. Going forward, the risk of rising rates remains. As of end-February 2017, investors anticipate a much more gradual increase in bond yields compared to last year: one-year forward yields are marginally higher than the current estimated level of rates, particularly for longer maturities (Figure 5).

**Figure 5. Current Levels of SDR-Weighted Yields and Market-Implied Forward Rates (in percent)**



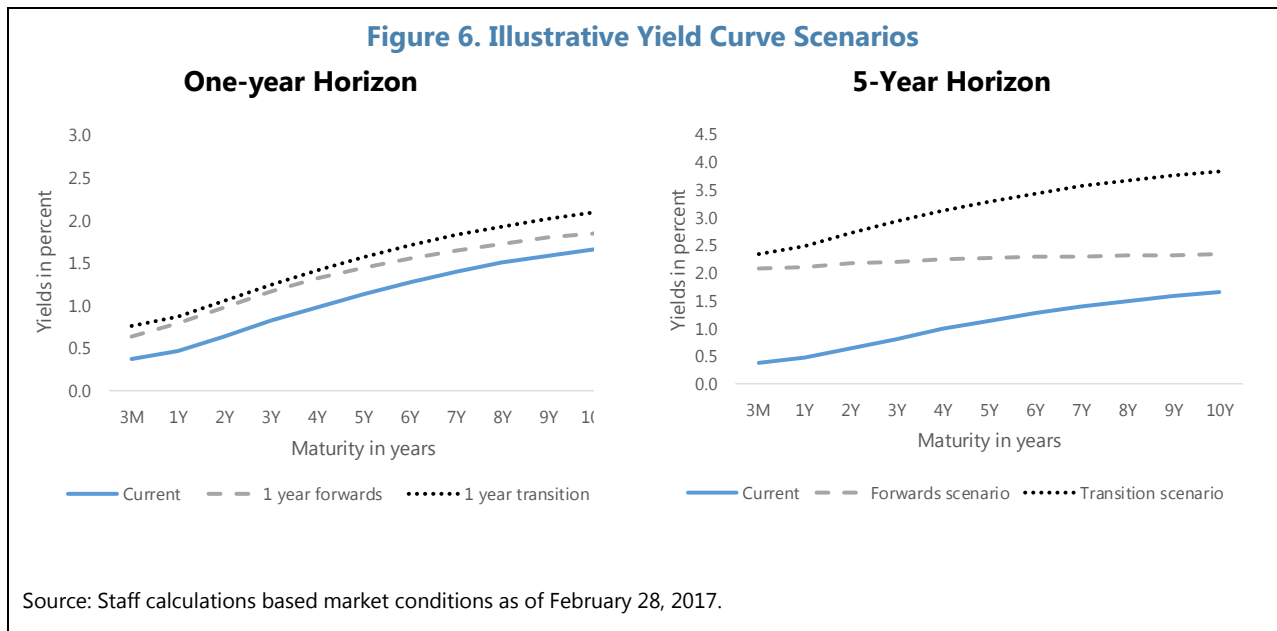
Sources: Bloomberg, Staff calculations

Taking into account the FI's new strategy, the preliminary return estimates are based on several assumptions. As with any model based estimation, there are limitations and caveats. Estimates assume a fixed duration of 1.4 years for Tranche 1 (reflecting the new 0-3 year benchmark index duration), and a 30 percent allocation to U.S. corporates rated A and above, as a proxy for new assets permitted under the revised Rules. It should be noted that the model does not estimate the impact of active management which could be quite substantial for this mandate, particularly for Tranche 1 where in practice the duration of the portfolio could be anywhere between 0 to 2 years. For Tranche 2 staff assume the return of the SDR 0-5 year government index. In line with past reviews of the Fund's income position, the analysis below outlines return scenarios for the FI

<sup>1</sup>In implementing the expanded investment authority under the Fifth Amendment, the Executive Board concluded a review of the FI investment strategy and adopted revised Rules and Regulations for the IA in August 2015. The eligible fixed-income universe was expanded considerably. The FI portfolio is split into two broadly equal tranches to improve diversification benefits and portfolio resilience amid challenging market conditions. Tranche 1 has a relatively shorter duration compared to the previous 1-3 year strategy and includes an expanded set of high-quality fixed-income assets beyond government bonds managed actively by external managers and broadly guided by a 0-3 year government bond benchmark. The longer-duration Tranche 2 is more passively managed, based on a 0-5 year government bond benchmark, and will be phased in over a five year horizon.

through end-FY 2017 and in FY 2018 (Table 7). In light of the longer investment horizon of the FI, the analysis also shows projections up to five years (Figure 6). The following yield scenarios are used to illustrate the impact of the performance relative to the 3-month SDR:

1. Yields remain unchanged from current levels;
2. Yields increase in line with market implied forward rates; and
3. Yields transition faster than embedded in forward rates and settle at higher levels at the end of 5 years, similar to levels observed in 2008.



The results of the analysis provided in Figure 7 suggest that total portfolio returns would be positive under each of the scenarios. The FI would generate positive excess returns relative to the 3-month SDR rate if yields stay unchanged. The FI would underperform the 3-month SDR rate in the short run if yields increase to a level higher than that implied by market forwards such as in the transition. Longer term projections show that FI returns continue to be positive on average over 5-years. Excess returns above the 3-month SDR rate are highest in the scenario in which yield curves remain unchanged at current levels. While excess returns are lower under a transition scenario, absolute returns are higher as higher yield levels translate into higher coupon income.

**Table 7. Fixed-Income Subaccount Performance Scenarios for FY 2017 and FY 2018  
(non-annualized returns in percent)**

	Unchanged yields 1/	Forwards 2/	Transition 3/
<u>Actual returns FYTD (May 2016-February 2017)</u>			
3-month SDR	0.12	...	...
Tranche 1	0.60	...	...
Tranche 2	0.57	...	...
IA	0.60	...	...
Excess Return	0.48	...	...
<u>FY 2017 (May 2016-April 2017)</u>			
3-month SDR	0.17	0.17	0.17
Tranche 1	0.71	0.68	0.64
Tranche 2	0.63	0.59	0.59
IA	0.69	0.65	0.63
Excess return	0.51	0.48	0.47
<u>FY 2018 (May 2017-April 2018)</u>			
3-month SDR	0.34	0.48	0.50
Tranche 1	0.80	0.59	0.51
Tranche 2	0.52	0.45	0.40
IA	0.52	0.52	0.46
Excess Return	0.18	0.04	-0.04
<u>Memo Items</u>			
<u>Assumed yield levels</u>	<u>Spot</u>	<u>Forwards</u>	<u>Transition</u>
3-month SDR	0.37	0.64	0.77
1 year maturity	0.47	0.79	0.88
2 year maturity	0.64	0.98	1.05
3 year maturity	0.82	1.16	1.24

Sources: State Street data, Bloomberg and staff calculations.

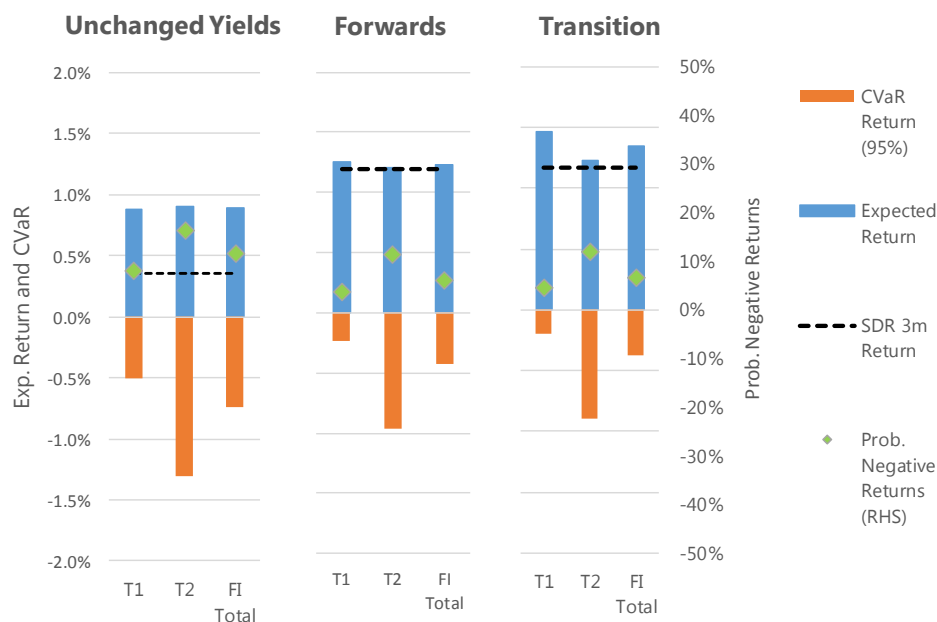
Note: Actual returns are based on audited performance data provided by State Street. Projections are based on a monte carlo simulation model using market conditions at the end of February 2017. As a proxy for the returns on the actively managed Tranche 1 mandate, projections assume a constant duration equivalent to the SDR 0-3 year benchmark index and a 30 percent allocation to credit instruments rated single-A and above. For Tranche 2, the projections are based on the SDR 0-5 year benchmark index and gradual phase-in over 5 years.

<sup>1/</sup> Returns are based on market conditions at the end of February 2017. Spot yields at the end of February are shown.

<sup>2/</sup> Returns are based on market implied forward rates as of February 2017. Average one year forward yields are shown.

<sup>3/</sup> Returns are based on the scenario that interest rates transition to higher levels reaching 2008 levels at the end of 5 years. Average yields at the end of one year are shown based on this path.

**Figure 7. Simulated 5-Year Projections of Average Annual Return and Risk for the Fixed-Income Subaccount Under Different Yield Curve Scenarios**



Source: Staff calculations based on market conditions at the end of February 2017.

Note: FI estimated performance includes the gradual phase-in of the longer duration T2.

## Endowment Subaccount

The three-year phased-in investment of the passively managed portion of the Endowment Subaccount (EA) was completed in the third quarter of FY 2017. The first out of two mandates of the actively managed portion of the EA was invested in the second quarter of FY 2017. The EA portfolio has a diversified asset allocation with a 65 percent share in global fixed-income assets and 35 percent share in equities. Short-term return projections for these investments are subject to considerable uncertainty given the higher volatility of the asset classes in which the EA is invested. So far, in FY 2017 (through February), the invested share of the endowment returned 5.97 percent in U.S. dollars. The share of gold sales profits not yet invested in the endowment pending the funding of the second active manager (2.3 percent of the EA) is placed in fixed-term deposits with the BIS.

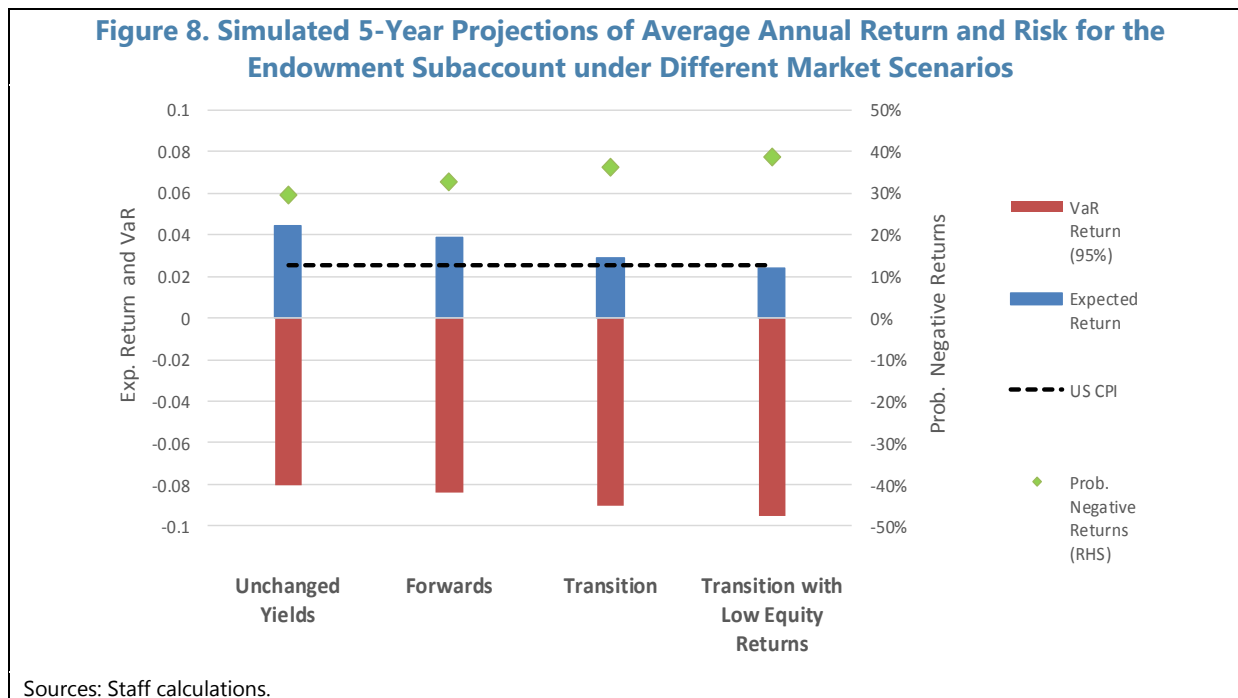
Compared with the FI, assets invested in the EA are exposed to greater market risks, particularly at short horizons. The estimated minimum potential loss in value for the invested share of the endowment based on a one-year 95 percent Value-at-Risk (VaR) is about 8.4 percent in U.S. dollar terms vs. approximately 0.5 percent for the FI.<sup>1</sup> Although market and credit risks are to some extent mitigated by the diversification of the portfolio, these risks are significantly larger than for the FI given the higher duration of the SAA's bond allocation (on average 6–6.5 years) and the allocation to equities and REITs. In addition, only non-U.S. dollar developed-market currency fixed-income

<sup>2</sup> These VaR estimates are calculated by the Fund's custodian, State Street. State Street's VaR methodology uses simulated 3-year historical data. VaR is calculated by first modeling the entire returns distribution for all assets at security level, then calculating the portfolio value at the percentile corresponding to the desired confidence level.

assets are required and allowed to be hedged, leaving approximately 25 percent of the portfolio unhedged to the U.S. dollar base currency. Going forward, rising U.S. interest rates and possible global equity market corrections remain key risks for the EA.

Consistent with the longer-term projections for the FI, staff conducted forward-looking simulations for the EA under the three yield curve scenarios as described in the previous section (Figure 6). In each of these scenarios, equities and REITs are assumed to return approximately 6 percent, somewhat below historical averages and at the lower end of long-term capital market assumptions provided by a range of asset managers. In addition, a fourth scenario is added which includes a transition in interest rates accompanied by lower equity returns of 4.5 percent to explore the indicative performance of the portfolio under a more adverse scenario of lower returns for both equities and bonds.

The analysis suggests that under all four scenarios, and as previously noted, it would be challenging for the EA to reach its real return target of 3 percent (Figure 8). Depending on the yield scenario, expected returns over the next five years could range between 2.4 and 4.4 percent per annum, vs. approximately 2.5 percent for the CPI.





## Annex V. Assumptions Underlying the Income Projections

	Actual through end- February 2017	FY2017 Current Projections	FY2018
	(In billions of SDRs)		
Regular Facilities:			
1. Purchases (excl. reserve tranche purchases)	5.2	7.0	10.7
2. Repurchases	5.2	5.5	3.0
3. Average balances subject to charges	48.7	48.7	53.2
4. Average SDR holdings	30.5	30.1	28.6
5. Average remunerated positions	40.1	40.4	45.2
6. Average investment account assets-Fixed-Income subaccount	12.1	12.5	15.4
7. Average investment account assets-Endowment subaccount	4.7	4.8	5.2
8. Average borrowings and issued notes	31.1	30.8	30.4
	(In percent)		
Return on investments-Fixed-Income subaccount <sup>1/</sup>	0.58	0.60	0.64
Return on investments-Endowment subaccount <sup>2/</sup>	9.33	10.02	5.00
Average interest rates:			
SDR interest rate and basic rate of remuneration	0.14	0.20	0.60
Basic rate of charge	1.14	1.20	1.60
Margin on the rate of charge	1.00	1.00	1.00
<sup>1/</sup> End-February figure is unannualized.			
<sup>2/</sup> The projected returns for the gold endowment reflect the phase in of investments under the strategic asset allocation and the earnings from the short-term deposits held in the interim.			

## Annex VI. Projected Income and Expenses—FY 2017

### Linking the analytical presentation with the Fund's income statement

The purpose of this Annex is to prepare a reconciliation between the analytical framework presented in Table 1 of this paper and the traditional format used to prepare the Fund's income statement under IFRS.<sup>1</sup> The formulation of the Fund's income and expense flow results in the same projected net income position. However, the analytical framework is preferred in discussing the income position for two reasons. First, it succinctly captures the main variables that drive the Fund's income position. To this end, the presentation focuses on the net contribution made by the Fund's income-earning assets. Second, the framework is used to reflect certain aspects of the Fund's practices, e.g., surcharge income is not included in the net operational income because it is assumed to be placed directly to reserves to help build up precautionary balances.

The starting point to move from the traditional format in the Fund's financial statements to the analytical framework in the paper is to net the financing costs (remuneration and interest on borrowings) against the income generated from Fund credit and the GRA's SDR holdings. This provides the income from the margin and interest free resources by eliminating the flows from the SDR interest rate between the debtor and creditor members of the Fund. Thereafter, the main adjustments involve re-arranging the various line items on the Fund's IFRS financial statements to the analytical framework. This includes:

- Allocation of surcharges from interest and charges to below the net operational income line reflecting the current Fund practice of placing surcharge income directly to reserves;
- Allocation of retained gold endowment income from investment income since this amount is retained in the investment account; and
- Folding-in the reimbursements and the IAS 19 timing adjustments into administrative expenses.

Table 8 below highlights this reconciliation process.

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<sup>1</sup> The Annex is prepared in response to requests by Directors to simplify/explain the process of reconciling various aspects of the Fund's financial structure.

**Table 8. Reconciliation of the Accounting and Analytical Presentations of Projected Income and Expense—FY 2017**

	Actual to end-Feb 2017	FY 2017 Projections	Adjustments			Analytical presentation
			Financing costs	Expenses	Surcharges and endowment income	
					IAS 19 expense re- allocation	
(In millions of SDRs)						
<b>A. Operational income</b>						
Interest and charges	958	1,151	-80		-584	487
Interest on SDR holdings	34	48	-48			0
Net income from investments	490	536			-461	75
Service charges and commitment fees	359	368				368
<b>Total income</b>	<b>1,841</b>	<b>2,103</b>				
<b>B. Operational expenses</b>						
Remuneration 1/	47	67	-78			-11
Interest expense on borrowings	36	50	-50			0
Administrative expenses 2/	745	912		76	-158	830
<b>Total expenses</b>	<b>828</b>	<b>1,029</b>				
<i>Other reconciling items:</i>						
IAS 19 timing adjustment		605			-158	447
Reimbursements				76		76
Surcharges					584	584
Endowment Subaccount investment income					461	461
<b>C. Net income 3/</b>	<b>1,013</b>	<b>1,679</b>				<b>1,679</b>

<sup>1/</sup> Interest free resources lower the Fund's costs by reducing members' reserve tranche positions and the Fund's remuneration expense resulting in implicit income for the Fund. At the present time, the interest free resources retained in the GRA comprises the SCA-1, unremunerated reserve tranche positions not represented by gold holdings, and GRA income for the year not transferred to the IA.

<sup>2/</sup> Administrative expenses presented on an IFRS basis include net administrative expenditures, capital budget items expensed, and depreciation. This is partially offset by reimbursements to the GRA. The IAS 19 timing adjustment at end-February 2017 is excluded.

<sup>3/</sup> Income statement on the basis presented in the Fund's annual IFRS financial statements.

## Annex VII. Cumulative Burden Sharing Adjustments at end-January 2017 (in millions of SDRs)

Member	Adjustments for Deferred Charges				Adjustments for SCA-1			
	Charges	Remuneration	Total	Percentage of total	Charges	Remuneration	Total	Percentage of total
Albania	0.1	0.0	0.1	0.0	0.1	0.0	0.1	0.0
Algeria	7.4	0.5	7.9	1.1	13.2	0.5	13.6	1.1
Angola	0.1	0.0	0.1	0.0	-	0.0	0.0	0.0
Antigua and Barbuda	0.0	-	0.0	0.0	-	-	-	-
Argentina	31.0	0.0	31.0	4.3	64.7	-	64.7	5.4
Armenia	0.2	0.0	0.2	0.0	0.2	0.0	0.2	0.0
Australia	-	3.0	3.0	0.4	-	7.0	7.0	0.6
Austria	-	4.6	4.6	0.6	-	7.6	7.6	0.6
Azerbaijan	0.3	0.0	0.3	0.0	0.9	-	0.9	0.1
Bahamas, The	-	0.0	0.0	0.0	-	0.0	0.0	0.0
Bahrain	-	0.7	0.7	0.1	-	0.9	0.9	0.1
Bangladesh	3.1	0.0	3.1	0.4	2.9	-	2.9	0.2
Barbados	0.1	0.0	0.2	0.0	0.2	0.0	0.2	0.0
Belarus	0.8	-	0.8	0.1	1.0	-	1.0	0.1
Belgium	-	6.3	6.3	0.9	-	12.3	12.3	1.0
Belize	0.0	0.0	0.1	0.0	0.0	0.0	0.1	0.0
Benin	-	0.0	0.0	0.0	-	-	-	-
Bhutan	-	0.0	0.0	0.0	-	0.0	0.0	0.0
Bolivia	0.9	0.0	0.9	0.1	0.9	-	0.9	0.1
Bosnia and Herzegovina	0.6	-	0.6	0.1	0.8	-	0.8	0.1
Botswana	-	0.2	0.2	0.0	-	0.3	0.3	0.0
Brazil	23.8	0.2	24.0	3.3	57.4	-	57.4	4.8
Brunei Darussalam	-	0.1	0.1	0.0	-	0.3	0.3	0.0
Bulgaria	3.7	0.1	3.8	0.5	8.2	0.1	8.3	0.7
Burkina Faso	-	0.1	0.1	0.0	-	0.1	0.1	0.0
Burundi	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Cabo Verde	-	0.0	0.0	0.0	-	-	-	-
Cambodia	0.0	0.0	0.0	0.0	0.0	-	0.0	0.0
Cameroon	0.7	-	0.7	0.1	0.8	-	0.8	0.1
Canada	-	6.3	6.3	0.9	-	14.3	14.3	1.2
Central African Republic	0.1	-	0.1	0.0	0.1	-	0.1	0.0
Chad	0.1	-	0.1	0.0	0.1	-	0.1	0.0
Chile	5.8	0.5	6.4	0.9	5.7	1.6	7.3	0.6
China	4.0	8.0	12.1	1.7	3.5	16.2	19.7	1.7
Colombia	-	1.3	1.3	0.2	-	2.3	2.3	0.2
Comoros	0.0	0.0	0.0	0.0	-	0.0	0.0	0.0
Congo, D.R.	3.4	-	3.4	0.5	3.9	-	3.9	0.3
Congo, Rep.	0.1	-	0.1	0.0	0.2	-	0.2	0.0
Costa Rica	0.4	0.1	0.5	0.1	0.5	0.1	0.6	0.0
Côte d'Ivoire	2.5	0.0	2.5	0.3	2.4	-	2.4	0.2

**Cumulative Burden Sharing Adjustments at end-January 2017**  
**(in millions of SDRs)**  
**(continued)**

Member	Adjustments for Deferred Charges				Adjustments for SCA-1			
	Charges	Remuneration	Total	Percentage of total	Charges	Remuneration	Total	Percentage of total
Croatia	1.1	-	1.1	0.2	1.6	-	1.6	0.1
Cyprus	0.0	0.2	0.2	0.0	-	0.4	0.4	0.0
Czech Republic	2.2	0.3	2.5	0.3	2.7	0.6	3.3	0.3
Denmark	-	3.6	3.6	0.5	-	6.2	6.2	0.5
Djibouti	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Dominica	0.0	-	0.0	0.0	0.0	-	0.0	0.0
Dominican Republic	2.5	0.0	2.5	0.3	2.2	-	2.2	0.2
Ecuador	2.0	0.1	2.1	0.3	2.6	0.1	2.7	0.2
Egypt	1.4	0.1	1.5	0.2	1.5	0.2	1.7	0.1
El Salvador	0.0	-	0.0	0.0	0.0	-	0.0	0.0
Equatorial Guinea	0.0	0.0	0.0	0.0	0.0	-	0.0	0.0
Estonia	0.1	0.0	0.1	0.0	0.3	-	0.3	0.0
Ethiopia	0.2	0.0	0.2	0.0	0.2	0.0	0.2	0.0
Fiji	0.0	0.1	0.1	0.0	0.0	0.2	0.2	0.0
Finland	-	2.7	2.7	0.4	-	4.6	4.6	0.4
France	-	19.2	19.2	2.7	-	33.5	33.5	2.8
Gabon	0.7	0.0	0.7	0.1	1.0	-	1.0	0.1
Gambia, The	0.1	0.0	0.1	0.0	0.1	-	0.1	0.0
Georgia	0.3	-	0.3	0.0	0.4	-	0.4	0.0
Germany	-	38.8	38.8	5.4	-	59.1	59.1	5.0
Ghana	1.7	0.0	1.7	0.2	1.8	0.0	1.8	0.2
Greece	2.1	1.2	3.3	0.5	-	2.1	2.1	0.2
Grenada	0.0	0.0	0.0	0.0	0.0	-	0.0	0.0
Guatemala	0.4	0.0	0.4	0.1	0.3	0.0	0.3	0.0
Guinea	0.1	0.0	0.1	0.0	0.1	-	0.1	0.0
Guinea-Bissau	0.0	0.0	0.0	0.0	0.0	-	0.0	0.0
Guyana	0.4	-	0.4	0.1	0.4	-	0.4	0.0
Haiti	0.2	0.0	0.2	0.0	0.3	-	0.3	0.0
Honduras	0.4	0.0	0.5	0.1	0.6	0.0	0.7	0.1
Hungary	7.3	0.4	7.7	1.1	6.9	1.3	8.2	0.7
Iceland	0.2	0.1	0.3	0.0	0.0	0.1	0.1	0.0
India	24.0	2.6	26.6	3.7	28.4	3.4	31.9	2.7
Indonesia	14.7	1.0	15.7	2.2	42.5	1.6	44.0	3.7
Iran, I. Rep. of	-	0.1	0.1	0.0	-	0.0	0.0	0.0
Iraq	0.7	0.5	1.2	0.2	0.6	0.3	0.9	0.1
Ireland	1.4	2.0	3.4	0.5	-	3.3	3.3	0.3
Israel	0.6	0.4	0.9	0.1	0.9	0.9	1.7	0.1
Italy	-	17.9	17.9	2.5	-	28.2	28.2	2.4
Jamaica	2.6	0.0	2.6	0.4	2.9	-	2.9	0.2
Japan	-	40.1	40.1	5.6	-	64.5	64.5	5.4
Jordan	1.7	0.0	1.7	0.2	3.1	0.0	3.1	0.3
Kazakhstan	0.8	0.0	0.8	0.1	1.7	-	1.7	0.1
Kenya	1.2	0.0	1.2	0.2	1.1	0.0	1.1	0.1
Kiribati	-	0.0	0.0	0.0	-	-	-	-
Korea	7.8	3.5	11.3	1.6	19.6	5.0	24.6	2.1

**Cumulative Burden Sharing Adjustments at end-January 2017**  
(in millions of SDRs)  
(continued)

Member	Adjustments for Deferred Charges				Adjustments for SCA-1			
	Charges	Remuneration	Total	Percentage of total	Charges	Remuneration	Total	Percentage of total
Kosovo	0.0	0.0	0.0	0.0	-	-	-	-
Kuwait	-	2.8	2.8	0.4	-	4.2	4.2	0.4
Kyrgyz Republic	0.1	-	0.1	0.0	0.3	-	0.3	0.0
Lao P.D.R	0.0	0.0	0.0	0.0	0.0	-	0.0	0.0
Latvia	0.4	-	0.4	0.1	0.5	-	0.5	0.0
Lebanon	0.1	0.3	0.4	0.1	-	0.3	0.3	0.0
Lesotho	-	0.0	0.0	0.0	-	0.0	0.0	0.0
Liberia	2.4	0.0	2.4	0.3	3.1	-	3.1	0.3
Libya	-	5.1	5.1	0.7	-	6.4	6.4	0.5
Lithuania	0.5	-	0.5	0.1	1.2	-	1.2	0.1
Luxembourg	-	0.3	0.3	0.0	-	0.6	0.6	0.0
Macedonia, F.Y.R.	0.3	-	0.3	0.0	0.5	-	0.5	0.0
Madagascar	0.4	0.0	0.4	0.1	0.4	-	0.4	0.0
Malawi	0.3	-	0.3	0.0	0.3	-	0.3	0.0
Malaysia	-	3.3	3.3	0.5	-	5.8	5.8	0.5
Maldives	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Mali	0.2	0.1	0.2	0.0	0.2	0.1	0.2	0.0
Malta	-	0.4	0.4	0.1	-	0.5	0.5	0.0
Mauritania	0.2	0.0	0.2	0.0	0.2	-	0.2	0.0
Mauritius	0.2	0.0	0.2	0.0	0.1	0.1	0.2	0.0
Mexico	38.3	0.8	39.1	5.5	57.0	1.2	58.2	4.9
Micronesia	-	0.0	0.0	0.0	-	0.0	0.0	0.0
Moldova	0.5	-	0.5	0.1	1.1	-	1.1	0.1
Mongolia	0.1	0.0	0.1	0.0	0.1	-	0.1	0.0
Montenegro	-	0.0	0.0	0.0	-	-	-	-
Morocco	2.8	0.2	3.0	0.4	2.8	0.3	3.0	0.3
Mozambique	-	0.0	0.0	0.0	-	-	-	-
Myanmar	0.1	-	0.1	0.0	0.1	-	0.1	0.0
Namibia	-	0.0	0.0	0.0	-	0.0	0.0	0.0
Nepal	0.1	0.0	0.2	0.0	0.1	0.0	0.1	0.0
Netherlands	-	9.8	9.8	1.4	-	17.7	17.7	1.5
New Zealand	-	0.7	0.7	0.1	-	1.8	1.8	0.2
Nicaragua	0.1	0.0	0.1	0.0	0.1	-	0.1	0.0
Niger	0.2	0.1	0.3	0.0	0.2	0.1	0.3	0.0
Nigeria	-	0.0	0.0	0.0	-	-	-	-
Norway	-	6.4	6.4	0.9	-	9.2	9.2	0.8
Oman	-	0.5	0.5	0.1	-	0.7	0.7	0.1
Pakistan	7.2	-	7.2	1.0	9.4	-	9.4	0.8
Panama	1.2	0.0	1.2	0.2	1.5	0.0	1.6	0.1
Papua New Guinea	0.3	0.0	0.3	0.0	0.6	0.0	0.6	0.0
Paraguay	-	0.2	0.2	0.0	-	0.2	0.2	0.0
Peru	7.1	0.0	7.2	1.0	9.4	-	9.4	0.8
Philippines	9.2	0.4	9.6	1.3	14.4	0.6	15.0	1.3
Poland	3.4	0.6	4.0	0.6	4.1	1.5	5.6	0.5
Portugal	2.3	2.1	4.3	0.6	0.8	3.8	4.6	0.4

**Cumulative Burden Sharing Adjustments at end-January 2017**  
(in millions of SDRs)  
(continued)

Member	Adjustments for Deferred Charges				Adjustments for SCA-1			
	Charges	Remuneration	Total	Percentage of total	Charges	Remuneration	Total	Percentage of total
Qatar	-	0.4	0.4	0.1	-	0.7	0.7	0.1
Romania	5.9	-	5.9	0.8	7.4	-	7.4	0.6
Russian Federation	23.7	0.4	24.1	3.4	61.9	-	61.9	5.2
Rwanda	0.0	0.0	0.1	0.0	0.1	0.0	0.1	0.0
Samoa	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
San Marino	-	0.0	0.0	0.0	-	0.0	0.0	0.0
Sao Tome and Principe	-	0.0	0.0	0.0	-	-	-	-
Saudi Arabia	-	11.0	11.0	1.5	-	17.1	17.1	1.4
Senegal	0.5	0.0	0.5	0.1	0.6	-	0.6	0.0
Serbia	1.9	0.0	1.9	0.3	3.2	-	3.2	0.3
Seychelles	0.0	0.0	0.0	0.0	-	0.0	0.0	0.0
Sierra Leone	0.5	-	0.5	0.1	0.5	-	0.5	0.0
Singapore	-	1.9	1.9	0.3	-	3.2	3.2	0.3
Slovak Republic	1.6	0.0	1.7	0.2	2.5	0.0	2.5	0.2
Slovenia	0.4	0.2	0.6	0.1	0.4	0.4	0.8	0.1
Solomon Islands	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Somalia	1.1	-	1.1	0.2	1.5	-	1.5	0.1
South Africa	1.7	0.0	1.7	0.2	2.9	-	2.9	0.2
South Sudan	-	0.0	0.0	0.0	-	-	-	-
Spain	-	11.2	11.2	1.6	-	16.3	16.3	1.4
Sri Lanka	2.2	0.1	2.3	0.3	2.1	0.1	2.3	0.2
St. Kitts and Nevis	0.0	-	0.0	0.0	0.0	-	0.0	0.0
St. Lucia	0.0	0.0	0.0	0.0	-	-	-	-
St. Vincent and the Sudan	0.0	0.0	0.0	0.0	-	0.0	0.0	0.0
	6.1	-	6.1	0.9	8.3	-	8.3	0.7
Suriname	0.0	0.0	0.0	0.0	-	0.0	0.0	0.0
Swaziland	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Sweden	-	4.6	4.6	0.6	-	8.2	8.2	0.7
Switzerland	-	4.4	4.4	0.6	-	10.8	10.8	0.9
Tajikistan	0.0	-	0.0	0.0	0.1	-	0.1	0.0
Tanzania	0.3	0.0	0.3	0.0	0.3	-	0.3	0.0
Thailand	4.1	1.3	5.4	0.8	9.0	2.0	11.0	0.9
Timor-Leste	-	0.0	0.0	0.0	-	-	-	-
Togo	0.2	0.0	0.2	0.0	0.2	-	0.2	0.0
Tonga	-	0.0	0.0	0.0	-	0.0	0.0	0.0
Trinidad and Tobago	1.5	0.2	1.7	0.2	1.5	0.3	1.7	0.1
Tunisia	2.4	0.0	2.5	0.3	2.8	0.1	2.8	0.2
Turkey	26.3	0.3	26.6	3.7	50.9	0.5	51.4	4.3
Turkmenistan	-	0.0	0.0	0.0	-	-	-	-
Tuvalu	-	0.0	0.0	0.0	-	-	-	-
Uganda	0.4	-	0.4	0.1	0.3	-	0.3	0.0
Ukraine	6.6	-	6.6	0.9	12.2	-	12.2	1.0
United Arab Emirates	-	2.3	2.3	0.3	-	3.3	3.3	0.3
United Kingdom	-	13.6	13.6	1.9	-	25.8	25.8	2.2
United States	-	102.8	102.8	14.3	-	157.9	157.9	13.3

**Cumulative Burden Sharing Adjustments at end-January 2017**  
**(in millions of SDRs)**  
**(concluded)**

Member	Adjustments for Deferred Charges				Adjustments for SCA-1			
	Charges	Remuneration	Total	Percentage of total	Charges	Remuneration	Total	Percentage of total
Uruguay	2.2	0.0	2.2	0.3	5.8	0.0	5.9	0.5
Uzbekistan	0.3	0.0	0.3	0.0	0.8	-	0.8	0.1
Vanuatu	0.0	0.0	0.0	0.0	-	0.0	0.0	0.0
Venezuela, R. B. de	15.4	2.1	17.5	2.4	19.8	2.4	22.2	1.9
Vietnam	0.6	-	0.6	0.1	0.9	-	0.9	0.1
Yemen, Rep. of	0.3	0.0	0.3	0.0	0.7	0.0	0.7	0.1
Zambia	5.2	0.0	5.2	0.7	5.5	-	5.5	0.5
Zimbabwe	0.8	-	0.8	0.1	1.6	-	1.6	0.1
	358.5	358.4	717.0	100.0	603.8	583.9	1,187.7	100.0