INTERNATIONAL MONETARY FUND

The Fund's Mandate—The Future Financing Role: Revised Reform Proposals

Prepared by the Finance, Legal, and Strategy, Policy and Review Departments

In consultation with other departments

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1. **This supplement provides clarifications and proposes revision to the reforms of the nonconcessional lending toolkit** contained in the staff papers on "*The Fund's Mandate—Future Financing Role: Reform Proposals*"*(hereafter, FFR: Reform Proposals paper)* based on feedback received from Executive Directors in the context of the three informal meetings on this subject. The focus of this supplement is on the Flexible Credit Line (FCL) and the Precautionary Credit Line (PCL), for which revised proposed decisions are attached (changes are highlighted in Annexes I-III). Staff look forward to Directors' feedback on the menu of ideas encompassed under the Global Stabilization Mechanism (GSM) and stand ready to simplify and streamline its design with a view to maximizing its effectiveness in mitigating systemic crises while minimizing moral hazard and reaching the broadest possible consensus at the Executive Board. In parallel, staff are also exploring ways to strengthen synergies between the Fund and Regional Financing Arrangements (RFAs). As a first step, a seminar with RFA representatives will be held during the Annual Meetings.

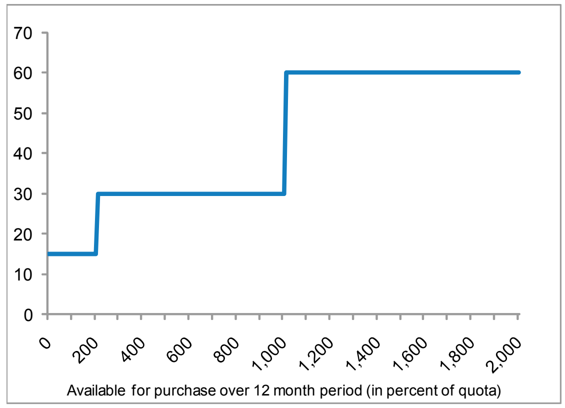
A. Refining the Design of the FCL

2. **The proposed enhancements of the FCL recognize the very strong nature of the members to which use of this instrument is targeted**. While preserving the high qualification bar of the FCL, it is proposed to (i) ***lengthen the duration of purchase rights*** by eliminating the mid-term review in 12-month arrangements and allowing two-year arrangements with an interim review of qualification after one year; and (ii) ***increase the flexibility of access*** by removing the implicit cap of 1000 percent of quota (PIN/09/41), access decisions would be based on individual country financing needs.

3. **While supporting the thrust of the proposals, some Directors sought strengthened safeguards**. In particular, to guard against excessive use of Fund resources on a precautionary basis, a few Directors proposed raising the implicit access cap or increasing commitment fees. But preserving a cap would not fundamentally obviate existing limitations,

and in fact may risk creating a higher access "norm" targeted by countries. As to the commitment fees, the fee schedule was overhauled in March 2009 (GRA Toolkit paper) replacing a downward sloping schedule with the current upward sloping schedule, with fees doubling to 60 bps for access above 1000 percent of quota, which already provides a significant deterrent against "excessive" recourse to the FCL. (Procedurally, modifying commitment fees would require a 70 percent majority of the total voting power.)

Figure 1. Commitment Fee Schedule
(in basis points)



4. **Staff proposes to strengthen procedures by requiring early Board involvement in assessing the contemplated access and the impact of such access on Fund liquidity**. Specifically, *Proposed Decision I* set forth in , FFR: Reform Proposals paper, Supplement 1 is proposed to be amended to specify that the staff note for the initial informal Board meeting setting out the basis on which approval of an FCL arrangement could be recommended by management will include (i) a *rigorous assessment* of the member's actual or potential need for Fund resources and capacity to repay and (ii) an assessment of the impact of the contemplated access on Fund liquidity in the context of other potential demand for Fund resources when access is above 1000 percent of quota or SDR 10 billion, whichever is lower (*Revised Proposed Decision I, paragraph 1(b))*.[1] Aside from these changes, the proposed trigger for an early Board review of the FCL and PCL decisions when aggregate outstanding credit and commitments under these instruments reach SDR 100 billion provides additional protection (*Revised Proposed Decision IV*). It should be emphasized that, in the final analysis, the most important safeguard for Fund financing under the FCL is its strict qualification standard, which ensures that use of this credit line is targeted to a small set of members with very strong fundamentals and policies and a strong track record of implementing such policies.

B. Establishing the PCL

5. **The PCL aims to provide effective crisis prevention to members with sound fundamentals, policies, and institutional policy frameworks but moderate vulnerabilities** that would not meet the FCL's qualification standard. Similar to the FCL, the PCL's ex ante conditionality signals policy strength. It also helps to identify vulnerabilities on which to

[1] Separate from this provision governing access and liquidity assessments in the staff note for the initial Board meeting, the FCL decision would continue to require an assessment of the impact of a proposed FCL arrangement on the Fund's finances and liquidity position in the final staff report recommending approval of the arrangement (paragraph 6(a)(iv) of Decision No. 14283-(09/29), adopted March 24, 2009).

focus ex post conditionality—the degree of ex post conditionality would tend to be inversely related to a member's strength of performance under the PCL's qualification standard (ex ante conditionality). Other safeguards for use of the Fund's resources include phased access (up to 500 percent of quota on approval and up to a total of 1000 percent of quota after 12 months), semiannual reviews, and early Board involvement under the exceptional access procedures, when access is above the normal GRA access limits.

6. **The proposed PCL is being revised to incorporate Executive Directors' feedback on clarifying the qualification framework and strengthening ex post conditionality**. In particular, some Directors felt that the qualification standard needed to be given greater specificity to increase predictability of access under this instrument and enable countries to conduct self-assessments of qualification with reasonable confidence. Many Directors also felt that the PCL's ex post conditionality needed to be strengthened and that the exclusion of quantitative performance criteria (PCs) risked creating imprecise targets for the authorities. In response and compared with the *FFR: Reform Proposals paper*, it is proposed to clarify the qualification framework to increase predictability and facilitate evenhanded decisions, and to strengthen ex post conditionality by allowing the use of semi-annual PCs.[2]

PCL Qualification

7. **PCL qualification, similar to that of the FCL, is a process requiring Board judgment about the strength of members' policies and track records, drawing on Fund surveillance**. For the PCL, qualification aims to establish confidence that the member will take appropriate measures to reduce remaining vulnerabilities and respond appropriately to shocks despite the absence of intensive ex post conditionality. The core standard of the PCL qualification is that a member does not face an actual balance of payments need at the time of approval of the arrangement and that it (i) has *sound* economic fundamentals and institutional policy frameworks, (ii) is implementing—and has a track record of implementing—*sound* policies and (iii) remains committed to maintaining such sound policies in the future. For access above the normal GRA access limits, observance of the substantive criteria and procedural requirements under the exceptional access policy is also required. Fund surveillance is expected to play a central role in informing qualification assessments, as qualification requires a generally positive assessment of the member's policies by the Board in the context of the most recent Article IV consultations.

8. **The qualification framework has been further clarified as follows** (*Revised Proposed Decision II*, *Paragraph 2*):

[2] A revision is also being proposed to the PCL decision (paragraph 4(b)) to allow augmentations under PCL arrangements (subject to the applicable PCL access ceilings) regardless of whether or not the member had made a drawing at the time of the augmentation.

a) To ascertain the soundness of fundamentals, policies and policy frameworks, the member will be assessed against the five broad areas encompassed by the FCL's nine specific qualification criteria, namely: (i) external position and market access, (ii) fiscal policy, (iii) monetary policy, (iv) financial sector soundness and supervision, and (v) data adequacy (see Table and the FCL guidance note for more detailed descriptions each of these elements).

b) Strong performance would be expected for PCL qualification only in *most* of these areas (i.e., at least three out of five), with no substantial underperformance in *any* of the five. In practice, while a PCL user would be expected to face *some* vulnerabilities, these should be *moderate* and such that they could be credibly reduced during the PCL arrangement. For example, a member requesting a PCL arrangement should not face entrenched fiscal or bank solvency problems.

c) Consistent with the above qualification requirements and with the condition that PCL arrangements can only be approved in the absence of an actual balance of payments need, certain approval criteria would also be applied to ensure to ensure the crisis prevention use of this instrument. Specifically, the revised proposed decision would provide that under no circumstances would a PCL arrangement be approved for a member facing *any* of the following circumstances:

   i. sustained inability to access international capital markets;

   ii. the need to undertake *large* macroeconomic or structural policy adjustments, unless these were set credibly in train before approval of the arrangement (judgment on whether an adjustment is *large* would be informed by the member's own experience and that of similarly-situated members);

   iii. a public debt position that is not sustainable in the medium term with a high probability; *or,*

   iv. widespread bank insolvencies.

9. **All PCL arrangements require ex post conditionality**. The extent of policy conditionality and monitoring would be tailored to the member's circumstances as informed by the initial assessment under the qualification framework and by subsequent semi-annual reviews. For example, ex post conditionality would focus on fiscal policy where fiscal vulnerabilities are present, or on reorienting the macroeconomic and financial policy mix where external vulnerabilities are at the forefront.

- As in other Fund-supported programs, the PCL requires that a member spell out in writing its ***policy commitments*** and a quantified macroeconomic framework underpinned by indicative targets and, where needed, structural benchmarks.

- Prior actions could be established, including for approval of an arrangement or completing reviews, in cases where the upfront implementation of measures to reduce remaining vulnerabilities is critical for successful program implementation. In fact, prior actions may often be appropriate in light of the PCL's frontloaded access.

- Observance of policy commitments would be monitored by the Executive Board in the context of ***semiannual program reviews***. Consistent with the *Guidelines on Conditionality*, these program reviews provide a framework for assessing whether the program remains on track to achieve its objectives based on relevant factors such as the member's observance of applicable PCs, indicative targets and structural benchmarks; its continued adherence to applicable PCL qualification standard; and its policy understandings for the future.

10. **Quantitative targets under a PCL arrangement would provide a benchmark against which to assess a member's progress in meeting program objectives in the context of a program review**. In this context, allowing the establishment of semi-annual PCs may be redundant as purchase rights will be interrupted in any event when semiannual reviews are not completed by the scheduled dates. Moreover, the introduction of PCs may raise concerns about the stigma associated with waivers of nonobservance and create interruptions in access due to the time needed for data needed to verify observance of such PCs to become available (i.e., blackout period). Nonetheless, a number of Directors noted that semi-annual PCs could be useful in some cases to strengthen confidence regarding the attainment of certain key policy objectives (for example, to guide fiscal consolidation plans).

11. **Given such views, it is proposed that the use of semi-annual PCs (in addition to the standard PCs identified in** *FFR: Reform Proposals paper*) **be permitted in PCL arrangements** (*Revised Proposed Decision II, paragraph 3(a))*. Whether semi-annual PCs are warranted would depend on the understandings reached between the authorities and staff, as is the case in other Fund-supported programs, subject to consistency with Fund policy. In this regard, and consistent with the *Guidelines on Conditionality* (9/25/2002), PCs will apply to those variables that are either so critical to the achievement of program goals or for monitoring implementation that purchases under the arrangement should be interrupted in cases of nonobservance. This approach would be consistent with ensuring that the choice in a PCL arrangement between a pure review-based approach and one supplemented by semi-annual PCs would, while entailing judgment, be based on the nature of underlying vulnerabilities of a member. In some cases, use of such PCs could also help crystallize expectations vis-à-vis market participants and build the support of domestic political constituencies.

Table. Qualification: Relevant Areas, Criteria, and Indicators

Area	Criterion	Indicators
I. External Position and Market Access		
	1. Sustainable External Position	Gross external debt/GDP including DSA assessment; debt-stabilizing noninterest current account deficit; net external debt/GDP; short-term gross external debt/GDP; share of bank, nonbank and public sector gross external debt
	2. A capital account position dominated by private flows	FDI plus portfolio inflows as a share of total inflows; ratio of private holdings of external debt to gross external debt; and private foreign holdings of domestic debt/total domestic debt
	3. A track record of steady sovereign access to international capital markets at favorable terms	EMBI spread; spread between country EMBI and EMBI overall index (using latest observation and averages over previous five years); current yield on benchmark bonds; credit ratings; and last external issuance (details on amount issued/ original yield/maturity)
	4. A reserve position that is relatively comfortable when the arrangement is requested on a precautionary basis	Ratio of reserves to: short-term debt (remaining maturity basis); short-term debt (remaining maturity basis) plus current account deficit; imports; and broad money
II. Fiscal Policy		
	5. Sound public finances, including a sustainable public debt position determined by a rigorous and systematic debt sustainability analysis	Public sector debt-to-GDP ratio, and debt sustainability assessment; primary and overall fiscal balance (average for the last 3/5 years); structural fiscal balances and debt-stabilizing primary balance. Assessment of MT plans anchoring fiscal policy outcomes; and overall sound institutional budgetary framework as informed by recent fiscal ROSCs, where available
III. Monetary Policy		
	6. Low and stable inflation, in the context of a sound monetary and exchange rate policy	Recent evolution of core and headline inflation and inflation expectations. Past and announced policy responses to inflationary shocks. Adequacy of monetary policy instruments to conduct monetary policy. Accountability, transparency, and communication regarding policy objectives and policy responses
IV. Financial sector soundness and supervision		
	7. Absence of bank solvency problems that pose an immediate threat of a systemic banking crisis	Capital adequacy and profitability: CAR (overall banking system and individual banks); and return on equity (overall banking system and individual banks).Liquidity and funding risks: liquid assets to total liabilities; liquid assets to short-term liabilities; loan-to-deposit ratio; and share of external funding in total liabilities. Asset quality: Credit to the private sector (real growth rate and share of GDP); and nonperforming loan ratios (overall banking system and individual banks)
	8. Effective financial sector supervision	Assessment of supervisory standards and practices based on FSAP findings, where available. Assessment of legal and institutional framework and operational capacity for prompt corrective actions and emergency liquidity assistance
V. Data Adequacy		
	9. Data transparency and integrity	Subscription to the SDSS or a judgment that satisfactory progress is being made toward meeting its requirements. Routine assessments (Article IVs) of data quality and integrity

PROPOSED DECISIONS

Accordingly, the following decisions, which may be adopted by a majority of the votes cast, are proposed for adoption by the Executive Board:

I. FLEXIBLE CREDIT LINE (FCL) ARRANGEMENTS

The decision on Flexible Credit Line Arrangements, Decision No. 14283-(09/29), adopted March 24, 2009, shall be amended as follows:

(a) Paragraph 5(a) shall be amended to read as follows:

> "5. (a) The Fund may approve a member's request for an FCL arrangement of either one year or two years duration. For FCL arrangements with a two-year duration, no purchase shall be made after one year has elapsed from the date of the approval of the FCL arrangement until an Executive Board review of the member's policies has been completed. Such a review will assess the member's continued adherence to the qualification criteria specified in paragraph 2 of this Decision, and would be scheduled with the objective of completion by the Executive Board immediately prior to the lapse of the one-year period referred to above.";

(b) Paragraph 6(a)(iii) shall be amended to read as follows:

> "6. (a)(iii) Once management decides that access to Fund resources under this Decision may be appropriate, it will consult with the Executive Board promptly in an informal meeting. For this purpose, Executive Directors will be provided with a concise staff note setting out the basis on which approval could be recommended under this Decision, including (I) a rigorous assessment of the member's actual or potential need for Fund resources and repayment capacity, and (II) an assessment of the impact of the arrangement on Fund liquidity in cases where it is contemplated that access would exceed 1000 percent of quota or SDR 10 billion, whichever is lower."; and

(c) Paragraph 10 shall be deleted.

2. All FCL arrangements with a twelve-month duration that are in effect as of the date of this Decision are amended to eliminate the requirement that the Executive Board conduct a review of the member's policies six months from the date of approval of these arrangements.

II. Precautionary Credit Line (PCL) Arrangements

1. The Fund decides that resources in the credit tranches may be made available under a Precautionary Credit Line (PCL) arrangement, in accordance with the terms and conditions specified in this Decision.

2. (a) A PCL arrangement shall be approved upon request in cases where the member does not have an actual balance of payments need at the time of approval of the arrangement and the Fund assesses that the member (i) has sound economic fundamentals and institutional policy frameworks, (ii) is implementing—and has a track record of implementing—sound policies, and (iii) remains committed to maintaining such policies in the future, all of which give confidence that the member will take the policy measures needed to reduce any remaining vulnerabilities and will respond appropriately to the balance of payments difficulties that it might encounter.

(b) In addition to requiring a generally positive assessment of the member's policies by the Executive Board in the context of the most recent Article IV consultations, a member's qualification for a PCL arrangement shall be assessed in the following areas (with the member being expected to perform strongly in most of these areas and not to substantially underperform in any of them): (i) external position and market access, (ii) fiscal policy, (iii) monetary policy, (iv) financial sector soundness and supervision, and (v) data adequacy.

(c) Notwithstanding subparagraph (b) above, the Fund shall not approve a PCL arrangement for a member facing any of the following circumstances: (i) sustained inability to access international capital markets, (ii) the need to undertake a large macroeconomic or structural policy adjustment (unless such adjustment has credibly been launched before approval), (iii) a public debt position that is not sustainable in the medium term with a high probability, or (iv) widespread bank insolvencies.

3. (a) The Fund may approve a member's request for a PCL arrangement with a duration of between one year and two years. PCL arrangements shall include indicative targets, as well as the standard performance criteria related to (i) trade and exchange restrictions, discriminatory currency arrangements, multiple currency practices and non-accumulation of external debt payments arrears as specified in paragraphs 3(d) and 3(b)(ii), respectively, of Attachment A of Decision No. 10464-(93/130), adopted September 13, 1993 as amended. PCL arrangements may also include other performance criteria, prior actions and structural benchmarks where warranted under the Guidelines on Conditionality set forth in Decision No. 12864-(02/102), adopted September 25, 2002, as amended. PCL arrangements shall provide for six-monthly reviews by the Executive Board to assess whether the member's PCL-supported program remains on track to achieve its objectives based on relevant factors such as the member's observance of performance criteria, indicative targets and structural benchmarks, as applicable; its continued adherence to the PCL qualification standard set forth in paragraphs 2(a) and 2(b) of this Decision; and its policy understandings for the future. Such reviews would be scheduled with the objective of completion by the Executive Board immediately prior to the lapse of each six-month period referred to above.

(b) A PCL arrangement will expire upon the earlier of: (i) the expiration of the approved term of the arrangement, (ii) the purchase by a member of the entire amount of approved access under the PCL arrangement, or (iii) the cancellation of the PCL arrangement by the member. Upon the expiration of a PCL arrangement, the Fund may approve additional PCL arrangements for the member in accordance with the terms of this Decision, subject to the cumulative limit on PCL arrangements set forth in Decision No. 14064-(08/18), adopted February 22, 2008, as amended by Decision No. 14716-(10/83).

4. (a) Access under PCL arrangements with a one-year duration shall not exceed 500 percent of quota at the time of approval of such arrangements, with the entire amount of access being available to the member upon approval of such a PCL arrangement and remaining available throughout the arrangement period subject to completion of the six-monthly review specified in paragraph 3(a) of this Decision. Access under PCL arrangements

with a duration of more than one year shall not exceed 1000 percent of quota and shall be phased, with an initial amount not in excess of 500 percent of quota being made available upon approval of the arrangement and the remaining amount being made available at the beginning of the second year of arrangement subject to completion of the relevant six-monthly review specified in paragraph 3(a) of this Decision.

(b) Subject to the limits specified in paragraph 4(a) above and in Decision No. 14064-(08/18), adopted February 22, 2008, as amended by Decision No.14716-(10/83), the Fund will stand ready to consider a member's request to rephase access under PCL arrangements with a duration of more than one year, or to make additional amounts available under any PCL arrangement, which request shall be considered in the context of a review in which the Fund assesses the member's actual or potential need for Fund resources and the extent to which the PCL-supported program remains on track to achieve its objectives based on the factors specified for six-monthly reviews in paragraph 3(a) of this Decision.

(c) A member may make one or more purchases up to the amount available under a PCL arrangement at any time during the period of the arrangement, subject to the provisions of this Decision. The Fund shall not challenge a representation of need by a member for a purchase requested under a PCL arrangement.

5. Phasing and performance clauses shall be omitted in any PCL arrangement in the first credit tranche. They will be included in other PCL arrangements pursuant to the terms of this Decision, but will apply only to purchases outside the first credit tranche.

6. In requesting a PCL arrangement, the member shall submit a concise written communication outlining its policy goals and strategies for the duration of the arrangement as well as measures aimed at addressing its remaining vulnerabilities, together with a quantified macroeconomic framework underpinned by a streamlined set of indicative targets, and where warranted, structural benchmarks and performance criteria.

7. In order to carry out the purposes of this Decision, the Fund will be prepared to grant a waiver of the limitation of 200 percent of quota in Article V, Section 3(b)(iii), whenever necessary to permit purchases under this Decision or to permit other purchases that would

raise the Fund's holdings of the purchasing member's currency above that limitation because of purchases outstanding under this Decision.

III. ACCESS POLICY AND LIMITS ON OVERALL ACCESS TO THE FUND'S GENERAL RESOURCES, AND EXCEPTIONAL ACCESS POLICY

Decision No. 14064-(08/18), adopted February 22, 2008, as amended, shall be amended as follows:

1. The introductory sentence in paragraph 3 shall be amended to read as follows:

   "3. Subject to paragraph 4 below, the Fund may approve access in excess of the limits set forth in this Decision in exceptional circumstances, provided the following four substantive criteria are met:";

2. Paragraphs 4 and 5 shall be renumbered as Paragraphs 5 and 6, respectively; and

3. A new paragraph 4 shall be added to read as follows:

   "4. When exceptional access is approved under a PCL arrangement pursuant to paragraph 3, such access, combined with the member's access to the Fund's resources under other PCL arrangements, shall in no event exceed a cumulative limit of 1000 percent of quota, net of scheduled repurchases."

IV. REVIEW OF DECISIONS ON FCL ARRANGEMENTS AND PCL ARRANGEMENTS*

*The Decision that was adopted by the Executive Board establishes that the decisions on Flexible Credit Line Arrangements and on Precautionary Credit Line Arrangements shall be reviewed jointly by the Fund no later than two years after the date of adoption of this Decision or whenever aggregate outstanding credit and commitments under these two decisions reach SDR 100 billion, whichever is earlier.

The decision on Flexible Credit Line Arrangements, Decision No. 14283-(09/29), adopted March 24, 2009, as amended, and the decision on Precautionary Credit Line Arrangements, Decision No.14715-(10/83) adopted August 30, 2010, shall be reviewed jointly by the Fund by August 30, 2013 or whenever aggregate outstanding credit and commitments under these two decisions reach SDR 100 billion, whichever is earlier.