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**Statement by Mr. von Kleist and Mr. Herold on 2020 Mid-Year Risk Update
(Preliminary)
Executive Board Meeting
June 11, 2020**

We thank the Office of Risk Management (ORM) for the insightful and comprehensive reports. While higher risks have accumulated during the ongoing crisis, this does not imply an acceptance of higher risks going forward. It should be differentiated between the crisis-related de facto higher and the aspired lower risk acceptance levels. Higher current risk levels increase the urgency to lower them to more acceptable levels in the medium term. **We thus do not concur with a revision of risk acceptance levels.**

We appreciate the increased board engagement in risk matters and look forward to further strengthening the enterprise risk management and mitigation processes. The findings of the current internal audit of enterprise risk management are expected to give useful input for that discussion.

We highlight and share the report's finding that "risks have increased across business areas, notably risks associated with the Fund's increased financial support to members consistent with the Fund's mandate" (Executive Summary). We further welcome the frankness by the ORM in describing the current state of risks. The judgement of risks to the Fund's portfolio as "extremely high" is alarming. In that context, we also underscore the finding that "risks relate mainly to the higher volume and changing nature of the Fund's lending portfolio, with a higher share of disbursements involving limited or no ex post conditionality. **These developments come on top of already elevated pre-crisis program risks, including risks associated with Argentina and other large programs**".

While we broadly agree with the assessment of risks, we would not fully subscribe to the view that the Fund's response to the rise in portfolio and lending risks from already high levels has been effective. We also do not agree that modifications to the lending toolkit in response to the COVID-19 crisis are characterized as steps to achieve risk mitigation for the Fund. For instance, the streamlining and acceleration of the review- and decision-making process for emergency financing does not constitute

a risk mitigation measure, but rather increases governance risks. Specifically regarding the new Short-Term Liquidity Line (SLL), the report makes the point that this could entail a residual risk to the revolving nature of Fund resources if there is successive use of the instrument.

Enterprise risks and related risk mitigation:

Generally, we appreciate that the risk mitigation activities undertaken during the crisis were tailored to the specific circumstances. Looking forward, we see merit to draft more general and risk mitigation strategies for the phase after the immediate crisis ("recovery phase"), to enable the Fund to exit the crisis-mode once the immediate challenges have been addressed and to return to non-crisis lending policies.

Lending: Use of Fund Resources (UFR):

We are concerned about the further increase of the already high UFR risks across the program portfolio, affecting also other areas of risk. This is especially worrying in light of the shift towards emergency financing lacking ex-post conditionality while parallel pausing most surveillance activities.

We fully acknowledge the Fund's difficult choices and the trade-offs involved, but the challenge is indeed to reconcile members' need for larger and swifter access with Fund access limits policy and safeguards. Inevitably, this requires recognition of "cases where the Fund cannot lend owing to conflicts with its policy framework".

In this context, we also welcome the link established to the risks around ensuring adherence of the Fund's policies and decisions, in particular the provision that Fund resources are to be made available under adequate safeguards. We see areas for concern here, in particular with regard to the issues of debt sustainability. Staff has even used the term "borderline DSAs" in its recent presentation on risks. We thus underscore the statement that robust application of Fund policies and proper scrutiny remain critical. In this context, we also underline the importance of a proper review process, notwithstanding the current challenges.

The overall risk situation facing the Fund has shifted fundamentally since the onset of the COVID-19 pandemic. To a large extent, this has to do with the new trends in IMF lending, which have given rise to a massive and abrupt intensification of risks.

The number of financial arrangements and the aggregate volumes of outstanding GRA and PRGT resources have increased in an unprecedented way and they will likely continue to do so. Alongside high volumes this includes bad program performances (if any), a higher probability for successor programs and risks stemming from further large **precautionary arrangements** which have to be carefully evaluated.

In the vast majority of cases, emergency financing has occurred without prior actions or ex post-conditionality and by way of (direct or indirect) budget support, providing weaker assurances of the capacity to repay than is usually the case.

The capacity to repay will be further affected adversely by a larger than usual bunching of repayment obligations for many members down the road, increasing credit risks. This is the result of the bulk of the resources being provided as one-off disbursements and of the temporary increase in access limits for emergency funds.

Compared to the GFC, risks to debt sustainability of members making use of Fund resources have increased markedly and the nature, multiple dimensions and geographical spread of the shock makes for higher economic risks and uncertainties than during the GFC.

Moreover, in the process the IMF is deliberately accepting a higher risk tolerance/acceptance in the application of its policy framework: in the majority of cases, applicable access limits are fully used, and requirements concerning UFR safeguards are interpreted in a very flexible manner or even being stretched (e.g. as regards debt sustainability or the scope for changing the phasing and access levels under pre-existing Fund arrangements). **In this regard, we would also like to emphasize that care should be taken to protect the catalytical role of Fund lending through a prudent calibration of access levels.** This is particularly important for countries with access to private capital markets, which - if borrowing excessive amounts from a preferred creditor like the Fund - **may raise credit risks for private lenders, thereby dampening their willingness to invest.** This should also be borne in mind in those cases where regular Fund-supported programs are presently under consideration to supplement emergency funds already disbursed.

Reduced circulation periods and requirements for documentation, **decision and review processes have been streamlined** both among staff and Board members, impeding due diligence.

Lending: Adequacy of Fund Resources:

We agree that there is uncertainty regarding the evaluation of the medium-to-long term adequacy of Fund resources, but we suggest to exercise caution in the **communication strategy** regarding the theoretically possible **exhaustion of Fund's lending capacity in certain scenarios.** Against the backdrop of the Fund's catalytic role in mobilizing financing, it is of core importance to bolster public trust in the capacity of the Fund and to avoid any allusions to potential Fund limitations. **Using the catalytic role of the Fund and more strongly involving other private and public financing would also strengthen market trust in the borrowing member.**

With regard to the steadily rising outstanding credit of the Fund, we find it essential to strengthen the **precautionary balances** as the central Fund's internal buffer against credit risks. We are looking forward to early board engagement on this matter.

We would also welcome additional concrete risk mitigation measures that would address the residual risks to Fund's finances resulting from the de facto increased credit risks from emergency financing. *Staff comments are welcome.*

Medium-Term Budget (MTB):

As already discussed in the Board meeting concerning the MTB, we appreciate the ongoing re-allocation of resources, and we take note of the activated risk mitigation measures. Whenever required, we stand ready to discuss a **temporary structural budget increase**, limited to crisis-response budgetary needs.

Human Capital:

We appreciate the actions undertaken to cope with the increased workload in the WFH situation. As the Fund's Human Capital constitutes one of its major strengths, it is continuously essential to keep

staff's motivation and morale high and to maintain highly qualified as well as diverse staff by continuing recruitment activities.

Information Security:

Information Security Risks, that exceeded the accepted low risk level already in the 2019 Risk Assessment, have been continuously high and even increasing. Against the backdrop of increased cyber-attacks, we strongly support the ongoing and planned activities to mitigate risks from third-parties and information security risks and re-evaluate the overall IT-risk environment at a time when virtually all fund business is dependent on our IT network and its continuous and safe and efficient delivery of service. If necessary, cyber security may well have to be stepped up faster and more stringently.

Reputation:

We may not lose sight of reputational risks stemming from ramped-up emergency financing, given the associated increased lending risks and weak administrative capacities in many recipient countries. While the quick and decisive reaction to the crisis was certainly beneficial for the Funds' reputation, in the short-term, any inappropriate or inefficient use of Fund resources will pose reputational risks in the medium to long term.