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**Statement by Mr. Mozhin, Mr. Palei, and Mr. Potapov on 2020 Mid-Year Risk Update
(Preliminary)
Executive Board Meeting
June 11, 2020**

1. We thank the Office of Risk Management (ORM) for the timely and comprehensive mid-year risk update. While this report was meant to be less prominent than it turned out, we recognize the extraordinary circumstances of the crisis and rapidly changing rules and practices. Hence, in our statement we raise many issues calling for urgent attention. The COVID-19 crisis has significantly elevated risks for the Fund that were already very high even before the pandemic. Now the Fund is facing difficult tradeoffs between moving toward much higher risk acceptance and failing to quickly sharpen its tools and policies to support the membership under severe pressures. We broadly share the ORM's assessment of emerging and residual risks. We support staff's efforts to identify the key risk mitigation actions. We understand that some risk drivers are beyond the Fund's control and mitigation efforts take time.

The COVID-19 impact on the Fund's risk profile

2. The Fund is facing an unprecedented surge in risks associated with the COVID-19 crisis. As rightly highlighted by the ORM, COVID-19 dominates the Fund's external and internal operating environment. The pandemic-related shocks have significantly affected the Fund's surveillance, lending, capacity development, work program, its operation modalities and, importantly, staff health and wellbeing. The surge in emergency financing requests from members has already raised concerns about the adequacy of the Fund's resources. Over the medium term, the Fund is expected to deal with many labor-intensive, complex, and sizable programs with ex-post conditionality. At the same time, as it was confirmed recently by the OBP, the Fund is facing an urgent need for a substantial structural increase in its budget envelope.

The Fund's immediate response to the crisis

3. We believe that the ORM's work on strengthening the enterprise risk function over the past several years has set a strong foundation for the Fund's COVID-19 crisis response, despite the relatively limited mandate and resources. The key recent enhancements include the push for more regular engagement with the Board, embedding risk management and ex-ante risk assessments in key strategic processes and policy papers, strengthening risk event reporting and engagement with departments to promote the risk culture. Risk mitigation has been helpful in adjusting internal operations in response to the crisis. Business continuity procedures were activated and technological capacity for remote work was scaled up. We are certain that the overall substantial strengthening of the Fund's risk management framework will be clearly recognized in the ongoing internal audit of enterprise risk management at the Fund. We also look forward to the discussion on further improvements in this area.

4. We agree with the ORM that the Fund's rapid response to the crisis has helped mitigate strategic and reputational risks. The Fund has quickly adopted its policies and procedures to support the membership and mitigate the immediate pandemic impact on the global economy. The Fund's operational resilience has withstood the initial shock.

5. At the same time, the crisis response has created additional risks for the Fund that need to be managed or accepted. As the ORM pointed out, the higher risks reflect a rise in de facto risk acceptance as a result of the Fund's decisions. *We encourage the ORM to prepare a comprehensive assessment of possible implications from changing the Fund's risk acceptance. Could staff also elaborate on the proposal to adopt a flexible approach depending on the duration of the crisis?*

Strategic risks

6. Despite risk mitigation, many strategic risks are acute, including those arising from the failure to improve the Fund's governance. Lagging governance changes, in turn, limit the Fund's legitimacy and its ability to facilitate international cooperation in the situation of rising geopolitical tensions.

7. We are concerned about the risk of diminished role of the Board in setting the Fund's strategic priorities. The Fund has to reformulate the work program and further postpone important policy reviews, in addition to putting on hold bilateral surveillance activities. The crisis dramatically highlighted the pitfalls of the past decisions on delaying key policy reviews, to a large extent, due to the rigid budget constraints. We refer to the long and unwarranted delays in the CSR, FSAP review, conditionality review, communication policy review, transparency policy review, and several other. Other residual risks have also intensified with rising tensions between the Fund's decisions and its policy frameworks, including in the context of debt sustainability assessments, the application of the exceptional access criteria, and lending into arrears policies.

Budget risks

8. The COVID-19 crisis will have a significant impact on the Fund's operations and budgetary needs. This impact should be addressed against the background of already diminished budgetary buffers in light of the rigid real flat budget strategy that has been in place for eight consecutive years. The scope for spending reallocations and prioritizations without adverse implications for the quality of the Fund's work and policy advice had waned even prior to the COVID-19 crisis. The ORM's analysis in the report confirms the urgent need for a sizeable increase in the Fund's structural budget resources. We note that under the post-COVID-19 baseline scenario, new program demand in FY2021 alone would imply an annual budget impact in the range of US\$60-100 million over the next three years. *Could staff elaborate on potential budgetary needs under the adverse scenario?*

The use and adequacy of the Fund's resources

9. We agree that lending risks have substantially increased across the Fund's portfolio. These risks were already growing before the wave of the COVID-19-related financing requests, reflecting the sizeable complex programs and the very large number of off-track programs. Credit risks are also exacerbated by the pre-existing debt vulnerabilities and extreme uncertainty, hampering judgment of debt sustainability and capacity to repay. We share the concerns about the changing nature of the Fund's lending portfolio due to the growing share of arrangements approved with limited or no ex post conditionality. The situation needs to be kept under close review. *Could staff elaborate on the cases where the Fund cannot provide financing owing to conflicts with policy frameworks and due to other politically motivated reasons?*

10. Another concern is related to a broader use of the Fund's precautionary instruments, including the recent creation of the SLL. On the one hand, we agree with the ORM that these instruments entail a residual risk to the revolving nature of the Fund's resources in case of their successive use. On the other hand, we believe that the Fund should continue to seek additional ways to support emerging markets and developing economies that have limited access to foreign exchange funds needed to help finance the higher fiscal deficits. At the same time, we note that the FCL now can face communication issues and questions about evenhandedness, since all four FCL users are from Latin America. We believe that many other emerging markets economies have similar sound fundamentals and strong policies. These countries should be able to gain similar access to the Fund's resources in case of their requests. *Could staff comment on possible evenhandedness risks in this area?*

11. Risks to the adequacy of the Fund's resources have increased substantially due to COVID-19 and the necessary modifications of the Fund's lending toolkit. We note that under the most plausible scenarios the NAB activation looks inevitable, while the BBAs activation is highly likely. The demand for the Fund's resources could exceed its current lending capacity over the medium term. PRGT resources are insufficient to meet the demands even in the baseline scenario. The possible increases in access limits will further raise risks for resource adequacy, while credit risk buffers will fall further as a proportion of rising

outstanding credit. *We call for regular reviews of adequacy of the Fund's resources. We would also appreciate staff's elaborations on possible additional risk mitigation actions in this area, including a contingency plan for the Fund's resources that was mentioned in the report.*

Surveillance risks

12. We believe that the Fund's crisis-related work needs to move from initial emergency response to ongoing crisis management and recovery. We are concerned that the delays in the Fund's surveillance and major policy reviews may create substantial challenges for the Fund and its members at the time when they are actively seeking the Fund's policy advice and when debt sustainability and financial vulnerabilities are being exacerbated. At the same time, uncertainty about the path and impact of the pandemic poses risks for the Fund's ability to accurately gauge the state of the global economy and calibrate country-specific policy advice. *Could staff elaborate on the key mitigation efforts to address the gaps in the Fund's surveillance cycle?*

13. We welcome the recent steps to strengthen knowledge management at the Fund, including the creation of the COVID-19 Knowledge Hub and the COVID-19 High-Frequency Data Hub. We believe that these initiatives can be very useful in supporting the efforts to address the current unprecedented crisis. Since the creation of the Knowledge Management Unit at the Fund, our chair has been actively calling for expeditious improvements in various knowledge platforms to facilitate and speed up the dissemination of knowledge, policy advice, and best practices across the Fund and its members. In this context, we continue to believe that changes to the Board's limited access to the Fund's knowledge are necessary to mitigate strategic and surveillance risks.

Human capital risks

14. The crisis is putting significant pressures on the Fund's human capital. We note that the immediate response to the COVID-19 crisis was based on staff's extraordinary efforts, a surge in uncompensated overtime, and ad-hoc and informal staffing arrangements. We are very concerned about the risks of excessive and sustained pressures on staff, their safety and health in the times of intensive program engagement combined with additional challenges from WFH. We welcome the risk mitigation efforts to temporarily modify the HR policies in response to the WFH environment and global travel restrictions. *We would appreciate the ORM's additional comments on how the COVID-19 crisis has impacted the recruitment and retention processes and on how to mitigate related risks.*

Information security risks

15. Information security risks remain elevated. According to the report, the cyber threat landscape has worsened for the Fund and its third-party providers. The crisis has highlighted the urgency of strengthening information security and third-party risk management. In this

context, we are concerned about the implementation delays of the information security roadmap. We call for a more proactive approach in addressing the identified constraints, including the lack of resources.

Reputational risks

16. According to the ORM, reputational risks have been contained by the Fund's effective crisis response. However, we believe that interconnections of reputation with all of the Fund's business areas expose the Fund to non-trivial risks affecting its reputation. We agree that addressing issues across the Fund's risk profile, strengthening safeguards policies, ensuring evenhanded treatment, and supporting proactive communication could mitigate reputational risks stemming from program performance and the potential misuse of the Fund's financing.