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**Statement by Mr. Guerra, Ms. Arevalo Arroyo, and Mr. Montero on 2020 Mid-Year
Risk Update
(Preliminary)
Executive Board Meeting
June 11, 2020**

We thank the Office of Risk Management (ORM) for the comprehensive reports, their engagement with our office and hard work under strenuous circumstances.

The IMF's mandate is certainly unique and different from other financial institutions. Ensuring the stability of the International Monetary System and fulfilling its role at the center of the Global Financial Safety Net inevitably involves risks. Indeed, the current crisis response entails residual risks, but we firmly believe that assuming these risks outweighs the costs of inaction, which could be damaging not only for the membership but for the Fund as well. In this sense, we consider that the Fund—and the Executive Board—should not fixate on a specific threshold of portfolio and lending risk. In fact, we are pleased to note that, through the actions, both Fund and Executive Board have naturally accepted a higher risk tolerance in several areas, consistent with the Fund's mandate. In the context of a crisis like no other, we wonder what the actual risk-taking stance of the IMF should be. It is legitimate to question the rationale for the very existence of the IMF if it fails to deploy the appropriate firepower to help its membership in times of need. In a nutshell, the risk assessment, particularly related to lending, should not constrain the Fund's unique role.

The current state of the world, and the uncertainty regarding its future evolution, makes risk identification, assessment and mitigation much more complex. Nevertheless, this should not hinder the IMF to fulfill its purpose. We agree it is fundamental that the Executive Board continues to have updated and most accurate risk information to make informed decisions and find effective ways to mitigate the risks. The uncertainty posed by

the COVID-19 pandemic will continue to dominate the short-and medium-term outlook for emerging risks. We firmly believe the Fund’s response to face the COVID19 crisis has been adequate and fully consistent with its mission to deploy its resources to aid member countries in need.

We broadly agree with the updated Fund risk profile and note that, while risk assessments are not revised until the Annual Risk Report, the directional change for capacity development and surveillance is evolving to “high”. We offer a detailed explanation below. Also, we would like to caution against deferring for too long some of the topics under consideration in the Strategic Directions risk area. We acknowledge the need to focus the attention on the most pressing issues in the near term, but we should not lose sight of other crucial topics such as climate change and inequality. Moreover, as mentioned in the paper, we can expect further divergence in views within the membership regarding economic and financial issues in the global economy, including trade, capital flows, and the role that international financial institutions like the IMF should play, which could entail increasing strategic risks for the Fund.

Lending

We do not believe that an increasing volume and pace of lending should be considered as extremely high UFR risk. The IMF role implies incurring those risks in order to reach objectives whenever necessary. We are concerned that an excessive focus on the assessment of credit risks may be interpreted as a call for more restrictive use of Fund resources when our membership needs support. When major central banks (e.g. the FED or the ECB) deployed massive QE to support the economy —entering into even riskier corners of the economy—, there was no such emphasis on the high risks assumed; it was accepted that incurring those risks is precisely within their mandate. Additionally:

- **By taking action, we are managing risks to the global economy thus to our lending portfolio going forward.** As the report states, the scale and timing of the crisis response should help reduce risks for the membership and potential needs for future support, as well as mitigate strategic and reputational risks.
- **By enhancing risk mitigation measures and stepping up surveillance and CD activities, we can further reduce lending risks.** Aside from the necessary safeguards, debt sustainability considerations, and capacity-to-repay assessments, the COVID-19 crisis requires a more active engagement with country authorities through policy advice and TA.

- **Regional concentration of the lending portfolio is inevitable.** Fund support to some regions cannot be diversified as in other financial institutions. Moreover, regional concentration has been higher in other crisis episodes.
- **Successor arrangements, particularly related to the precautionary toolkit, should not be seen as increasing risk but rather as mitigators.** Also, the precautionary toolkit was designed to provide insurance and bolster confidence for countries with strong fundamentals, hence, it should not be seen in the same way as programs that have already been disbursed.
- **The use of temporary resources cannot be seen as a risk as they are part of the Fund's financial resource envelope.** The report seems to portray the activation of NAB resources as both a risk and a mitigation factor which we believe could be misleading.

Income risk

In the area of financial assets and income, we lean towards a more benign view than staff on the risk directional change. All the evidence points to a substantial increase in Fund lending, either through new programs, follow-up programs or augmentations. Even though program risks may be rising, lending income should considerably increase relative to expectations. Therefore, we would expect income risk to diminish, instead of remaining unaltered. Relatedly, credit risk buffers are expected to fall as a share of outstanding credit. This risk can be easily mitigated by allocating part of the expected additional income to build more buffers, particularly precautionary balances.

Resource envelope for PRGT

We concur with staff's view that PRGT adequacy and self-sustainability risks are elevated due to the COVID-19 shock. However, we would like to underscore the successful response from membership to urgently replenish the PRGT loan account, which will help address even the most adverse scenarios. A main concern, though, is the risk to "self-sustainability" owing to the lack of resources in the subsidy account. We encourage staff to explore all options to raise funding to mitigate this risk, including a new SDR allocation and the possibility of gold sales.

Surveillance and Medium-term budget

One of the most significant strategic risk is the crowding out of surveillance activities owing to the urgent work to address the COVID-19 emergency. We fully agree with ORM that risk mitigation will likely need to include additional resources in order to ensure continued effective Fund service to the membership.

- **The IMF reacted swiftly, effectively and flexibly to reallocate scarce resources to address the pandemic, but this can only be deemed as a short-term solution, not sustainable in the medium term.** The postponements of Art. IVs and delayed FSAP reviews will compound surveillance risks at a time when these activities are of strategic importance to identify risks to the recovery and to follow up on program policy implementation. Also, some specific bottlenecks could appear in the following months: the need to undertake many central bank safeguards assessments in a very short period to cope with successor programs demand. Putting in place the new MAC-DSA framework will also imply additional workload for country teams in the following year.
- **Given that rapid financing instruments lack ex-post conditionality, additional resources will be needed to follow up on IMF policy advice through increased surveillance in order to safeguard program resources.** We will have a significant number of new programs to follow up.
- **The rundown of budgetary buffers call for a timely increase in temporary resources.** As stated in the report, *there are already indications in several departments regarding increasingly binding resources constraints. Can staff elaborate on these indicators and which departments are more affected? Does staff have any indication of the effectiveness of the mitigation measures, such as re-hiring retirees?*

Capacity Development

Under the COVID-19 juncture, risks to the implementation of CD, the IMF's capacity to address higher demand, and future funding of CD are significant concerns. A recurring topic in Board discussions is how COVID-19 has made the delivery of CD activities more complex. Given the current travel restrictions, new modalities of delivery have been envisaged. However, under the new normality of potential remote engagement, there is still a risk that, even if it is provided, CD will not be as timely and effective, and will be harder to assess. Additionally, more resources will be needed in order to fulfil the commitment to support rapid financing programs with TA and policy advice. *Can staff elaborate why the directional change in risks to CD is assessed to be constant? What*

strategic risk mitigation measures does staff consider will be adequate to address CD funding risks in the medium-term?

Human Capital

Staff is the most important asset of the Fund. Previous risks reports pointed to work pressure on personnel as an increasing risk, even previously to the COVID-19 crisis. Even though mitigation measures have been put in place, the increased workload and the challenges arising from WFH have put significant pressures on our Human Capital (HC). Mindful that we cannot request staff to maintain a crisis mode for a long period of time, *we would like staff to comment on which indicators could be used to follow and assess risks to HC, particularly related to work pressures? Does staff see scope to include a periodic report to the Board on HC indicators to assess the evolution of this risk during the pandemic?*

Technology

We understand that risks appear to have remained stable even with the impact of the pandemic, but concern remains regarding implementation given underspending of the modernization projects. We take positive note of the effectiveness of mitigating measures on the risks related to shifting Fund business entirely to remote mode, but other risks persist.

- **Underspending in IT projects and the modernization agenda.** We remain concerned that underspending in IT capital projects prevails. This reflects the strained ITD absorption capacity to cope with the transition under the modernization process and the risk mitigation roadmap. Going forward, while we note that mitigations identified in the 2019 Risk Report have helped, given the interdependencies of the projects, delays could negatively impact the modernization process and put pressure on the budget as underspending today implies overspending later.
- **Third-party risk management.** Another cause of concern is management of third-party risks. While we welcome that the ongoing third-party risk management project is on track, we note that this framework has only been on a small scale and with limited vendor coverage. Moreover, we take note of the materialization of vendor risk in May 2020, and that asset recovery is now in progress. We fully agree that third-party risk management needs to be adequately resourced and supported. In this vein, we welcome the new CSF unit and look forward to the proposal for setting an operating model and process under the second phase of the TPRM project.

Advancing risk management at the Fund

We underscore the good work in advancing risk management, with enhanced engagement of ORM with the Board and increased information flows, as requested.

Going forward, we consider that the changes to the risk management framework should be taken step by step and after great reflection on the aims, goals and best organizational set-up. We underline the importance of having a well-thought road map for this process. Much has been gained in the past years in advancing the Fund's risk management framework, as we have managed to set the foundations and build a culture of risk identification, mitigation and reporting. We look forward to the discussion of the roadmap for enhancing risk management at the Fund and the internal audit report on the enterprise risk management framework.