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**Statement by Mr. Pösö and Ms. Skrivere on Interim Review of the Adequacy of the Fund's Precautionary Balances  
(Preliminary)  
Executive Board Meeting  
December 13, 2021**

We welcome the opportunity for an interim discussion on the adequacy of the Fund's precautionary balances and thank staff for an informative paper also covering a number of related policy factors. In the context of large demand for Fund support, the role of precautionary balances in the Fund's risk management framework and in protecting the Fund's balance sheet is ever more important. **We emphasize the importance of achieving the medium-term target of SDR 25 billion without delays to the current timeline and highlight the central role of surcharge policies in achieving this. We do not see a need in changing the current surcharge policies.** Further, we continue to call for establishing the SCA-1 account as a more permanent layer of the Fund's risk management framework.

*Assessment of financial risks and adequacy of precautionary balances*

**We broadly agree with staff's assessment of credit risks facing the Fund.** Credit outstanding and commitments are near historic highs, the lending portfolio remains concentrated toward the largest borrower and regionally, and there are added risks arising from the high share of emergency financing instruments without ex-post conditionality and with challenges related to governance safeguards. The overall credit quality of the borrowers remains weak and needs to be closely monitored given the significant uncertainties as well as the high level of debt vulnerabilities across countries. We would welcome a thorough analysis of the overall repayment capacity assessments of the borrowers to be presented to the Board in the next review.

**The substantial uncertainty related to Argentina's approaching large repayments presents a significant risk in the near term.** We note that negotiations are ongoing on a new program to refinance those payments to the Fund. We appreciate the constructive engagement between the IMF staff and the Argentinean authorities and that there seems to be a mutual desire to make swift progress in program negotiations to address the significant challenges facing Argentina. However, while we are hoping for the best, time is running very short, and we need to prepare for a possibility that the repayments scheduled for March 2022 will not be met. Thus, **we call for staff to bring to the Board a comprehensive scenario analysis of this tail risk event and its implications.**

**The medium-term target for precautionary balances of SDR 25 billion remains appropriate and the projected pace of reserve accumulation to reach the target level by FY2025 is acceptable.** Thus, we concur with the assessment that at this point no additional steps are needed to accelerate the pace of accumulation of precautionary balances. However, given the significant credit risks in the Fund's lending portfolio and the current repurchase schedule heavily concentrated in the FY2023-2025 window, we do not see much room for delays in the current expected timeline for reaching the target and stress the importance of a close monitoring of the developments concerning the Fund's credit risk exposure.

**We agree with staff to keep the minimum floor for precautionary balances unchanged at SDR 15 billion.** This issue can be revisited after the next review of the Investment Account to allow the Board discussion to be better informed by considerations impacting the broader investment outlook and risks.

While the current transparent and rules-based framework for the adequacy assessments has worked well, **we would prefer to take a more holistic perspective on these assessments within the broader multi-layered risk management framework.** A comprehensive discussion considering the other layers of the framework – including access policies and safeguard assessments, the different enterprise risks facing the Fund, and the recent decisions that have had an impact on the precautionary balances – would better inform the Board about the broader set of developments impacting the Fund's risk profile.

#### Surcharge policies

**We do not see a need for any changes in the current surcharges policy, or for a consideration of temporary relief from surcharges.** Surcharges are an essential part of the Fund's risk management framework and are crucial to reach the agreed indicative target for precautionary balances. They also support the Fund's lending policies by discouraging excessively high and prolonged use of Fund financing support and by providing incentives for timely repurchases, underpinning the revolving nature of Fund resources. Further, the

effective level of surcharges is modest and the cost of borrowing from the Fund is well below market rates for surcharge paying members. Overall, we find that staff analysis provides further confirmation that the current structure of surcharges appropriately balances the considerations from the borrowing country's perspective and from the perspective of the adequacy of Fund safeguards.

*Issues related to the SCA-1 account and credit impairment provisioning*

**We strongly support leaving the SCA-1 account open.** In our view, the SCA-1 has played a valuable role in protecting the Fund's balance sheet and contains beneficial elements, distinct from the general and special reserves, as a first line of defense against potential credit losses and as a protection against the need for provisioning. In the current context of elevated debt vulnerabilities and repayment risks, the possibility of new arrears arising in the coming years cannot be disregarded. We are unwilling to accept a higher risk of provisioning in the future, as this would jeopardize the long-standing practice of the Fund showing its loans in full value on the balance sheet.

**We see merit in considering a more permanent role for the SCA-1 account as a buffer in the Fund's financial risk management framework.** The suggestion that considerations for replenishing the SCA-1 account could wait until new arrears arise is somewhat problematic, as we would see a need for the additional layer of protection against the need for provisioning to be in place prior to that risk materializing. In our opinion, the burden sharing mechanism would be the best option for rebuilding the SCA-1 account, if deemed appropriate and effective. While the current capacity of the mechanism is very low, given the low level of the SDR rate, it would be beneficial to consider the merits of its activation once the capacity improves. **Thus, we ask for a broader discussion of the SCA-1 account and the burden sharing mechanism in the next review.** This would support more comprehensive considerations of different benefits, costs, and implications of the account's ownership structure.

*Treatment of Pensions Net Asset/(Liability)*

The significant volatility in precautionary balances arising from pension revaluations has been a clear challenge. It makes the context for the adequacy assessments less predictable and excessively dependent on short-term movements in financial markets. Thus, we are supportive of considering alternative approaches that could limit the accounting volatility. **We see merit in pursuing the proposal for the long-term economic measure of the net pension-related assets and liabilities.** Further, we agree with the need for potential adjustments if a materially underfunded position in the Fund's pension plans would occur. This would be a prudent approach to ensure that economic risks for the Fund are not

underestimated at any time. Nevertheless, an evaluation from external auditors of the proposed approach would be appropriate. *How would a reassessment of an appropriate long-term real rate of return impact the long-term economic measurement and assessments of over- or undervaluations?*