

SU/21/167

December 15, 2021

**The Chair's Summing Up**  
**Interim Review of the Adequacy of the Fund's Precautionary Balances**  
**Executive Board Meeting 21/118**  
**December 13, 2021**

Executive Directors welcomed the opportunity to review the adequacy of the Fund's precautionary balances ahead of the standard two-year cycle. They generally emphasized the importance of maintaining an adequate level of precautionary balances to mitigate financial risks, safeguard the strength of the Fund's balance sheet, and protect the value of members' reserve positions in the Fund. An adequate level of precautionary balances would thus continue to play an integral part of the Fund's ability to lend.

Directors generally noted that overall financial risks remain elevated but have not increased significantly since the last review. In particular, credit risks are driven by a combination of historically high exposure, significant loan concentration toward the largest borrower, whose repurchases schedule is bunched in the near future, as well as a sizable share of emergency financing without ex-post conditionality in the lending portfolio.

In light of this, Directors broadly agreed to leave the medium-term target of SDR 25 billion, and the minimum floor of SDR 15 billion, unchanged at this time. Taking into account the expected new demand for Fund lending, the current target for precautionary balances of SDR 25 billion would remain within the indicative range of the forward-looking measure of average credit outstanding. Directors broadly noted that other qualitative considerations, while pointing to elevated risk, do not suggest a significant deterioration compared to the last review. A few Directors felt that raising the medium-term target would have been justified, while a few others thought that the level could be reduced if appropriate once the crisis abates. Against the backdrop of continued uncertainty about the global recovery, Directors noted that the target will need to be reassessed at the next regular review in about a year's time. The minimum floor could be revisited after the review of the Investment Account.

Directors broadly considered that with the projected increase in lending income, the pace of precautionary balances accumulation is expected to remain adequate relative to the medium-term indicative target. Even after factoring in the proposed budget augmentation, the SDR 25 billion target would be reached in early Fiscal Year 2025 under the desk survey scenario for future lending—one year earlier than projected at the 2020 review. A few Directors stressed the importance of avoiding delays in the pace of accumulation, and a few others felt that it could be strengthened. Directors asked staff to closely monitor risks.

Directors welcomed the analysis provided by staff on the role of surcharges as part of the Fund's risk management framework and their financial implications on members. Some

Directors were open to exploring temporary surcharge relief to help borrowing members free up resources to address the health and economic challenges posed by the pandemic. Some suggested reflecting on how best to implement surcharges during pandemic situations. A number of Directors did not see a need to review the policies on surcharges or change their design at this stage, given overall low total cost of borrowing from the Fund and noting the critical role of surcharge income in ensuring an adequate build-up of risk buffers. Most other Directors expressed openness to an appropriately-timed, more holistic review of surcharge policies in the context of the Fund's income model and overall financial outlook.

Directors also broadly supported the measures proposed by staff to mitigate the volatility of precautionary balances created by the accounting treatment of pension revaluations under IAS 19. While recognizing that income volatility stemming from the pension-related gains and losses cannot be eliminated for financial reporting under International Financial Reporting Standards, the new approach for determining precautionary balances seeks to reflect their role as a long-term buffer for economic and financial risks. It aims to achieve this by replacing the accounting valuation of the net pension-related assets and liabilities with a more long-term economic measure, and taking a more prudent stance on any economic gains. The transition to the new approach would be applied prospectively, commencing in FY 2022.

Directors broadly supported keeping the SCA-1 open with a zero balance for the time being. Staff should monitor the need, and opportunities, for further SCA-1 funding, and engage the Executive Board on developments as warranted. Some Directors encouraged staff to explore further options for providing funding for the SCA-1. A few Directors highlighted the importance of the burden-sharing mechanism and the timely completion of the 16<sup>th</sup> General Review of Quotas. Some Directors noted that with the SCA-1 balance depleted, a need to book a provision for credit impairment could potentially arise and emphasized that the Executive Board should be informed ex-ante.