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International Monetary Fund
Washington, D.C. 20431 USA

IMF Tightens Defenses Against Financial Contagion by Establishing Contingent Credit Lines

The IMF's Executive Board has agreed to provide Contingent Credit Lines (CCL) for member countries with strong economic policies as a precautionary line of defense readily available against future balance of payments problems that might arise from international financial contagion. The approval of financing under the CCL will signal the IMF's confidence in the member's economic policies, and in the member's determination to adjust them as needed should contagion hit.

The CCL is being established for a two-year period and will be reviewed after one year's experience. It is intended to be a new instrument of crisis prevention by creating further incentives for members to adopt strong policies and adhere to internationally accepted standards; by encouraging the constructive involvement of the private sector, thereby reducing the risks of contagion; and by signaling the IMF's willingness to provide its financing to the member should it be struck by contagion.

The CCL provides short-term financing--if the need arises--to help members overcome the exceptional balance of payments financing needs that can arise from a sudden and disruptive loss of market confidence due to contagion, that is, circumstances that are largely beyond the member's control and stem primarily from adverse developments in international capital markets consequent upon developments in other countries. It takes the form of an addition to the IMF's existing decision on the Supplemental Reserve Facility (SRF), established in December 1997. A key difference is that the SRF is for use by members already in the throes of a crisis, whereas the CCL is a preventive measure intended solely for members that are concerned with potential vulnerability to contagion, but are not facing a crisis at the time of commitment.

The IMF has ensured the effective use and safeguarding of IMF resources by establishing the following criteria for access to the CCL: (1) at the time of Board approval of a commitment of CCL resources, the member is implementing policies considered unlikely to give rise to a need to use IMF resources and is not already facing contagion-related balance of payments difficulties; (2) the member's economic performance should have been assessed positively by the IMF in the last Article IV consultation and thereafter, including (3) its progress in adhering to relevant internationally-accepted standards[1]; (4) it should have constructive relations with private creditors with a view to facilitating appropriate private sector involvement, as well as satisfactory management of its external debt and international reserves; and (5) it should submit a satisfactory economic and financial program, including a quantified framework. When a member requests actual use of CCL resources, a special "activation" review will be conducted--expeditiously--by the Board. At that review, the Board will need to ascertain that the member, having successfully implemented its program to date, is nevertheless severely affected by a crisis stemming from contagion and intends to adjust its policies as needed.

The CCL will not be subject to general access limits, but commitments under the CCL would be expected to be in the range of 300 to 500 percent of the member's quota in the IMF, unless otherwise warranted by exceptional circumstances, and with due regard to the IMF's liquidity position.

CCL commitments are to be made for up to one year. At the time of the special "activation" review, the Board would decide on the amount to be released immediately and on the phasing of the balance remaining, and the associated conditionality. Countries drawing under the CCL are expected to repay within one to one and one-half years of the date of each disbursement (the Board may extend this repayment period by up to one year). During the first year following the first drawing of CCL resources, the member will pay a surcharge of 300 basis points above the rate of charge on regular IMF drawings[2]. The surcharge increases by 50 basis points every six months thereafter up to a maximum of 500 basis points.

Details of the criteria applicable to CCL commitments and disbursements, and related factors that the Executive Board will consider when approving a CCL are contained in the attached Board decision on "The Supplemental Reserve Facility and Contingent Credit Lines" and Summing Up by the Chairman.

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[1]In particular, the member would have subscribed to the Special Data Dissemination Standard and be judged to be making satisfactory progress towards meeting its requirements.

[2]The rate of charge is a weighted average of short-term interest rates paid in domestic money markets by the five countries whose currencies comprise the SDR valuation basket.

INTERNATIONAL MONETARY FUND

Contingent Credit Lines

Executive Board Decision – April 23, 1999

Effective April 26, 1999, Decision No. 11627-(97/123) SRF, adopted December 17, 1997, as amended, on the Supplemental Reserve Facility shall be amended in the following manner.

1. The title of the decision shall be amended to read "The Supplemental Reserve Facility and Contingent Credit Lines" and the title immediately before paragraph 1 shall be amended to read "I. Supplemental Reserve Facility." References to "this Decision" in paragraphs 1 through 12 shall be replaced by "this section".

2. The following shall be added immediately after paragraph 12.

"II. Contingent Credit Lines

13. Through May 4, 2001, the IMF will be prepared to commit and provide financial assistance to a member under the terms and conditions specified in this section.

14. Financing under this section will be committed to a member: (I) that, at the time of commitment, is implementing policies that are considered unlikely to give rise to a need to use IMF resources, and is not facing balance of payments difficulties of the type described in paragraph 15; (ii) whose policies have received a positive assessment from the IMF at its last Article IV consultation and whose policies have continued to be assessed favorably by the IMF thereafter based on economic indicators reflecting domestic stability and external sustainability, and taking into account the extent of the member's adherence to relevant internationally-accepted standards; in particular, the member would have subscribed to the Special Data Dissemination Standard and be judged to be making satisfactory progress towards meeting its requirements; (iii) that is maintaining constructive relations with its private creditors with a view to facilitating appropriate involvement of the private sector, and has made satisfactory progress in limiting external vulnerability through the management of the level and structure of its external debt and international reserves; and (iv) that has submitted a satisfactory economic and financial program, including a quantified framework, which the member stands ready to adjust as needed.

15. Financing under this section will be provided where, as a result of circumstances that are largely beyond the control of the member and that stem primarily from adverse developments in international capital markets consequent upon developments in other countries, the member is experiencing exceptional payments difficulties due to a large short-term financing

need resulting from a sudden and disruptive loss of market confidence reflected in pressure on the capital account and the member's reserves, if there is a reasonable expectation that adequate financing and the implementation of any necessary adjustment policies will result, within a short period of time, in an early correction of such difficulties.

16. Financing under this section will be committed and provided under a stand-by arrangement, in addition to resources in the credit tranches. Financing will be committed under this section in cases where purchases in the credit tranches or under the extended Fund facility, taking into account outstanding purchases, would otherwise exceed either the annual or cumulative access limit.

17. The IMF may commit resources under this section at any time under an arrangement but will only make such resources available when it finds that the member meets the conditions specified in paragraph 15. The arrangement will specify the amount of resources committed under this section and will normally provide for the continued availability of such resources beyond a specified date to be subject to the completion of a program review by the IMF. When the IMF decides to make such resources available to a member, it may phase such resources in as many purchases and subject to such conditionality as it considers appropriate. The IMF may commit resources under this section for a period of up to one year and, after it decides to make such resources available, may extend such period for up to one year from the date such resources are made available.

18. Notwithstanding the provisions of paragraph 16, financing under this section may be committed and provided under any extended arrangement in effect at the time the provisions of this section become effective.

19. Paragraphs 6 to 11 of this Decision shall apply to purchases under this section.

20. This section and its operation will be reviewed no later than May 5, 2000."

Summing Up by the Chairman
Contingent Credit Lines
Executive Board Meeting 99/48
April 23, 1999

Directors have given extensive consideration to a role for the IMF in providing members with contingent credit lines (CCLs). There is now agreement to proceed with this concept, essentially as an important instrument of crisis prevention, creating further incentives for the adoption of strong policies and adherence to internationally accepted standards, encouraging the constructive involvement of the private sector, and thereby reducing the risks of contagion, and Directors have approved the decision establishing the CCL. There are, however, a number of elements in this decision which require some elaboration in order to express the Board's understanding as to how they will operate.

Foremost among these elements are the four eligibility criteria referred to in paragraph 14 of the decision. As is clear from the decision, and as Directors have agreed, for a member to be eligible for the CCL, it must satisfy all four of these criteria. Directors have also agreed, however, that in assessing whether an individual criterion is satisfied, the Executive Board would take into account a range of factors, and would exercise judgement as to whether a sufficient "critical mass" of factors relevant to the criterion is in evidence.

Let me start with the first criterion. It is agreed that, for a member to be eligible for the CCL, the member's policies should be such that, absent a future balance of payments problem of the type for which CCL resources are intended, the member would not otherwise be expected to need to use IMF resources. This criterion would not exclude members with arrangements in place where members are treating these arrangements as precautionary or where drawings are outstanding but the need for further drawings under the arrangements is judged to have ceased as confirmed by the member.

As indicated by the second criterion, the member's policies should "have received a positive assessment from the IMF at its last Article IV consultation" and its policies should have "continued to be assessed favorably by the IMF thereafter based on economic indicators reflecting domestic stability and external sustainability, and taking into account the extent of the member's adherence to relevant internationally accepted standards". It is understood that by a "positive assessment", it is meant that the Board should have expressed its broad satisfaction with the member's policy stance and prospects, although this does not necessarily mean an assessment entirely devoid of recommendations for changes in policy. But it would be important that the Board should be of the view that the member's policies themselves would not expose it to significant risk of balance of payments pressure , and this should be true both of the member's policies in the recent past and of the policies it plans to implement in the future. This broadly satisfactory assessment should have been expressed at the time of the most recent Article IV consultation, and reaffirmed, with respect to the policies the member has been implementing and the policy plans it has framed since the Article IV consultation, at the time of the commitment of

CCL resources. If the member has not already done so, the IMF would strongly encourage a member that contemplates use of the CCL to volunteer for the pilot project and publish its Article IV staff report.

Directors are agreed that, in judging eligibility under this criterion, the Board should take into account the member's progress in adhering to relevant internationally accepted standards. The member would have subscribed to the Special Data Dissemination Standard and be judged to be making satisfactory progress toward meeting its requirements. In addition, at this early stage, the Board would take into account the member's adherence, or progress toward adherence, to the Basle Core Principles for Banking Supervision, the code of transparency in the area of fiscal policy and, when it is agreed, the code of transparency in monetary and financial policy. Other standards, some of which are still under development, could also be added as they are developed, so long as the IMF is able to assess adherence, possibly taking into account the views of other organizations. As standards are developed and experience is gained, the question of requiring adherence to certain standards could be reviewed.

The third criterion provides that a member would be eligible if it is maintaining constructive relations with its private creditors with a view to facilitating appropriate involvement of the private sector, and has made satisfactory progress in limiting external vulnerability through the management of the level and structure of its external debt. This is a complex area, and many aspects of it remain to be fully worked out. Directors have accepted that a judgmental approach to assessing overall progress in this area will be needed, and they have pointed to a number of factors and considerations that would be relevant to this criterion. For a member to be judged to have constructive relations with private creditors, for example, it would seem essential that the member not have external payments arrears on sovereign debt, nor on private debt as a result of exchange controls. In examining a member's request under the CCL, the Executive Board would take account of market assessments of the country's situation . In addition, a member should have in place, or demonstrate that it is making credible efforts toward putting in place, appropriate arrangements to involve the private sector. These might include, by way of example, (I) contingent private credit lines or similar arrangements, (ii) call options in debt instruments, which would permit the debtor to extend their maturity, (iii) terms and conditions in recent and forthcoming bond contracts that include provision for the adjustment of terms by qualified majorities, collective representation provisions, and sharing clauses, (iv) as they are developed, other debt instruments designed to provide efficient and appropriate insurance against shocks, (v) a framework for debtor-creditor discussions, (vi) effective debt management procedures, and (vii) strong domestic bankruptcy regimes. It has to be recognized that most of these arrangements are not yet in general use, and we will need both to evaluate what countries have achieved in this area relative to changing practices, and be prepared to learn from experience. As experience is gained and instruments are developed, this checklist will need to be adapted and, as in the area of standards, we could consider whether it would be possible to define more concretely a critical mass of steps that should be expected. It would be appropriate to consider all these issues in the context of the review of the CCL.

In assessing the member's external vulnerability and the management of its external debt profile, the Board will take into account a range of factors or "sustainability checks" including, inter alia, the evolution of the real exchange rate (to establish that this has not moved to an unsustainable level), the level and composition (currency denomination and maturity profile) of public debt (including with reference to derivatives, and with consideration of creditors' put options), the level and composition of external debt (including with reference to derivatives, and with consideration of creditors' put options), the level of gross and net international reserves, the share of short term external debt unmatched by private contingent credit lines or reserves, the net foreign asset position of commercial banks, and the evolution of domestic credit in relation to GDP. To assist the Board's assessment in this respect, the staff and the authorities should work to provide quantified "stress simulations" which will aim to take into account both potential outflows and secured inflows in the event of a crisis. The policies the member has implemented with a view to limiting vulnerability would also be taken into account. The appropriateness of the exchange rate regime will be important in this respect, but other factors will also be relevant, such as the degree to which the member has avoided bias (for instance, in its regulatory and tax system) in favor of short-term borrowing and the existence of a system to monitor private external liabilities.

The final criterion requires that a member should submit for the Board's approval "a satisfactory economic and financial program, including a quantified framework, which the member stands ready to adjust as needed". As is customary in support of a request for access to IMF resources, the member would present to the Board a description of its planned economic policies for the period for which access to CCL resources is approved, including a quantified framework that will guide its macroeconomic policies, and the structural policies it intends to implement. There would be a strong presumption that this statement of policies would be released to the public. Such policies would be expected to be of sufficient quality and strength that they would meet the standards required of drawings in the upper credit tranches. The quantified framework should be specified in such a way that the staff and the Board would be able to form a rapid assessment of the member's compliance with it and thereby facilitate the rapid release of resources upon the request for activation of the CCL. While this would not necessarily involve monthly benchmarks, it would involve regular and timely provision of relevant data to the staff and continuous monitoring by the staff of the country's economic situation.

I turn now to the subject of access. While there is no general access limit, it is accepted that, unless warranted by exceptional circumstances and while paying due regard to the liquidity position of the IMF, commitments under the CCL would be expected to be in a range of 300-500 percent of quota. Access policy under the CCL would be an important part of the focus of the review of the CCL, scheduled for one year from its inception.

In its consideration of a member's request for a commitment of the IMF's resources under the CCL, the Executive Board will also consider the potential impact on the IMF's liquidity position and on the level of the IMF's usable and potentially available resources over the period of the requested commitment. The Executive Board will monitor the IMF's liquidity position on a continuing basis paying particular regard to the possible evolution of commitments under the CCL as well as under the IMF's other facilities. The Executive Board will also consider in the light of experience the appropriate method to assess the impact of CCL commitments and possible purchases on the IMF's liquidity position.

CCL resources would be committed under a stand-by arrangement.[3] In accordance with the principles on access under arrangements, upon Board approval of an arrangement establishing a contingent credit line, a small purchase of credit tranche resources (typically 5 percent of quota) would be immediately available. Beyond this, activation of the credit line will required a Board review. This approach would also be applied if CCL resources are committed in the context of an existing arrangement (namely an arrangement that the member treats as precautionary).

A member for which a CCL has been approved may, at any time, request access to CCL resources, which would require a special "activation" review by the Board. The Board would expeditiously complete this review, and make available the associated purchase, if it were satisfied that: (I) the member is experiencing exceptional balance of payments difficulties due to a large short-term financing need resulting from a sudden and disruptive loss of market confidence reflected in pressure on the capital account and the member's reserves, (ii) these difficulties are judged to be largely beyond the member's control and to be primarily from adverse developments in international capital markets consequent upon developments in one or several other countries, (iii) up to the time of the crisis, the member has successfully implemented the economic program that it had presented to the Board as a basis for its access to CCL resources, and (iv) the member is committed to adjusting policies to deal with any real economic impact that may follow from contagion. The monitoring arrangements already in place would allow this review to be completed rapidly. At the time of the activation review, the Board would decide on the amount to be released immediately and on the phasing of the remaining amount through the remainder, or extension, of the arrangement, as well as on the related conditionality.

Upon approval of the arrangement committing CCL resources, the Board will schedule a mid-term review to be completed by a specified date if the activation review is not completed before this date. After this date has passed, the mid-term review will need to be completed before a purchase associated with the activation review can be released. At the mid-term review, the Board would satisfy itself that the member was successfully implementing the economic program earlier presented to the Board and had adjusted that program appropriately in response to any changes in circumstances.

The introduction of the CCL is an important initiative for the IMF. It involves several aspects that are new or still under development, and we will need to approach it experimentally, with a view to learning and, if necessary, adapting it. In any case, we will have a full review in a year's time.

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[3]However, CCL resources could also be committed under an extended arrangement in effect at the time this decision is adopted.