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INTERNATIONAL MONETARY FUND

Minutes of Executive Board Meeting 08/36-1

11:00 a.m., April 28, 2008

1. Review of the Fund's Income Position for FY2008 and FY2009

Documents: EBS/08/45

Staff: Kuhn, FIN

Length: 39 minutes

Executive Board Attendance

T. Kato, Acting Chair

Executive Directors	Alternate Executive Directors
	J. Sulemane (AE), Temporary
L. Rutayisire (AF)	
	C. Pereyra (AG), Temporary
	W. Mañalac (AU)
	J. Prader (BE)
	O. Demirkol (BE), Temporary
	H. Mori (BR), Temporary
	J. He (CC)
	A. Guerra (CE), Temporary
	P. Jenkins (CO), Temporary
	B. Claveranne (FF)
	A. Rieck (GR), Temporary
	S. Krishnan (IN), Temporary
A. Sadun (IT)	
D. Kotegawa (JA)	
	S. Rouai (MD), Temporary
A.S. Shaalan (MI)	
A. Bakker (NE)	
	J. Bergo (NO)
	A. Lushin (RU)
	A. Al Nassar (SA)
P. Warjiyo (ST)	C. Sucharitakul (ST)
	R. Weber (SZ), Temporary
M. Lundsager (UA)	
	J. Larsen (UK)

B. Esdar, Acting Secretary
O. Vongthieres/S. Maxwell Assistants

Also Present
African Department: C. Delechat. Asia and Pacific Department: L. Valdivieso. External Relations Department: C. Lotze. Fiscal Affairs Department: R. Hemming. Finance Department: D. Andrews, C. Beaumont, S. Fennell, H. Hatanpaa, C. Hemus, M. Kuhn, J. Mburu, Y. Metzgen, A. Ndiaye, D. Ordoobadi, R. Price, M. Rossi, S. Sahay, M. Savastano, A. Trana, N. Velikova, B. Yuen. Human Resources Department: C. McDonald. Legal Department: G. Rosenberg, B. Steinki, R. Weeks-Brown. Middle East and Central Asian Department: L. Perez. Office of Budget and Planning: J. Green. Office of Internal Audit and Inspection: B. Keuppens. Office of the Managing Director: P. Gerson. Policy Development and Review Department: M. Fisher, C. Gust, R. Kincaid, A. MacArthur. Research Department: E. Borensztein. Secretary's Department: P. Gotur, M. Yslas. Technology and General Services Department: J. Johnson. Western Hemisphere Department: P. Druck,

A. Santos. Senior Advisors to Executive Directors: G. Cipollone (IT), M. Kaplan (UA), D. Kihara (JA), N. Raman (ST), N. Riad (Mi), P. Weber (FF). Advisors to Executive Directors: S. Duggan (AU), N. Imamura (JA), T. Kudiwu (AF), H. Malothra (BE), C. Mira (CE), K. Mogensen (NO), H. Ou (CC), T. Rookmaaker (NE).

1. REVIEW OF THE FUND'S INCOME POSITION FOR FY2008 AND FY2009

Mr. von Stenglin and Ms. Rieck submitted the following statement:

We thank the staff for the concise paper. It is reassuring, at first glance, that the FY2008 net operational income is expected to turn out more positive than estimated some months ago. Even with the restructuring costs taken into account, the overall income position is somewhat better than last year. Still, this is not a sustainable financial basis for the Fund in the longer run. We therefore hope that the new income model can be made operational very soon in order to avoid continued structural income shortfalls as occurred in recent years. The medium-term income outlook hinges critically on the early implementation of the agreed package.

We can support the proposed decisions and would like to make the following additional comments.

The transfer of FY2008 investment income of the Investment Account to the GRA is appropriate as this will protect the reserves from being eroded even further. More generally, we underscore the importance for the Fund to have sufficient precautionary balances.

As already indicated in the Board meeting in March, we can go along with a rate of charge of 100 basis points over the SDR interest rate. However, since the Fund's financial situation is likely to remain tight, we do not see any room for further reductions in the margin in the short to medium term. Having said that, we would have no problem with keeping the margin at its current level of 108 basis points in case the necessary majority for setting the rate of charge at the level proposed by staff cannot be reached at this stage.

Mr. Shaalan submitted the following statement:

We thank staff for a clear and concise paper on the Fund's FY2008 income position and outlook for FY2009. We agree with the proposed decisions 1-3 pertaining to FY2008 which are largely based on previous Board decisions, as illustrated in Box 1. We can also go along with the proposed decisions 3-5 regarding FY2009 as they broadly reflect the Board's understandings and decisions concerning some of the key assumptions underlying the projections. We would like to emphasize the following points:

The paper's view that the impact of the restructuring costs on the FY2008 income position be determined by the Fund's accounting framework, namely International Financial Reporting Standards (IFRS), is appropriate. We note staff's interpretation that the decisions and actions taken by Management and the Board regarding the separation of 300 staff are sufficient to meet the criterion of "demonstrably committed" to the termination process. We are reassured by the staff's statement that "a final determination on this interpretation will be made in May at the time of the annual external audit." This verification is quite important in order to demonstrate full transparency regarding the accounting for restructuring costs. We also note that the restructuring figures in Tables 1 and 2 are notional. Would staff have an update in light of recent information on voluntary separations?

During the Board discussion in March on the setting of the basic rate of charge, we expressed the view that the underpinnings of the staff's proposal to set the initial margin of 100 basis points, needed to be further refined. We remain of the same view. However, we also recognize that we need to move forward on this issue, and could therefore support the proposed margin of 100 basis point margin at the present time, as an initial step in implementing the new income model. In making this decision, we take into account the broad support for the proposed margin received during the March Board discussion.

Similarly, we had expressed doubts that the existing burden sharing mechanism was consistent with the principles of the new income model, and were among those who had called for its immediate review during the above-mentioned Board discussion. Moreover, and in order to relieve the pressure on the rate of charge, we had also supported consideration of a modification to the Fund's de-escalation policy for members with overdue obligations. We note staff's proposal in this paper that no changes be made to the burden sharing mechanism at the present time, but are reassured that they would keep the issue under close review and revisit it once the remaining elements of the new income model are in place. On that basis, we can agree with the proposed decision.

Staff's assumption that the income related to the decisions to sell gold and expand the investment authority will not start accruing until FY2010, is reasonable in our view and we can support it.

Mrs. Mañalac and Mr. Duggan submitted the following statement:

We thank staff for their paper, including the explanations provided in Box 2 and Box 3 of how the Fund's restructuring costs have been accounted for under International Financial Reporting Standards.

We note that the Fund is projected to record a net income deficit of around SDR 55 million in FY2008, as net operational income of SDR 2 million is more than offset by SDR 57 million in accrued costs associated with the Fund's restructuring. The small net operational income surplus now projected for FY2008 is a welcome surprise and a significant improvement from the FY2007 outturn. However, the large revision since the midyear review also demonstrates the sensitivity of the Fund's financial bottom line to developments in international capital markets. This underscores the importance of timely implementation of agreed income and expenditure measures to place the Fund's finances on a solid, sustainable footing.

We support each of the proposed decisions relating to FY2008 income, specifically:

- Transferring investment income for FY2008 to the General Resources Account (GRA), reducing the call on the Fund's reserves and consistent with the purpose of the Investment Account;

- Reimbursing the GRA for the expenses of conducting the business of the SDR Department and administering SDA resources in the MDRI-I Trust, in line with recent practice and again reducing the call on Fund reserves in FY2008;

- Setting the rate of charge on the use of Fund resources for FY2009 at 100 basis points over the SDR rate. At the Executive Board Meeting on March 12, we indicated our support for the Crockett Committee's recommendation that the basic rate of charge be set as a margin over the SDR interest rate to cover the Fund's intermediation costs and finance a modest build-up of reserves. We also agreed that long-term credit market conditions could provide a useful cross-check to ensure that the Fund does not price itself out of the market (adjusting for conditionality and the Fund's preferred creditor status) and to discourage prolonged reliance on Fund financing. This framework implies a degree of judgment and in this context we can go along with staff's proposal to reduce the basic rate of charge to 100 basis points for FY2009, sufficient to cover the Fund's estimated costs of intermediation (equivalent to around 67 basis points) and financing a very modest accumulation of reserves (less that ½ a percentage point) at a time when the Fund's financial position remains precarious. At the same time, we join other chairs in reiterating that future decisions on the basic rate of charge should be informed by an agreed reserves accumulation policy and greater detail on the Fund's costs of intermediation. Along with a dividend policy, we consider establishment of an agreed reserves accumulation policy one of the key objectives of the upcoming review of the Fund's precautionary balances; and

- Maintaining the existing system of levying special charges. We are happy to complete the annual review of special charges—applicable to overdue obligations to the GRA, the Structural Adjustment Facility and the Trust Fund—noting that no changes are proposed to the current system.

On burden sharing, while we agree that there is no immediate need to modify the existing arrangement, we remain open to discussing alternative allocation keys that address equity concerns arising from the decline in the number of GRA borrowing countries. We also look forward to discussing a possible modification of the de-escalation policy to make remaining current on new obligations falling due a firm test of cooperation with the Fund, encouraging members to settle current obligations as they arise and thereby reducing the financial impact of burden sharing for both GRA debtors and FTP members.

Finally, we reiterate our call for the Review of Charges and Maturities—now almost 3 years overdue—to be conducted prior to the 2008 Annual Meetings, providing a holistic basis on which to evaluate the cost structure of (and incentives attached to) IMF financing instruments.

Mr. Warjiyo and Mr. Raman submitted the following statement:

We thank staff for a helpful update of the current income position for FY2008 and outlook for FY2009. For the record, we can support all five decisions contained in the paper.

Nevertheless, we remain cautious on Decision 4, namely to set the rate of charge on the use of Fund resources at 100 basis points over the SDR rate. At the time of the March Board meeting on the matter, we were not fully convinced by the cost accounting for lending activities for setting the rate as proposed, the treatment of reserves accumulated by the various revenue activities in the Fund, and the level of cross-subsidization implicit in the proposal. Nevertheless, we indicated then that we were prepared to go along with staff's proposal, and this still remains our position. We expect that the rate of charge will need to be looked at again in the context of a comprehensive review of the entire system of charges and maturities, and within the context of the Fund's reserve accumulation policy going forward. We are pleased to note that this remains on staff and management's radar and again join other chairs who have asked for this matter to be brought before the Board before the Annual Meetings.

Turning to burden sharing, we were disappointed not to see a clearer commitment for a review of the system. Notwithstanding the status of discussions in March, burden-sharing as it stands is not sustainable, given its overwhelming dependence on charges paid by very few members, which has led to the suspension to SCA-1 accumulations since the last fiscal year. In the event our last remaining large borrower were to substantially downgrade their financial arrangements with the Fund, we would need to look again at the entire mechanism in order to avoid putting undue pressure on the remaining borrowers. In such a context, staff's proposal to "…revisit this issue once the remaining elements of the new income model are in place" seems curiously complacent. Given that it could take another year before we can effect actual gold sales, is it staff's proposal to launch a review only when all the elements of the new income model are in place? We would appreciate staff's clarification. Our own preference is for a review that takes place sooner rather than later, given the inequity of the system and the very real risk it would not be sustainable over even the near term, and certainly not to wait for anywhere between two to four years until a new income model is in place.

Like Mr. von Stenglin and Ms. Rieck, we welcome the better-than-expected financial position of the Fund. However, we agree with them that this positive development is not likely to be sustained, given the one-off nature of many of the improvements. Therefore, there is no reason to be complacent in implementing the new income model, which should be done as expeditiously as possible. Against this background, we are surprised by the 47 percent drop-off in investment income projected for FY2009, due mainly to a nearly 300-basis point reduction in the rate of return on investments. While we note that the income for FY2008 was higher-than-expected, reflecting a number of one-off factors, the magnitude of the decline seems excessive. First, we expect that at least during some part of FY2009, the broadened investment mandate should come into force. Have staff factored in a potentially higher rate of return arising from the adoption of the expanded investment mandate? Second, we note that a large part of the gains in FY2008 was due to capital gains from rising bond prices as interest rates in a number of countries have come down. Are staff now expecting rates to rise in the major advanced countries in FY2009, thereby unwinding the earlier gains? Is such a view consistent with that contained in the recent WEO?

Mr. Larsen and Ms. Farrant submitted the following statement:

We agree with Decisions 1, 2 and 3.

On Decision 4 covering the basic rate of charge, as we stated at the meeting in March, we consider that further work needs to be conducted before there is merit in changing the rate of charge from its current level of 108bps. The Crockett Report recommended that 'the rate of charge should cover both the costs of intermediation and the accumulation of reserves which are needed to mitigate the effects of credit losses for GRA activities.'

The work carried out by staff that generated the 100bps number remains incomplete because the analysis on the role and adequacy of reserves—crucial to estimating the required margin—has not been completed, and the Board has not come to a final view.

We also note the strong emphasis in the Crockett report and in our discussions that the various elements of the new income model constitute a package. Our implementation should reflect that.

We note from the staff report that the margin can be changed and a new rule can be adopted during the course of FY09. We expect that the required work will be completed ahead of the Annual Meetings and that a new decision can be taken soon. In the meantime, it makes sense to retain the current margin of 108 bps.

While we can agree to Decision 5, we would argue that a review of surcharges also needs to be carried out and that this should be included as part of the Fund's work on the basic rate of charge and precautionary balances, given that these are all linked.

Staff suggest that the burden-sharing arrangements should be revisited once remaining elements of the new income model are in place. But in reality, the burden-sharing mechanism should be an integrated part of the lending model that is transparent and rules based. So such analysis should be conducted in parallel to the other work being conducted on the income model for the Fund's lending activity.

Finally, we note that the IMFC in its Spring Meeting Communiqué requested the Board to complete the work on the income model by the time of the Annual Meetings.

Mr. Bergo and Ms. Mogensen submitted the following statement:

We welcome the improved outlook for the Fund's income position for the financial year 2008. This is particularly welcome while we are awaiting the necessary steps to move forward with implementing the new income model—steps still urgently needed as the medium-term financial outlook remains bleak. The much stronger performance of the Investment Account than previously projected reflects short term fluctuations in investment income, rather than an improved income situation as such.

We are ready to support the proposed decisions with the following remark. We can support a margin of 100 basis points or somewhat more. However, we underline the need for further reflections on how an appropriate reserve accumulation policy can be reflected in the margin in a simple and transparent manner. As we expressed in the initial discussions on this issue in March, it is not evident to us what the underlying reserve accumulation policy is behind the suggested margin of 100 basis points.

Mr. Sadun and Mr. Cipollone submitted the following statement:

We thank staff for the update on the net income position, which shows a balanced budget for FY2008, excluding the appropriation for financing restructuring costs. In FY2008, the higher-than-projected investment income has been the main contributor to the achievement of this objective. However, for FY2009 and onwards the Fund's budget deficit will sharply widen despite the assumed resumption of the administrative costs of the PRGF-ESF expenses.

Although the full impact of the new income model, fully supported by the IMFC in its last communiqué, will not be in place before FY2010, it is already clear that reaching a balanced budget strongly hinges on the investment income, which is very volatile. Therefore, further work on the possible use of members' quota position should remain high on our agenda, as pointed out by several chairs in the Board meeting on the Report on the new income and expenditure framework.[1]

[1] IMFC/Doc/17/08/7

With regard to the decision No.4, we are reluctant to support a reduction of the rate of charge from the current 108 to 100 basis points for a number of reasons.

First, further work is needed to identify the role of reserves and the reserve accumulation policy, to be designed to cover credit risks of the Fund. Together with the intermediation cost, it will play a crucial role in quantifying the rate of charge. Second, the reduction of the rate of charge from 108 to 100 basis points will contribute to further increase the Fund's FY2009 budget deficit by SDR 6 million according to the staff forecast.

Against this background, we would favor a postponement of the decision on the rate of charge until the above-mentioned reviews have been completed and the new elements of the new income model, namely the gold sale and the expansion of the Fund's investment authority, are in place.

Finally, we support Decisions No. 1, 2, 3 and 5.

Mr. Torres and Mr. Pereyra submitted the following statement:

We can support the proposed decisions pertaining to FY2008 and FY2009, which generally reflect previous discussions—especially on the new income model. We would just like to emphasize our position on certain specific aspects.

As during the March 12 discussion, we agree with the proposed rate of charge, i.e., 100 basis points over the SDR rate, which would be broadly consistent with the principles suggested by the Crockett Committee—cover the Fund's intermediation costs and allow a modest amount of reserve accumulation. However, we stress that more work needs to be done—for instance to link the rate of charge more clearly with actual market conditions—in the context of a comprehensive review of the system of charges and maturities.

Additionally, like other Directors, we continue to believe that the burden-sharing mechanism for deferred charges needs to be reviewed to address sustainability and equity issues. We should not take comfort in the fact that there is no immediate need to modify the mechanism. Instead, we should be consistent with our advice to member countries that they should take corrective action before it is inevitable—and costly—to do so. While it is a welcome development that recent arrears clearance operations would restore burden-sharing for deferred charges to historical levels, the staff has highlighted that the impact of credit concentration on the remaining debtors would still be a concern. Thus, the current system is unsustainable and we continue to see merit in exploring an alternative criterion for burden-sharing through a distribution key based on the distribution of the total burden on the aggregate quotas of debtors and creditors. We share Mr. Warjiyo's and Mr. Raman's frustration in this respect and we would like their request for a review to take place "sooner rather than later." We would appreciate clarification on what Management's plans are in this respect.

Ms. Lundsager and Mr. Kaplan submitted the following statement:

Of the three principles for setting the basic rate of charge listed in paragraph 17 of the staff report, we put the most stress on broadly aligning the basic rate of charge with long-term credit market conditions. We note the technical difficulties with assessing an adequate benchmark for such market conditions, in particular, given the prohibition in the Articles against charging a given borrower based on an assessment of its creditworthiness. We recall that, not so many years ago when market conditions for emerging markets were less benign, debate centered on whether certain borrowers were benefiting from an inappropriate subsidy on their non-market financing sources, including from the Fund.

For this reason, we associate ourselves with the perspective of Mr. von Stenglin and Ms. Rieck that the proposal for a 100 basis points rate of charge is acceptable, but that we do not see room for further reductions in the margin in the short to medium term. As we believe that a higher basic rate of charge can be justified, we would have no problem with keeping the margin at its current level of 108 basis points if the requisite majority cannot be mustered for the staff proposal.

At the time that the Investment Account was established, it was thought that the higher return earned by the IA would allow for a speedier increase to the required level of precautionary balances. We concur with the staff, however, that the main objective of the IA has become to generate additional income to meet the Fund's expenditure needs. We support transferring the full amount of the IA income to the GRA.

We agree to charge the Fund's operational deficit against the Special Reserve, once the exact income shortfall is established.

We agree to continue burden-sharing. We also support prompt Board consideration of a modification to the Fund's de-escalation policy for members with overdue obligations, which has the potential to ease pressure on the rate of charge, and to provide the many members of the Financial Transactions Plans with a higher return on their reserve tranche positions.

Looking ahead, the Board will consider a range of income related issues over the next six months, including surcharges, a possible increase in the volume of lending that could be made available before surcharges are imposed, and the adequacy of precautionary balances. These issues clearly are an integrated package. We look forward to swift conclusion of discussions in a manner that will safeguard the financial integrity of the Fund.

Mr. Moser and Mr. Weber submitted the following statement:

We have taken note of the fact that the net operational income in FY2008 has significantly exceeded the projections and even turned out to be positive. However, we consider this improvement as largely transitory since it is driven by exceptionally favorable returns from the investment account and Liberia's arrears clearance. The outcome also looks much less favorable if the restructuring costs (to be covered with Fund's Special Reserve) are accounted for. We remain concerned about the trend deterioration of the Fund's operational income and consider it a priority to preserve what income there is today until additional income will be generated from the new income model. We therefore support decisions 1, 2(i) and 2(ii), 3, and 5. On decision 4 that proposes the lowering of the margin of the rate of charge, we favor maintaining the margin at 108 percent.

Given the ongoing financing reform and pending implementation of the new income model, the level of uncertainty on the Fund's income will remain high. As the new income model takes shape, we propose that this review in the future includes a medium-term outlook and takes place simultaneously with the discussion on the budget. This would be consistent with moving towards an integrated income-expenditure framework. We have the following additional comments with regard to the medium-term outlook for the income position and the further work program.

The measures proposed in the context of this review represent marginal adjustments in relation to the broader problem of generating sufficient income to close the widening financing gap, even given the "downpayment" of notable expenditure cuts. It is therefore essential that the measures agreed in the Governor's Resolution on a new income model be implemented rapidly. We have taken note that staff assumes the decision on gold sales to be adopted in FY2009. This decision is key and we encourage a strong political effort to achieve the necessary voting threshold in the Board within this time frame.

Under the new income model—and as agreed by the Board—the basic rate of charge will no longer be determined as a function of the income target. In the absence of such a link and without an agreed method for setting the margin for the rate of charge, we continue to believe that maintaining this rate at its current level of 108 basis points above the SDR rate in FY2009 would be reasonable, and on the safe side. We consider it particularly important to agree on amore robust and transparent way for setting the margin. We would want to revisit this question in the context of reviewing policies on reserves, on charges and maturities, as well as on the functioning of the burden sharing mechanism. Under the new income framework, this review seems no longer to be the appropriate place to decide on the level of the rate of charge. Durable solutions on these issues should be found before the new income model will be implemented, i.e., within the next fiscal year.

We agree with the staff's position not to modify the burden sharing at this point in time. Nevertheless, we ask staff to propose ways on how a burden sharing could be designed that would have all members contributing equitably. Transparency would be served with a snapshot of burden sharing flow data for FY2008 and projected for FY2009, rather than cumulative data, and we ask staff to provide the Board with such a table.

Mr. Fayolle submitted the following statement:

We thank staff for their informative report.

- Higher investment income, increased expenditure discipline helped by a supportive evolution in the USD/SDR exchange rate, and one-off gain from arrears clearance should result in a substantially better-than-expected net operational income for the current fiscal year. This welcome outcome is without prejudice to the necessity to move expeditiously toward a reformed financial model for the Fund. We hope that an early implementation of the agreed package of reforms will be possible, including the sale of part of the gold stock.

- We support decisions 1, 2, 3, and 5.

- On decision 4, we note that staff proposes to set the margin over the SDR interest rate at 100 basis points. We also note that the revision of the mechanism for setting the rate of charge is still pending. While the Board had a first discussion on a possible revision of the current mechanism in March, more work is needed, including on the reserve accumulation policy that would accompany the new mechanism. At that time, the calculation by staff of a 100 basis points margin was subject to questions, which will need to be addressed as work proceeds. As staff acknowledges, there is a case for adjusting the margin only when the reformed financial model is implemented. Against this backdrop, we could go along with staff's proposals to set the margin at 100 basis points, provided that work towards a new mechanism will be completed expeditiously.

- On the burden-sharing mechanism, we support the comments by Mr. Larsen and Ms. Farrant.

Mr. Kiekens and Mr. Demirkol submitted the following statement:

During the March 12 Board discussion, we had urged the Board to consider the fairness and sustainability of the present levels of the rate of charge, surcharges and the burden sharing mechanism. The staff paper for today's Board meeting underscores our points once again. While we support the proposed decisions, we would like to emphasize that it is not fair to ask borrowing countries to continue to bear a disproportionate part of the Fund's expenditures until the new income model is fully adopted. In this context, we would reiterate the views which we have previously expressed with regard to the income framework.

We consider the proposed reduction in the margin over the SDR rate, which form together the rate of charge, to be only an initial and an inadequate step, although in the right direction. The assumptions underlying the proposed margin of 100 basis points, as also requested by Mr. Shaalan, should be refined. A comprehensive cost accounting system is necessary for all Fund transactions. We remain unconvinced that intermediation cost of less than ten arrangements for access to the GRA is substantially higher than the cost of administering the PRGF Trust with more than twenty arrangements.

We support the proposed amounts of expenses paid by the GRA for conducting the business of the SDR Department and the MDRI-I Trust, to be reimbursed by the SDR Department and by the MDRI Trust. The staff has incorporated in their projections, reimbursement of the GRA for the cost of administering the PRGF-ESF Trust, assuming that the Board will decide in

FY 09 to sell gold. This reimbursement would reduce the net amount of Fund's expenditures, financed from the GRA and will be a concrete step towards ending the cross subsidization of Fund activities.

Like many other Directors, we call for an urgent review of the burden sharing mechanism. We welcome the recent arrears clearance and its positive impact on the burden sharing adjustments. The clearance of some arrears has provided relief on burden sharing for both creditor and debtor countries in the Fund. However, this does not address the intrinsic flaws in the mechanism, resulting from an allocation of 50 percent of the burden to borrowers which may, at times, only be very few and represent only a marginal fraction of total quotas, while the countries included in the financial transactions plan, and representing more than 80 percent of total quotas, also only share the same burden of 50 percent. We believe that this is not an issue that can wait until all the remaining elements of the new income model are put in place. In the meantime, the Board should urgently consider the proposals for modifications to the Fund's de-escalation policy for members with overdue obligations.

As called for in the IMFC Communiqué, the Board should also promptly undertake the long overdue review of charges and maturities, the review of the role and adequacy of precautionary balances and consider increasing the normal level of access to the Fund resources. Management should soon schedule a series of Board meetings so that all these issues can be discussed as a package.

Mr. Al Nassar submitted the following statement:

I thank the staff for the well-written paper on the review of the Fund's income position for FY2008 and FY2009. I welcome the much better than expected projected outturn for the net operational income in FY2008. I am particularly encouraged by the strong performance of the Investment Account (IA) and the lower than envisaged expenditures. Nevertheless, due to restructuring costs, a net income shortfall is projected for FY2008. Also, a much higher net income shortfall is projected for FY2009. These developments underscore the importance of moving forward in a timely manner to implement the new income model.

On the disposition of FY2008 investment income, I endorse the staff's proposal to transfer the 2008 investment income from the IA to the GRA. I also support the plan to charge the actual income shortfall for FY2008 against the Special Reserve once the exact income shortfall is established. I also endorse proposed decisions 2 and 3 regarding the reimbursement to the GRA for the expenses of conducting the business of the SDR Department and the MDRI-I Trust.

Turning to the rate of charge for FY2009, I can go along with a margin of 100 basis points over the SDR interest rate. I also support staff's proposal to complete the review of the system of special charges.

Mr. Charleton and Mr. Jenkins submitted the following statement:

We thank the staff for a report that is both concise and informative. We welcome the upward revision of the projected financial outturn for FY2008, which reflects the better-than-expected performance of the Investment Account.

We approve the proposed Decisions: transferring investment income of the Investment Account to the GRA, reimbursing the General Department for the expenses of the SDR Department, through an assessment of participants in the SDR Department, reimbursement of the GRA for the costs of administering the MDRI-I Trust, and retaining the current structure of special charges.

We approve the reduction in the rate of charge to 100 basis points above the SDR interest rate—an amount that is approximately 50 percent higher than the estimated costs of intermediation and thus provides a modest contribution to reserves and/or other public goods provided by the IMF. Given the weakness in the IMF's financial position, and the uncertainty about the timing of, and eventual proceeds from, gold sales, we would not consider further near-term reductions to be appropriate. Indeed, like Mr. von Stenglin and Ms. Rieck, we could support keeping the margin at the present 108 basis points if the needed majority for the reduction to 100 basis points does not materialize.

Clearly, the Fund's long-run approach to setting the rate of charge will need to be determined in light of progress toward putting in place all elements of a new income model, and in tandem with work on reserves and dividends policies. We look forward to the opportunity to consider these issues in the context of a unified income and expenditure framework, with appropriate preparation through the Budget Committee.

Mr. He and Mr. Ou submitted the following statement:

We appreciate the opportunity to review the Fund's income position for FY2008 and FY2009, especially at the conjuncture of the forthcoming new income model. We support the staff proposals and wish to emphasize the following points.

Although the outcome of FY2008 is better than projected mainly due to the favorable change in market conditions and arrears clearance by Liberia, the pressure of the income gap has not abated. The new income model should be put in place as soon as possible. In particular, given the low level of Fund lending and the critical contribution of the investment revenue to the Fund's financial position, a decision on the gold sale should be adopted and implemented without delay.

The proposed 100 basis point of the rate charge margin for FY2009 is at best a reasonably balanced choice involving mechanical and judgment elements. We look forward to a full review of charges and maturities and precautionary balances.

Ms. Agudelo and Mr. Mori submitted the following statement:

We thank staff for the informative paper.

We support Decisions 1, 2, 3 and 5. On Decision 4, we feel that the proposed rate of charge of 100 basis points seems to be overestimated.

The Executive Board agreed that, under a New Income Model, the rate of charge should no longer cover the full range of Fund's activities, but rather should be set as a margin over the SDR interest rate to cover the Fund's intermediation costs and the buildup of reserves. The accumulation of reserves has in turn the objective of mitigating the effects of credit losses for GRA activities.

In the previous discussion on the issue, staff indicated that the margin of 100 basis points over the SDR interest rate would be sufficient to cover the Fund's average intermediation costs over the past three years and to allow a modest amount of reserve accumulation.

The proposed rate of charge was based on a given intermediation cost projected by staff. In a supplementary paper issued later on, however, the numbers were revised downward. This revision in the cost may suggest that the rate of charge could be somewhat lower than the one initially recommended by staff.

Annex II shows that reserves are projected at the level of SDR 5.8 billion, while the outstanding credit is SDR 5.9 billion for end-FY2008. Reserves are, hence, at levels sufficient to cover the outstanding credit, which leads us to the conclusion that there is no reason to accumulate reserves for credit risk motives.

Also, there has been so far no agreed methodology to assess the rate of charge to see whether it is in line with the rates observed in the long-term credit market. This other concept recommended by the Committee cannot be applied at this stage. Therefore, if two out of three criteria were applied, they would suggest that the rate of charge could be lower than 100 basis points. Yet, we can support the rate proposed by staff with the understanding that it would be a ceiling.

A reason to justify the proposed rate could then be to mitigate the reduction in reserves in the intermediary period before the New Model is fully implemented. The current income level without the addition resulting from the selling of gold may lead to more drawing of reserves to finance the Fund's expenditures. The objective of reserve accumulation is, hence, to address income risks. Such a practice continues to be unfair to a few number of borrowers, which have to cope with the burden of financing Fund's activities, a practice that the Crockett Committee intended to eliminate.

Therefore, for the full implementation of the New Model, there is a need to make a distinction between the income and credit risks of the Fund in the reserve accumulation policy. This is the way to separate the Fund's public good activities and its lending operations.

More work is necessary to refine the procedure with transparent and objective criteria to calculate the rate of charge. The work agenda has to address as well other equally important issues: the burden sharing mechanism, the review of charges and maturities and the increase in access policy, as well pointed out by Messrs. Kiekens and Demirkol.

Mr. Gakunu and Mr. Sulemane submitted the following statement:

We thank staff for the updated paper on the Fund's income position for FY2008 and 2009. We are encouraged by the good performance of the net operational income for FY2008, which shows a significant increase compared with the FY2007 outcome. We will make brief comments on few specific issues below:

The positive changes in the net operational income are significant and the Investment Account (IA) outturn is remarkable. The projected outcome on the investment income demonstrates the need for a reasonably aggressive investment policy and paying close attention to market developments. We note that the one-time income gain, related to arrears clearance by Liberia, had an impact on the income performance. Given this positive outcome, we urge that similar action be expedited on arrears' clearance for Sudan. Like other Directors, we agree with the proposal to transfer the IA income into the GRA.

Although it is commendable to note the achievement of lower capital and administrative expenditures in FY2008, we need to be assured that the planned activities are being accomplished without compromising quality.

We are prepared to support the maintenance of the current margin of 108 basis points as proposed and discussed in the Executive Board on April 7, 2008, if a consensus emerges in the Board. We are however, concerned that burden sharing would largely be in terms of charges on a handful of countries. An equitable burden sharing is necessary. A review of the modality in this respect is, therefore, considered as the appropriate step to take.

In general, we support the proposed decisions.

Mr. Bakker and Mr. Rookmaaker submitted the following statement:

We thank staff for a clear, concise paper. With regard to the income position, we generally welcome staff's approach, as it seems to be in line with IFRS.

The projected positive net operational income for FY2008 is welcome. At the same time, we realize that to a large extent the improvement merely reflects financial benefits resulting from the impact the current global financial turmoil has had on global government bond markets. Income has increased as a result of lower policy interest rates and a generally more cautious investment approach taken in the markets. Moreover, the US dollar depreciation has reduced operational costs in terms of SDR. The remarkably good performance of the Investment Account is related to the large share of investments in sovereign bonds, reflecting the currently limited investment mandate, which results in a large exposure to interest rate risk. The new, broader investment mandate of the Fund is not only expected to increase the average expected earnings over the medium term, but would also lead to a more diversified investment strategy.

The need to implement the new income model as soon as possible—as also highlighted by Mr. von Stenglin and Ms. Rieck—is even more pronounced in the projections for FY2009, as the projected net operational shortfall is large. In this light, we wonder whether staff would perhaps see any possibilities to speed up the amendment of the investment mandate. While we acknowledge that changing the Articles of Agreement takes time, we would like to ask staff's views on the possibilities to introduce the new investment mandate before FY2010. With regard to the FY2009 administration costs of the PRGF-ESF Trust, we believe that the estimated SDR 43 million seems to be on the high side. Hence, we would welcome a detailed break-down of this amount into the different costs. Staff comments are appreciated.

We support the use of surcharge income to finance administrative costs, as well as the proposed Decisions 1, 2, 3 and 5. On the proposed decision 4 we would, at this stage, prefer an unchanged margin for the rate of charge of 108 basis points, but we are willing to go along with the consensus. As pointed out by Mr. Larsen and Ms. Farrant, as well as Mr. Sadun and Mr. Cipollone and others, it seems premature to lower this margin before further work has been done on the role and accumulation policy of the Fund's reserves. For several years this chair has been advocating further work in this regard. From a more pragmatic point of view, keeping the rate of charge unchanged would, moreover, cause the income shortfall for FY2009 to be reduced by SDR 6 million.

Mr. Kotegawa and Mr. Imamura submitted the following statement:

We view the proposed Decisions 1, 2, 3 and 5 as appropriate.

Under the current circumstance that calls for an early agreement on a new mechanism for setting the rate of charge under the new income model, the rate of charge for FY2009 should be regarded as a transitional one and it is desirable that we maintain the margin of 108 basis points. Having said that, in view of avoiding unwarranted delays in the decision-making on this issue, we are prepared to go along with a reduction of 100 basis points should a broad consensus moves in such direction. We stress that the decision on the rate of charge today is transitional and that the Board discussion should take place at an earlier stage during FY2009.

Mr. Rutayisire submitted the following statement:

We thank staff for providing us with a comprehensive paper on the review of the Fund's income position for FY2008 and FY2009, which also takes into account the recent constructive discussions on the new income model for the Fund.

With regard to the Fund's income position in FY2008, it is encouraging to note that the net operational income is showing a significant improvement, compared with initial projections. We welcome this positive development, which stems from the strong performance of the Investment Account (IA), a one time income gain linked to Liberia's arrears clearance in mid-March 2008 and lower expenditures. Moreover, the results shown in Table 1 regarding the overall income are encouraging, even with the inclusion of restructuring costs. On the latter, we would appreciate an update from staff in light of recent information on voluntary separations, as well as on implications that this might have on the budget.

However, we see merit on the importance of ensuring a stable and durable income base that would permit the Fund fulfill its mandate in an efficient and predictable manner. In this regard, we are hopeful that the remaining elements of the new income model will be put in place as soon as possible.

On the burden sharing mechanism, we would like to reiterate our position that since it has been an important tool in protecting the Fund's income position, the mechanism should be maintained and kept unchanged. At the same time, we also see merit on staff keeping closer review of the mechanism, including the development in Fund credit outstanding.

Concerning the proposed decisions, our position is as follows:

We support Decision No.1 regarding the transfer of investment account to the General reserves Account, so as to meet expenses of conducting the business of the Fund during FY2008. We also support Decision No.2 on the assessment in the SDR Department, in order to reimburse the General Department for the expenses of conducting business of the SDR Department.

On Decision No.3, we can go along with the proposed decision on the reimbursement of the expenses of administering the MDR-I Trust. Moreover, we find the proposed SDR 2.3 million to be a reasonable estimate, which is consistent to the amount retained in FY2007.

Regarding Decision No.4, the staff recently proposed to the Board that, providing subsidized lending to low-income countries was no longer sustainable at the current moment when the Fund was facing a tight income position. Today, a proposal is being presented to the Board that the Fund should provide price subsidy to high income country borrowings. This chair cannot support this proposal, as it fails a social justice test. Moreover, at a time when interest rates on financial markets are very low, it is also not recommendable, in our view, that the Fund should be engaged in rate cutting competition with financial markets. Margins should fully cover the cost of the Fund's activity and the existing margin of 108 basis points should be maintained.

Finally, we support Decision No.5 on the review of the system of special charges and agree that no changes should be proposed to the current system at this time.

Mr. Kishore and Mr. Krishnan submitted the following statement:

We are in a position to support all the five proposed decisions in the staff paper. We would like to make the following observations:

Firstly, although in FY2008 a small positive net operational income is expected, this is primarily on account of fortuitous circumstances. Hence, there is still considerable urgency to ensure that the elements of the new Income model which have already been agreed upon are implemented at the earliest.

Secondly, on the issue of rate of charge and the proposed margin of 100 basis points, we reiterate our earlier views at the time of the discussion on the review of the rates of charge and maturities on March 12 that we are not convinced that this is a rate which has emerged out of a scientific analysis of the costs of intermediation and the requirements of reserve accumulation for the reasons stated in the preceding paragraphs, we are willing to support the decision as an interim measure, subject to a more detailed review.

Third, on the issue of burden sharing, we join many other Directors in calling for an early review of this mechanism and to resolve possible overlaps with the reserves accumulation policy.

Mr. Guzmán and Mr. Guerra submitted the following statement:

We believe that the expected outturn of the net operational income for FY2008 can serve as a reminder of how volatile the Fund's financial position is. Although the results are better than expected, we can be certain that negative outturns could happen in the near future. Given the uncertainties surrounding the global economy and the fact that we are in the middle of the restructuring process, all budget estimates and related decisions have to be assessed with caution. The staff analysis also reminded us of the current sensitivity of the Fund's income position to market developments, in particular to changes in interest and exchange rates.

In this context, the recent steps taken to put the income position on a sustainable basis gain more relevance but they must not be taken for granted. As other Directors, we call for a rapid implementation of the proposed measures.

We can support all the proposed decisions. Nevertheless, regarding decision 4 we ask staff for an update on how the intermediation costs have evolved during FY2008 and about projections for FY2009. As other Directors, we think that there are reasons to believe that these costs have continued to decrease and that a margin of 100 basis points should be regarded as a ceiling. Nonetheless, we must not forget, as recommended by the Crockett Committee, that one of the main objectives of the income reform was to separate our rate of charge policies from the results of the income position, and we still need to agree on a transparent methodology for setting the charges that takes into account long-term market conditions.

Finally, we also agree with staff not to modify the burden sharing mechanism at this point but we reiterate our call to revisit this issue very soon. Along with other data requested by Directors, we ask staff to keep providing data on cumulative burden sharing by members and we expect that this information continues to support our discussions on the burden sharing rules.

Mr. Rouai made the following statement:

We thank the staff for a comprehensive paper on the Review of the Fund's Income Position for FY2008 and FY2009. For FY2008, we note with satisfaction the better-than-expected outturn for the net operational income due to the strong performance of the Investment Account, the one-time income gain linked to the clearance of Liberia's overdue obligations, and the lower-than-projected expenditure. Even after accounting for the cost of restructuring, the net income shortfall projected for FY2008 is significantly lower compared to the projection at the beginning of the year. This development is encouraging; it augurs well for the move toward a new income model based on the expanded investment authority, and underscores the importance of a timely agreement on all the elements of the income package.

On the disposition of the investment income for FY2008, we endorse Decision No. 1 to transfer the 2008 investment income from the Investment Account to the GRA. We also support the staff's proposal to charge the actual income shortfall for FY2008 against special reserves.

Since the exact income shortfall will depend on the extent and phasing of staff separations, we would appreciate an update from management on the results of the voluntary separation exercise. While still on FY2008, we can also endorse Decisions No. 2 and No. 3 regarding the reimbursement to the GRA for the expense of conducting the business of the SDR Department and the MDRI-I Trust.

Turning to the rate of charge for FY2009, we share the views expressed by Ms. Agudelo and Mr. Mori. Although we supported a lower margin in previous Board discussions, we can go along with Decision No. 4, setting the rate of charge for FY2009 at 100 basis points over the SDR interest rate. In this regard, we thank the staff for Annex IV on the SDR interest rate projections. We note the move by the staff from using WEO projections to relying on forward market rates. While we understand the rationale behind this change, we would appreciate staff's elaboration on the confidence it attaches to forward market rates compared to WEO projections since there is a limited experience regarding the discrepancy between the two rates.

We support Decision No. 5 on the review of the system of special charges.

The reimbursement of the administrative costs of the PRGF-ESF Trust is the only new income measure for FY2009 if a decision authorizing gold sales is adopted within the financial year. Mr. Bakker and Mr. Rookmaaker estimated that SDR 43 million seemed to be on the high side. We note, however, that this figure was prepared for the medium-term income framework sometime ago, before the onset of the current food crisis. A revival of the ESF or increased access to PRGF resources to deal with the costs of the current food crisis could, therefore, impact both the cost estimate as well as the envelope of available PRGF-EFS resources.

Finally, we look forward to further reforms that will have an impact on income, including the review of charges and maturities and the assessment of the adequacy of precautionary balances.

On the burden-sharing mechanism, we tend to agree with Mr. Larsen and Ms. Farrant that its review should not await the finalization of the remaining elements of the new income model.

Mr. Lushin made the following statement:

We support all the five decisions proposed by the staff, and would like to make two brief comments.

We recognize the weaknesses still present in our framework for setting the basic rate of charge under the new income model. Still, we support this framework as a step in the right direction and look forward to its refinement. Because of this, we support setting the margin for the rate of charge at 100 basis points as a step toward establishing a new rule for the rate of charge. This said, if a consensus emerges in favor of keeping the margin for the rate of charge at 108 basis points, we can go along with it. However, for symbolic reasons, we would like the new framework to take hold right now.

We also understand that the burden-sharing mechanism is becoming unsustainable going forward if our credit outstanding remains low or decreases even further. We look forward to consideration of the new mechanism for burden sharing in the future. At this point, we can go along with the proposal to retain it as is.

The Director of the Finance Department (Mr. Kuhn), responding to questions and comments from Executive Directors, made the following statement:

> First, I would like to thank Directors for their supportive statements. I will group my comments around a number of issues that have been raised.
>
> First, on the rate of charge, there were two approaches to setting it as laid out in the paper. One possibility was to continue with a margin of 108 basis points. This margin has been in place for several years since the last time the old income model was fully applied in FY 2006. Arguments could be made that the margin should continue until each and every element of the new income model falls into place. A number of steps still need to be completed and we accept that. On the other hand, since the March discussion on the rate of charge, the Board has already taken a number of very important and essential steps of reform in the implementation of the new income model, with the Report of the Executive Board to the Board of Governors on the amendments to the Articles. The Report also lays out the next steps to be taken. The Board has also reached agreement in principle on the next steps on the rate of charge.
>
> We see the proposal on 100 basis points as yet another step forward in operationalizing the new income model. Under the proposal, the rate of charge is no longer set on the basis of history or inertia, but explicitly takes into account the principles that underlie the determination of the rate of charge in the future—the cost of intermediation, the Fund's reserves, and the broader, long-term conditions in financial markets. This 100 basis point margin seemed to us in March and seems to us now a reasonable first initial margin.
>
> As many Directors have pointed out, this is not yet perfect. We are not fully there yet in specifying all aspects of the new income model. Indeed, this was spelled out in the Report of the Executive Board to the Board of Governors, and it was again spelled out in the IMFC communiqué. We will have a rich work program in the months ahead, with further discussions on charges and maturities, on investments, on access limits, and on the Fund's reserves. Another aspect will be the Fund's de-escalation policy, which the staff sees as a first step toward further discussions on burden sharing and which could relieve any pressures that may emerge on the burden-sharing mechanism. So, setting the rate of charge today at 100 basis points is an initial first step, a transitional step, but nevertheless a very important step of principle to make this aspect of the new income model operational. I would hope that we find the necessary broad consensus.

There were a number of more technical questions that Directors asked on the Investment Account, the specification of costs, and the timing of updates. On the Investment Account, the projections for income in the next financial year do not assume that the new investment mandate is in place. We assume that this will be in place in the following financial year. We would hope for a quick adoption of the amendment of the Articles of Agreement, but we cannot assume that it will be in place already in the next financial year.

The interest rate assumption is purely an assumption. We would not want to pretend that we can project interest rates with any degree of certainty. Our interest rate projections used to be based on the WEO projections. As Annex IV lays out, we have some difficulty with those projections, because they are based on LIBOR/PIBOR rates. Since the emergence of the financial turmoil last fall, the historical relationship between underlying high-quality government securities and LIBOR/PIBOR rates have broken down. Therefore, the assumption in the paper is broadly based on current rates. We will continue to look at the possible projection methods. I should also note that currently nothing really depends, in terms of the decision and further decisions to be made, on interest rate assumptions, unlike in the past when the interest rate projection was a very important part of setting the overall rate of charge.

We will also continue to look carefully at what we can do about our investments within the current investment authority, as Mr. Bakker has noted. We continue to look at the various instruments that we could use even within the current authority.

Finally, on next steps and updates, we are two days before the end of the financial year. We, therefore, have no updates today on what the final outcome will be two days from now. Rather, we are focused on closing the financial year; that will continue to keep us busy and will be the focus of our work in the next weeks. Once we have the final data, we will, as always, communicate them to the Board in the form of a short update paper. At that time, we will also have an accounting determination of the restructuring costs, as well as final data on all the intermediation costs. Those final data will also have been audited.

Mr. Rutayisire made the following statement:

I thought when we discussed the income model and the components of that model, the objective was to place the Fund's income on a sustainable footing. Now we have a situation in which certain pricing is being revised downward, and we are saying that this is consistent with the objective of placing the Fund's income on a sustainable footing. I do not understand the logic of that.

I do not see the difference between the Fund's intermediation costs and the full cost of Fund operations. The current proposal seems to be considering intermediation costs and not covering the full cost of Fund operations, which appears to be in one of the decisions that were made when the rate of charge of 108 basis points was being proposed. I do not understand how this could be overtaken by history.

When we were discussing the income model, a number of chairs raised issue of subsidies and the fact that, at the current level of the Fund's budget envelope, it was not possible—even if the Fund was willing—to continue to provide subsidies to the membership. Our countries, having been the beneficiaries of subsidies through the PRGF, accepted a proposal that the PRGF-ESF Trust would be reimbursing its administrative costs to the Fund subject to certain wording that the Board agreed and that the IMFC approved. At this stage, it is surprising that we see a proposal that is proposing a price subsidy to other sections of the Fund's membership. I could not understand why that proposal is being made.

We also think that conditions in the financial markets are such that interest rates are attractive, and perhaps this should not be the time for the Fund to compete with markets to lower interest rates and subsidize members that do not acutely need that subsidy. For that reason, this chair supports all the proposed decisions, except Decision No. 4, which we do not support.

Mr. Guerra commented that he regarded the adoption of the proposed margin as only a reasonable first step in the direction proposed by the Crockett Committee, which was consistent with the decision that had been reached by the Board at its previous meeting. As stressed in his gray, the assumptions underlying the proposed margins should be refined further. Such refinement should be preceded by a comprehensive cost accounting system. It would be useful to learn from the staff whether any progress had been made on that front and whether there were any plans for setting up that cost accounting system in the future.

Mr. Weber made the following statement:

First, having read the grays, we were struck by the sensitivity of the Fund's income to financial conditions. This has actually led to high returns to the Investment Account. It is ironic that the new income model aims at securing a stable income source, but we have instead a highly volatile income source. That actually speaks for rapidly deciding and implementing the new income model and all its elements.

Second, we were a bit surprised to see that the cost of the Fund's restructuring was predicated on the separation of 300 Fund staff members (Paragraph 5). We were wondering where this figure came from. Maybe an explanation would be helpful.

Third, on the rate of charge, I noted considerable support for keeping the rate of charge at 108 basis points, but also considerable reluctance to complicate matters for management. This chair does not consider it necessary to change the margin, which is already based on the exceptional circumstances clause. Nevertheless, given the small amount involved, I can join the broad consensus for the proposed decision, but associate myself with the view expressed by Ms. Lundsager, Mr. von Stenglin, and Mr. Charleton, that we do not see a further reduction feasible in the short to medium term. The methodology should be taken up as part of a comprehensive review to put in place the various parameters for the new income model, as called for by many others.

Mr. Rouai wondered when the Board would be updated on the restructuring exercise, including its impact on the Fund's income position for FY2008.

Mr. Warjiyo asked how sensitive the projected income for FY2009 was to the implementation of the expanded investment authority, part of which was expected to start in FY2009. In projecting the FY2009 income, the staff had not assumed that the new investment mandate would be put in place in that year.

The proposed margin of 100 basis points was appropriate, Mr. Warjiyo continued. It was a meaningful step in the right direction toward setting the rate of charge to cover the Fund's intermediation costs and finance a modest build-up of reserves under the new income model. Nonetheless, further refinements would still be needed on cost accounting for lending activities, the treatment of reserves accumulated by the various revenue activities in the Fund, and the level of cross-subsidization implicit in the proposal. The rate of charge would need to be looked at again in that context. The intention of management and the staff to keep these issues on the agenda was appreciated.

On burden sharing, the current mechanism was not sustainable and had to be reviewed sooner rather than later, Mr. Warjiyo reiterated. The staff was asked to elaborate on the timetable for such a review.

Mr. Bakker made the following statement:

I take comfort from the remarks of Mr. Kuhn on the investment mandate that the staff will proceed as quickly as possible under the existing mandate, which still has room to maneuver, as well as under the new investment mandate. That is urgently needed. We see that the combination of a new accounting system and the way we invest has made us very vulnerable to interest rate risk. That has gone in a good direction this year, but as we all know, it might go in the other direction again.

This leads me to the question of whether all the preparations will be taken before we can actually implement the new investment authority. In other words, will we have in the work program all the elements needed, including an Investment Committee and guidelines for setting strategic benchmarks? I would very much appreciate seeing in the next work program that all these preparations are made so that we can start on Day 1 rather than discussing these matters at that time. If, under the existing mandate, there are some possibilities of reducing interest rate risk, the staff could be well-advised to look into that.

On the rate of charge, I was among those Directors who actually would like to follow what we call the "royal route." We should first have everything in place before we change the rate of charge. But I see that royalty is decreasing. A large number of Directors are willing to take that step now to lower the rate of charge to 100 basis points. I do not want to be seen as standing in the way of that consensus. However, I do think that it is important that in the work program we also will clearly see, preferably before the Annual Meetings, that we now have this long-awaited discussion on the role of reserves and reserve accumulation. If it is possible to get that out of the way quickly, we will have a firmer basis to say retroactively that indeed we could have moved to a margin of 100 basis points.

Mr. Larsen made the following statement:

I wanted to follow-up on the last point that Mr. Bakker just made. Mr. Weber made the point, too. There is considerable support for maintaining the margin at 108 basis points, not on the basis that this is going to be the final outcome. To reduce the rate as an initial first step without firm foundations is undesirable. It leaves us with no arguments for defending the 100 basis point margin, and at least to my mind, it implicitly ties our hands for the review that we are supposed to do very soon. The IMFC communiqué contains a statement that we are supposed to have this work done by the 2008 Annual Meetings. This is not a deadline that we should take lightly.

As I said, it is unfortunate that we might end up with a proposal that carries reluctant support from a great number of Directors to change something without having firm foundations for making that change. I do not want to firm my mind up on whether we should stick with 100 or go to 95, or whatever we should end up with. I feel that by accepting that nice, round number of 100, we are effectively tying our hands, if not explicitly then at least implicitly. That is a very unfortunate way of making the decision on the rate of charge.

Mr. Shaalan reiterated that, as expressed during the March 12 Board discussion, he supported a margin of 100 basis points above the SDR interest rate and could even support a lower rate. He therefore supported Decision No. 4 and considered it a first initial step toward operationalizing the new income model while refinements were being made to the components of the rate of charge.

Mr. Sadun made the following statement:

I would like to thank the staff for the additional clarification, particularly on the issue of the rate of charge. As we have stated in our gray, we support all the proposed decisions, with the exception of the decision on the rate of charge. The reason for that is quite clear. The staff has stated that the decision to reduce the rate of charge is mostly a symbolic reason. I agree with that. My question then is what kind of symbolic message we want to send out. The staff suggests that the message we want to send out is that we want to encourage and reward ourselves for the good work that we have done so far, and continue with the positive trend in putting this institution on a sound financial footing. I appreciate the good feeling, but it seems to me that that is a bit premature.

A more appropriate attitude, an attitude that certainly befits in my view a financial institution like the Fund, is that we should not rush to congratulate or reward ourselves until all the major components of the financial remedies that we have identified are put in place.

The situation, it seems, has improved, but it is also very clear that we are not out of the woods yet. For this symbolic reason, it would be advisable to wait rather than rush to reduce the rate of charge. Having said that, we are certainly not prepared to stand in the way of a decision if a clear majority of the Board would like to take that direction.

The Director of the Finance Department (Mr. Kuhn), in response to additional questions and comments from Executive Directors, made the following further statement:

> The basis for determining the basic rate of charge clearly needs to be refined. I accept that, and all Directors have echoed that as well. It is an important part of the work program.
>
> One element is cost accounting. Improvements are very much at the top of the agenda for OBP, which will lead the effort. OBP is working with other departments on improvements and aims to have something significantly more robust in place during the coming financial year.
>
> On the question of how much difference it would make to investment income if we had a broader investment authority, a change of 50 basis points over the SDR interest rate, which is an assumption, would give us an additional SDR 30 million. Whether those 50 basis points in the end will be dominated, as they have been in the past, by the fluctuations in underlying interest rates, I do not know. It is part of the overall uncertainties we are currently facing.
>
> The preparations for changes in the investment authority are already underway. The staff will be coming back to the Board on all aspects that are part of the work program as already spelled out, and also endorsed by the IMFC, including the role of reserves.

Mr. Weber requested that the staff provide more information on burden sharing to his chair bilaterally.

The Director of the Finance Department (Mr. Kuhn) agreed to do so.

The Acting Chair (Mr. Kato), responding to Mr. Rouai's question on the outcome of the voluntary separation process, said that the window for voluntary separations had been closed on April 21. The applications were being processed, and the Managing Director hoped to be able to report, on both the outcome and next steps, to the Board in the week of April 28.

As proposed, the paper would be published, together with a press release summarizing the Board discussion, the Acting Chair concluded.

The Executive Board took the following decisions, with one abstention from Mr. Larsen (UK) and one objection from Mr. Rutayisire (AF) on Decision No. 4 on the rate of charge on the use of Fund resources for FY2009:

Transfer of Investment Income for FY 2008 to General Resources Account

The investment income of the Investment Account for FY 2008 shall be transferred to the General Resources Account for meeting expenses of conducting the business of the Fund during FY 2008. (EBS/08/45, 4/15/08)

Decision No. 14097-(08/36), adopted
April 28, 2008

Assessment Under Article XX, Section 4 for FY 2008

Pursuant to Article XVI, Section 2, and Article XX, Section 4, of the Articles of Agreement and Rule T-2 of the Fund's Rules and Regulations, it is decided that:

(i) The General Department shall be reimbursed for the expenses of conducting the business of the SDR Department for the period of May 1, 2007 through April 30, 2008; and

(ii) An assessment shall be levied on all participants in the SDR Department. The special drawing right holdings accounts of participants shall be debited on April 30, 2008 with an amount equal to 0. 00710109 percent of their net cumulative allocations of special drawing rights. The total assessment shall be paid into the General Department. (EBS/08/45, 4/15/08)

Decision No. 14098-(08/36), adopted
April 28, 2008

MDRI-I Trust Reimbursement for FY 2008

In accordance with paragraph 6 of Decision No. 13588-(05/99) MDRI, adopted November 23, 2005, effective January 5, 2006, the General Resources Account shall be reimbursed the equivalent of SDR 2.307 million by the MDRI-I Trust in respect of the expenses of administering SDA resources in the MDRI-I Trust during FY 2008. (EBS/08/45, 4/15/08)

Decision No. 14099-(08/36), MDRI adopted
April 28, 2008

The Rate of Charge on the use of Fund Resources for FY 2009

Pursuant to Rule I-6(4)(a), last sentence, the rate of charge shall be 100 basis points over the SDR interest rate under Rule T-1. (EBS/08/45, 4/15/08)

Decision No. 14100-(08/36), adopted
April 28, 2008

Review of the System of Special Charges

The Fund has reviewed the system of special charges applicable to overdue obligations to the General Resources Account, the Structural Adjustment Facility, and the Trust Fund. (EBS/08/45, 4/15/08)

Decision No. 14101-(08/36), adopted
April 28, 2008

APPROVAL: August 1, 2008

SHAILENDRA J. ANJARIA
Secretary