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IMF Overhauls Nonconcessional Lending Facilities and Conditionality

On March 24, 2009, the Executive Board of the International Monetary Fund (IMF) approved comprehensive reforms to strengthen its capacity to prevent and resolve crises. In particular, the effectiveness of its nonconcessional lending facilities in meeting members' financing needs were enhanced, while preserving adequate safeguards on Fund resources, by modernizing the conditionality framework applying to all Fund arrangements—including those which are concessional, increasing access limits to nonconcessional lending, and reforming the pricing of high and precautionary access to nonconcessional lending.

Background

The IMF has completed a major overhaul of its nonconcessional lending framework to ensure it is well-suited to meet members' needs in the current as well as in future crises. These reforms, together with an expanded pool of loanable resources, would enable the Fund to play a larger role in tackling the ongoing global financial crisis to the benefit of all its members. All aspects of the IMF's lending instruments and policies were assessed: the existing General Resources Account facilities, the conditionality framework, access levels, charges and fees, and maturities. Complementary reforms of concessional lending instruments for low-income members are being pursued in parallel. The key reforms approved by the Executive Board are:

- **Modernizing the conditionality framework** to ensure conditions linked to IMF loan disbursements are sufficiently focused and adequately tailored to the varying strengths of members' policies and fundamentals, thereby reducing stigma associated to Fund lending. This is to be achieved by relying more on pre-set qualification criteria (ex-ante conditionality) rather than on traditional (ex-post) conditionality. In addition, structural reforms will from now on be monitored in the context of program reviews, rather than through the use of structural performance criteria, which will be discontinued in all Fund arrangements, including those with low-income countries.

- **Establishment of the Flexible Credit Line** (FCL) arrangements. This new credit line is designed to provide large and upfront financing to members with very strong fundamentals and policies. As access to the FCL is restricted to those members that meet strict qualification criteria, drawings under it are not tied to policy goals agreed with the country. The flexibility built into the design of the FCL relates to its uncapped access, its long repayment terms (3¼ –5 years), its unrestricted renewals, and its dual-use for contingent (precautionary) and actual balance of payments needs.

- **Enhancements to the Stand-By Arrangement** (SBA). Reforms to the SBA—the Fund's workhorse lending instrument for crisis resolution—also provide flexibility and ensure it is used also as a crisis prevention instrument by members that may not qualify to the FCL. The modified SBA framework provides increased flexibility by allowing frontloading of access and reducing the frequency of reviews and purchases where warranted by the strength of the member's policies and the nature of the balance of payments problem faced by the member.

- **Simplification of Fund lending toolkit** to eliminate certain rigid facilities that have been little used since they cater to narrow balance of payments problems.

- **Doubling of access limits** to 200 percent of quota on an annual basis and to a 600 percent of quota cumulative limit. These higher limits give confidence to countries that adequate resources will be accessible to them to meet their financing needs. There continues to be scope for access above these limits, for example through the FCL, or following intensified scrutiny under the exceptional access framework, which was also overhauled.

- **Adapting and simplifying cost structures** of high-access and precautionary lending across facilities. Surcharges will continue to enable the Fund to build reserves to mitigate credit risks and the revised surcharge schedule will also increase price incentives to make early repayments at the same time that the current time-based repurchase expectations policy is repealed. The commitment fee schedule is adapted to help contain risks to Fund liquidity from large-scale precautionary lending (which is facilitated by the creation of the flexible credit line and the reforms to high access precautionary SBAs).

By enhancing instruments for precautionary lending and tailoring the use of Fund resources to the strength of members' policies and fundamentals, these reforms aim to encourage members to approach the Fund early, thereby reducing the likelihood of crises or mitigating their ultimate costs. Together with a substantial increase in the Fund's resources, these reforms provide a strong platform from which the Fund can respond robustly to help members tackle the current as well as future crises.

Executive Board Assessment

The Executive Board has adopted a number of decisions to reform the Fund's GRA lending and conditionality frameworks to ensure that the Fund is well-equipped to fully meet the needs of its membership. While many Directors expressed some reservations on certain elements of these reforms, Directors generally considered the overall package to be a satisfactory compromise that balances the diverse interests of the membership.

Modernizing Conditionality. Most Directors noted that structural performance criteria are perceived as reducing national ownership of Fund-supported programs, while being difficult to define objectively. Accordingly, they agreed that structural performance criteria would be replaced under all Fund arrangements, including those under facilities designed for low-income countries, with a review-based approach to monitoring the implementation of structural reforms in Fund-supported programs. A few of these Directors supported replacing structural benchmarks and prior actions, as well. For existing arrangements, a few Directors would have preferred a faster transition to review-based conditionality, by automatically discontinuing all structural performance criteria in upcoming program reviews. Some Directors, however, wanted to retain structural performance criteria for macro-critical measures, while a few Directors would have also supported adoption of a review-based approach for quantitative variables.

Flexible Credit Line (FCL). Directors supported the creation of the FCL to enable very strong-performing members to have high and front-loaded access to Fund resources. The FCL could be used for contingent or actual financing needs stemming from all types of balance of payments problems. Directors broadly agreed with the FCL's key design elements. Directors stressed that the assessment of a member's FCL qualification should be undertaken confidentially and only at the request of the member. In emphasizing the importance of transparency, Directors agreed that the Managing Director should generally not recommend that the Executive Board approve a request to use the FCL unless the member had consented to publication of the associated papers. Some Directors, however, considered that publication should always take place in FCL cases. It was agreed that the Board will revisit this issue in the context of its review of the Fund's transparency policy later this year.

A number of Directors remained concerned that the FCL could induce large precautionary use of Fund resources, crowding out lending for crisis resolution. Directors agreed that the FCL should be reviewed in two years, or earlier if commitments under the FCL reach SDR 100 billion, while a few Directors preferred reviewing the FCL in three years. Some Directors would have preferred an access limit to help safeguard Fund resources and to ensure even-handedness and predictability of Fund lending, but welcomed staff's expectation that access would not normally exceed 1,000 percent of quota. A few Directors reiterated their concern that ex-ante conditionality might not provide adequate safeguards for the use of Fund resources.

Directors called for rigorous and even-handed application of the FCL's qualification framework, as further elaborated in Annex I of the staff paper, to ensure that only members with very strong macroeconomic fundamentals and policy frameworks, sustained track records of implementing very strong polices, and a commitment to maintaining such policies, would have access to FCL financing. A number of Directors stressed the importance of relying on Executive Board assessments of members' policies in the context of recent Article IV consultations. These Directors expected that a member that qualifies for the FCL would normally have held the most recent Article IV consultation in accordance with the standard cycle for such consultations. A few Directors considered that qualification assessments should also be informed by a recent FSAP or FSAP update.

Enhancing Stand-By Arrangements. Directors supported making high-access precautionary SBAs (HAPAs) available on a more regular basis. In addition, all SBAs, including HAPAs, could be designed flexibly—including with respect to phasing and frontloading of access, and frequency of performance criteria test dates and Board reviews—in recognition of members' varying circumstances. At the same time, a few Directors expected that quarterly phasing would continue to be used in cases of large access to Fund resources. Directors looked forward to a future staff paper addressing the "black-out period" problem under SBAs, which currently blocks members from making purchases during certain periods when data for performance criteria assessments are unavailable.

Access Policies. Directors agreed to double normal GRA access limits to 200 percent of quota annually and 600 percent of quota cumulatively. They also supported the modification of the four substantive exceptional access criteria so as to allow exceptional access for potential and actual BOP needs stemming from both capital and current account crises, and to eliminate rigidities and ambiguities in the criteria. Some Directors felt that aspects of the modifications could weaken this policy, but welcomed the preservation of the procedural aspects of the policy, which they considered to be an essential part of Fund risk management.

Surcharges and Fees. Directors supported the proposed simplification of the current level-based surcharge structure, the introduction of a new time-based surcharge, and the elimination of the time-based repurchase expectations policy. They considered the proposals to strike a balance between simplifying the cost and repayment structures for Fund lending, and mitigating credit risks and encouraging timely repayment of Fund resources.

In discussing the staff's proposal, a few Directors reiterated their preference to align the threshold for the level-based surcharges with the new normal access limits. A few other Directors expressed concern that the alignment of the Extended Fund Facility (EFF) and SBA time-based surcharges would make high access under the EFF unduly costly for low-income members. It was recognized, however, that high access would not normally be expected under the EFF, as the SBA would be a better instrument for such purpose. A few Directors also requested an early review of the burden-sharing mechanism.

Directors concurred that the new upward-sloping commitment fee structure will discourage unnecessarily high precautionary access, helping to contain risks to the Fund's liquidity. While supporting the decision, some Directors also felt that fees were too high, while some other Directors believed that fees should have been higher.

Eliminating Special Facilities. Directors agreed to abolish the Compensatory Financing Facility, the Supplemental Reserve Facility, and the Short-Term Liquidity Facility, which have been seldom or not used. Directors supported retaining the EFF, particularly given its usefulness to low-income countries.

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