June 28, 2010
Approval: 7/6/10

INTERNATIONAL MONETARY FUND

Minutes of Executive Board Meeting 10/24-1

10:00 a.m., March 17, 2010

1. Facilitating Mobilization of Loan Resources for Concessional Lending to Low-Income Countries

Documents: SM/10/46

Staff: Tweedie and Lin, FIN; Weeks-Brown, LEG

Length: 1 hour, 25 minutes

Executive Board Attendance

N. Shinohara, Acting Chair

Executive Directors	**Alternate Executive Directors**
	M. Majoro (AE)
L. Rutayisire (AF)	K. Assimaidou (AF)
	V. De la Barra (AG), Temporary
H-S. Lee (AU)	
	J. Prader (BE)
P. Nogueira Batista, Jr. (BR)	
J. He (CC)	Y. Luo (CC)
R. Guzmán (CE)	C. Pérez-Verdía (CE)
	M. Sajkunovic (CO), Temporary
A. Fayolle (FF)	A. Ducrocq (FF)
K. Stein (GR)	
	P. Weerasinghe (IN)
	S. Krishnan (IN), Temporary
	N. Giammarioli (IT)
D. Kotegawa (JA)	
	S. Rouai (MD), Temporary
	S. Geadah (MI)
A. Bakker (NE)	
P. Callesen (NO)	J. Bergo (NO)
A. Mozhin (RU)	A. Lushin (RU)
A. Alazzaz (SA)	
	A. Chua (ST)
	D. Tartari (SZ), Temporary
M. Lundsager (UA)	D. Rediker (UA)
A. Gibbs (UK)	

S. Tiwari, Secretary
R. Mowatt/V. Thakoor, Assistants

Also Present
Asia and Pacific Department: D. Cowen. Finance Department: J. Lin, M. Manno, R. Powell, A. Tweedie. Institute: E. Verreydt. Legal Department: I. Mouysset. Middle East and Central Asia Department: T. Schneider. Secretary's Department: P. Gotur, P. Martin. Strategy, Policy, and Review Department: H. Bredenkamp. Statistics Department: A. Galicia-Escotto. Western Hemisphere Department: H. Shi. Senior Advisors to Executive Directors: W. Abdelati (MI), C. Balsa (CE), M. Choueiri (MI), S. Duggan (AU), E. Meyer (UA), M. Nomura (JA), J. Poulain (FF), G. Purves (CO), M. Sidi Bouna (AF), A. Tall (AF), A. Tolstikov (RU). Advisors to Executive Directors: S. Alnefaee (SA), N. Choudhary (IN), J. Franco (UA), A. Gerdes (GR), R. Hills (UK), M. Holmberg (NO), K. Ismail (MI), L. Jimenez (CE), S. Keshava (SA), E. Lambregts (NE), R. Lin (CC), M. Maung Gyi (ST), D. Mevis (BE), S. Meyer (GR), P. Fachada (BR), N. Thapa (ST), E. Uanguta (AE), R. Ward (UK).

1. FACILITATING MOBILIZATION OF LOAN RESOURCES FOR CONCESSIONAL LENDING TO LOW-INCOME COUNTRIES

Mr. Geadah and Ms. Choueiri submitted the following statement:

We thank staff for a well thought-out paper, which outlines options for facilitating mobilization of loan resources for concessional lending. The staff proposals appropriately aim at helping to mobilize the SDR 9 billion resources that are needed to meet the projected loan demand through 2014 by addressing the needs and preferences of potential lenders, and we can support them. While the staff have maintained the medium-term estimates for total loan demand that were made in June 2009, it is important that the outlook for LIC loan demand be kept under review. We will turn in what follows to the issues raised by staff for discussion.

In light of the sharp increase in demand for Fund concessional financing in 2009, available loan resources, including new agreements, currently amount to SDR 0.9 billion. The staff estimates that these resources are only sufficient to cover expected demand for a few more months. Accordingly, we agree that it is urgent to meet the Board-endorsed fund raising target for additional loan resources to ensure timely funding of the new LIC facilities. In this connection, we welcome recent pledges by member countries to provide additional loan resources, including use of their SDR holdings.

Several members that are planning to lend in SDRs consider it important for their new loan contributions to the PRGT to qualify as reserve assets. To this end, staff proposes establishing an encashment regime under the PRGT. They rightly indicate that a relatively broad participation by lenders would be critical for such a regime to work. Given that existing lenders would be able to participate in the encashment regime only with respect to the undrawn balance of their commitments, we would be grateful for further elaboration by staff on the participation needed for the regime to work.

The staff's proposal to create a liquidity buffer to ensure that sufficient resources are available to meet requests for encashment is reasonable. In this regard, we support the suggested target of 20 percent, which is in line with the prudential balance established for GRA lending. Notwithstanding the difficulty to mobilize new loan commitments of about SDR 1.8 billion to form the liquidity buffer, we are not in favor of using the resources that are available in the PRGT Reserve Account as a liquidity buffer to meet possible requests for encashment. The staff rightly notes that this approach would reduce the amount of security available to all PRGT lenders at a time where existing and potential members are enquiring about the safety of their new loan resources to the PRGT. Moreover, this approach would create additional uncertainty about the future self-sustained lending capacity of the PRGT, as indicated by staff.

We agree with the proposed approach to issue PRGT notes, especially that the key financial terms between loans and notes would be similar. We also concur with staff proposals to allow for shorter notional maturities for PRGT borrowing, and to pay the three-month official SDR interest rate for loan resources in SDRs and the derived six-month SDR interest rate for borrowing in currencies.

With regard to the treatment of SDRs lent to the PRGT for the purpose of the voluntary SDR trading arrangements, we support Option 3. This option proposes to handle SDR conversions related to PRGT through the informal burden sharing arrangement under the voluntary SDR trading arrangements. We appreciate that the latter arrangements are intended to serve as a backstop to guarantee the liquidity and the reserve asset character of the SDR. Nonetheless, we agree with staff that Option 3 would balance the urgent need to mobilize PRGT loan resources with the concerns expressed by a number of members that such loans should not be used as an indirect means of transferring SDRs to other participants in the voluntary trading arrangements. Moreover, we note that the amounts of SDR sales from the PRGT (estimated at about SDR 1 billion per annum) are not expected to be large relative to the overall SDR market (of about SDR 60 billion at present). In light of the concerns expressed during the informal Board briefing of last Tuesday, we could support amending Option 3 by encouraging the countries lending SDRs to the Trust to agree to buy back the bulk of these SDRs for currencies on request by LICs. We also support calls for a periodic transparent reporting mechanism on SDR conversions.

Based on current projections, staff indicates that the PRGT Reserve Account could provide adequate security to PRGT lenders/note purchasers. Nonetheless, these projections are subject to important assumptions regarding the rate of investment earned on the Reserve Account balance, interest rates paid to lenders, resumption of reimbursement of the GRA for PRGT administrative expenses, and repayments of overdue Trust Fund, Structural Adjustment Facility, and PRGT obligations by the protracted arrears cases once their arrears are cleared. 1 Furthermore, the Reserve Account has

[1] Update on the Financing of the Fund's Concessional Assistance and Debt Relief to Low-Income Member Countries, SM/09/99, April 17, 2009.

contributed an amount of SDR 0.62 billion to subsidy resources for LIC financing under the financing package. Accordingly, careful monitoring of the capacity of the Reserve Account to cover projected outstanding credit over the medium term is warranted.

The options proposed by staff rightly aim at mobilizing needed loan resources for LIC financing. It is well to note, however, that such financing cannot take place without sufficient subsidy resources. To date, pledges of new subsidy resources are estimated at about SDR 0.1 billion, well short of the targeted SDR 0.2–0.4 billion contributions. The Fund's income resources are providing the bulk of the total additional subsidy resources estimated at SDR 1.5 billion. We, therefore, strongly encourage management and staff to intensify their fund raising efforts to reach the target for additional bilateral subsidy contributions.

Mr. Gibbs and Mr. Fayolle submitted the following joint statement:

In Istanbul, our Ministers jointly responded to the Managing Director's call for additional loan resources for the PRGT by pledging SDR1.25 billion each, subject to the approval of the Executive Board. They did so in recognition of the urgency of the financing position of the PRGT and in support of the new framework for LIC lending that the Executive Board put in place last year. They also hoped that by making an early response to the Managing Director's request they would help catalyze his fund raising effort. We strongly welcome the commitments made by several other shareholders in this regard.

Board approval of the framework proposed in the staff paper today will make it possible for those resources to be deployed in support of critical programs in some of the poorest member countries. We strongly support the proposed framework, including in particular the encashment arrangements and Option 3 for exchanging hard currency for SDRs. Our authorities are committed to playing a full part in the effort to convert SDR resources.

The need for further loan resources is now even more urgent than it was in Istanbul. Loan resources are expected to be exhausted within a matter of months. It is therefore essential that the new SDR pledges, which provide over 80 percent of the new loan pledges that have been made so far, can be unlocked and made available for concessional lending this year.

We are very grateful to staff for their clear paper and for their efforts in recent months to consult with Executive Directors to identify solutions that will facilitate the provision of loan resources, including through the use of notes and the encashment regime. We therefore agree with the staff's proposals and strongly support the continued use of voluntary trading arrangements to facilitate the conversion of SDR loan resources. Furthermore, these features will be important and relevant in attracting further contributions to the PRGT loan account.

As the staff paper sets out, there are clear precedents for SDR lending to the PRGT. In recent years SDRs have been used by a range of countries on a number of occasions to support financing for LICs, including for both subsidy and loan resources at the Fund.

The proposed voluntary encashment regime is an important element of the framework insofar as it supports the appropriate classification of loan resources as reserve assets. This is a critical element to unlock donor pledges. It is also very similar to the regime under the bilateral GRA borrowing arrangements. As staff make clear in the paper, and also clarified in the recent informal meeting, participation in the regime is entirely voluntary.

We strongly agree with staff that Option 3—to use the existing voluntary trading arrangements—is the right approach to support the conversion of SDR loan resources. The VTAs have formed the basis for exchanging previous SDR loan resources and is practically and operationally the most appropriate and least burdensome. The existing capacity of VTAs (around SDR60 billion) far exceeds the expected annual average amount that will arise from the PRGT loans over the next decade (less than SDR1 billion). In any event, we understand from staff that the United Kingdom and France would most likely be eventually asked to exchange the majority of our loans for hard currency and we both stand prepared to do so. Since last summer, the United Kingdom and France have together been very active in the VTAs, exchanging more than one-fifth of all SDRs that have been transacted.

Given the urgent need for new concessional resources to support LICs through the current challenging global environment, we call upon the Board to support the proposed decision and encourage all loan account contributors to provide agreement to the changes to the PRGT framework, thereby allowing the use of existing pledges. Finally, we also call on other countries that have yet to make pledges to the PRGT to do so in a timely manner.

Mr. Lee and Mr. Duggan submitted the following statement:

The growing number of ideas on use of 'surplus SDRs' demonstrates the need for a broader discussion on the operation of SDRs, including whether the current allocation rules required under the Articles are optimal, the implications of members granting or loaning SDRs and the Fund's role in facilitating post allocation redistribution. We look forward to exploring these issues in greater depth as part of the mandate review.

On loans to the PRGT, the critically low level of resources indicates that we need to move quickly on these issues in a way that supports meeting the SDR 9 billion resource requirement. In this spirit, our view is that the staff proposals strike a reasonable balance.

Reserve Assets

We support efforts to classify PRGT loans as reserves and the proposed encashability arrangements, supporting the provision of loans by members that would not otherwise be in a position to contribute. While the level of PRGT loan resources necessary to reach sufficient assurance on encashability is difficult to judge, the 20 percent proposal is reasonable when judged against the buffer for lending to the GRA and the commitment made by the largest lender. We also agree that the Reserve Account, which provides insurance to all PRGT lenders and secures the financial operations of the PRGT, is not the appropriate vehicle.

The proposed encashability regime rests on securing loan resources additional to the projected need for concessional lending as insurance against PRGT creditors experiencing balance of payments distress, which we recognize may present difficulties for some lenders. Therefore, we would ask staff to keep the Board updated on progress in raising the additional loan resources and to articulate a contingency plan in the event that the 20 percent buffer is not raised. This could include considering how gold sales proceeds can be best employed in support of raising the required concessional resources.

PRGT Notes, Maturities and Interest Rates

In principle, lending to the PRGT should be on the same terms as lending to the GRA. Therefore, we can support introducing the same flexibility to utilize notes, adjust the maturity and change the interest rate duration at the discretion of the lender. This support is based on staff's assurances that the Fund will not bear any additional costs or financial risks and that there are no implications for the operations of the PRGT. In this context, and on the specific issue of loan maturities, we agree that the effective maturity should be aligned with the repayment schedule for PRGT lending to LICs to minimize the risks to the Reserve Account.

SDR Conversion

As we understand it, the attraction of providing SDR loans is essentially three-fold: it allows some countries to lend to the Fund from reserves without incurring a prohibitive fiscal cost; it is currently financially advantageous for some lenders compared to the cost of financing hard currency loans through market borrowing; and it is in accordance with the lender's reserves management objectives. However, there is no free lunch. To the extent that SDR loans are financially advantageous and have benefits from a reserves management perspective, providing SDR loans could impose counterpart costs on other members with voluntary SDR trading arrangements.

We carefully considered the arguments in favor of Option 1. However, our conclusion was that forcing SDR lenders to bear the full burden of subsequent hard currency conversions by PRGT borrowers may achieve little (if these SDR lenders then entered the market to exchange the SDRs for hard currency) and could be counterproductive (if it undermined the Fund's capacity to raise the required PRGT loan resources).

Therefore, we can support Option 3—whereby a member's SDR holdings ratio would be reduced in proportion to the amount of SDRs lent to the PRGT—as a compromise. The staff paper asserts that Option 3 has the feature that members lending SDRs will bear the largest cost of the subsequent conversions into hard currency (all else being equal). For this to be the case, however, SDR lenders must have a voluntary arrangement of sufficient size. Therefore, our support for Option 3 is conditional on SDR loans only being accepted from countries that have voluntary agreements in place of at least the same magnitude as their proposed SDR loan.

In reaching this judgment, we note that potential SDR loans are small relative to the overall capacity of the voluntary SDR market. We also recognize that the implications of this proposal for both SDR lenders and other members with voluntary SDR trading arrangements is broadly equivalent to an alternative whereby potential SDR lenders instead utilize their existing flexibility to exchange their SDRs for hard currency through the voluntary market to on-lend to the PRGT.

Given the uncertainties on the interaction between SDR loans and the voluntary SDR market, however, we support reviewing these arrangements in 12 months time. We also support those who have called for greater transparency in the operations of the voluntary SDR market.

Safety of Loan Resources to the PRGT

Based on the information presented in the staff paper, we are satisfied that the risks to member's loan resources to the PRGT are low and well-managed.

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

We thank staff for the concise and focused report as well as for the extensive consultations of the past several weeks which aimed at reaching a consensus among the different parties involved. After last year's approval of the comprehensive reform of the Fund's lending facilities and the financing framework for low-income countries (LICs), and the introduction of all the amendments of the Poverty Reduction and Growth Trust (PRGT) Instrument concluded in January, it is now crucial to swiftly mobilize the required resources in order for the reform to become effective and operative.

Failing this task would severely endanger the Fund's efforts to support LICs' programs financed by the PRGT. The available loan resources under the PRGT have fallen to a level that would be sufficient to cover expected demand for just a few months unless additional resources are secured in a timely manner. The proposed framework to facilitate the mobilization of loan resources for concessional lending to LICs broadly provides, in our view, the requested clarification and amendments to accommodate the needs of potential contributors. While we are ready to support the staff's proposals, we would like to offer our comments and suggestions on the different aspects of the framework.

Encashment of PRGT Claims

The proposed scheme would provide contributors with the right to request early repayment of outstanding claims should balance of payments needs arise, as is the case under the GRA bilateral borrowing agreement. Establishing an encashment regime under the PRGT requires the creation of a liquidity buffer, according to staff's proposal, of 20 percent of outstanding loans from participating contributors. This implies that resources amounting to almost SDR 11 bn. would need to be mobilized in order to meet the projected demand of SDR 9 billion. Could staff clarify if the proposed size of the liquidity buffer was determined with the assumption that all of the contributors would join the encashment scheme? Could staff also clarify that the increased amount of resources will be secured by enlarging the number of contributors and update the Board with recent developments in this respect?

While we do not have a strong preference for encashment, we are ready to join the scheme in order to facilitate the functioning of the regime and to improve the attractiveness of the PRGT for potential new contributors.

Issuance of PRGT Notes and Loan Maturities

We are in favor of accommodating the preferences expressed by some potential lenders for purchasing notes from the PRGT provided that, similar to the framework for GRA lending, such notes have identical financial terms as loan claims. We also support the proposed loan maturity of one year with the provision that the Fund can unilaterally extend the maturity for additional periods up to ten years. This would provide contributors with the required maturity to consider the loans as reserves, but at the same time it would align the effective maturity with the repayment schedules for PRGT lending to LICs.

Interest Rate

It has been common practice for decades for the different trust funds (ESAF, PRGF, and PRGF-ESF) to pay interest to lenders semi-annually at the six month SDR interest rate. This interest rate has been applied to loan agreements involving both currencies and SDRs. We do not see any compelling reason to change this practice at the current juncture. The envisaged increase of contribution in SDRs cannot be considered a trigger to change a well-established practice. This change would create an unwarranted discrimination against SDRs in a context in which the use and role of SDRs is being expanded. We would rather prefer to have a unified approach, eventually with loans in currencies and SDRs receiving a three-month interest rate, as is the case for the reserve tranche positions. However, should a consensus emerge on the staff proposal, we are ready to join it for the sake of a swift approval of the framework.

Conversion of SDR Loan Resources

SDRs lent to the PRGT should ultimately be converted in the same way as other SDRs through the informal burden-sharing arrangements under the voluntary SDR trading arrangements (VTAs). Accordingly, we support Option 3. There are several advantages of this option compared to the others illustrated by staff. First and most important, it would facilitate raising the needed PRGT loans. Second, it would avoid a segmentation of the SDR market, which goes against the spirit of the establishment of the VTAs. Last, it would be the easiest mechanism to be implemented, since the alternative Option 1 would require determining the portion of SDRs received by LICs through the PRGT and through the allocation, a difficult task especially if SDRs are converted through time. In addition, the effective amount of SDRs to be converted, compared to the total capacity of the VTAs, is so small that establishing an ad hoc mechanism appears unwarranted.

It is clear that SDR lenders to the PRGT would need to have a VTA place and should stand ready to convert SDRs into currencies. Moreover, SDR lenders are expected to bear the burden of such a conversion, given the rules governing the burden-sharing mechanism under the voluntary SDR trading arrangement. Italy, whose trading arrangement will be signed by the central bank's Governor shortly, stands ready to facilitate the functioning of this system.

Safety of Lending to the PRGT

We believe that assuring the safety of lending to the PRGT is of the utmost importance. Therefore we welcome the staff's findings which confirm that the PRGT Reserve Account provides adequate protection to PRGT lenders over the medium-term.

Mr. Prader and Mr. De Lannoy submitted the following statement:

We thank staff for their concise informative paper. It is important that additional loan resources for concessional lending to LICs are mobilized soon.

We wonder whether the modalities proposed in the paper would apply to all outstanding PRGT commitments or only to new ones.

We support staff's proposal on an encashment regime. Some lenders consider it essential for their new lending to the PRGT to qualify as international reserve assets. This would encourage a larger number of countries to contribute to the loan accounts of the PRGT. Moreover, this would be in line with the modalities for lending to the GRA. We would, however, prefer that participation in the encashment regime is mandatory rather than optional, given the need for broad participation by lenders/note purchasers for an encashment regime to work. What will be the use of earmarking resources to a particular PRGT loan account, if all committed resources would be available for the encashment of outstanding claims on all loan accounts of the Trust?

We support the staff proposal to issue PRGT notes, in addition to traditional loans. This is likely to encourage PRGT funding by countries that prefer purchasing notes. It is in line with the options for bilateral lending to the GRA.

We can go along with the staff proposal on shorter maturities for drawings under PRGT agreements. Shorter maturities should not be excluded, but ideally they should be the exception rather than the rule. The intention of the Fund is to have an effective maturity aligned with the repayment schedules for PRGT lending to LICs.

We support the staff's proposal on differentiated interest rates. This entails that the PRGT would pay, on a quarterly basis, the 3-month official SDR interest rate under loans/notes agreements involving SDRs, while continuing to pay on a semi-annual basis the derived 6-month SDR interest rate under agreements involving loans/notes in usable currencies. As the direct cost of lending SDRs to the PRGT is the 3-month SDR rate, maintaining the 6-month rate as the interest rate paid on SDR contributions to the PRGT would in fact create incentives to provide contributions to the PRGT in SDRs. Will this differentiated approach apply only to new SDR lending to the PRGT, or to all agreements in SDR, including those that were already concluded?

We support Option 3 with regard to the conversion of SDR loan resources. We agree with staff that for Option 3 to work, all SDR lenders to the PRGT would need to have a voluntary SDR trading arrangement in place with a capacity that is significantly larger than their expected loans to the PRGT. A voluntary SDR trading arrangement with the lender for an amount significantly larger than that country's expected SDR lending to the PRGT should be a precondition for the PRGT to borrow in SDR from that country.

For the sake of transparency, we ask the staff to report regularly to the Board on SDR trading related to PRGT borrowing. Sufficiently detailed data should be made available, for example bi-annually, to allow for an informed discussion and review of the application of the regime applied to the conversion of SDRs borrowed by the PRGT. According to the staff paper, members lending SDRs to the PRGT would likely end up buying most of the SDRs back over time.

Ms. Lundsager and Ms. Franco submitted the following statement:

The G-20 and IMFC called for additional concessional resources and for the use of excess profits from agreed gold sales along with surplus income, to support low-income countries during the crisis. We remain committed to this goal and recognize the urgent need to ensure full funding of the new LIC facilities. We welcome the commitment by donors to finance the PRGT loan and subsidy accounts, and we can reluctantly go along with the proposed recommendations and changes to the PRGT that accommodate the legal and logistical requirements of donors lending primarily in SDRs. To accommodate our concerns, however, we seek clear management and the staff commitment to provide periodic reports to the Board regarding the transactions taking place under the SDR lending and voluntary trading arrangements.

The newly proposed SDR loan amounts are significantly larger than previous SDR lending to the PRGT. Given the large shift to SDR resources, it would be useful to understand clearly the ramifications of this shift. We understand the staff's estimates that SDR sales from the PRGT are not expected to be large relative to the overall SDR market. Nonetheless, the increase in SDR lending raises questions about the potential impact on the voluntary trading arrangement system that many of us agreed to previously. Thus, we are sympathetic to those who favor Option 1. However, even Option 1 is not a guarantee and, as Messrs. Fayolle and Gibbs point out, many of these SDR lenders have been very active in the voluntary arrangement system in the period since the SDR allocation in August. We would not wish them to decline non-PRGT related transactions in the voluntary purchase agreements or to forgo providing resources to the PRGT as a result. Therefore, we welcome statements as provided by Messrs. Fayolle and Gibbs that they will exchange a majority of their SDR loans. We would welcome other SDR lenders doing the same. This would be extremely important to securing the broad support needed to make the SDR loan/voluntary exchange agreements operate successfully.

We support the option to purchase notes from the PRGT and the proposals on maturities and interest rates. Regarding the encashment scheme and the 20 percent liquidity buffer requirement, we understand management's recommendation that this buffer come from additional funds beyond the

SDR 9 billion target and be replenished over time with new loan commitments. Given the exceptionally high loan coverage ratio in the Reserve Account, far about the historic average of 40 percent, we would not rule out the Reserve Account as a possible source to finance the buffer if existing fundraising efforts fall short. We would be interested to see a more detailed analysis from the staff on the amounts needed to achieve the future self-sustained lending capacity of the PRGT.

Transparency is crucial. Specific reporting on PRGT trading in the semi-annual report on low income financing is a step in the right direction. However, we seek quarterly reporting of SDR conversions in the voluntary trading arrangement system, including those related to PRGT drawings. In addition, we seek a commitment to report immediately to the Board any transactions or developments arising from SDR lending to the PRGT that are unusual or generate unintended consequences.

Mr. Pereira and Mr. De la Barra submitted the following statement:

We share the sense of urgency put forward in the staff report, where it is stated that available loan resources under the PRGT have fallen to near record lows even after concluding the borrowing agreements with the Bank of Spain and Danmarks Nationalbank. Indeed, the resources left are only expected to cover the projected demand until next July. In this regard, we would like to praise the Managing Director for his proactive role in approaching a wide range of members to ensure a timely mobilization of needed concessional resources. Those efforts have succeeded, with new loan commitments reaching 7.505 million SDRs as indicated in Table 1. Progress has also been made in obtaining the needed subsidy resources through additional bilateral subsidy contributions and the mobilization of the Fund's internal resources. However, it is still imperative to turn those pledges into loanable resources to meet the demand of Low-Income Countries (LICs) accommodating the needs of potential lenders.

When we discussed the overhaul of the lending facilities for LICs, a huge concern has always been the lack of sufficient concessional resources. This somehow prevented more flexible and tailored facilities to the needs of these countries, asymmetrically affected by this global financial crisis and not without long-lasting setbacks in poverty levels and development needs. Access levels were doubled, but fell short in containing the adverse impact of multiple external shocks. Given this constraint, this Chair claimed from the outset that the general SDR allocation opened a window of opportunity for a redistribution of those resources in favor of the poorest countries. Facilitating their transfer to these countries was one way to overcome one of the key shortcomings of the current SDR system: SDRs are allocated to countries on the basis of their quotas, so those who do not have liquidity and reserve needs get the vast majority of these resources

We learn today that most of the members that have pledged loan resources have indicated their intentions to use part of their recent allocations of SDRs. This is most welcomed, but we would like to highlight that by channeling these resources through the Fund we are turning unconditional resources (SDRs) into debt-creating loans attached with policy conditionality. This is not a minor change and could have been avoided transferring part of those SDRs directly to the LICs. Our point is therefore straight forward: both borrowers and lenders must be provided with adequate and equal flexibility in order to make this system work. Very innovative proposals have been put forward to address the need of the lenders. A reciprocate treatment must be provided to the borrowers, particularly in recognition that this crisis is not of their own making. We look forward for further reforms of the lending toolkit for LICs to meet their diverse needs.

Keeping that in mind, we support the proposals to modify the current borrowing framework in order to meet the preferences of potential contributors. Although the cost of transferring the SDRs has been eliminated through subsidy contributions, we understand that many potential lenders have accounting rules which count SDRs as assets, preventing them from transferring without incurring in a loss in their balance sheets. Thus, we can go along with the proposal of encashment of their PRGT claims in order to keep on qualifying as reserve assets being readily payable in case of need. On the proposal of establishing a liquidity buffer of 20 percent of outstanding loans, we fail to see how those resources would be used for PRGT lending without falling into continuing borrowing agreements that in any case must be put aside as a liquidity buffer. Using resource available in the PRGT reserve account seems preferable, although we trust in the staff recommendation to establish a buffer as part of new loan commitments.

The idea of issuing PRGT notes is appealing. Borrowing from the framework of GRA notes, this could provide a venue for significant additional contributions. We would like to ask the staff to provide a rough estimate about the potential demand for these notes. On loan maturities, the staff proposal seems to strike the right balance, accommodating some members' preferences while keeping the prerogative to unilaterally extending the maturity for additional periods as needed, effectively aligning the maturity with repayment schedules for PRGT lending. The changes in interest rates are less clear to us, but also seem to be tailored to lenders' preferences depending on whether SDRs or currencies are provided. However, by opening two types of interest rates (three-month official SDR interest rate), it will be cost-neutral for the SDR lenders. In fact, according to footnote 17, a small saving for the Subsidy account of the PRGT is expected. All in all, having resources in the subsidy account, we fail to understand the rationale behind this proposal. Finally, on the conversion of SDR loan resources, we would like to hear more about the pros and cons of the three options put forward in the staff report. It is subject to challenge that countries lending SDRs to the PRGT would end up buying most of the SDRs back over time, as asserted for Option 3. It looks like the burden sharing arrangements under the voluntary SDR trading would most likely be spread across trading arrangements. Option 1 seems consistent with countries' voluntary willingness to provide resources and ensure full funding of the new LIC facilities. We wonder why this would necessarily undermine the effectiveness of the current fund-raising exercise. We would like to take opportunity of the Board discussion to further assess this issue, keeping in mind that raising the needed PRGT loans is a key priority.

To conclude, while in broad agreement with most of the staff proposals, we claim that further flexibility must now be provided to LICs under this concessional window if most of the resources will come from the SDR allocation. It will be misleading to turn unconditional resources into debt-creating loans with policy conditionality as a way to address LICs' vast needs if we fail to provide in return higher access and conditionality is not limited in order to meet LICs' truly development needs. We look forward for a new overhaul of the lending facilities in the short-term.

With these comments, we would like to thank the staff for a well written report and their helpful clarifications in bilateral discussions.

Mr. Majoro submitted the following statement:

We thank staff for their well-written paper and the Managing Director for his tireless and dedicated effort to mobilize bilateral contributions in support of the Poverty Reduction and Growth Trust (PRGT). We note the concerns expressed and adjustments sought by lenders and subsidy contributors to the PRGT. We welcome and support the proposed new framework for mobilizing concessional loan resources to ensure timely and adequate funding and expeditious implementation of the new Fund facilities for LICs. We broadly support the proposed approach, including the specific elements of encashment, issuing of notes, shorter notional maturities and conversion of SDRs.

It is imperative that the Fund's PRGT resources are and remain adequate at a time of still lingering uncertainty and instability, and when LICs are in need of more concessional support from the Fund. The proposed adjustments need to be viewed from this perspective coupled with an appreciation of the urgency of replenishing and stocking the PRGT. Moreover, the proposals are mostly clarifications in terms of substance and are consistent with the core objectives and implementation modalities of the Trust.

We note that several members requested their new lending to the PRGT to qualify as reserve assets, be they in SDRs or other forms. They find it necessary that these claims to PRGT should always be liquid at the time of a balance of payments need. Furthermore, the Fund's tightening of the statistical reporting standards under the recent editions of the Balance of Payments Manuals, for loan resources to the PRGT not to qualify as reserve assets unless they were readily repayable necessitated the lenders' demand. In this regard, we support staff's encashment proposal as we see it providing a realistic solution and also because it is consistent with historical practice. We, however, note that encashment will require the maintenance of a significant liquidity buffer, which may in effect reduce the funds actually lent to the LICs relative to total mobilized resources and increases the cost to the subsidy account. Thus, while we support the encashment proposal, we urge that it should not reduce the targeted quantum of loanable resources.

We would support the purchase of notes as an added option to traditional loan agreements if this would facilitate or enhance some members' commitments to the Trust. It is our view that the Trust needs to be vested with the necessary flexibility, consistent with its objectives of mobilizing adequate funding and providing the needed safeguards for contributions to remain an effective instrument. A PRGT framework for issuance of notes along the same lines as the GRA's NPAs would contribute to higher mobilization of resources for the Trust.

In the same vein, the clarifications provided by staff on SDR loan conversions and the three alternatives they present to address the issues and concerns raised by contributors are very helpful. We agree with the need to continue with the current practice of handling PRGT related SDR Loan conversions through the burden sharing arrangements under the voluntary SDR trading mechanism as proposed in Option 3. This option has less of the limitations of the other two with the added advantage that it may eliminate the reservations of some members in participating in the PRGT. In addition, the expected annual average amount from the PRGT loans of less than SDR1 billion, would be far below the voluntary trading arrangement of SDR60 billion. Further, under this option, those members who have not contributed any financial resources could still be counted as supporting LICs through the burden sharing arrangements.

We note that some contributors to the PRGT have stressed the importance of assuring the safety of lending to the PRGT. In this regard, we are very much encouraged by the LICs' repayment track record of more than two decades long. We trust that this excellent record would be maintained and duly recognized and would provide the necessary comfort to PRGT contributors.

Finally, as we discuss necessary refinements to the PRGT framework, we would like to emphasize that ensuring sufficient resources to service both new loans and subsidies is of utmost importance. Therefore, we consider that all potential avenues beyond the traditional creditors, including Sovereign Wealth Funds should be explored.

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

We thank the staff for preparing a well-written paper that proposes a practical framework to facilitate loan resource mobilization for the Poverty Reduction and Growth Trust (PRGT). The proposed framework heightens the flexibility of donors to provide loans to the PRGT by enabling the PRGT to issue bonds and by establishing a new mechanism for lending SDRs to the PRGT. These measures will surely contribute toward widening the scope of donors and, thereby, toward accelerating the fund-raising drive for the urgently needed loan resources for the PRGT. In view of the deteriorating fiscal situations in advanced countries, now there is a much higher need to expand the scope of donor countries to secure the necessary resources for the PRGT. In this regard, contributions by emerging market countries, in addition to advanced countries, are strongly encouraged.

Against this background, this chair supports the staff proposal and, for emphasis, would like to offer the following comments:

Liquidity of Claims on the PRGT

The proposal to introduce full encashability and shorten the maturity to one-year will enable donor countries to count their claims on the PRGT as reserve assets. This proposal would certainly make it easier for donors to provide loan resources to the PRGT. Thus, it is anticipated that they would contribute toward securing the currently targeted amount of loan resources for the PRGT, and, possibly, exceeding the target.

Interest Rates

It seems quite fair to set the interest rate for SDR lending at a three-month SDR rate, because this brings about neither a profit nor a loss for SDR lenders. It should also be noted that paying a lower interest rate for SDR lenders than that assumed for the projection of necessary additional subsidy resources, means that SDR lenders would make financial contributions not only for loan resources but also for subsidy resources.

Conversion of SDR Loan Resources

In order to ensure the effective and smooth operation of the newly proposed mechanism for lending SDRs, it is crucial to establish a credible mechanism for swiftly converting the SDRs lent to the PRGT into freely usable currencies. In this regard, we would like to emphasize that Japan is well-prepared to buy back the SDRs lent to the PRGT if required under the existing SDR Voluntary Trading Arrangement (VTA).

Among the three options presented in the staff paper, Option 3 is clearly the most sensible, because: i) unlike other options, Option 3 does not require additional administrative costs to track the recording of PRGT-related SDR transactions separately from other SDR transactions; ii), under Option 3, a broader set of member countries are expected to participate in the international effort of securing enough resources for the PRGT, since the obligation of converting the SDRs into currencies is shared by all VTA participants; and iii) the current absorption capacity of the VTAs is large enough to accommodate the expected increase in SDR liquidity. It should also be noted that, as the staff points out, a large majority of the SDRs lent to the PRGT would be bought back by the SDR lenders themselves.

Safety of Lending to the PRGT

In order to widen the scope of donors and accelerate the fund-raising drive of PRGT loan resources, it is most crucial to conduct a thorough analysis on, and to provide strong evidence of, the safety of lending to the PRGT. In this sense, the Board's decision in1987 (Decision 8759, 12/18/87) which stipulates that the Fund commits itself to consider fully, and in good faith, all such initiatives as might be necessary to assure full and expeditious payment to creditors of the ESAF (currently converted to the PRGT), is essentially important. It should be noted that this decision also holds effect with regard to the PRGT. In addition, should a delay in the repayment to the PRGT be anticipated, the Fund should swiftly notify creditors and the Board of this forecast with an analysis of the possible negative impact on the sound financial operation of the PRGT, and take necessary measures as appropriate.

Mr. Hockin and Mr. Sajkunovic submitted the following statement:

We thank the staff for its report on the mobilization of loan resources for concessional lending. Ensuring that there are sufficient loan and subsidy resources for the PRGT is very important and is a joint responsibility of the membership, both traditional donors as well as those seeking a larger role in this institution. Clearly, our first preference would be for loan contributors to provide usable currencies as this would negate the number of challenges that appear when dealing with SDRs.

While this is our preference and represents the approach that Canada has taken, we can accept that for some loan contributors this may not be possible. Thus we are willing to look at ways to make the SDR lending proposal work in order to ensure that the Fund has sufficient liquidity to support concessional financing for its low-income members. However, this support would be conditional on having adequate safeguards in place and having the costs of such an approach distributed appropriately.

Encashment

We can agree with the proposal to allow for the encashment of new loan contributions so that they can qualify as reserve assets provided that the intention is for the buffer to be financed by the addition of new lenders and staff is confident that they can secure these additional resources and not impair the lending headroom of the PRGT. Should there be a problem raising the additional funding for the buffer, we would suggest that those lenders that require such a buffer for reserve treatment reasons consider increasing their contribution by the corresponding 20 percent. Participation in the encashment regime should remain voluntary.

We also agree with staff that the PRGT reserve account is not an appropriate financing source for such a liquidity buffer.

PRGT Notes, Loan Maturities and Interest Rates

As some members have indicated that they are willing to provide resources to the PRGT if they are able to purchase notes instead of providing loans we can support such an adjustment to the Trust Agreement. Similarly, we can also support the proposal for shorter loan maturities provided that the Fund retains the option to unilaterally extend the maturity to avoid mismatches between PRGT borrowing and Trust loans to LICs, if this will facilitate increased lender participation. Finally, staff's proposal to have differentiated rates for usable currency loans and SDR loans is appropriate as it better reflects the cost of funds under the two approaches (with the 3-month rate offsetting the cost of SDR loans and the 6-month rate partially offsetting the cost of usable currency loans).

Conversion of SDR Loans

As Mr. Lee and Mr. Duggan note, there is no free lunch when it comes to the conversion of SDR loans, particularly as these loans could impose counterpart costs on other members with voluntary SDR trading arrangements. As Canada is a usable currency provider that is already incurring associated costs to provide loan resources to the PRGT we would therefore prefer Option 1.

That being said, in light of our overall goal of ensuring that the Fund is able to support its low-income members we are willing to consider supporting Option 3 with a couple caveats. Our support for Option 3 would be conditional on (i) all SDR lenders to the PRGT having in place a voluntary SDR trading arrangement that is significantly larger than their expected loans to the PRGT and (ii) greater transparency through regular reporting to the Board on SDR transactions related to the PRGT. Our view on this issue has been helped by the repeated assurances provided by staff that the bulk of the SDRs lent to the PRGT are expected to be converted by the lenders through the normal operations of SDR market and the helpful statements by prospective SDR lenders of their willingness to buy back their SDRs.

Finally, we would also like to express our full support for the intention to have a formal review of the implementation of the proposed framework in one year to ensure that the allocation of SDR sales has been in line with expectations. Should the regular reporting and/or one year review indicate a deviation from expectations we would have to further assess our willingness to support such an approach through our voluntary trading arrangement.

Mr. Alazzaz submitted the following statement:

I thank the staff for a clear and well-focused paper on facilitating mobilization of loan resources for concessional lending to low-income countries (LICs). The discussion is timely in view of the far-reaching reforms of the Fund's concessional lending facilities for LICs and the decrease in available loan resources under the PRGT to a very low level that would be sufficient to cover the expected demand for only a few more months. Here, it is encouraging to note that the framework proposed in the paper has been developed to accommodate the needs of potential loan contributors that should help raise the necessary loan resources to meet the projected demand over the medium term.

The proposed encashment regime to help support the qualification of loan contributions to the PRGT as reserve assets and the option to purchase notes from the PRGT similar to the ones issued under Note Purchase Agreements (NPA) for the General Resources Account (GRA) should facilitate the provision of loan resources. Therefore, I can go along with these proposals.

Since new loan resources provided in SDRs are expected to be a major funding source as evident from recent pledges, it is important to clarify how the conversion of SDR transactions arising from PRGT loans would take place. In this regard, three options have been presented in the paper and the staff has recommended the Option 3, which would handle SDR conversions in the same way as other requests to sell SDRs through the informal burden sharing arrangements under the voluntary SDR trading arrangements. We can support this option for the reasons given in the staff paper, but it is essential that the transactions are conducted in a transparent manner and the informal burden sharing arrangements are strictly adhered to in these transactions. I can also go along with the suggestion to look at this issue after a year to assess whether the allocation of SDR sales relating to PRGT loans has been in line with the expectations.

Finally, I welcome the analysis of the adequacy of the PRGT Reserve Account for ensuring the safety of lending to the PRGT and am reassured by the assessment that the PRGT Reserve Account will continue to provide adequate protection to PRGT lenders/note purchasers over the medium term. Here, it is encouraging to note that the loan coverage ratio of the PRGT Reserve Account compares favorably with that in other international financial institutions.

Mr. Chua and Ms. Maung Gyi submitted the following statement:

We welcome the staff paper, which addresses the current state of PRGT resources and highlights the urgency to mobilize additional concessional financing resources to meet the needs of LICs. We agree with staff that it is urgent to mobilize resources to meet the needs of PRGT concessional financing. We support the proposed framework, and would like to highlight a few comments.

Encashment of PRGT Claims

In light of the sharp increase in concessional lending to LICs in 2009, recent pledges by member countries to provide additional loan resources in the form of their SDR holdings is timely and appropriate. We support the establishment of an encashment regime to allow lending to the PRGT to qualify as reserve assets while maintaining the current role of the Reserve Account. While noting that availability of committed resources is essential to make the encashment regime operational, it is also important to maintain an adequate liquidity buffer over time. The liquidity buffer is set at 20 percent of outstanding loans. While we support this, we would encourage staff to do additional work to provide us with greater assurance that this buffer would be adequate, even under stress scenarios.

Issuance of PRGT Notes, Maturities and Interest Rates

We are also supportive of the other proposals that will facilitate the provision of more loan resources. We welcome the option for the PRGT to issue notes to lenders who would find this helpful, as well as the shorter loan maturities, with the Fund having the discretion of unilaterally rolling over the loan to match the repayment period. We also support the differentiated interest rate that is proposed.

Conversion of SDR Loan Resources

With regard to the proposed approaches on conversion of SRD loan resources, we support the staff's proposal to continue with the current practice. We welcome Messrs Fayolle's and Gibbs' statement that France and the United Kingdom stand prepared to exchange the majority of their loans for hard currency. Like Ms Lundsager and Ms Franco, we would welcome other SDR lenders doing the same. We support a review of the SDR trading related to the PRGT after 12 months.

Safety of Lending to the PRGT

Improved transparency of PRGT financial transactions will be helpful in providing greater assurances of the safety of loans to the PRGT. Careful implementation of program designed by country authorities and close monitoring of program implementation by the Fund will help reduce the credit risks associated with PRGT financing.

Mr. Rutayisire submitted the following statement:

We welcome this discussion as an important step to ensure the effectiveness of the effort made by the Fund in 2009 to revamp its concessional lending facilities to make them more flexible and hence better help low-income countries weather the severe impact of the global financial crisis and economic downturn. The international adverse environment paired with the protracted balance of payments imbalances of LICs has induced an increasing demand for financial assistance from countries, both for short term needs and for longer term concerns of growth and poverty reduction. In such a context, we think that it is vital to broaden the spectrum of potential contributors and the Fund should take every necessary measure to facilitate mobilization of resources for concessional lending to LICs.

The staff has stressed the urgency of expeditiously securing additional loan resources given that available loan resources under the PRGT have fallen to near record lows due to the sharp increase in concessional lending to LICs in 2009. In addition, Table 1 P. 5 shows that pledges in SDRs constitute the majority of loan commitments to date. We therefore support, as many other chairs, the view that arrangements should be made to allow contributors to lend SDRs to the PRGT.

This chair is grateful to the members that have committed resources to fund LICs and encourage other contributors to join the effort. Aside the commensurate financing needs of the LICs, the encashment regime proposed by staff implies for management to mobilize resources beyond the target set forth. We understand that the lessons drawn from recent crises require caution from every country, and members, regardless of the size of their economies, might face abrupt changes and hence need to be repaid back. However, the possibility for lenders to request early payment and the need for liquidity buffers, among other factors, could put special pressures on the PRGT, if sufficient resources are not raised. Furthermore, we should make sure that the PRGT has much resource as needed, so that any accommodation to a lender in need does not preclude the Trust from meeting its primary purpose of lending to LICs.

Although we strongly support the approach of flexibility and the need to accommodate the will of potential lenders to mobilize enough resource as needed for the PRGT, we would caution against setting too many options—on lending options, interest rates, etc.—which could be difficult and costly to manage going forward. We encourage staff and management to explore the possibility of streamlining options and accommodations to groups of lenders that present similar features.

Finally, we appreciate the steps achieved to date in the context of the far-reaching reform of the concessional lending facilities for LICs. A comprehensive support emerging from today's discussion will undoubtedly reinforce the cooperative nature of our institution and help provide the needed resources for this reform to come into effect.

Mr. Bakker and Mr. Callesen submitted the following joint statement:

Ensuring adequate funding for concessional lending to low-income countries financing is important. Amid the global crisis, concessional lending to LICs has sharply increased. At the same time, uncommitted resources under the PRGT are dwindling, which underscores the urgent need to secure additional loan resources. Several countries in our constituencies have therefore already committed to sizable loans in usable currency, totaling 1 billion SDRs, as well as subsidy resources.

We recognize that SDR loans are important to reach the fund-raising target, although we have reservations using the SDRs for concessional financing. SDRs serve in the first place as a reserve asset. The Fund implemented the general allocation of SDRs to boost countries' external position and to help liquidity-constrained countries to address the fallout from the crisis. Using the SDRs for concessional financing or other purposes not envisaged at the time of the general allocation is in our view not in line with the purpose of the SDRs, and risks undermining its liquidity. The preferred course, also in terms of simplicity and transparency, is to provide loan resources through pledges in usable currency, as is also reiterated by staff. The creative use of SDRs begs for a broader Board discussion on the use of SDRs, including on the implications of 'earmarking' SDRs for possible reconstitution or cancellation of SDRs.

We can agree to the introduction of an encashment regime for claims on the PRGT, although we have some questions as to the specific design proposed. The staff argues that the reserve asset status of claims on the PRGT may be most important to members where loans are provided by the central bank. At the same time, we observe that claims on the PRGT constitute only a very small part of members' overall reserves. As a result of making the claim liquid, the Trust needs to raise more resources upfront than originally targeted. We have given our loan to be fully used to help LICs. While staff argues that a request for encashment is likely to be a very rare, the proposal of a substantial liquidity buffer to cope with this risk seems at odds with this claim. Hence, we would appreciate staff's comments on the possibility of holding a lower liquidity buffer than 20 percent of the outstanding loans, as seems warranted from the arguments presented above. Further, we would appreciate if staff could present options as to how to minimize the risk that funds lent to one PRGT sub-account is not used for lending under another sub-account following the unlikely event of encashment.

The alternative of PRGT note purchases is acceptable, as long as the financial conditions are the same as when providing loans in the traditional form. For the sake of meeting the fund-raising target and given that the Trustee would have the discretion of unilaterally extending the maturity for additional periods as needed, we also agree with the proposals to allow for shorter maturities.

Given our reservations against SDR lending, we favor those members who provide SDR loans to the PRGT to stand ready to fully buy these back for currencies requested by LICs. We note that likely trading of PRGT-related SDRs in relation to actual trading on the voluntary SDR market, and not in relation to total capacity of that market, could become quite substantial. We believe that the option of full conversion on behalf of SDR lenders (Option 1) would reduce concerns about fair burden-sharing, not least as SDR lending this time is on an entirely different scale than in the past. We fail to understand why members who provide usable currency loans to the PRGT should run the risk of paying twice, as they would also have to carry some of the burden of converting the SDRs (Option 3). If the overall motivation is to help attract sufficient financing for the LICs, we expect SDR lenders to maintain their pledges and commit clearly to buying back the SDRs for currencies requested by LICs also if they would have to fully reabsorb the SDRs that were lent out.

We strongly encourage SDR lenders to promptly establish a voluntary trading arrangement of sufficient size insofar they do not have one already.

The staff argues that under Option 3 SDR lenders will be responsible for providing the bulk of the usable currency. However, in practice we have seen prolonged periods in which some members have had holdings far below their allocations. We would appreciate staff's comments as to how to ensure that all countries lending SDRs will have sufficient voluntary trading arrangements in place to bear their fair share of the financial burden of SDR conversion. From a burden-sharing point of view, the situation described under Option 2, where much of the SDRs lent to the PRGT would end up be transferred to other participants in the voluntary trading arrangements, is unacceptable, and it should not even have been presented as an option. Could staff confirm that no arrangements are in place or being considered, that would have the same effect on the voluntary SDR market as Option 2?

We support staff's call to review the trading of SDRs related to the PRGT after 12 months. The uncertainty around the assumptions of the projected PRGT lending, the PRGT-related SDR transactions in relation to overall SDR trading, and the members' actions in the voluntary standing arrangements warrant a careful assessment after 1 year. In the meantime, we would expect staff to provide a clearer update on the status of the voluntary trading arrangements on a quarterly basis.

Resources in the PRGT reserve account appear adequate on the basis of staff projections. We note the strong track record of debt service to the Trust lenders. Key in ensuring that the PRGT will fulfill its future obligations to lenders is strong implementation of the economic adjustment programs that are supported by the Fund. We agree with the assessment by staff that using the reserve account to cover the liquidity buffer for encashment would not be appropriate.

We support the change to use the 6 month SDR rate on lending in usable currencies and the 3 month rate on lending in SDRs. This would reduce the incentives to prefer lending in SDRs, which would be cost-neutral. Any bias should favor lending to the Fund in usable currencies.

Mr. Stein, Ms. Gerdes and Ms. Meyer submitted the following statement:

We thank the staff for their paper on options to mobilize loan resources for concessional lending to low-income countries and appreciate the useful clarifications provided by the staff on the occasion of the informal briefing.

We are aware that securing the PRGT financing is an urgent matter, since the resources of the PRGT would otherwise run out later this year. At the same time and while recognizing the preference of some countries to provide financing for the PRGT in the form of SDR loans, we are concerned about the fact that part of the financing will now be secured by financial means that have been created by the Fund itself. Being the very institution to create and allocate SDRs, the Fund will become an indirect provider of PRGT financing if most of the contributions are lent in SDRs. We believe that this is not consistent with the Fund's role as a monetary institution. Furthermore, in our understanding, currency reserves should in general not be used in relation with IMF concessional financing facilities. The design and modalities of PRGT programs are different from GRA facilities and should therefore be financed differently. While SDRs may be considered as a means of a short-term solution or bridge financing by some countries, we caution against considering the provision of SDRs for PRGT financing as a viable long-term solution going forward. In any event, reserve assets should not be promoted by the staff as a means for concessional financing.

Against the background of the urgent financing needs of the PRGT and given that some countries prefer to provide SDR to the PRGT loan account, we would not want to stay in the way of the proposed modifications to the PRGT instrument, provided that other countries, if they wish so, are not affected by this arrangement. With regard to the conversion of SDRs lent to the PRGT, Option 1 constitutes in our view the best mechanism both in terms of a fair burden sharing with regard to the cost arising from PRGT financing, and also with a view of minimizing the effects on the functioning of the SDR voluntary trading arrangements (VTA). In contrast, Option 2 and Option 3 would involve all countries with a VTA and confront them, to some extent, with the cost of converting PRGT related SDR transactions into hard currency. Based on the staff paper and the informal briefing, we emphasize the following:

We understand that countries providing hard currency loans may decide to adapt their VTAs in a manner that will leave them unaffected by the trading of SDRs used for PRGT financing. In this regard, Germany will opt for not converting SDRs that are in any way related to the PRGT. In that context, the staff will need to ensure sufficient transparency of SDR trading.

We understand the participation in the PRGT encashment regime is voluntary. At this point, it is not our intention to participate in a possible PRGT encashment regime. Therefore, any financing contribution from Germany shall not be used in case an encashment is requested from a PRGT lender. Germany will also not participate in financing the respective liquidity buffer.

Furthermore, we agree with the staff that there should be no resort to the reserve account in case the Trust fails to secure the necessary financing for the liquidity buffer. It is essential that the reserve account constitutes an adequate safety net for lenders to the PRGT. In light of the substantially reduced conditionality standards of the PRGT facilities and increased lending volumes a higher safety level than the historical average reserve coverage ratio may be needed. In any event, this ratio should be considered as a minimum safety level.

Going forward, PRGT financing needs to be more balanced across the membership, in particular with regard to G20 countries. It is also essential to better monitor the volume and efficiency of PRGT loans and to seriously evaluate its self-sustained financing capacity. In particular, the recent high increase in PRGT commitments should be thoroughly examined. Furthermore, we see a need to have a more critical look at cases of prolonged use of PRGT financing.

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

We had already welcomed the initiatives to reform the financing instruments for low income countries (LICs) and to revise the conditionality framework. The Fund can also greatly benefit LICs by concentrating on its core mandate of ensuring macroeconomic stability, developing cross country perspectives and drawing and disseminating lessons from the experiences of advanced and emerging market countries. We thank staff for the long awaited paper on “Facilitating Mobilization of Loan Resources for Concessional Lending to Low-Income Countries.”

Our main concern is that any proposal to utilize the newly allocated SDRs for supporting LIC lending should meet the tests of transparency and equity. This chair had sought greater clarity on this issue on a number of occasions in the past. In our view, had this clarity been provided in a timely fashion, at least some potential contributors would have been in a position to commit resources to meet urgent requirements.

The Fund and a number of members have been championing greater transparency in what the Fund does. We expect similar transparency in the financing mechanisms used by the Fund. Aid to low income countries is primarily a fiscal function at the national level and ideally both and loan and subsidy resources for the PRGT should have been raised through national fiscal contributions. However, given the urgent need for loan resources for the PRGT, we are in a position to support the raising of resources through SDR loans from members and related elements of the proposal including the framework for encashment, issue of PRGT notes and shorter notional maturity periods.

However, since freely usable currency loans are clearly the preferred option, the terms of the loans should be decisively tilted in favor of such currency loans. This could be done through:

- Preserving the higher interest rate for currency loans;
- Inserting a clause in PRGT loan/note purchase agreements that borrowings made in freely usable currencies would be repaid in the same currencies and borrowings in SDRs would be repaid in SDRs.

Our other key concern is that transparency is also maintained as to who is bearing the real costs of the proposed transactions and in what proportion. The costs of holding SDRs for non-reserve currency issuing countries are higher than those for reserve currency issuing countries, and this could potentially result in transferring the subsidy burden from the budgets of rich countries to emerging markets. This in our view is neither transparent nor equitable. Hence our first preference is for Option 1 in paragraph 28 of the staff paper.

We are not sure whether the proposed arrangements under Option 3 of paragraph 28 and in paragraph 30 in their current form would be adequate to address our concerns about transparency and equity. We would expect greater clarity and firm safeguards regarding Option 3 to ensure that subsidy burdens are not unduly shifted. Why is it proposed to only have an expectation, and not a requirement, that a country lending SDRs to the PRGT would also have a two-way voluntary arrangement? What would be proposed proportion of the size of the voluntary arrangement to the amount of SDR lending? We presume existing and new entrants to voluntary trading arrangements would have the option under the arrangements to not buy SDRs that had been lent? We would also be interested in hearing from staff on the suggestions for greater reporting transparency made by Ms. Lundsager and Ms. Franco.

Mr. Mozhin and Mr. Tolstikov submitted the following statement:

We thank staff for a well-written paper and for their efforts to clarify the proposals and achieve a better understanding by all interested parties.

There is an urgent need to gear up the adoption of additional commitments to provide loan resources for the PRGT, because available resources have fallen to near record lows and may be exhausted in a few months. Therefore we welcome the proposals aimed at making the conditions for lending to the PRGT more attractive for potential new lenders. We mostly support them, although some further improvements could be considered.

The proposed amendments to PRGT mechanisms may be appealing for central banks, which will appreciate the possibility to treat PRGT loans as an allocation of their foreign reserves. The amendments aimed at facilitating the use of SDRs will further help the central banks to lend to the PRGT. Taking into account that many governments are facing fiscal consolidation problems, we hope that such strategy may open additional opportunities for fundraising.

Encashment Mechanism

We support the proposals on the encashment mechanism, which will allow the loans to the PRGT to qualify as international reserve assets. Unfortunately, there is no free cheese and additional loan resources (about SDR 1.8 billion) should be drawn in order to create a liquidity buffer for encashment. We hope that improved attractiveness of loans to the PRGT will help to engage new lenders to cover the need for additional loan resources.

However, in order to maintain the concessional nature of PRGT loans, additional subsidy resources should be provided in connection with all new loans in order to subsidize interest rates. We, therefore, would welcome staff comments on the possible need for subsidy resources required to support the projected increase of the PRGT by SDR 1.8 billion. It is also important to know if additional subsidy recourses would require additional contributions from donor countries. The staff's comments are welcome.

In some countries loans to the PRGT may include the requirement to provide money strictly for low income countries' borrowing needs, but not for the other countries' early withdrawal of funds. In this regard, it is important to establish a procedure that will clearly demonstrate that even in the event of encashment the funds from the liquidity buffer are used for substituting a fall-out financing for low-income countries.

PRGT Notes, Maturities and Interest Rates

We agree with the proposal to issue PRGT notes, as this will align PRGT mechanisms with the options that exist in bilateral lending to the GRA.

We also support the option to lend in shorter maturities. However, we agree with Mr. Prader and Mr. De Lannoy that such shorter maturities should be the exception rather than the rule. This creates the risks of maturity mismatch and, probably, the need for additional reserves. We would welcome staff comments on whether there is a need for such reserves or the existing Reserve Account could be used for these purposes.

We can go along with the proposed differentiation of interest rates. This will make lending in SDRs even more straightforward and therefore attractive to potential lenders, while no harm will be done to those lenders who will continue to provide resources in freely usable currencies.

Conversion of SDR Loan Resources

This is the most contentious issue of the proposed mechanism and the controversy that appeared around it suggests that assets in SDRs are regarded as less attractive than the assets in freely usable currencies. Therefore, some participants in the voluntary SDR trading arrangement may want to accept the SDRs only from those countries that experience real financial problems, but not from other, mostly trouble-free participants. "A few members have already indicated that their participation in the voluntary SDR trading arrangements should exclude SDRs lent to the PRGT, while others have been reluctant to establish voluntary trading arrangements until this matter is clarified" (page 13).

Russia is not the member of the voluntary SDR trading arrangement for the lack of reconstitution requirement. Having no vested interest in the SDR conversion discussion, we can only observe, that currently Option 3 is de-facto in place. "Under previous loan agreements four members committed, in aggregate, about SDR 1 billion of loan resources in SDRs. Conversion of the SDRs was handled through the voluntary trading arrangements" (page 14). The third option would avoid the fragmentation of the SDR market and support smooth functioning of the voluntary trading arrangements mechanism.

Having said this, we fully support the calls for greater transparency in reporting on SDR trading, which should become quarterly and allow us to distinguish the conversion operations related to the PRGT drawings. Full transparency may be helpful for easing possible tensions between participants of the voluntary trading arrangements.

It looks also that the introduction of Option 1 is technically possible, although it cannot be extended to all participants of the voluntary SDR trading arrangements. The country choosing Option 1 can lend to PRGT in SDRs and then buy them all back. As we understand, at the same time a country may refuse to buy the SDRs resulting from other countries' lending—this is possible under the terms of voluntary SDR trading arrangements. Therefore, Option 1 and Option 3 could coexist and the difference in views should not be an obstacle for the fundraising efforts. The staff's comments are welcome.

Mr. He and Ms. Lin submitted the following statement:

We welcome this opportunity to discuss proposed approaches to mobilizing the necessary resources for concessional lending to LICs, including the idea of utilizing the general SDR allocation to mobilize additional loan resources, given the fact that loan resources are inadequate while SDR resources remain under-used. We agree with Mr. Lee and Mr. Duggan that a broader discussion on the operations of SDRs is needed in greater depth going forward.

In principle, we believe that the staff's proposal constitutes a pragmatic solution to promptly raising needed loan resources for PRGT by accommodating potential contributor's concerns over liquidity, safety and rate of return on committed resources. However, 6-month rate should apply not only to those contributing in currencies, but also to SDR contributors participating in SDR voluntary trading arrangements.

Encashment Mechanism

We see merit in establishing an encashment mechanism in order to ease contributors' concern over the qualification of their pledges as reserve assets. Judging against the level of liquidity buffer for lending under GRA, the proposed 20 percent of outstanding credit seems to be a reasonable benchmark. We agree with the staff that a separate liquidity buffer should be set up instead of using PRGT reserve account as such account is intended to provide security for loans under all facilities of the PRGT.

Issuance of PRGT Notes

We support the introduction of PRGT notes based on recent experience with the framework for GRA notes, which provides more options for potential contributors. Moreover, the PRGT notes should carry identical financial terms as loan claims. We look forward to the discussion on the general terms and conditions (GTC) for PRGT notes and note purchase agreements (NPA).

Loan Maturities and Interest Rate

We agree that a shorter maturity along with the discretion of extending the maturity up to 10 years would ease members' concerns over liquidity while addressing the mismatch in maturities between PRGT borrowing and Trust loans to LICs.

We have reservation about the proposed differentiated approach with respect to the interest rate paid on borrowing, depending on whether SDRs or currency are provided. The rational for this is that 3-month official SDR interest rate reflects the direct cost for members of lending their SDRs. It is true that the intermediation cost of providing SDRs loans is 3-month SDR rate. However, for those members who provide SDRs loans and then buy them back using their own hard currency under the existing SDR voluntary trading arrangements (VTAs), the whole practice does not differ from providing currency. Hence the 6-month rate should also apply to the contributors participating in SDR VTAs.

Conversion of SDR Loan Resources

On balance, we support Option 3, which strikes a right balance of prompting the mobilization of much-needed PRGT loan resources and presenting a reasonable burden-sharing arrangement across VTA participants as countries extend SDR loans to the Trust would end up buying back the bulk of the extended SDR loan resources. In addition, the option helps avoid segregating the SDR markets, which is good for the functioning of the market. However, to ensure the envisaged burden-sharing mechanism, members providing SDR loans are encouraged to sign VTAs and take their due responsibility.

Safety of Lending to the PRGT

Due attention should be given to the safety of lending to the PRGT. The credit risks of PRGT lending rise along with the enlarged credit outstanding over the medium-term. We urge the staff to keep a close eye on the adequacy of the PRGT Reserve Account as its coverage ratio would drop dramatically over the medium-term.

Sustainability of PRGT

We are convinced that only a long-term reliable funding for the Trust could meet the LICs' need for poverty reduction and growth. To the extent that the PRGT becomes unsustainable LICs will suffer the most. .We hope that the staff could make an objective assessment of the Trust's sustainability after this round of fund-raising activity and come up with options to strengthen its sustainability.

Mr. Weber and Ms. Tartari submitted the following statement:

We welcome that the comprehensive reform of the Fund's concessional lending framework and the amendments introduced to the Poverty Reduction and Growth Trust (PRGT) are now being underpinned with concrete financing arrangements. The proposals in the paper demonstrate staff's willingness to swiftly move forward with the fund raising needed to support these reforms, while accommodating the special needs of some contributors and other members. While we maintain our commitments to meet the crisis-related needs of low income countries (LICs), we remain to be convinced of the proposed lending framework.

We have strong reservations about the proposal to make the PRGT claims encashable and about shortening loan maturities. Long-term needs should continue to be financed with long-term funds, avoiding a maturity mismatch. The staff proposes to introduce a liquidity buffer of 20 percent, which in fact not only accommodates the needs of some members to request early repayment of outstanding claims and to qualify their new lending as international reserves, but also increases the volume of loan resources that must be raised. It is disconcerting that staff implicitly requests to augment bilateral loan contributions by SDR1.8 billion without justifying this level in a satisfactory way.

We would clearly prefer that donors to the PRGT provide hard currency liquidity. This is what the Trust and ultimately the recipient LICs require. Option 1 would thus be the most appropriate solution in our view. We are disappointed that staff did not itemize the reasons why members might not be willing to lend SDRs to the Trust in cases in which they are required by LICs to automatically stand ready to buy them back. However, the statement made by Messrs. Fayolle and Gibbs that they will exchange a majority of their SDR loans provides some comfort and opens the door for considering Option 3. If Option 3 is chosen, then we have a strong expectation that all members pledging SDRs enter a voluntary SDR arrangement of at least the same magnitude as their proposed SDR loan.

In addition, a review of SDR trading related to the PRGT after 12 months is warranted to take stock of the proposed framework and to verify whether there is a free-rider problem that threatens to overstretch the system. Further and, most importantly, we expect a clear commitment from staff to enhance transparency. We support the points made by Messrs. Hockin and Sajkunovic on these two issues. The suggestions made by Ms. Lundsager and Ms. Franco are very welcome.

As to the PRGT Reserve Account, we should make sure that it provides adequate security to PRGT lenders. Doubling the access limits of concessional lending facilities and streamlining the conditionality of programs may have increased the credit risk despite the constant metrics mentioned by staff. In this regard, we agree with staff that the PRGT reserve account should not be tapped for financing the liquidity buffer.

In a similar vein, we call on staff to present a binding timetable and to identify and earmark the resources needed to achieve a self sustained Trust. We should recall that the borrowing arrangements are supposed to be a financing source to bridge the time until the PRGT is self sustained.

Unfortunately, most of the proposed changes would call for an amendment of the PRGT just a few months after we amended it. The “raison d’être” of such a contract is to provide a predictable framework that should not be altered too frequently. In addition such amendments are also very costly. In the case of Switzerland, each amendment needs a formal government decision and a legal opinion on the necessity of a parliamentary procedure.

Mr. Guzmán and Ms. Balsa submitted the following statement:

Our overarching priority when approaching today´s issues is to contribute to the purpose of securing the additional loan resources to cover concessional lending by the PRGT. It is in this light that we welcome proposals by staff to modify the framework for lending to the PRGT, even though countries in my constituency had already signed lending agreements whose terms seemed reasonable to both parties. In that sense, we make a general call to colleagues not to lose sight of our main objective. It would be both regrettable and unacceptable to leave the PRGT—and, by extension, the IMF—with an unfunded mandate (commitments without resources) to lend to LICs in the aftermath of the crisis, barely months after the Board agreed to meet the projected demand for concessional financing through 2014. We call on the membership to urgently consider contributing to the task; staff points out that due to the sharp increase in concessional lending to LICs in 2009, available resources are only sufficient to cover expected demand for a few months.

In support of the success of these new agreements, we can agree to the staff's proposals for amending or clarifying the lending framework.

As a general comment, we consider that the situation of current lenders who have already concluded their agreements should be dealt with minimizing changes and/or avoiding unnecessary modifications and the specific treatment of the relevant issues should be clarified by the staff, case by case.

On the main modifications/suggestions for the framework:

Encashment

We can support other members' requirement to lending qualifying as reserve assets and the staff proposal to establish a voluntary encashment regime under the PRGT. Clarifying the treatment for the case of current lenders is especially relevant in this case.

In any case, as staff states in its report, two elements are critical for such regime to work: relative broad participation by lenders and a 20 percent buffer of loan resources amounting to SDR 1.8 billion. We would like to highlight, however, that the combined effect of this buffer with the reserve policy for the PRGT would leave 60 percent of the lendable resources unused. Taking into consideration the de-facto nature of preferred creditor of the IMF, the track record of our loans, the fact that in this particular instance we are talking about concessional loans (always the last to go unpaid), and last, but not least, the fact that encashment would only become relevant if in the extremely rare event when a creditor country were affected by a BoP crisis, we consider this combined level of idle resources excessive. This is consistent with our position in the debate on the accumulation of reserves at the GRA.

Whatever the size of the buffer and reserve level we might agree to, in seeking additional pledges the staff should address in the first instance the creditor countries requesting encashability, only then resorting to new contributing countries perhaps less interested in the regime, and as a last option, to countries with agreements in place. This process would be consistent with the need to cover the overall needs of the PRGT (loans plus reserves plus buffer) and would incentivize participation in the encashment regime.

Be it as it may, we agree with Mr. Lee in that, to prevent any problem in this relation, staff could perhaps articulate a contingency plan for the event that the 20 percent buffer is not raised, including the final use of proceeds from gold sales.

PRGT Notes

We support the proposed approach for issuing PRGT notes. We do this in the understanding that they are to be strictly equivalent in financial terms to the standard loan contributions.

Maturities and Interest Rates

With regard to maturities, we share with others the concern that shorter maturities (one year) could create a mismatch with the repayment period of PRGT loans (up to ten years). Nevertheless, we feel comfortable with the provision that the Fund would have the discretion of unilaterally extend the maturity for successive years.

We can also support the regime suggested for interest rates. We reiterate that this particular change (plus the introduction of the encashment regime and the possibility of issuing notes) leaves the existing contracts with a need to be reviewed in order to guarantee uniformity of treatment.

SDR Conversion

We agree that the third option should be pursued, that is to continue handling SDR conversions in the same way as other requests to sell SDRs through the arrangements under the voluntary SDR trading system. We believe it is the best way to maintain broad support for the voluntary agreements while raising the needed funding.

As the staff report points out, there are clear precedents for SDR lending to the PRGT. The PRGT instrument and its predecessors authorize Trust borrowing in freely usable currencies or in SDRs. Furthermore, the maximum requests for SDR conversion associated with PRGT lending could amount to less than SDR 1 billion per annum, compared with the total capacity of the voluntary SDR trading arrangements at present of about SDR 60 billion. Finally, the Articles of Agreement remind us that we should promote the use of SDR and we are having difficulties in finding a more justified, safer and nobler use to the instrument.

Within this constituency, the authorities with voluntary agreements in place are, as Mr. Gibbs and Mr. Fayolle, committed to playing a full part in the effort to convert SDR resources.

While countries are free to reject a sale offer under their voluntary agreements, the staff should keep in mind that, were this attitude to affect the funding or the effective operation of the PRGT, the deficit should be brought to the immediate attention of the Board in order to discuss the necessary alternative measures.

Among them, the simplest would perhaps be to proceed ahead with a selective SDR allocation to the PRGT eligible countries, to cover their financing needs for a certain period of time, while we simultaneously activate the mandatory SDR designation plan. We could also explore convening a pledging conference among Ministries of Finance to cover the gap.

Mr. Nogueira Batista and Mr. Fachada submitted the following statement:

We thank staff for the effort to find alternatives to increase the lending capacity of the Poverty Reduction and Growth Trust (PRGT).

We support several of the staff's proposals, which have similarities to the framework approved last year by the Board for borrowing by the Fund. These proposals include: (i) the encashment regime, which enables contributing countries to consider their pledges to the PRGT as reserve assets; (ii) the maintenance of a liquidity buffer to guarantee encashment; (iii) the issuance of notes by the Trust; (iv) the shorter maturity of commitments, extendable by the Fund up to ten years, consistent with PRGT borrowing maturities; and (v) the use of the 3-month SDR interest rate on SDR lending.

Some of the above-mentioned proposals also have similarities with options under consideration in the new and expanded NAB. We therefore concentrate our comments on the more controversial issue—judging by last week's informal briefing—of the conversion of SDR loans.

Among the options that are suggested by staff regarding SDR conversion, our preference is for Option 1, which requires lenders to stand ready to convert SDRs into freely usable currencies at the request of borrowers. Some member countries may prefer to lend SDRs to the Trust instead of providing freely usable currencies. However, the reasons not to fully commit to the conversion seem quite obscure. Indeed, if SDR lenders are willing to, and will eventually end up buying most of the SDRs back over time through the voluntary trading system, as staff expects, why shouldn't this option be adopted upfront?

Option 1 also has the clear advantage of protecting participants and potential participants of the voluntary trading system from the burden-sharing associated with the PRGT. It would be particularly unfair to those members that are committing to lend freely usable currencies to the Trust that they should be called to provide further amounts of international liquidity to cover request by borrowers.

As a compromise, we could envisage an intermediary option between staff's Options 1 and 3, depending on the members' ratio of SDR holdings-to-allocation. Among the six countries that are committing to lend SDRs to the Trust, half had, at end-February (most recent position), SDR holdings above their allocation and the other half had holdings well below allocation. Therefore, our suggestion would be that, if the SDR holdings-to-allocation ratio is below 100 percent, the member should stand ready to convert its SDRs. If the level of SDRs is reconstituted and holdings reach 100 percent of allocation, we could support that conversions be carried out through the voluntary system.

The staff estimates that the existing 28 voluntary arrangements would be able to absorb up to SDR 60 billion. Despite the high volume traded since last year's allocations to February, only about half the members with voluntary arrangements actually acquired SDRs, as can be inferred from SDR holdings data in the Fund's webpage. Among the purchasers are countries that have an above average ratio of SDR holdings-to-allocation, while others that have a relative low ratio have not entered the market. As discussed in the informal briefing, this can be explained by trading ranges. However, if that is the case, some participants may have very narrow trading limits and their voluntary arrangements may be irrelevant from an operational point of view. The voluntary mechanism lacks transparency and it would be useful if staff provided more detailed information on trading to the Board on a quarterly basis in the report on Voluntary Trading Arrangements and Designation Plan. Although this information may be confidential, it can, in one way or another, be tracked from data already published on a monthly basis in the Fund's website.

Brazil chose to reconstitute its SDR holdings immediately before the 2009 allocations, thus indirectly contributing to the absorption of part of the supply that was expected to materialize. Of note, the magnitude of this acquisition, relative to allocation, was larger than the acquisitions of any country with trading arrangements since the 2009 allocations. We therefore urge members that are willing to lend SDRs to the PRGT to lead by example and reconstitute their SDR holdings.

The Acting Chair (Mr. Shinohara) made the following statement:

This is my first Board meeting, and I very much look forward to very long and productive relationship with all Board members.

We meet today on an issue which has been at the core of the Fund's work for decades—the framework for mobilizing loan resources for lending to low–income countries. As Directors no doubt realize, the staff has provided us with a rich set of proposals, even though at first sight they appear quite technical. In an informal briefing on this paper, as well as several bilateral discussions, staff has provided clarifications and answered many questions.

As Directors noted in their grays, we need to finalize the new framework so that we can deliver on reforms on concessional lending facilities agreed by the membership last year.

As you know, there is added urgency to this task because remaining uncommitted loan resources have now fallen to very low levels. As I read the grays last night, I saw broad support developing on many of the proposals. I also realize many Directors have gone the extra mile in support of the package, and I am grateful for that.

As we embark on this discussion today, I look forward to the consensus emerging in support of the proposal, and this paper.

Mr. Rouai made the following statement:

We thank staff for their concise paper and for their outreach and informal meeting which was helpful in clarifying many of the issues for consideration. We can go along with staff proposals because of the urgency to mobilize loans resources for the PRGT and also because the use of SDR to provide loan resources would somehow contribute to promoting the SDR. In this connection, we join other Directors' call for an early Board discussion on the SDR mechanism.

We have no difficulty with staff proposals to introduce PRGT notes similar to those issued under the Note Purchase Agreement for GRA borrowing, to shorten the maturity under loan/note purchase agreements, and to allow the PRGT to pay the 3–month SDR official interest rate quarterly on loans in SDRs.

We support the proposal to set up an encashment regime for PRGT claims so as they can qualify as reserve assets. However, while we see the rationale for a 20 percent liquidity buffer, we have an open mind on how such a reserve is to be financed. We can support additional fund–raising efforts to mobilize SDR1.8 billion, although one may argue that the latter amount should also require a liquidity buffer. We note, however, that current loan commitments fall short of the SDR 10.8 billion. While we encourage staff to persevere in their fund–raising efforts, we can support the use of the Reserve Account to finance the liquidity buffer. We take note of staff's reservations about this option; however, the staff also makes a strong argument about the low probability of encashment.

On the conversion of SDR loan resources, we can go along with Option 3 and support its review after one year. However, we will be more comfortable with Option 3 if the proposed framework is transparent. For example, we fail to understand the confidentiality argument behind the lack of details on individual SDR trading arrangement, the more so since all the terms and conditions of all other individual transactions with the Fund, including the FTP, loans/notes purchase agreements, and the NAB are made public. The staff's clarifications on how to implement Option 3 while keeping SDR trading arrangements confidential would be welcome. We encourage staff to persevere in their efforts to expand voluntary trading arrangements to additional participants in the FTP.

Finally, we join Mr. Geadah and Ms. Choueiri in encouraging management and staff to intensify their fund–raising efforts to reach the target for additional subsidies contributions.

Mr. Callesen made the following statement:

As Directors will understand from our gray, we are among those who are quite skeptical about these developments and the use of SDRs for many different purposes, and we thought quite a bit about this. I do not want to leave the impression that my authorities are overly paranoid about developments in this area, but they feel that they, together with a few others, have born quite a lot of financing burdens in this area for the last 50 years or so. They are not quite sure if it is appreciated to the same extent any longer, as evidenced by the governance reforms at the World Bank, the general pressure on Europeans at on Governance issues and the construction of the G–20, etc. There is a perception that one needs to be a little more careful that burdens are being shifted even more to our countries.

Option 1 would definitely be a clear preference, but we can also see the arguments put forward by quite a few that in between Option 1 and 3, one may actually see the situations that come out with rather similar results. Whatever option is chosen, there is a need to work out some safeguards on a couple of issues. First of all, we would need to listen carefully around this table to hear what is happening with the commitments to buy back SDRs from the countries who choose to lend in SDRs.

The second issue we are seeking clarification on is what is happening with the voluntary trade arrangements in countries that have not yet established them. That could, as several Directors have indicated, form a portion of the conditions for lending in SDRs.

The third issue, as mentioned by many, would be the issue of transparency, and we would like to ask staff to come up with a system that can be established toward transparency in this field with a review, say, over 12 months, based on the overall development in SDR markets, and how those changes in the SDR holdings relate to the lending in SDRs for this new purpose.

The fourth consideration could be SDR lenders coming together as a group, creating some kind of solidarity between them, if the reasoning behind SDRs would be greater flexibility. If they would, as a group, agree to exchange and buy back SDRs, that would be more comfortable for those countries that at the first stage lend in hard currencies and not SDRs.

Finally, we would like to ask staff what the available backstop or safeguards would be for avoiding unwanted burden–sharing outcomes for countries lending in hard currencies, which are somewhat worried that the SDR lending could deliver burden–sharing problems. What safeguards could be developed here? The Germans have a specific model, which I am not sure will be tremendously effective in practice, but that is one way of doing it. Perhaps another way would be to look into the voluntary trading arrangements.

These would be the issues that would need to be considered, whatever option is selected.

Mr. Fayolle made the following statement:

I have a few points to make after reading the grays for this discussion. I presented my own view in the gray I submitted together with Mr. Gibbs.

The first point is that pledges are still falling short of the target, and we need to continue supporting low–income countries. From this point of view, what the staff has managed to propose after extensive consultations with lenders, potential lenders, and potential borrowers, is an adequate and fair framework that is consistent with the urgent need to boost resources and enlarge the base of contributors. It is neutral for potential borrowers.

As Mr. Kotegawa said clearly in his gray, having SDR loans with a three–month interest rate and not the traditional six–month interest rate, as was done in the past, is equivalent to making SDR lenders contribute not only to loan resources but also to subsidy resources. This is because projections of subsidy resources were based on the assumption that the six–month interest rate would be paid to lenders. Mr. He is also right to point out that SDR lenders will incur a cost at the time of the buy–back.

Turning to SDR questions, we support many arguments given by colleagues in favor of Option 3. First, like Mr. Majoro, Mr. Geadah and Mr. Kotegawa, we note the amount of SDRs related to PRGT loans is very small compared to the overall size of the voluntary arrangements, which is obviously the only relevant benchmark to assess the potential impact of SDR lending.

Second, we agree with Mr. Sadun, Mr. Majoro and Mr. Kotegawa that this is the most practical and least burdensome option. Third, as pointed out by Mr. He, Mr. Mozhin and Mr. Sadun, this option would avoid a segmentation of the SDR markets, and this is also very important for us.

I also do not understand the importance of adding adequate safeguards to ensure Option 3 in the implemented in a fair manner. On this, I have three comments.

First, as stated in my joint gray with Mr. Gibbs, SDR lenders are expected to convert the bulk of their SDRs to usable currencies, not least because such lending activity reduces the lending ratio. Reading the grays of Ms. Lundsager and Mr. Geadah, I hope this can ease their concern.

Second, all lenders will have a voluntary arrangement in place at the time their loan becomes effective, which I hope addresses the request of Mr. Lee and Mr. Weber.

Finally, I think it is a good idea that transparency and the transactions resulting from this agreement would be made open, and that would help to have transparency in these kinds of transactions, as suggested by Mr. Hockin, Mr. Prader, and by Ms. Lundsager.

Ms. Tartari made the following statement:

We have presented our position in our gray, and would like to add the following comments after having read the other grays.

First, like the German, Dutch, and Nordic chairs, we consider the use of SDRs for concessional financing or other purposes not envisaged at the time of the general allocation as not in line with the purpose of the SDRs.

Second, on encashment, we remain skeptical about the idea to make the PRGT claims encashable, as we also underscored in our gray. However, in case such a decision were taken and problems with raising the additional funding for the buffer emerge, we join the Canadian chair and suggest that those lenders that require such a buffer for reserve treatment reasons consider increasing their contribution by the corresponding 20 percent.

Third, as reported in our gray, we could consider supporting Option 3 if three conditions were met. First, all SDRs lenders to the PRGT should have in place a voluntary SDR trading arrangement. We agree with the Belgian chair's observation that for Option 3 to work, this voluntary SDR trading arrangement should have a capacity that is significantly larger than the lender's expected loans to the PRGT. Therefore, having a voluntary SDR trading arrangement with a lender for an amount significantly larger than the country's expected SDR lending to the PRGT should be a precondition for the PRGT to borrow in SDRs from that country.

The other two conditions to be met for us to support Option 3 are a clear commitment from staff to improve transparency, and a review 12 months after the implementation of the proposed framework. In addition, we reserve our right to revise our position if evidence of free riding were to be found.

Mr. Guzmán made the following statement:

We have issued our gray. I read the rest of the grays and, because in our gray we state the position of our whole constituency, I need to clarify the position of countries involved in the PRGT and lending.

For the record, Spain has contributed in SDRs, and Spain is prepared to take part in the encashment regime provided we clarify what happens with the amounts disbursed already from existing loans. That, I assume, will be taken care of by staff on a case-by–case basis. Spain has a voluntary agreement in place and is prepared to purchase SDRs from the PRGT in the amount the agreement allows for, which in terms of the size that concerns some colleagues, is 2.5 times larger than our loan to the PRGT.

In my constituency, Mexico also has a voluntary agreement in place, and would be prepared to attend to demands from the PRGT.

More generally, though, I would like to state that we consider the discussion on the conversion very unfortunate. It is an instance where multilateralism has worked poorly. I would like to clarify that we understand this mechanism only as a means to facilitate increasing the resources available for concessional lending by the PRGT.

In the context of the returns on the loans, several colleagues have said that there is an advantage in lending in SDRs to the PRGT. The amounts involved are minimal. This has been highlighted by a number of colleagues. If there are any the return differentials, it should be pointed out that today's SDR rate is higher than the dollar rate. If there was any differential, it would amount to a ridiculously small share of the total income obtained by central banks from the reserves. Any unforeseen or unwanted position in SDRs that would arise from the lending to the PRGT by others would be neutralized in the same morning that the transaction takes place, by a compensating operation in the markets. So, after having checked with the two central banks in my constituency that have voluntary agreements, we fail to see where the reason lies for such an amount of skepticism and conditionality imposed by several colleagues on the use of the voluntary agreements, to purchase SDRs coming from the PRGT.

Anyway, we are prepared to join our voice to any consensus and in any case, we congratulate staff on their patience.

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

Let me first thank Directors for their time and support in helping the staff develop the proposals that the Board has before it today. As the Acting Chair noted, these have benefited from several rounds of consultation, and Directors have been helpful to us throughout this process in providing us with feedback and with consulting with their capitals.

I will touch on two broad issues that have been raised by Directors, and then my colleagues will also address some of the additional questions.

The first issue I want to talk about is encashment where there were a number of questions about the size of the liquidity buffer, the degree of participation needed to make it work, and the implications if we have lower than expected participation.

Let me say a few words on how we see this working in practice. First, I want to confirm that participation in the encashment regime would be voluntary. If countries do not wish to participate and have their lending counted as reserves, they are free not to do so. This said, of course, we would encourage as wide a participation as possible. This adds to the pool of resources that the Fund can draw on if a lender requests encashment and thus would help to make the regime more robust, which would benefit all the participating lenders. I am pleased to say that we have indications from six lenders that they are likely to participate in this regime, so we are off to a good start on that.

In practice, initially we only need a modest buffer, as it will take a number of years for the stock of encashable claims to build up. Based on the projected path of disbursements this stock is not expected to peak until about 2015 or 2016. We start with a low level of credit outstanding, as the new lending is disbursed and gradually increased. At the same time, we will start with a high level of commitments, and that will gradually decrease. Initially, we will have a substantial buffer, and it is only in the outer years that the buffer could potentially become an issue.

This said, if the Fund is going to commit to encashment, it needs to have a plan on how it would meet any such calls. We recognize that it is unlikely, but still it would be a commitment on the part of the Fund, so we need to have a plan, and that is why we are proposing to seek additional loan resources now. This way, we can be confident that we can meet any calls from lenders, while still meeting the projected loan demand from low–income countries.

I should add, in response to a couple of comments in the grays, that we are not assuming that lenders that have already pledged will increase their commitments to help us meet the liquidity buffer. Of course, they would be welcome to do so. Rather, what we are hoping is that the new framework including encashability and the provision of notes will allow other lenders, including lenders that have not previously been contributing to the Trust, to participate in the loan mobilization exercise and that will help us increase the overall level of resources available.

What happens if we are not successful in getting more than SDR 9 billion? This does not mean we would not be able to begin lending. We will have a substantial buffer in any case. What it does mean is that we would probably need to come back to lenders for a new round of loan mobilization somewhat earlier than we would have otherwise anticipated, and before we had committed the full SDR 9 billion of lending to low–income countries. But this would be several years down the track and is not an immediate issue.

I should also clarify that there are no implications for subsidy needs of raising additional loan commitments now. The subsidy need estimates that we have been working with are based on our projections of actual loan disbursements, and these have not changed.

On the size of the liquidity buffer, there is no hard–and–fast rule for assessing what is adequate, particularly as we have no historical experience with lenders requesting encashment, since it was not available in the past. Lenders have been able to transfer their loans, but that has not happened.

Nevertheless, we do have practice in other contexts, particular in the GRA where the Board has endorsed a 20 percent buffer as a reasonable liquidity buffer. When we looked at this, we estimated that it would provide a satisfactory coverage relative to the likely largest individual loan exposure, assuming we have relatively broad participation. But in practice this is something we will need to monitor as we move along, to make sure that the liquidity buffer is adequate relative to potential needs.

Perhaps now I can say a few words on SDR conversion, which was probably the most contentious issue in the grays. First, let me give Directors a bit of the background to the thinking behind the staff's proposal.

The amount of loan resources we are seeking to mobilize is not large relative to the amounts we have been mobilizing for the GRA. However, it is large relative to the previous fund–raising for the PRGT and its predecessors. We are targeting loan resources of SDR 9 billion for the next six years. That compares with a total amount of SDR 16 billion that we have mobilized in the 23–year history of the Trust. SDR 9 billion for the next five or six years compared with SDR 16 billion over 23 years is a substantial increase, and, I would say, a significant challenge.

Moreover, we have had a relatively narrow participation in the loan mobilization effort in the past. Only 15 members have contributed over the 23 years, and of those 15, three have accounted for more than 70 percent of the total. We have been heavily reliant on a small group of members to support the Loan Account.

When we started approaching lenders for the current exercise, it very quickly became evident to us that a number of those wished to use their SDRs for this purpose, including two of the three largest contributors to the Trust in the past. It was evident to us that we would not achieve the target if we did not find a way of facilitating these transactions.

Those lenders have all been clear—as reflected in their grays—that they stand ready to buy back the bulk of their SDRs through the voluntary trading arrangements.

While the staff has sought to simulate how this would work, it is difficult in practice to anticipate all the permutations that could arise from the voluntary trading arrangements. However, we are reasonably confident that it can be managed in such a way that the SDR lenders would indeed end up buying back the bulk of their SDRs through the normal burden–sharing mechanism of the voluntary arrangements. Hence, there would be relatively little to be absorbed by other participants. That is our expectation.

On Mr. Callesen's questions on safeguards. In the first instance, the onus is on the staff to make this work. The second safeguard is reporting. I would like to confirm that we intend to increase the transparency of the reporting of the SDR operations, as many Directors have requested, by reporting regularly on both the SDR lending to the Trust and also broader SDR transactions. We currently have two vehicles through which this can be done: the designation plan and the semiannual update on concessional financing.

We also aim to have a review after a year, a suggestion that was supported by number of Directors.

It is important to note that the voluntary trading arrangements are voluntary. As such, if participants that have voluntary trading arrangements are not satisfied with how they are being conducted, they have the right to alter those arrangements. Hence, that is a key safeguard for individual members.

I should mention that, as we will be reporting in connection with the next SDR designation plan, there has been relatively little SDR trading in 2010 so far. We have had only two sales under the voluntary agreements in 2010 compared to the last quarter of 2009 when we had around six a month.

Let me turn to three specific questions on this topic. First, I would like to confirm that there are no voluntary agreements in place, or being considered, that would have the same effect as Option 2 in the paper.

There was a question in a couple of grays on how to ensure that SDR lenders have a voluntary arrangement in place with sufficient capacity. The best mechanism would be a clear statement in the summing up for this meeting that it is expected that SDR lenders would have a voluntary arrangement in place with sufficient capacity. This would give the staff the necessary guidance to implement that. In this context, Mr. Guzmán just mentioned Spain's arrangement. I can confirm that five of the six members that have pledged to lend SDRs so far have voluntary agreements in place. In all of those cases, the capacity of the agreements is well in excess of their loan commitments—at least double in all cases and more than five times in one case. That is already happening through the pledges we have received so far.

Finally, there was a question on whether existing or new entrants to the voluntary trading arrangements would have the option not to buy SDRs that have been lent. The answer is yes. While we are trying to encourage the voluntary agreements to be as flexible as possible, members have the option of not participating in any given transaction.

The staff representative from the Finance Department (Mr. Lin), in response to comments and questions by Executive Directors, made the following statement:

Several questions were raised by Directors regarding other aspects of the proposed lending framework.

There was a question on whether the proposed lending framework would apply to all lenders or just new ones. We can confirm that the proposed lending framework is available to all lenders, including existing ones. The existing lenders would have the option to amend their loan agreements in order to incorporate the new elements under the proposal.

A question was also asked about how the earmarked loan resources to the PRGT loan accounts could be used for encashment. As noted in the staff report, while lenders may earmark their loan resources to a particular PRGT loan account for the encashment regime to work effectively, the committed resources would also have to be available for the encashment of outstanding loans on all loan accounts under the trust. However, given that encashment is an unlikely event, the probability that a lender's earmarked loan resources would be used for this purpose could be relatively low. If a lender chooses not to be part of the encashment, then all its loan resources would be made available for LIC lending through the earmarked loan account.

There was a question on the possibility of using the PRGT Reserve Account resources to finance the buffer if existing Fund raising efforts fall short. As Directors may recall, the primary purpose of the Reserve Account is to provide security to all Trust lenders in the event of a delay or non–repayment by borrowers. As discussed at the time of the Multilateral Debt Relief Initiative (MDRI) debt relief in 2005, and the 2009 LIC reforms, the general understanding was that a Reserve Account coverage ratio of around 40 percent—which is historical average—was desirable. While current coverage is quite high, it is projected to decline to around 40 percent over time. In any event, using such resources for the liquidity buffer will require a Board decision with 85 percent of the total voting power and consent from all lenders.

There was also a request for an estimate of the demand for PRGT notes. It is difficult to provide an estimate at this stage. A large lender has already indicated that it intends to purchase these notes. There are also indications that other potential lenders may prefer notes over traditional loans.

Finally, there was a question as to whether the proposed short maturities would create any risks that would require additional reserves. The answer is no. The proposal allows for shorter maturities on PRGT borrowing, with the provision that the Fund as trustee would have the discretion to unilaterally extend maturities for an additional period to match the repayment schedule of outstanding loans. The ability of the Fund to extend the maturity is important and will ensure that there will be no maturity mismatch. Hence, the proposal will have no implications for additional reserves.

Mr. Stein made the following statement:

I thank the staff for all the answers and explanations—this has made my task a little bit easier.

Let me first say that Germany is one of the biggest contributors to the PRGT, and we intend to continue contributing to the PRGT in hard currency. Unfortunately, during the negotiations of a new lending agreement, the staff has not shown as much flexibility as is shown in this paper on the usage of SDR. Nonetheless, I am hopeful that we can reach a closure since contributing hard currency is more expensive than contributing SDRs.

We have a more fundamental problem with this arrangement, as mentioned in my gray. We do not believe that reserve assets are there to finance the long-term needs of developing countries. After reading the grays, there seems to be a two-thirds majority for Option 3—meaning one third of the Board would favor Option 1. Hence, we will likely have Option 3 as the proposal in the final paper, and this makes the need for safeguards more important. We believe Option 1 would have provided the best safeguard.

Insofar as the safeguards are concerned, I completely support what Mr. Callesen has said. I welcome the commitment of France and the United Kingdom to buy back the bulk of their SDRs. I also appreciate the staff's reply to this issue.

I support the staff's call for a clear statement in the summing up that those who contribute SDRs to the PRGT would also have a voluntary trading arrangement in place. The trading arrangement should be sufficient to buy back the lent SDRs. I believe this would be in line with proposed system.

I also appreciate the proposal for greater transparency and look forward to the reports. If needed, these reports might be restricted to the Board, and not meant for publication.

Finally, I want to be counted with those who favor the three–month SDR rate instead of the six–month SDR rate. This is because hard currency contributions are more expensive than SDR contributions and there is no reason for those who provide SDR to make a profit out of it.

Mr. Bakker made the following statement:

I thank the staff for the answers and the useful informal meeting which helped clarify some of the issues.

We appreciate the difficult position the staff finds itself in attracting sufficient loan resources. It has been a while since the G–20 asked for the Fund to enhance its LIC financing and we would have hoped for a little bit more leadership there. Hence, I hope the staff and the management would do their best to increase the circle of contributors to resolve this situation.

We have made clear, in our joint statement with Mr. Callesen, that the preferred option of the staff would have been that all countries contribute in usable currencies. It is by far the most transparent, simple and fair method. It would have been a multilateral approach if all countries had followed that approach. However, it seems there is a need to accommodate some countries and allow them to use SDRs.

Hence, this begs the question—something the Board should discuss in future—of what exactly is the role of the SDR. At the moment, we are going ahead with an allocation without having had a thorough discussion on what we are trying to achieve. The discussions should also consider the purpose of the voluntary arrangement, which in our view was meant to increase the attractiveness of the SDR as a reserve asset and not to be used for financing development assistance.

Taking into account those factors, the Netherlands has made it clear that it will make a contribution in usable currencies.

I am not sure about Mr. Stein's argument about the costs. In fact, some others might argue the other way round: for central banks that have an active asset management, there may be an opportunity cost in switching between SDRs and the usable currencies. We should not overstretch the demands we place on our most important stakeholders, the central banks.

Regarding the decision, I had some sympathy for Mr. Mozhin who said Option 1 and Option 3 are both possible if countries wish to choose whether they would buy back the bulk of the currencies. They could choose Option 1 and I am not sure that should be excluded in the decision. Option 3 needs to have more safeguards than the ones we have now.

While I am pleased to note the statements that countries are willing to buy back the bulk of the SDRs, we need to have a clear understanding of what that means. At the informal meeting, the staff indicated that the bulk would be about two thirds. That would be a benchmark which we should use in the review that at least two thirds of the SDRs would be bought back by the countries. I take comfort that the voluntary arrangements are at least double the size of the contribution.

The argument that the PRGT transactions are small in relation to the size of the markets is not entirely fair. The benchmark here should be the actual transactions in the market. Initially they had been quite large because some countries immediately exchanged their SDRs into usable currencies. It has now slowed down considerably. Transactions of about SDR 1 billion a year for the PRGT would be quite sizable if one takes the other actual transactions into account.

Regarding transparency, we need to be clear what sort of transparency we mean. A staff report on all transactions would be too much. We need something which is analytically useful. We also need data to reflect the intention of members to have a fair distribution and a fair burden sharing of this PRGT financing.

Mr. Nogueira Batista made the following statement:

As indicated in our gray, we support the proposed framework in overall terms and our preference is for Option 1.

I would briefly like to address the more controversial issue, which is the conversion of SDR loans. I would like to know why countries that are choosing to lend SDRs to the Trust do not automatically stand ready to buy them back for currencies on request by LICs. The reasons not to fully commit to conversion do not seem clear. If SDR lenders are willing to—and will eventually—absorb the bulk of the SDRs back over time, as the staff and Mr. Fayolle stated, why should they not adopt this option upfront? This question was also asked by Mr. Weber and Ms. Tartari in their gray and I quote: “We are disappointed that staff did not itemize the reasons why members might not be willing to lend SDRs to the Trust in cases in which they are required by LICs to automatically stand ready to buy them back.”

I would like to know the reasons for this reluctance, given our preference for Option 1. Maybe Mr. Fayolle and Mr. Gibbs could enlighten us on that.

Mr. Lee made the following statement:

I thank the staff for their efforts in removing the constraints to the mobilization of PRGT loan resources. As Mr. Kotegawa demonstrated clearly during the informal briefing, the level of loan resources is critically low and we need to move quickly to meet the SDR 9 billion resource requirement. Our view is that the staff proposal strikes a reasonable balance.

I share the same concerns as other colleagues. However, to make our office’s position clear, I would like to make three points.

First, the proposed encashability may present difficulties for some lenders. The staff has explained that this will be taken on a voluntary basis and will not create any immediate problem. I fully agree with that. However, I am still skeptical as to whether the Fund can secure enough resources in the long run. Hence we ask the staff to keep the Board updated on progress in raising the additional loan resources and create a contingency plan in the event that the 20 percent buffer is not raised.

Second, the relationship between SDR loans and the voluntary SDR market is the most contentious issue. We can support Option 3 as a compromise on the condition that SDR loans will only be accepted from countries that have voluntary agreements in place of at least the same magnitude as their proposed SDR loans.

Finally, we agree that the growing number of ideas on the use of surplus SDRs demonstrates the need for a broader discussion on SDRs, including the current allocation rules and whether they are optimal. We look forward to exploring this issue in detail as part of the mandate review.

Mr. Giammarioli made the following statement:

I would like to thank the staff for the answers and their efforts to find a common ground on this contentious issue. We believe that the proposed framework strikes the right balance between different positions.

We do not have a strong preference for the encashment, for lowering the notional maturity, and for issuance of notes, but we understand that those features would help others to contribute. Hence, we can go along with all these proposals.

On the interest rate, we expressed our reservations in our gray on the differentiation between the interest rate paid on SDRs and that on currencies. We would have preferred either the three–month rate for both or the six–month rate for both. Italy has always contributed in SDRs and I can assure Mr. Stein that if we made any profits, these were tiny and have been used for providing subsidies to the PRGT and its predecessors.

On exchanging the SDRs with the currency, we are in favor of Option 3 for the reasons expressed in the paper, and also highlighted by Mr. Fayolle this morning. Italy has pledged to contribute SDR 800 million in this round. I can assure the Board that our primary goal is to provide the most needed resources to support programs in LICs through mechanisms compatible with our budget constraints, our rules, and the division of responsibilities among different ministries and the central bank in Italy. It is not our intention to free ride on others and enjoy any free lunch.

I finally reiterate that the paperwork for the voluntary trading arrangements has been finalized will soon be signed by our Governor. Like Mr. Fayolle and Mr. Gibbs, I can confirm that my authorities will do their part to exchange SDRs under this voluntary trading arrangement.

Mr. Sajkunovic made the following statement:

I will just highlight a few points to reiterate our position.

Our preference is for lenders to provide usable currencies. This is a statement that others have made and we associate ourselves with them.

I would also like to highlight the importance of the safeguards. We have made note of that and take some comfort from statements from the staff and others around the table.

This chair would like to associate itself with Mr. Bakker and others who have called for a more formal review of the role of the SDR and the proper use of the voluntary arrangements. We also associate ourselves with Mr. Stein who called for a clear statement in the summing up on some of the safeguards that we have been discussing.

Mr. Krishnan made the following statement:

We can go along with a lot of what Mr. Bakker and Mr. Stein have said. I want to make a few points.

If we had clarity on how these SDRs would be used—something that we called for very early in this discussion—the position regarding the fund-raising would have been much better than it is right now. We recognize that there is a commitment by the G–20 and the Fund that to raise more funds for LICs. India has been a contributor to the Subsidy Account of the erstwhile PRGF and we are also considering joining the lending arrangement. However, the lack of clarity on how the SDRs would be used is something which has delayed this decision and our decision to join the voluntary trading arrangements. We are grateful that at least now we are gaining greater clarity on these issues. Resources are not being raised fast enough and the problems lie in a number of areas.

While our preference is for Option 1, like Mr. Stein, we recognize that Option 3 will find broader support. Our chair has always attempted to reach a consensus on important issues, and we would like to be contributing to that consensus here again. However, it is important that many of the safeguards which have been highlighted by Mr. Callesen and Mr. Bakker, Mr. Stein and others are built into this proposal and reflected in the summing up, and perhaps in further guidance that the Finance Department could give out. The staff's assurances in this regard are particularly helpful.

During the detailed discussion on transparency in this Board many members have supported the case for greater transparency. We have always been in favor of greater transparency and I think we should demonstrate our commitment to transparency in this context as well. I would like to underline what Mr. Bakker said, that the transparency needs to be specific, with reference to the burden–sharing mechanisms of PRGT, and not a more generalized question of transparency on voluntary trading arrangements.

I also support the call for a formal review of the role of SDRs as it is an important discussion that we need to have.

Mr. Gibbs made the following statement:

I would like to make a few general comments.

Like others, I think the overriding priority that is important to keep in mind is that we are here to facilitate the provision of resources to LICs. I agree with those colleagues who say that hard currency loans would be ideal. However, we are not in a perfect world. Otherwise, we would have had enough pledges of hard currency and would not be having this discussion today.

It was the Board that pressed the Managing Director to step up his fund–raising effort when we were reforming the facilities for LICs. The Managing Director reached out to donors and, recognizing the scale of the need and the scale of the challenges faced by donors domestically, asked us to consider all the possible options, including the option of an SDR loan. The latter, I would stress, is not a new mechanism since SDR loans have been used before. Several countries have responded positively and we have an opportunity to move ahead, although more needs to be done.

The United Kingdom, although a substantial contributor to the Subsidy Account, has never contributed to the Loan Account. Hence, the SDR loan that we are proposing is genuinely additional and something that the United Kingdom has never done before. We probably would not have contemplated doing so had we not been asked specifically as part of this fund–raising exercise that the Managing Director has appropriately carried out at the request of the Board.

Despite being active purchasers of SDRs since the voluntary arrangement was put in place, the United Kingdom has plenty of headroom within its current arrangement. Under Option 3, a little noted fact is that headroom automatically increases the moment we make the loan. As mentioned in my joint gray with Mr. Fayolle, we definitely stand ready to purchase the bulk of these SDRs and that should not be in question. Option 3 contains within it a mechanism to ensure that happens.

Mr. Fayolle has clearly said, drawing on points made in colleagues' statements, what the key arguments are for Option 3. Critical to all of this is the voluntary system. Anything else would disrupt a voluntary system, given that SDRs are also a voluntary system. Hence, Option 3 represents the existing mechanism for handling these. To depart from Option 3 we would need a compelling case in terms of the need and the capacity in the system and it is clear from the staff answers that this compelling need is simply not there. If it were to be there in future, maybe we would have to look again. From the United Kingdom's point of view, there is plenty of headroom in our bilateral arrangement. In the spirit of facilitating resources, I hope we can move ahead on the basis that the staff proposes.

Mr. Rouai made the following statement:

While I hear a lot of support for transparency for this exercise, I fail to understand the reason behind the lack of support for providing detail on the voluntary trading arrangements. All other transactions between member countries and the Fund are provided in detail, including loan and note purchase agreements, and the New Arrangements to Borrow.

I note that the paper is not proposed for publication, and this is appropriate since the discussion we are having may give the impression outside the Fund that SDR is a lower class reserve management policy. This is one of the reasons we are supporting a general discussion on the role of SDRs.

Mr. Guzmán made the following statement:

To follow up on Mr. Rouai's point, we are in favor of having a review on the use of the SDRs in the context of the PRGT next year.

I would suggest with Mr. Rouai that the overall use of the voluntary agreements is necessary. We need to have some light there because if the operation of the PRGT were put at risk, because insufficient holders of voluntary agreements were willing to convert SDRs, then another alternative would be for other voluntary agreements to reject purchasing from the GRA. Hence, we need to know how the whole operation of the voluntary agreements is being conducted and how the volumes are converted from one source or another.

Mr. Fachada made the following statement:

Mr. Nogueira Batista has already stated that we prefer Option 1. Mr. Bakker and Mr. Callesen have asked why some countries that are contributing with hard currency should be made to pay twice.

We would appreciate some clarification as to why countries are committing to lend in SDRs and are saying that they will buy back the largest part of their SDRs. While we clearly understand the preference for SDRs—domestic reasons, fiscal reasons—the guarantee that the authorities will buy them back is obscure.

We proposed in our gray a mechanism that would mix Option 1 and Option 3. This would help burden sharing, the best indicator of which in the SDR market is the position of holdings relative to the allocation of each country. We would take this benchmark as a reference for the commitment of countries—if countries have already carried the burden sharing of the SDR markets in the past, they would be able to lend SDRs, and acquire them or not according to the voluntary arrangement. However, for countries that have not participated in the burden sharing, we would favor that these countries be committed to buy back the SDRs.

I would like to hear the staff comments about the possibility of mixing Option 1 and 3.

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

I do not want to get too technical about this since we discussed this in the informal briefing. To explain briefly, the way we are operating the burden–sharing mechanism right now in the voluntary trading arrangements consists of two benchmarks. The first is the position of members' holdings relative to allocation. The second is the position relative to the midpoint of their trading arrangement.

Mr. Nogueira Batista's position would be to focus on the first, which is the position relative to allocation. That would be a different approach to the one we have been following. Our assessment so far is that taking both into account reflects the concerns of many chairs that countries that have a relatively low holding relative to allocation would carry a larger burden in the voluntary trading arrangements. This has indeed been happening. Equally, the use of the midpoint allows us to tap some countries, which, through their voluntary trading arrangements, have signaled that they are willing to hold a higher level of SDRs than some other members. Hence, it is appropriate that we take both elements into account.

To respond to Mr. Krishnan's comment, I am pleased to hear that the efforts we propose to make the reporting more transparent will help in the fund–raising exercise.

Mr. Bakker wondered whether a country's commitment to buy back the bulk of the SDRs depend on the country's willingness to change its midpoint. That could be a feasible expression of commitment.

The Director of the Finance Department (Mr. Tweedie) replied that the commitments that had been made by lenders so far indicated that they were willing to stand ready to buy back the bulk of the SDRs. It needed to be seen how the existing trading arrangements would work with the distribution currently in place, and countries wanting to expand their range and increase it were welcome to do so. However, this did not currently appear to be needed to make the system work as envisaged.

Ms. Lundsager made the following statement:

I appreciate the staff comments and all the efforts made to discuss many of the concerns around the table before this meeting.

Regarding transparency, our proposal is for quarterly reporting. I was wondering when we have some of these monthly work program implementation discussions, if the Secretary could give us an indication on the reporting intentions so we get some sense of it and know what to look for as different efforts are made over time. That would be useful to increase the comfort level among us collectively and may save a lot of time.

The Acting Chair (Mr. Shinohara) said the Secretary would engage in further discussion with Ms. Lundsager on the issue of transparency.

The Acting Chair (Mr. Shinohara) made the following summing up:

Executive Directors welcomed the opportunity to consider the proposed new framework for mobilizing bilateral loan contributions to finance the Fund's concessional lending to low-income countries (LICs). Directors underscored the urgency of securing new loan resources to ensure that the Fund remains in a position to meet low-income countries' needs. They welcomed the recent pledges of bilateral loan contributions and urged other members, including potential new lenders, to be forthcoming with additional contributions. Directors also emphasized that, in addition to securing the needed loan resources, efforts must continue to mobilize the targeted additional subsidy contributions.

Directors noted that the proposed loan framework seeks to address a number of issues that have been raised in discussions with potential lenders. These include the treatment of PRGT loans as reserve assets, the availability of PRGT notes, the maturities and interest rate structure, the conversion of SDRs lent to the PRGT, and the safety of lending to the Trust. While some Directors expressed misgivings about some of the staff's recommendations, in particular those related to the use of SDRs for concessional financing, most Directors supported the proposals laid out in the staff paper.

Qualifying PRGT Loans as Reserve Assets

Most Directors supported the proposal to establish a voluntary "encashment" regime to enable outstanding PRGT loans to be readily repayable to lenders in case of balance of payments need. All new loan contributors would be encouraged to participate in the encashment regime and allow use of their resources to fund encashment in the unlikely event of a request for encashment by one or more lenders. Directors generally supported staff's assessment that a liquidity buffer of 20 percent of outstanding loans from participating contributors would appear sufficient to support such an encashment regime. As a consequence, total loan resources of about SDR 10.8 billion would need to be mobilized to meet the projected loan demand through 2014. Some Directors questioned the need for a substantial liquidity buffer, given the expectation of only infrequent encashments and the importance of ensuring adequate funds for lending to LICs.

Issuance of PRGT Notes

Directors noted the preference of some members to purchase notes from the PRGT as an alternative to traditional loans. They agreed that this could be accommodated by establishing a framework to allow the Trust to issue notes to interested lenders under Note Purchase Agreements, similar to the framework for note issuance under the GRA. Directors also agreed that PRGT loans and notes should carry the same financial terms, and could both participate in the proposed encashment regime.

Maturities and Interest Rates

Directors observed that some members would like to have the option to lend to the PRGT for shorter maturities than under traditional loan agreements. To accommodate these preferences, most Directors agreed that PRGT borrowing could be structured to provide for shorter maturities, of say one year, provided that the Fund, as Trustee of the PRGT, would have the discretion to unilaterally extend the maturity for additional periods up to 10 years.

Most Directors agreed with the proposed differentiated approach to interest rates on PRGT loan/note purchase agreements. Under this approach, the Trust would pay the 3-month official SDR interest rate on a quarterly basis on borrowing in SDRs, while continuing to pay the derived 6-month SDR interest rate on borrowing in currencies on a semi-annual basis.

SDR Conversion

Directors discussed the options available for handling the conversion of SDRs lent to the PRGT under the voluntary SDR trading arrangements. A number of Directors favored Option 1 in the staff paper that would require countries lending SDRs to automatically buy them back for currencies on request by members receiving SDR disbursements from the PRGT, noting that this approach would promote fair burden sharing. Most Directors, however, expressed strong support for, or could go along with, Option 3 that would continue the current practice of handling SDR conversions from the PRGT in the same way as other requests to sell SDRs under the voluntary SDR trading arrangements, together with appropriate safeguards. These Directors noted that, under the current SDR voluntary trading arrangements, it is expected that members lending SDRs to the PRGT would likely end up buying most of the SDRs back over time. They welcomed the explicit statement made by most SDR lenders that they would stand ready to do so as requested under the voluntary trading arrangements. Directors also stressed that all SDR lenders would need to have voluntary arrangements with a sufficient capacity in place. Directors emphasized the need for greater transparency regarding information on SDR conversions and urged that such information be reported to the Board on a regular basis. Directors also supported a review of SDR conversions from the PRGT after one year. Some Directors looked forward to a broader discussion of the role of the SDR as part of the upcoming consideration of the Fund's mandate.

Safety of Lending to the PRGT

Directors agreed that the Fund has maintained an excellent track record of repayment to Trust lenders and that the PRGT Reserve Account is expected to continue to provide adequate security to PRGT lenders/note purchasers. Nevertheless, pointing to the substantial increase in recent lending to LICs under the PRGT facilities, Directors stressed the importance of ensuring the safety of lending to the PRGT.

Next Steps

The Board had a productive discussion of the various issues and proposals provided in the staff paper, with most Directors agreeing to the proposed framework to facilitate mobilization of bilateral loan contributions. The staff will prepare a follow-up paper with proposed decisions, including amendments of the PRGT Instrument, for adoption by the Executive Board. We will then seek consents from existing PRGT lenders to make the proposed amendments effective expeditiously.

APPROVAL: July 6, 2010

SIDDHARTH TIWARI
Secretary