**FOR AGENDA**

SM/10/162

June 29, 2010

To: Members of the Executive Board

From: The Secretary

Subject: **The Fund's Mandate—The Future Financing Role—Reform Proposals**

Attached for consideration by the Executive Directors is a paper on the Fund's mandate—the future financing role: reform proposals, which is tentatively scheduled for discussion on **Friday, July 16, 2010**. Issues for discussion appear on pages 22 and 23.

The staff proposes the publication of this paper after the Executive Board completes its discussion, together with a PIN summarizing the Executive Board's discussion.

Questions may be referred to Mr. Giorgianni, SPR (ext. 35326), Ms. Weeks-Brown, LEG (ext. 36896) and Mr. Beaumont, FIN (ext. 37411).

This document will shortly be posted on the extranet, a secure website for Executive Directors and member country authorities.

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INTERNATIONAL MONETARY FUND

# The Fund's Mandate—The Future Financing Role: Reform Proposals

Prepared by the Finance, Legal, and Strategy, Policy and Review Departments

In consultation with other departments

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June 29, 2010

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## Executive Summary

***Motivation***. The global crisis has underscored the need for effective global financial safety nets to protect countries with sound policy frameworks from adverse outcomes. Complementing the traditional crisis resolution role of the IMF, which has been instrumental during the recent crisis and is expected to remain dominant going forward, further strengthening instruments to prevent crises and mitigate contagion in systemic events would contribute to the IMF's mandate to secure global stability.

***Evolutionary reforms***. This paper proposes specific reforms of crisis prevention instruments, and separately presents further considerations for strengthening the IMF's toolkit for dealing with systemic crises. The proposals, which have benefited from feedback from policymakers and other stakeholders, build on last year's major overhaul of the IMF lending toolkit and the reform options considered earlier this year by the IMF Executive Board in the context of a broader review of the institution's mandate.

***Crisis prevention instruments***. The reforms—with proposed decisions to be circulated as a supplement to this paper—aim to broaden the availability of insurance instruments in a way that responds to the heterogeneity of countries' policies and circumstances.

- The *Flexible Credit Line* (FCL), which was introduced last year and is available to countries assessed to have very strong policies and not requiring (ex post) policy conditionality, is to be further refined by: (i) allowing this credit line to be open for one or two years—in the latter case, an interim assessment of continued qualification is required after one year; and (ii) removing the implicit access cap of 1000 percent of quota, allowing more flexible access consistent with countries' circumstances.
- A new *Precautionary Credit Line* (PCL) is proposed for countries with sound policies but that nonetheless do not qualify for the FCL. Similar to the FCL, the PCL would be approved based on qualification criteria; but it would also have streamlined ex post policy conditionality focusing on reducing any remaining vulnerabilities. Access would be capped at 1000 percent of quota for a period of between 12 and 24 months subject to semiannual assessments of continued qualification and performance consistent with the credit line's policy objectives.

***Systemic crisis resolution***. The paper discusses options to establish a mechanism for mitigating contagion during systemic events, such as the recent global financial crisis. A Global Stabilization Mechanism (GSM) would be activated only in systemic events with the aim of proactively channeling financial assistance to help countries cope with large-scale liquidity withdrawals. As efforts at preemptively resolving systemic events have a global public good character, predictability on how such events would be handled in the future would contribute to global financial stability. Under the GSM, the IMF would mount a comprehensive response to systemic events by (i) making unilateral offers to approve FCL arrangements for systemic qualifying countries, (ii) activating other liquidity instruments for countries with sound policies that do not qualify for the FCL, and (iii) adopting a range of other measures as appropriate, such as activation of the New Arrangements to Borrow to expand loanable resources and considering an increase in global liquidity through general allocations of Special Drawings Rights (SDR).

## I. INTRODUCTION[1]

1. **Recent developments in the global economy highlight the need to further strengthen global financial safety nets**. The global crisis, which ensnared many emerging market and low-income economies in 2008−09, and the recent rapid spread of stress from Greece to other European countries, have heightened perceptions of volatility and interconnectedness, pointing to the importance of effective crisis prevention instruments and predictable frameworks for coordinating the international response to systemic events.

2. **Enhanced multilateral instruments for crisis prevention and systemic events would contribute to a stronger global financial safety net**. The Fund has a clear comparative advantage in playing a countercyclical role in crises, stemming from its ability to provide financing with policy conditionality as well as its de facto preferred creditor status. The Fund's crisis resolution framework has proven to be robust in meeting the wide-ranging needs of its membership. Lending with ex-post policy conditionality under Stand-By Arrangements (SBAs) has been used flexibly to deal with different and evolving balance of payments (BoP) needs resulting from a multitude of problems, from bank funding and solvency problems to sovereign financing shortfalls. The reforms considered in this paper would strengthen the Fund's role in preventing crises and mitigating contagion in systemic events, complementing the institution's traditional crisis resolution role—which is expected to remain dominant—and national and regional efforts to strengthen financial safety nets.

3. **In a recent paper (SM/10/72, 3/26/10; hereafter, *FFR paper*), staff set out options for modernizing financing instruments as part of broader mandate reforms**. A core set of suggestions, building on the lending reforms adopted in the depths of the global crisis (SM/09/69, 3/13/09), included: (i) refining the design of the Flexible Credit Line (FCL), (ii) introducing a new Precautionary Credit Line (PCL) for sound performers that do not qualify for the FCL, (iii) establishing a dedicated mechanism to mitigate contagion from systemic events, and (iv) creating stronger synergies with regional financing arrangements.

4. **Executive Directors broadly supported these core reforms for strengthening the Fund's financing role in member countries (BUFF/10/50, 4/20/10)**.

- ***Enhancing the FCL***: The Board generally endorsed the proposals to enhance the design of the FCL, including doubling the duration of purchase rights to one year and removing the implicit cap on access. While some Directors favored increasing predictability of qualification, most did not support maintaining a running list of qualifying countries and preferred the flexibility of the current judgmental approach.

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[1] Paper prepared by an interdepartmental team coordinated by C. Beaumont (FIN), L. Giorgianni (SPR), and R. Weeks-Brown (LEG) and comprising L. Kohler and M. Rossi (all FIN), K. Christopherson, D. Eastman, A. Giddings, K. Kwak, Y. Liu, and G. Rosenberg (all LEG), and G. Adler, M. Goretti, K. Guo, I. Halikias, B. Joshi, S. Lanau, J. Roaf, M. Saenz, and A. Stuart (all SPR).

- ***Establishing the PCL***: Directors welcomed consideration of possible instruments for members that do not meet the FCL's high qualification bar, to broaden the Fund's ability to address precautionary financing needs of members with moderate vulnerabilities. Some, however, expressed concerns that creation of the PCL could reduce the attractiveness of High Access Precautionary Stand-By Arrangements (HAPAs), increasing the complexity of the toolkit and creating tiering of members.
- ***Introducing a systemic crisis mitigation mechanism***: A number of Directors supported a dedicated instrument to mitigate contagion in a systemic crisis, considering a unilateral and multi-country mechanism to be effective in addressing the hesitancy of members in requesting Fund support (the "first-mover problem"). A number of other Directors, however, had reservations about publicly identifying a set of qualified countries, and many expressed concerns about the operational complexity of such an instrument and its uncertain resource requirements.
- ***Strengthening synergies with regional safety nets***: Directors saw considerable scope for further strengthening the Fund's engagement with regional financing arrangements, and welcomed specific proposals on coordinating lending activities.

Staff also considered more innovative reform options, such as allowing lending solely against collateral, issuing guarantees on sovereign borrowing, and making schedules for repayments to the Fund contingent on exogenous events. However, there was only very limited Board support for pursuing these ideas, many of which would have required changes to the Articles of Agreement or greater flexibility in mobilizing resources.

5. **The G20 leaders, at their recent summit in Toronto, urged rapid progress in reviewing the Fund's lending instruments**. Acknowledging the need for national, regional, and international efforts to address capital flow volatility, financial fragility, and crisis contagion, the G20 leaders asked for proposals to strengthen global financial safety nets, reforming Fund lending facilities as appropriate.

6. **This paper focuses on evolutionary reforms to further enhance the global financial safety net**. Section II considers further improvements to crisis prevention tools by refining the design of the FCL and establishing the PCL. Section III revisits the options for introducing a predictable framework to tackle systemic crises, including by establishing a dedicated new short-term liquidity line. The reforms considered in this paper embed a number of safeguards to contain moral hazard—notably by tailoring instruments to countries' fundamentals and policy track records. Resource implications are discussed in the Annex, which concludes that the total resource envelopes currently being discussed as part of the $14^{th}$ General Review of Quotas, entailing a doubling of quotas or somewhat larger increases together with the activation of the expanded New Arrangements to Borrow (NAB), would be sufficient to accommodate the potential increase in commitments from the reforms considered in this paper.

7. **At this stage, only the decisions setting forth the legal framework for FCL and PCL reforms are being proposed for adoption by the Board**. These will be covered in a forthcoming supplement to this paper. Given the novelty and complex design features of the Global Stabilization Mechanism for systemic crises, this paper presents alternative design options for further consideration by the Board. Based on feedback from Directors, a decision on such a framework could be developed and proposed for approval by the Annual Meetings. Staff also plans to explore the scope for enhancing synergies with regional financing arrangements by consulting members of such regional arrangements in the coming months.

## II. STRENGTHENING CRISIS PREVENTION TOOLS: REFORM PROPOSALS

### A. Refining the Design of the Flexible Credit Line

8. ***Rationale***. The introduction of the FCL was generally recognized as a significant improvement to the Fund's toolkit. The limited demand for it during the recent crisis may have, to some extent, reflected positive "externalities" from the introduction of the instrument—markets may have perceived that strong emerging market performers would qualify for the FCL, since spreads narrowed for a set of countries well beyond the three members using the instrument (as discussed in the *FFR paper*). At the same time, in discussions with staff and in an informal survey, stakeholders pointed out a number of design features that may have reduced the FCL's attractiveness to the very strong performing countries that would qualify for this instrument. These issues—namely, the short duration of purchase rights and the implicit cap on access—are addressed below.

9. ***Double the duration of purchase rights to twelve months***. Currently, FCL arrangements can be for a period of either six or twelve months, with an interim review of qualification required in the latter case after six months. As explained in the *FFR paper*, the very strong creditworthiness and track record of members qualifying for the FCL provides room to lengthen the duration of purchase rights without unduly reducing safeguards. It is therefore proposed that FCL arrangements be approved for a period of either one year with no interim reviews or two years with an interim review of qualification required after twelve months. Staff would keep the Board informed of developments during the year in members with FCL arrangements through Article IV consultations and informal staff briefings.

10. ***Remove the implicit access cap of 1000 percent of quota***. The Board's summing up to the paper on establishing the FCL (BUFF/09/50, 3/27/09) contains an expectation that access under FCL arrangements would normally not exceed 1000 percent of quota, to safeguard Fund resources and ensure their adequacy for crisis lending. As discussed in the *FFR paper*, such a cap however provides a weak signal to markets—and perhaps attracts undue attention—should potential financing needs be perceived to be larger. It is also counter-intuitive that access under the FCL—an instrument available only to the strongest performers—remains less flexible than that under the SBA—where normal access limits can be exceeded, subject to the requirements of the Fund's exceptional access policy. Given these

factors, and the safeguards provided by the very strong fundamentals and policies of FCL-qualifying members, staff proposes to eliminate the implicit cap on access under the FCL.

11. ***Clarify exit strategy from FCL arrangements***. While the FCL decision permits successor FCL arrangements, it does not set expectations about "graduation" from the FCL (the FCL operational guidance note suggests how to manage expectations via carefully crafted external communications, SM/09/270, 11/3/09). It may thus be useful to clarify that access in successor FCL arrangements would normally be expected to decline whenever steady improvements in official and private financing prospects have reduced countries' BoP needs in a sustained way by the time a successor arrangement is requested; the final determination would, as normal, take into account the unique circumstances of each case.

12. ***Transitional issues***. The six-month review is proposed to be eliminated for all FCL arrangements of one-year duration in place when the decision to modify the FCL is adopted.

## B. Establishing a Precautionary Credit Line

13. ***Rationale***. A dedicated credit line for *crisis prevention* could also be beneficial for countries with sound policies but facing moderate vulnerabilities that disqualify them from the FCL. A HAPA, the currently available instrument, is viewed by some as unattractive because—as a form of an SBA—it may be associated with crisis resolution, with a presumed need for strong policy adjustment monitored with heavy ex post conditionality. The proposed PCL would help insulate countries from external shocks by providing front-loaded access subject to qualification requirements (signaling policy strength) and focused ex post conditionality aimed specifically at addressing remaining vulnerabilities. The PCL allows rephasing access if large actual BoP needs materialize unexpectedly. As such, the PCL could play both a crisis *prevention* and *resolution* role similar to the FCL's dual role.

14. ***Nature of instrument***. Like the FCL, the PCL would be established as a window in the credit tranches (permitting its use in addressing any BoP problem and carrying the same charges, surcharges and repurchase period as the SBA) and would be subject to similar, though less stringent, ex ante conditionality requirements. But differently from the FCL, PCL arrangements would include focused ex post conditionality and be exclusively targeted to members that do not have an actual BoP need at the time of approval. From this perspective, the PCL shares some similarities with the existing HAPA. But, as noted in the *FFR paper*, the proposed PCL design bears closer resemblance to the Rapid Access Line, the liquidity instrument considered by the Board in the period leading up to the 2008 crisis. As such, the features of the PCL as described below borrow extensively from SM/06/276, SM/07/69 and SM/08/283, as well as BUFF/06/140, BUFF/07/39, and BUFF/08/136.

15. ***Length***. PCL arrangements could be approved for a period of between one to two years; the minimum one-year period is intended to make precautionary financing available for a period long enough to enable the member to make progress in address its remaining vulnerabilities. Semiannual reviews would cover compliance with qualification criteria and

performance relative to policy objectives (as further discussed below). Following its expiration, a new PCL arrangement could be approved based on a full reassessment of qualification, including policies required to address remaining vulnerabilities (see also ¶21).

16. ***Qualification***. PCL arrangements would be approved only for members that do not have an actual BoP need at the time of request and that, while facing moderate vulnerabilities, are assessed to (i) have sound economic fundamentals and policy frameworks; (ii) be implementing and to have a strong track record of implementing sound policies; and (iii) remain committed to maintaining these policies in the future. These requirements are intended to give confidence that the member will take any policy measures needed to reduce remaining vulnerabilities and resolve its BoP difficulties even without intensive ex post conditionality. Members requesting a PCL arrangement would be assessed *in light of* the FCL qualification criteria; while these would not need to be met as completely as required for the FCL, most of them would still need to be met to warrant approval of a PCL arrangement. As the PCL would in most cases provide access above the normal limits, it would be subject to the exceptional access criteria shown in Box 1 (like the HAPA but unlike the FCL, which is subject to its own similar substantive and procedural requirements).

Box 1. Exceptional Access Policy: Substantive Criteria

The Fund may approve access in excess of the normal 200 and 600 percent of quota annual and cumulative limits, respectively, in exceptional circumstances, provided certain procedural requirements and the following four substantive criteria are met (BUFF/09/50):

(a) The member is experiencing or has the potential to experience exceptional balance of payments pressures on the current account or the capital account, resulting in a need for Fund financing that cannot be met within the normal limits.

(b) A rigorous and systematic analysis indicates that there is a high probability that the member's public debt is sustainable in the medium term. *However, in cases where there are significant uncertainties that make it difficult to state categorically that there is a high probability that the debt is sustainable over this period, exceptional access would be justified if there is a high risk of international systemic spillovers.*[1] In those cases, the Fund would need to come to the judgment—as in cases of normal access—that the debt is sustainable in the medium term. In all cases, debt sustainability for these purposes will be evaluated on a forward-looking basis and may take into account, inter alia, the intended restructuring of debt to restore sustainability. This criterion applies only to public (domestic and external) debt. However, the analysis of such public debt sustainability will incorporate any potential contingent liabilities of the government, including those potentially arising from private external indebtedness.

(c) The member has prospects of gaining or regaining access to private capital markets within the timeframe when Fund resources are outstanding.

(d) The policy program of the member provides a reasonably strong prospect of success, including not only the member's adjustment plans but also its institutional and political capacity to deliver that adjustment.

1/ See BUFF/10/56.

17. ***Ex post conditionality***. In addition to meeting most of the FCL qualification criteria, members requesting a PCL arrangement would commit to implement a focused set of policies aimed at addressing the most pressing remaining vulnerabilities, as identified in the qualification process. The authorities would be required to summarize such policies, together with a quantified macroeconomic framework underpinned by a streamlined set of quantitative targets, in a concise written request for a PCL arrangement. The monitoring framework would consist of mandatory semiannual reviews focusing on the achievement of policy objectives supported by the arrangement and appropriate policy adjustments in response to economic changes. A review will normally be completed when the member continues to adhere to the qualification criteria for approval of PCL arrangements and policy performance is in line with the overall objectives of the arrangement as demonstrated by observance of the relevant quantitative targets and measures specified in the authorities' policy framework. Unless required by changes in the member's circumstances, new written communications from the authorities restating their policy plans would not be needed for completing semiannual reviews. To avoid interrupting purchase rights, semiannual reviews should, to the extent possible, take place shortly before each six-month period lapses. Prior actions could be established, but performance criteria and structural benchmarks would not be used, except for the standard performance criteria on trade and exchange restrictions, discriminatory currency arrangements and multiple currency practices, and external arrears.

18. ***Access***. Access under PCL arrangements would be capped at 1000 percent of quota on a cumulative basis. As with standard Fund cumulative access limits, this cap on PCL access would be assessed against the sum of requested access and outstanding purchases, but arising from PCL arrangements only. The member would have the option to draw available amounts under an arrangement—with no separate activation review prior to drawing—in one purchase or to make multiple purchases. These purchases, in any event, may not exceed the member's actual BoP need.

19. ***Phasing***. Access would be frontloaded, with up to 500 percent of quota available upon approval of the arrangement. For arrangements of one year, there would be no phasing—the full amount available upon approval would remain available throughout the arrangement subject to the completion of the semiannual review. For arrangements with duration longer than 12 months, additional access of up to 500 percent of quota would normally be made available at the start of the second year under the arrangement upon completion of the second semiannual review.

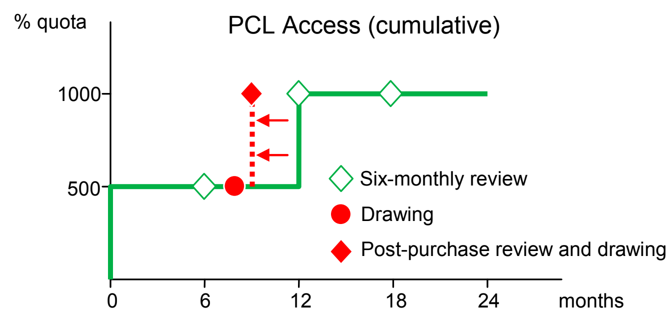
20. ***Crisis resolution use***. To enable flexible use of the PCL for crisis resolution purposes, it is proposed that if an actual BoP need materializes during the first year of an arrangement with more than one year duration and the member purchases the entire amount available upon approval, it could request an ad hoc post-purchase review by the Board to bring forward (rephase) the additional access under the arrangement that would have become available at the start of the second year (Box 2). This review is a key safeguard that allows a fresh stocktaking of the underlying causes for the opening of an actual BoP need and the

Box 2. PCL Phasing of Access: An Illustrative Example

The following example clarifies the proposed phasing of PCL arrangements (see chart below):

*Assume a two-year PCL arrangement of total access of 1000 percent of quota with 500 percent of quota made available on approval.*

*After eight months, the member faces an unexpected actual need and purchases the entire 500 percent of quota made available on approval. The additional amount of 500 percent of quota approved under the arrangement would normally be made available following completion of the second semiannual review (four months after the purchase in this example). However, the member could also request that this amount be rephased and made available sooner, following completion of an ad hoc post-purchase Board review.*




policy responses needed. The Board would be expected to complete such a review if the member continues to adhere to the PCL qualification criteria and policy performance remains in line with the overall objectives of the arrangement—as demonstrated by observance of the targets and measures specified in the authorities' policy framework. As with all Fund arrangements, a PCL arrangement would expire upon the earlier of (i) the purchase of the full amount of access under the arrangement, (ii) the expiration date of the arrangement, or (iii) the cancellation of the arrangement by the member.

21. ***Exit strategy***. The exit strategy proposed for the FCL could be replicated here to ensure successful and timely graduation from PCL use. However, approval of new PCL arrangements would be permitted only for members whose outstanding purchases under the PCL are below the instrument's 1000 percent of quota cumulative cap, with additional financing needs beyond this cap possibly met by requesting an SBA. Graduation from a completed PCL arrangement to an FCL arrangement may also be possible, provided the stricter qualification requirements of the FCL are met by that time.

22. ***Terms***. As a window in the credit tranches, PCL arrangements would be subject to the same charges, surcharges, commitment fees and repurchase period (3¼ to 5 years) as FCL arrangements and SBAs.

23. ***Policies and procedures***. Rapid approval of PCL arrangements would be possible under the Emergency Financing Mechanism. The PCL would also be subject to other general policies governing use of the Fund's resources, including those on safeguards assessments and post-program monitoring. An initial mission to help the member design its policy strategy under the PCL would be expected but not required. Cases where a member expresses

interest in a PCL arrangement but management decides that access to Fund resources under the PCL is not suitable would be treated confidentially by management and staff.

24. ***Board majority requirement***. Establishing the PCL as an instrument in the credit tranches would require a Board decision adopted by a majority of the votes cast.

## C. Periodic Review of Crisis Prevention Instruments

25. **The (revised) FCL and PCL decisions are proposed to be reviewed jointly by the Board no later than three years from the date of adoption of the reforms in this paper**. An ad hoc review would be triggered whenever aggregate commitments outstanding under these two instruments reach SDR 100 billion in order to ensure sufficient resources for crisis resolution (with the separate existing trigger of SDR 100 billion in FCL commitments proposed to be eliminated). This review would provide an opportunity to reassess the design of the Fund's crisis prevention instruments in light of their use and the potential need to support members' adjustment programs with nonprecautionary arrangements.

## D. Frequently Asked Questions on Reforming Crisis Prevention Instruments

26. ***Would the proposed changes to the design of the FCL increase risks to the Fund?*** Although increasing the duration of purchase rights and removing the implicit access cap may increase the supply of precautionary resources, a number of preventative measures would contain their demand and mitigate risks to the Fund:

- access requests in individual cases will continue to be based on actual and potential financing need and capacity to repay scenarios prepared by staff, and subject to early scrutiny by the Board;
- the upward-sloping commitment fee structure and the doubling of the marginal fee to 60 basis points for access above 1000 percent of quota will discourage unnecessarily large precautionary access, helping contain risks to the Fund's liquidity;
- as an added precaution, staff proposes that for any request for an FCL arrangement above 1000 percent of quota or above SDR 10 billion, whichever is lower, a short staff statement assessing the impact of the proposed arrangement on the Fund's liquidity position in the context of other potential demand for Fund resources will be prepared by the Finance Department and submitted to Executive Directors at the time of the initial informal meeting;
- the FCL would continue to be subject to an aggregate trigger for an off-cycle review of the instrument (see Section C above); and,
- as with any nonconcessional lending, drawings under FCL arrangements cannot exceed the member's actual BoP need at the time of drawing.

27. ***What are the safeguards embedded in the PCL?*** Safeguards would include the combination of ex ante conditionality (qualification criteria), focused ex post conditionality to help address remaining vulnerabilities, relatively short duration of purchase rights (no more than six months, compared to the twelve-month window under the FCL as proposed to be modified in this paper), adherence to the exceptional access policy (where relevant), a hard cap on access (compared to no cap under the FCL modified as proposed in this paper, or under HAPAs), and the phasing of access such that any amounts above 500 percent of quota are available only after successful implementation of policy commitments in the first year (or subject to review by the Board if needed earlier). In addition, unlike the FCL, the PCL would be subject to the Fund's policy on safeguards assessments for Fund arrangements. The PCL would also be subject to the Fund's policy on post-program monitoring.

28. ***What are the resource implications of establishing the PCL?*** As discussed in the Annex, a modest additional net demand for Fund resources from the establishment of the PCL is expected as the PCL would by and large absorb *potential* demand from HAPAs. The design advantage of the PCL over the HAPA is, nevertheless, expected to increase *actual* demand for precautionary resources.

29. ***Why create a new crisis-prevention instrument?*** The creation of an instrument with both ex ante and ex post conditionality such as the PCL would fill a gap in the Fund's *crisis-prevention* toolkit, currently featuring the FCL (with only ex ante conditionality) and the HAPA (with only ex post conditionality). It would also complement the other nonconcessional *crisis-resolution* instruments (Table 1). The creation of the PCL is thus an evolutionary change in the toolkit that recognizes the inherent heterogeneity in Fund members, better meeting their crisis prevention needs while preserving adequate safeguards.

30. ***Would creation of the PCL increase the complexity and proliferation of unused instruments***? Staff believes that a balance needs to be struck between simplicity and the need to differentiate instruments along a spectrum of countries' fundamentals and policy track records. From this perspective, the PCL fills an existing gap in the Fund's crisis prevention toolkit between the FCL and the HAPA, with the latter remaining a suitable option for countries that are in need of precautionary resources to back medium-term adjustment plans. In the future, periodic reviews of the PCL could be used as an opportunity to reconsider further simplifications to the toolkit including retention of the HAPA.

31. ***Would the PCL create an unwelcome tiering of the membership?*** Tiering is intrinsic in any assessment of countries' fundamentals and policies. Failing to recognize such heterogeneity would reduce the Fund's ability to serve the needs of its members in a well-tailored manner. Responding to this need, the FCL was established to provide a dedicated crisis prevention instrument for the strongest performing segment of the membership. The PCL would create space for positive signals on countries that do not qualify for the FCL but which nevertheless have sound fundamentals and policy frameworks. For such countries, the availability of the PCL would lessen any negative effects of *not* qualifying for the FCL.

## III. A Framework for Resolving Systemic Crises: Further Considerations

32. ***Systemic crises***. *Systemic* crises are virulent events where localized problems trigger panic responses by investors and set off chain reactions across asset markets and countries irrespective of their fundamentals (Box 3).[2] By cutting off countries from capital markets and increasing borrowing costs, systemic shocks that are left unattended could transform a generalized liquidity run into a self-fulfilling solvency crisis, affecting many countries at once—a dynamic similar to a bank run yielding broader solvency threats. Containing the propagation of a systemic shock beyond its epicenter, therefore, requires a *coordinated response to proactively channel liquidity* to countries suffering funding pressures. Preemptive resolution of systemic events can be considered a global public good, limiting negative externalities, and thus greater predictability regarding the handling of such events can contribute to global financial stability.

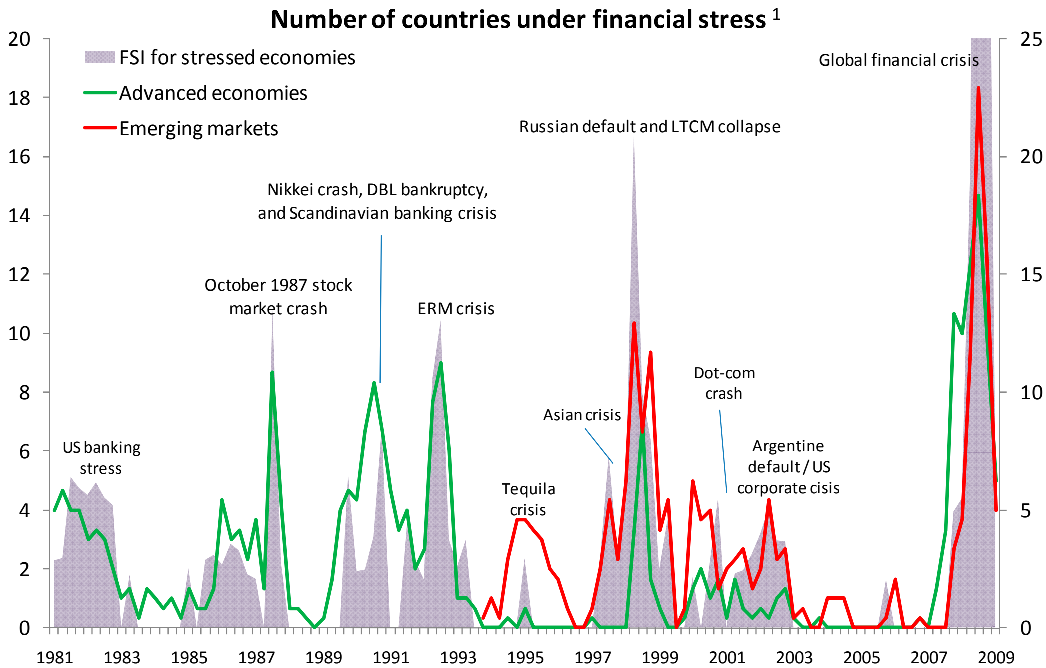
33. ***Fund role***. With its mandate to oversee global financial stability, ability to mobilize resources, and multilateral approach, the Fund is well placed to coordinate global responses to systemic events. In addition to deploying large-scale financial assistance to countries impacted by the shock, the Fund could also catalyze support from monetary authorities and regional financing arrangements. But how could such a coordination role be codified into a predictable framework that reduces the incidence and costs of systemic crises? In this regard, it is useful to consider the problems policymakers face in a systemic crisis and the ingredients that would comprise an effective response by the Fund:

- ***Country coverage***. To stem the shock from spreading across countries, any financial assistance needs to be deployed quickly and focus on those countries that are systemic, in the sense that they are not only impacted by the shock but they also have the ability to transmit it. Determining whether a country is systemic would depend on the type of shock but factors such as the size of the economy, trade openness, or sectoral dominance (e.g., oil or finance) could be relevant. A small country could still be considered systemic if adverse developments therein could impair confidence across other countries or broader asset markets, and further stoke contagion.
- ***Form of support***. Given the likely liquidity shortages in a systemic crisis, existing Fund instruments—which can address either liquidity or solvency problems—could be used, or a new instrument aimed specifically at liquidity needs in a systemic crisis could be established. Moreover, policies governing the use of Fund resources (such as access policies) could also be adapted to the particular nature of systemic events.
- ***First-mover problems***. Countries are typically hesitant to request financial assistance, fearing a negative signal about their own fundamentals or because association with the Fund is problematic from a domestic political perspective. Thus, to avoid a

[2] See Caballero, Ricardo, 2009, "Sudden Financial Arrest," Department of Economics Working Paper No. 09-29 (Cambridge: Massachusetts Institute of Technology).

**Box 3. Incidence of Systemic Crises**

**Systemic crises tend to be episodes of widespread financial stress where several economies are affected at once through their direct or indirect linkages to other economies under stress**. Such co-movements are typically rooted in financial linkages among economies and generalized risk aversion among creditors.




1/ Countries under financial stress are defined as those with a financial stress index that exceeds its country-specific mean by at least one standard deviation. Financial stress indices were calculated for advanced economies and emerging markets as in WEO April 2009 except for the period 1994-1996, where the index for emerging markets is proxied using EMBI only.
Source: WEO April 2009

**The past three decades provide an interesting sample of crisis events.**[1] As seen in the chart, crises—defined as spikes in financial stress—occurred, on average, three times per decade, with five out of about 10 crises observed in the 1990s. The number of countries showing signs of financial stress in each episode varied widely across episodes, between 3 and 14 advanced economies and between 3 and 11 emerging markets; this excludes the 2008-09 crisis, which has indeed affected most countries. But only the most acute and virulent of these crises could be said to be systemic; since the mid 90s, arguably only the Russian default-LTCM collapse (which should arguably be considered together with the Asian crisis) and the recent global financial crisis belong to this category. Prior to this, the October 1987 stock market crash and the 1992 ERM crisis could be considered to be crises of systemic proportions.

**The following stylized facts regarding past systemic crises can be observed**:

- **Triggers** have included a sovereign default (Russia 1998), an attack of a currency peg (ERM in 1992), or bursting of asset bubbles (1987 stock market crash and the recent global crisis).
- **External shocks**—such as collapse in commodity prices, US interest rate hikes, and exchange rate depreciation in competitor countries—normally set the stage for contagion.
- **Economic vulnerabilities** tend to amplify the extent to which a country is susceptible to a shock.
- Additional **contagion mechanisms** also come into play: deleveraging by common creditors, and/or collapse of financially linked entity (e.g., LTCM after Russia's sovereign default; Bear Stearns, Lehman, and AIG during the latest crisis) can spread the crisis beyond the "usual suspects."
- Contagion could be **bi-directional**. Available evidence[2] indicates that financial stress episodes in advanced economies, together with country-specific vulnerabilities explain to a large extent periods of high financial stress in emerging markets. However, financial stress can also spread in the opposite direction: a shock in an emerging market (Russian sovereign default of 1998) can spread to advanced economies (collapse of LTCM in the U.S.).

1/ Periods of stress are identified using data on an Financial Stress Index (FSI) for advanced economies—derived from the 2009 *World Economic Outlook*—and EMBI for emerging markets.

2/ *WEO*, April 2009, Chapter 4.

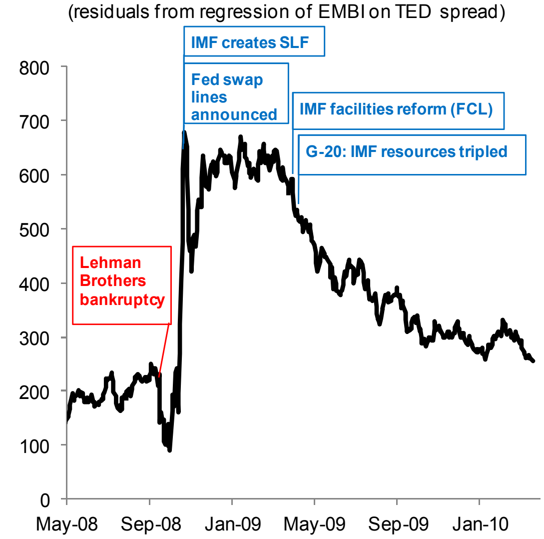
delayed and piecemeal response that could amplify crisis effects, the Fund could proactively invite countries impacted by the shock to make use of financial assistance tailored to their particular situation—in particular through a dedicated formal coordination mechanism to *publicly offer* simultaneous and rapid assistance to systemic countries that meet certain qualification requirements.

- ***Moral hazard***. Any standing facility to provide financial assistance could give rise to moral hazard, by easing lending constraints and inducing excessive borrowing. To avoid this, the form of assistance (choice of lending instrument and intensity of conditionality) should be tailored to a country's performance and the nature of its BoP need. Countries with sound fundamentals and policy frameworks suffering an exogenous liquidity shock should be able to use short-term, quick-disbursing instruments based on ex ante conditionality (qualification) only. Conversely, countries with relatively weaker track records of policy performance and significant home-grown vulnerabilities (which would likely include those at the epicenter of a systemic event) would most likely have more than just self-reversing liquidity needs and would thus benefit from using instruments that provide phased financing based on ex post policy conditionality. This approach would signal relative policy performance and also help mitigate concerns about stigma attached to Fund financing in strong-performing countries discussed above.

- ***Resource adequacy***. To ensure credibility of any offer to provide financial assistance, the Fund would need to demonstrate that its resources are adequate to deal with the magnitude of the shock. To complement its own resources, the Fund could coordinate with monetary authorities and regional financing arrangements to put in place a multi-layered web of bilateral swaps, and regional and Fund lending. If further needed, the Fund could also assist in coordinating the involvement of the private sector though voluntary initiatives aimed at inducing high private sector rollover rates similar to the recent European Bank Coordination Initiative.

- ***Announcement effects***. To maximize the impact on market confidence, the global response should be announced in coordinated fashion similar to the April 2009 announcement of the G20 leaders on increasing Fund resources and the flexibility of instruments to assist countries hit by the forces of global deleveraging. Such an announcement helped place emerging market spreads on a declining path, reversing the sharp widening observed in September 2008 following the Lehman collapse (Figure 1).

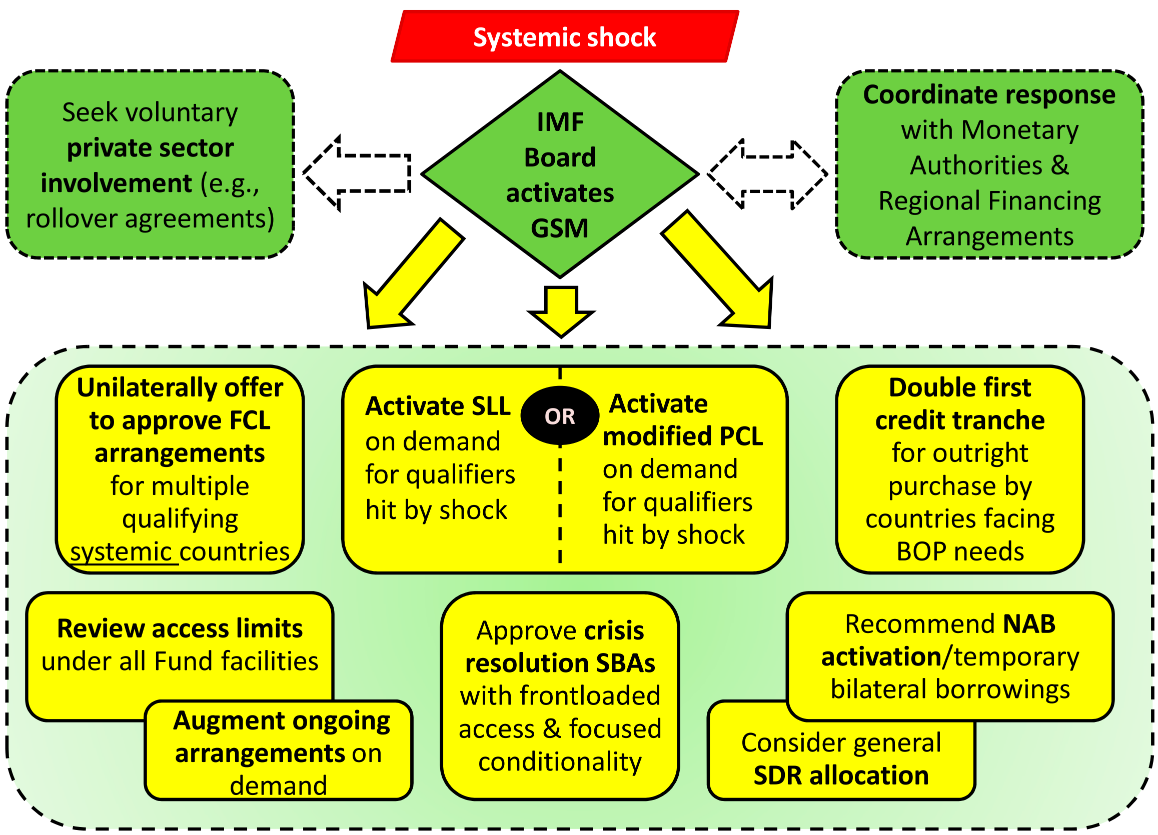
**Figure 1. EMBI-specific risk**
(residuals from regression of EMBI on TED spread)



### A. The Global Stabilization Mechanism

34. **A new policy establishing a Global Stabilization Mechanism (GSM) could formalize these key elements of a framework for responding to systemic events**. At a general level, the GSM policy would enable the Fund to proactively provide financing to the membership, expand its resource base, and, if needed, boost global liquidity. Alternative modalities for such a formal framework could be considered, providing varying degrees of predictability and efficacy in handling systemic crises. The GSM policy could encompass (i) procedures for identifying a systemic event that activates the mechanism; (ii) a set of financing instruments to be offered or activated during a systemic event; (iii) procedures for making offers to approve Fund arrangements; (iv) guidelines about possible adaptations of policies governing Fund financing (such as access policy and conditionality); (v) modalities for ensuring adequacy of resources and global liquidity; and (vi) where needed, modalities for coordinating the Fund's response with relevant monetary authorities and regional financing arrangements, and for seeking voluntary private involvement. Figure 2 summarizes such a framework, with its various elements discussed in turn below.

Figure 2. The Global Stabilization Mechanism (GSM)




35. ***Board role***. The GSM would be a Board-centered process to assure members and the markets of the full support of the international community in responding to a systemic crisis, thus reinforcing the credibility of the response. Early Board consultation would also facilitate

a more effective decision-making process, internalizing resource constraints and other strategic objectives of the Fund. Both the decision adopting a new GSM policy, and a future decision activating the GSM during a systemic crisis, could be adopted by a majority of the votes cast, as neither involves any of the matters for which a qualified majority is required under the Articles. Nonetheless, broad consensus at the Board can only enhance the credibility of the Fund response.

36. ***Activation***. The GSM would be activated by a decision of the Board determining that a "systemic event" has occurred. An event triggering this decision could be a generalized global or regional shock, or a shock in a single country that, if unaddressed, has a high probability of spilling over into other countries. The triggering event could in theory be identified mechanically using quantitative indicators (such as spreads, stock price volatility, or reserves and exchange rates) and based on past observations of systemic crises. However, given the many ways in which a systemic event may arise, it would be more realistic to use quantitative indicators only to inform a judgmental process based on the Fund's enhanced global surveillance, with its focus on spillovers and macro-financial linkages and risks.

## B. Potential Elements of a GSM

37. **This section considers a range of options for mobilizing and adapting lending instruments and policies that could be activated in a systemic crisis**.

- ***Make a unilateral offer*** of financial assistance to a group of members to address the first-mover problems, as elaborated in Section C below.
- ***Activate short-term liquidity instruments*** available only in systemic events, as discussed in Section D below.
- ***Augment existing arrangements***. A number of Fund arrangements may well be in place at the time the Board activates the GSM, with embedded macroeconomic scenarios, access levels, and policy frameworks that do not reflect the full implications of a systemic shock. Thus, to provide immediate confidence, the Board could signal willingness to approve expeditiously and upon request augmentations of arrangements that are assessed to be insufficient to cope with BoP financing pressures due to the systemic shock (along with appropriate adjustments to policy frameworks).
- ***Modify access limits***. The current limits and caps on concessional and nonconcessional lending as well as on the proposed PCL could represent an undue constraint on addressing systemic events. This constraint may be more binding when quotas do not provide a good metric of members' financing needs. Thus, a temporary increase of access limits and caps could be made an additional tool under the GSM, subject to an assessment that resources are adequate.
- ***Increase access under the first credit tranche (FCT)***. The Board could temporarily double the FCT to 50 percent of quota—from the current first 25 percent of the Fund's holdings of a member's currency above its quota. As discussed in the *FFR*

*paper*, a similar approach was followed in 1976 to tackle liquidity pressures (pending the entry into effect of the Second Amendment, the first credit tranche was temporarily increased from 25 percent to 36¼ percent of quota; see SM/76/14 and Decisions No. 4934-(76/5), adopted 1/19/76). Purchases within the FCT require that the member is making reasonable efforts to solve its BoP problems, but are not subject to phasing and performance criteria (Decision No. 12865-(02/102), 9/25/02). Increasing the size of the FCT would thus provide more space for drawings without ex post policy conditionality at times of global liquidity pressures. While, by itself, raising the FCT would only have a marginal impact on countries facing large liquidity pressures, it could serve a useful purpose combined with other proposals discussed in this section, and could also be especially beneficial for smaller members. Safeguards concerns would be mitigated by the fact that Fund financing would be directed to address the largely self-reversing liquidity needs resulting from the crisis.

- ***Coordination***. Systemic events—and the possibly large resource needs they involve—may require close coordination with other multilateral institutions, regional financing arrangements, and major central banks. Pure short-term liquidity shortages in the financial sector might best handled by central banks. Other shocks, such as sovereign funding shortfalls, may be best handled by the Fund. In a systemic event, therefore, central banks' swap lines to selected countries provided in a manner consistent with their domestic mandates could be usefully complemented by a predictable framework such as the GSM that ensures broader and even-handed country coverage consistent with the Fund's global reach. Avenues for co-financing by other multilateral and regional institutions could also be explored. This would be similar to the recent Fund-supported programs with European Union members as part of the European Stabilization Mechanism, or envisaged under the European Financial Stabilization Facility for euro area members and the Chiang Mai Initiative for the ASEAN+3 countries. In addition, depending on the nature of the shock, concurrent discussions could be pursued with governments and regulators of home-country financial institutions to support voluntary private-sector rollovers and mitigate the risk that Fund resources finance sustained capital flight.

- ***Mobilizing resources***. To ensure the credibility of efforts to provide expanded financing to members, the GSM would also trigger a rapid review of the adequacy of Fund resources and options to supplement these resources if needed. The Board could recommend that the Managing Director propose the establishment of an "activation period" to participants under the amended NAB, as the systemic shock underpinning the GSM could be consistent with the requirements for NAB activation (that supplementary resources to quota resources are needed in order to forestall or cope with an impairment of the international monetary system).

- ***Boosting global liquidity***. The Board could request that the Managing Director propose a general SDR allocation. Under the Articles of Agreement, before making a proposal to allocate SDRs, the Managing Director must be satisfied that, inter alia, the allocation would meet a long-term global need to supplement existing reserve assets and broad support for the allocation exists across the membership. Assessment of long-term global need would be based on economic and financial conditions at the time of GSM activation.

### C. Policy for Making a Unilateral Offer to Approve Financial Assistance

38. ***Motivation***. Inducing countries to make early use of financial assistance during a systemic shock would attenuate first-mover problems and stigma concerns driven by domestic political considerations, while providing adequate policy signals to markets:

- The Managing Director or the Board could make a ***general invitation*** to all member countries to approach the Fund for financial assistance. This would avoid the risk of engendering negative perceptions for members that do not receive the offer. But an untargeted invitation may lack adequate incentives to generate sufficient interest, especially in the initial phases of a systemic crisis and among those with relatively stronger fundamentals, including because of the risk of signaling larger problems than hitherto assumed by market participants.
- Fund staff and management could initiate confidential ***bilateral discussions*** with members to simultaneously deploy FCL, PCL or stand-by arrangements for countries impacted by the systemic shock. Such an informal approach involving bilateral discussions, while providing maximum flexibility, may not result in broad participation of all systemic countries (needed to mitigate contagion).
- An alternative approach would be to make a ***unilateral offer to approve Fund arrangements*** in clearly defined systemic circumstances.[3] This could catalyze early interest by countries and avoid sending potentially ambiguous policy signals. However, a number of design issues arise in announcing a group of countries which are offered arrangements—mainly, stigma and signals about the quality of policies of countries covered in the offer and of those excluded from the offer. Choosing the FCL as the underlying instrument to be offered would balance these considerations while mitigating stigma: policymakers in countries where resistance to the Fund is the strongest could more easily defend the use of Fund resources or, more simply, turn down the offer while still benefitting from the positive signal it provides. However, the FCL's very strict qualification requirement narrows the coverage of the offer, necessitating simultaneous use of other dedicated instruments to maximize the chance of mitigating contagion and instilling confidence (discussed in Section D below).

[3] The policy to formalize a unilateral offer to approve assistance would be analogous to the Trade Integration Mechanism (TIM), an existing policy under which the Fund stands ready to approve increased access to members with existing Fund arrangements where this is needed to address balance of payments difficulties arising from multilateral trade liberalization measures undertaken by other countries. The TIM, which is not targeted to any specific list of members, was designed to make Fund resources predictably available to members with Fund arrangements that were affected by trade liberalization measures implemented by other countries.

39. ***Nature of the offer***. Under the GSM, it is proposed that the Board would be able to make a unilateral offer to approve FCL arrangements for multiple qualifying countries that are systemic and meet the FCL's high qualification bar. As discussed in the *FFR paper*, in the event that a member wishes to take up the offer and notifies the Fund to this effect, a separate Board decision would be taken to confirm the qualification criteria continue to be met and approve the arrangement on a lapse-of-time basis. Members to whom the offer is not made—because they are judged not to be systemic and/or not to meet the FCL qualification requirements—would remain free to request financing assistance under other Fund instruments. To avoid unintended signals regarding the relative strength of policies and fundamentals, the offer would be for uniform access (in percent of quota). In determining such an amount, the Board would take into consideration the level of uncommitted resource in relation to the potential financing needs of countries covered under the GSM and of those countries that may approach the Fund for financial assistance outside the GSM. *Importantly, any such amount offered would be indicative, and the amount eventually approved by the Board could vary according to countries' specific BoP needs*.

40. ***Length***. The unilateral offer would be open for a limited term to be specified in the Board decision activating the GSM, generally a window of three to six months at the discretion of the Board, with a presumption—though not a requirement—that the offer will not be extended. (However, during the offer period, it would be possible for the Board to expand the offer to include a separate set of members that have been subsequently affected by the same systemic event and/or are subsequently determined to qualify for the FCL.) The limited-time nature of the offer is intended to induce qualifying countries to accept the offer in a timely manner when such financial assistance is expected to have the greatest benefit in containing the crisis. Moreover, limiting the offer duration also contains the period over which resources are pre-committed, protecting the credibility of the offer.

41. ***Disclosure of offered countries***. Consistent with Article XII, Section 8 (and as reflected in the existing rules for publication of documents containing Board views on members' policies under the current Transparency Policy), the Board could not publish the GSM offer without the covered members' consent, as the FCL qualification assessment involves a statement of the Board's views on the member's policies. (See, for example, *Legal Aspects of the Publication of Staff Reports on Article IV Consultations and Use of Fund Resources,* SM/99/80, 3/29/90, for a detailed discussion of limitations on publication under Article XII, Section 8.) It is therefore proposed that there would be voluntary but presumed publication of the group of qualifying members. If a member were to object to publication, the Fund could either omit the member from publication or not publish any of the country names at all, stating only that offers had been made. In any event, highlighting the criteria used to select qualifying members and making an announcement of the offer in itself is presumed to provide some assurances to markets during a systemic event. A separate issue relates to members to whom the Fund does not make an offer. The Fund would be careful in its public announcements to clarify that a qualification assessment had been definitely concluded only for those members to whom an offer had been made (as noted in ¶40 above,

new members could be added to the group of countries offered assistance following a confirmation of either their FCL qualification or their systemic importance). The Fund would also emphasize that the composition of the group is not exclusively determined by FCL qualification (e.g., an offer may not have been made because a member was not affected by the shock or was not systemic in relation to it). It would also be made clear that members to whom an offer has not been made could still apply for any Fund lending instrument should they wish to do so.

### D. A Short-term Liquidity Line

42. ***Motivation***. As part of the GSM, the Fund could establish a new and dedicated Short-term Liquidity Line (SLL) to be activated only at the onset of systemic crises (with the facility being dormant in normal times). By design, the SLL would be restricted to countries with sound fundamentals and policies sufficient to qualify for the PCL, but unlike the PCL (and similarly to the FCL) would not be subject to ex post conditionality. This feature is designed to encourage qualifying members to arrange liquidity support more quickly in a systemic event than may be possible with a PCL arrangement or an SBA. The absence of ex post policy conditionality would be justified by the rare and extreme nature of systemic events (which could require prompt and extraordinary measures to control its propagation) and also by the anticipated short-lasting nature of the crisis-triggered liquidity need (which also justifies the short arrangement duration). In addition, the PCL-like qualification requirements as well as the short offer period of the GSM and short period within which the covered BoP need is expected to be resolved (as also reflected in the SLL's short repayment period) would provide adequate safeguards. These features—availability only in the face of a shock and the short-term BoP need addressed—also justify it as an additional instrument distinct from the PCL.

43. ***Features***. The SLL would be established as a special facility outside the credit tranches, which would be available to meet both actual and potential BoP needs, and would have the following features:

- ***Activation***. The SLL could be activated by the activation of the GSM and would be available for the same period as the GSM offer mechanism is available.
- ***Type of BoP problem***. The specific BoP problem addressed by the SLL would be a temporary, short-term liquidity need resulting from developments in the global capital markets that are not primarily under the control of the member where, as a result of the member's sound fundamentals and policies and the provision of Fund liquidity support, the country is expected to be able to resolve its liquidity difficulties before they morph into more entrenched solvency problems.
- ***Length***. An SLL arrangement would be approved for a period of six months, and could be renewed once by the Board at the request of the member, provided the country continues to meet the qualification requirements and to experience the special BoP need addressed by the SLL.

- ***Qualification***. Accessing SLL resources would be conditional on meeting the facility's own qualification criteria regarding economic fundamentals and policies, which would be identical to those proposed for the PCL, including those regarding the applicability of the substantive criteria under the exceptional access policy where relevant. In the event of a request for a successor arrangement under the SLL, qualification would be reassessed.

- ***Access***. Access under SLL arrangements would normally be approved for amounts up to 500 percent of quota. However, such a cap could be raised by the Board, if warranted by the nature and intensity of the shock, upon activation of the instrument and provided sufficient resources are available to cover potential SLL commitments without undermining confidence in the adequacy of Fund liquidity to meet other potential needs of members.

- ***Phasing***. Reflecting its ex ante conditionality structure, the entire amount of access approved under the SLL arrangement would be made available upfront and remain available throughout the arrangement period. Multiple purchases during the arrangement period up to the approved amount would be allowed. Drawings would be automatic—i.e., they would not be subject to an activation review.

- ***Terms***. Drawings on the SLL would have a repurchase period of 1¼-2 years, with each purchase repurchased in four quarterly installments starting 15 months after the date of the purchase. Other financial terms (periodic charges, surcharges and fees) would be the same as those applying to financing in the credit tranches.

- ***Safeguards***. The combination of strong qualification criteria (signaling the ability of the authorities to undertake measures to alleviate temporary short-term BoP stress), largely self-reversing nature of the BoP need, adherence to the exceptional access policy where applicable, relatively short duration of purchase rights, and capped access all provide adequate safeguards for the use of Fund resources. While the facility does not involve ex post conditionality, the qualification criteria that serve as the primary basis for the ex ante conditionality, together with the possibility of establishing prior actions, provide assurances that appropriate policy measures would be taken if needed. Given these features, a safeguards assessment of the external audit mechanism only would be initiated at the time of a member's request for assistance under the SLL, and undertaken during the term of the arrangement, providing assurance that the key requirement of the safeguards policy has been met.

- ***Procedures***. The procedural requirements for individual SLL arrangements would be similar to those for the PCL arrangements, though given their potentially urgent nature, approval may often be expedited under the Emergency Financing Mechanism.

- ***Board voting requirement***. Establishment of the SLL would require a Board decision adopted by an 85 percent majority of the total voting power, as required under Article V, Section 7(d) for any special facility with a repurchase period different than that of the credit tranches (and under Article XXX(c) for any facility that allows "floating" against the reserve tranche). Once established, activation of the SLL in the context of the GSM would require a Board decision adopted by a majority of votes cast.

44. ***A new credit tranche window for systemic crisis***. As an alternative to creating the SLL as a special facility with a special repurchase period to address a special BoP problem, the decision on the PCL could include a separate lending window that would be activated under the GSM and could be used to address non-precautionary/liquidity needs of PCL qualifiers. This approach would be more consistent with the principle emphasized in last year's reforms of maintaining a streamlined nonconcessional lending toolkit with a limited number of special facilities. Such a new lending window would be similar in many respects to the PCL, but with the following differences, to make this instrument more effective in addressing contagion in PCL-qualifying countries hit by a systemic shock:

- It would be available for both potential and actual BoP needs, to allow for immediate drawing on approval if needed;
- Its duration would be six months, reflecting the short-term nature of the liquidity shock. Since a six-month arrangement would not involve a review, this option would obviate the need to negotiate ex post conditionality. As discussed above in connection with the SLL, the absence of ex post policy conditionality (though, prior actions could be established) would be primarily justified by the anticipated short-lasting and self-correcting nature of the liquidity need (which also justifies the short arrangement duration), and by the need for prompt and extraordinary measures to control the propagation of systemic crisis.
- Such a six-month arrangement could be renewed once, subject to again meeting qualification requirements, and any prior actions as needed.
- Access would be 500 percent of quota, but the Board could consider revising this level under the GSM if warranted by circumstances and resource availability.

Other features of the PCL would apply to this separate lending window—notably, the qualification criteria would be unchanged. From a safeguards perspective, the most substantive differences of this lending window with the PCL are (i) the possibility of using it for an actual, and not only potential, BoP need on approval; and (ii) the absence of a monitoring framework for assessing observance of ex post conditionality, given the duration of the arrangement would be the same as the periodicity of reviews. The possibility of using prior actions and the short-term, exogenous nature of the shock would be balancing considerations.

## IV. Conclusions and Issues for Discussion

45. ***New toolkit***. The 2008−09 global crisis and more recent events have prompted a fresh rethink of the future financing role of the Fund in the broader context of mandate reforms. The ideas considered in this paper build on the reforms of the nonconcessional lending

toolkit implemented in 2009, and aim to ensure that the Fund remains effective in meeting the needs of as broad a spectrum of members as possible under a variety of crisis circumstances. In particular, the proposed organization of lending windows according to the strength of members' fundamentals and policies allows tailoring conditionality to the different characteristics of members, thus facilitating the balance of competing objectives of providing countries with insurance instruments that can complement international reserves with the need to guard against moral hazard and other risks.

- The proposed enhancements to the FCL and the creation of the PCL would significantly strengthen the Fund's crisis prevention capacity, complementing its demonstrated competence in crisis resolution.
- Recognizing the exceptional risks to global economic stability posed by systemic crises, the paper includes proposals to erect a firewall by providing liquidity support to countries that may become engulfed by systemic shocks.
- Complementing these steps, further work is planned to build stronger synergies with regional financing arrangements.

46. ***Resource implications and financing operations***. Although larger overall resource commitments may be needed in many crises if all the reforms considered in this paper are adopted, the total resource envelopes discussed in the initial Size of the Fund paper (EB/CQuota/10/2) appear to be broadly sufficient to accommodate such demand. Until the expanded NAB becomes effective, the proposed reforms could increase the likelihood that the Fund would need to bolster its resources temporarily, such as through expanded bilateral borrowing. As further discussed in the Annex, increased precautionary commitments may also have implications for the liquidity management of some creditor members.

47. ***Directors may wish to consider the following issues for discussion***:

- Do Directors agree that a predictable and coordinated response is needed to deal with systemic crises? How can the Fund facilitate this process?
- Given the recent experience with a large-scale crisis, do Directors agree that a multi-pronged approach—such as that embodied in the GSM—could address future such occurrences? What are Directors views on each the elements of the GSM?
- How do Directors see the balance between the global public good provided by proactively channeling liquidity to contain a crisis and safeguards?
- Do Directors agree that the SLL or a new lending window in the PCL decision (¶44) is needed to provide Fund financing in a systemic crisis?

**Table 1: The Fund's Nonconcessional Lending Instruments**
(Proposed changes are highlighted)

| | **Stand-By Arrangement** (SBA, 1952) | **Extended Fund Facility** (EFF, 1974) | **High Access Precautionary SBA** (HAPA, clarified in 2009) | **Precautionary Credit Line** (PCL) | **Short-term Liquidity Line** (SLL) | **Flexible Credit Line** (FCL, 2009) |
|---|---|---|---|---|---|---|
| **Availability** | Any time | Any time | Any time | Any time | Only in systemic events | Any time |
| **Qualification** | No | No | No | Yes, Sound policies | Yes, Sound policies | Yes, Very strong policies |
| **BoP Need** | All types of BoP need (including precautionary) | Longer-term BoP needs (structural maladjustments, price/cost distortions, slow growth, inherently weak BoP position) | All types of BoP need; expression of intention not to draw at time of approval | All types of BoP need; absence of actual BoP need required on approval | Special BoP need: temporary, short-term liquidity need from systemic shock | All types of BoP need (including precautionary) |
| **Access** | No hard cap (normal limits may be exceeded under exceptional access policy) | No hard cap (normal limits may be exceeded, but high access generally discouraged) | No hard cap (normal limits exceeded by definition and therefore subject to exceptional access policy) | Cap of 1000 percent of quota, with 500 percent cap on approval | Cap to be decided by Board on activation of facility in systemic event based on size of shock and available resources | Uncapped |
| **Exceptional access policy** 1/ | Yes | Yes | Yes | Yes | Yes | No |
| **Ex post conditionality** | Yes. Reviews and PCs | Yes, structural focus. Reviews and PCs | Yes, streamlined. Reviews and PCs | Yes, focused. Reviews only (no PCs) | No | No |
| **Phasing and monitoring** | Phased. Quarterly or semiannual reviews depending on circumstances | Phased. Quarterly or semiannual reviews depending on circumstances | Phased. Quarterly or semiannual reviews depending on circumstances | Frontloaded. Up to 500 percent of quota available on approval. Up to additional 500 percent of quota available at start of second year or earlier based on ad hoc review. Semiannual reviews | Frontloaded. Total amount available on approval. No reviews | Frontloaded. Total amount available on approval. Mid-term review to assess qualification only in 2 year arrangements |
| **Arrangement length** | Normal length 12-18 months, but up to 3 years if needed. Successor arrangements allowed | 3 years. Can be extended to 4 years. Successor arrangements allowed | 12 months to up to 3 years. Successor arrangements allowed | Between 1 to 2 years. Successor arrangements allowed | 6 months. Up to 1 successor arrangement allowed | One- or two-year arrangements. Successor arrangements allowed |
| **Repayment period** | 3¼-5 years | 4½-10 years | 3¼-5 years | 3¼-5 years | 1¼-2 years | 3¼-5 years |
| **Charges, fees** | Charges and Fees are as for the SBA for all instruments | | | | | |

1/ Triggered when annual or cumulative access is above, respectively, 200 and 600 percents of quota.

## ANNEX. FUND RESOURCES AND FINANCING OPERATIONS

*This Annex reviews the status of current and prospective Fund resources and presents a preliminary assessment of the impact of the reforms proposed in this paper on the demand for Fund resources. The preventative nature of the proposed reforms would likely increase potential resource commitments early in a crisis, while, at the same time, reducing the need for commitments under traditional crisis management instruments. While the proposed reforms would tend to increase the frontloading of demand for Fund resources, the overall resource envelope discussed in EB/CQUOTA/10/2 (3/15/10) under the "tail risk" scenarios appears broadly adequate. Nonetheless, these reforms would tend to increase the advantages of quota resources relative to borrowing, and may also have implications for liquidity management by creditor members.*

### A. Current and Prospective Resources

**The Fund's forward commitment capacity (FCC) is currently at a record high level owing to bilateral borrowing**. Following calls by the G-20 and IMFC, the Fund expanded its resources through bilateral loan and note purchase agreements, with a total of 19 agreements totaling SDR 174 billion made effective by late June 2010. This borrowing supplements the quota resources of members with an external position sufficiently strong to be included in Financial Transactions Plan (FTP), and brings the Fund's lending resources to a total of SDR 356 billion (Table I.1). Even with the record level of outstanding credit and undrawn commitments (SDR 125 billion), this borrowing has boosted the Fund's FCC to a record high level of SDR 162 billion ($239 billion).

**Resources are being further increased, especially through the expansion of the NAB**. A number of bilateral loan agreements are in the process of being made effective, and completing this process will boost resources by a further SDR 26 billion. If needed, the existing NAB could also be activated, for a total of SDR 34 billion.[1] Together, these items would boost the FCC to a total of SDR 210 billion (just over $300 billion), assuming no change in total credit and commitments outstanding. The Board approved the expanded NAB (of SDR 367 billion) in April 2010, which is now in the process of being made effective.[2] Once the required majorities are reached and the NAB becomes operational, it is expected that bilateral borrowing agreements would be folded into the NAB, with a net increase in supplementary resources of about SDR 168 billion. Together with the ad hoc quota increases agreed in 2008, activation of the expanded NAB would bring the total Fund lending resources to SDR 567 billion ($837 billion), roughly doubling the FCC to SDR 330 billion (about $480 billion) assuming the current level of Fund credit and commitments.[3]

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[1] Until a decision to activate the NAB is taken, it is not included in the FCC.

[2] As of June 28, 2010 a total of 16 participants had consented or adhered to the expanded NAB, with a list available at http://www.imf.org/external/np/fin/misc/nab.htm

[3] As of June 28, 2010, 82 countries representing around 78.1 percent of the total voting power had accepted the amendment on voice and participation, with three-fifths of members (113) having 85 percent of the total voting power required before the amendment to become effective.

**Table I.1. Indicators of Fund Resources and Lending Capacity**
(as of June 24, 2010)

| | SDR billion | US$ billion | Euro billion |
|---|---|---|---|
| **Existing Resources and Forward Commitment Capacity (FCC)** | | | |
| A. Total Lending Resources | 355.8 | 525.5 | 428.6 |
| Quota resources of FTP members | 179.7 | 265.4 | 216.5 |
| Effective Loan and Note Purchase Agreements | 173.3 | 256.0 | 208.7 |
| Other resources, net 1/ | 2.8 | 4.1 | 3.4 |
| B. Credit outstanding and credit commitments | 125.3 | 185.1 | 150.9 |
| Fund credit outstanding | 46.6 | 68.9 | 56.2 |
| Undrawn balances under Fund arrangements | 78.7 | 116.2 | 94.8 |
| C. Repurchases due in next 12 months | 1.8 | 2.7 | 2.2 |
| D. Prudential Balance 2/ | 70.6 | 104.3 | 85.0 |
| E. Current FCC (A-B+C-D) | 161.7 | 238.8 | 194.8 |
| **Supplementary Resources and Agreed Resource Increases** | | | |
| Pledged Bilateral Borrowing Not Yet Effective 3/ | 25.9 | 38.2 | 31.2 |
| Activation of Existing NAB | 34.0 | 50.2 | 41.0 |
| Expanded New Arrangements to Borrow | 367.5 | 542.8 | 442.7 |
| Net Impact After Expiry of Pledged Bilateral Borrowing | 168.3 | 248.6 | 202.8 |
| Quota Increase Agreed in 2008, Impact on FTP Members | 19.5 | 28.8 | 23.5 |
| **Potential Lending Resources and Forward Committment Capacity** | | | |
| I. Activation of Existing NAB plus Pending Bilateral Borrowing | | | |
| Total Lending Resources | 415.6 | 613.9 | 500.7 |
| Prudential balance 2/ | 82.6 | 122.0 | 99.5 |
| FCC before Commitments or Repurchases | 333.1 | 492.0 | 401.2 |
| FCC with Current Commitments and Repurchases | 209.6 | 309.6 | 252.5 |
| II. Full Activation of Expanded NAB plus 2008 Quota Increase | | | |
| Total Lending Resources | 566.7 | 837.0 | 682.6 |
| Prudential balance 2/ | 112.8 | 166.6 | 135.9 |
| FCC before Commitments or Repurchases | 453.9 | 670.4 | 546.8 |
| FCC with Current Commitments and Repurchases | 330.4 | 488.0 | 398.0 |
| ***Memo items*** | | | |
| Exchange rate per SDR (Jun 24, 2010) | | 1.47714 | 1.20465 |

1/ Balances in the SCA-1 and net income provide small additional resources besides quotas and borrow

2/ The prudential balance sets aside 20 percent of quota of FTP members and of effective borrowing to safeguard the liquidity of creditors' claims and take account of the potential erosion of the IMF's resource base. The prudential balance does not represent a rigid minimum and IMF resources could on a strictly temporary basis, fall below this level.

3/ Excluding the amount pledged by Greece.

**The size and composition of Fund resources are currently being reviewed in the context of the 14th General Review of Quotas**. A preliminary analysis of the adequacy of Fund resources (*EB/CQUOTA/10/2*)—which did not incorporate the facilities reforms proposed in this paper—pointed to the need for a substantial quota increase, with some indicators suggesting a doubling of quotas and others pointing to somewhat larger quota increases.[4] For illustrative purposes, quota increases of 100 to 150 percent (starting from quotas agreed in 2008) would raise the quotas of members included in the FTP by approximately SDR 200 to 300 billion.[5] If such increases were agreed, the Fund's total financing capacity from quota resources would be about SDR 320 to 400 billion, increasing to SDR 610 to 690 billion in case the expanded NAB were fully activated.[6] These figures should, however, be treated as upper limits on lending capacity since, in circumstances warranting activation of the NAB, some members may have to be excluded from the FTP and their NAB credit arrangements would not be available for drawings.

### B. Potential Impact on Demand for Fund Resources

This section discusses the potential impact of each of the main reforms proposed in the paper and provides an update of some of the scenario analysis in *EB/CQUOTA/10/2*.

*Direct Impact of the Proposed Reforms*

***Enhanced FCL*: expect broader use of the FCL and potentially higher average access, generating some increase in resource demand**. The shift to 12-month purchase rights could increase the willingness of eligible members to request an FCL. In addition, the removal of the implicit cap on access could raise access levels, at least in those cases where potential needs may be greater than 1000 percent of quota.

***Establishing the PCL*: expect broader use relative to HAPAs, generating some increase in resource demand**. Much demand for the PCL would likely reflect substitution from the HAPA as the PCL provides substantial front-loaded access and focused ex post conditionality. Also, additional members may find a PCL attractive as qualification offers a positive signal to markets. The net impact of the PCL on access levels is, however, unclear: (i) access may tend to rise toward the cap of 1000 percent of quota (exceeding the average HAPA access to date of 300 percent of quota) despite the upward-sloping commitment fee schedule; (ii) early access to a PCL may avoid the need for a higher access SBA later.

***Introducing the GSM and SLL*: expect a rise in demand for Fund resources in a systemic crisis**. Qualification criteria for liquidity instruments under the GSM would be the same as those for the PCL or FCL. The unilateral nature of the offer and the country coverage under the GSM could, however, bring forward requests for Fund resources, while the lack of ex

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[4] *Fourteenth General Review of Quotas—The Size of the Fund—Initial Considerations* (EB/CQUOTA/10/2, 3/15/10).

[5] The exact figures will depend on the distribution of quota increases across members.

[6] Following the completion of the 14th review, it is agreed that there would be a review of the expanded NAB.

post conditionality under the SLL may broaden the range of members willing to consider Fund support despite its shorter repurchase obligations.

*Overall Impact on Resource Needs*

**Larger commitments of resources for *crisis prevention* would be expected to moderate the need for commitments under *crisis resolution* instruments**. Experience in the current crisis is consistent with precautionary arrangements serving as a valuable preventative tool for the member with the arrangement, with no drawings under FCLs or HAPAs. Given the integrated nature of international capital markets, committing Fund resources earlier in a crisis would likely minimize spillovers to other members, moderating the demand for Fund resources via its crisis resolution instruments.

**Further analysis of the "tail risk" scenarios in EB/CQuota/10/2 offers insights on the overall potential impact of the proposed reforms on resource needs**. The analysis in Annex IV of EB/CQuota/10/2 focused on tail risk scenarios for both emerging markets and advanced economies. In the case of advanced economies, scenarios representing a systemic banking crisis and with some countries experiencing difficulties funding government debt generated financing needs of about SDR 150 billion, or commitments of about SDR 290 billion assuming that all the countries with a financing need received access of 1000 percent of quota.[7] Recent developments, such as the SBA with Greece and the Fund's role in the European Financial Stability Facility, have confirmed the potential for commitments to advanced economies of such substantial magnitudes. Further analysis presented in this annex focuses on emerging market economies, where a broader group (57 countries) was included in the tail risk scenarios, encompassing members that might qualify for crisis prevention instruments and those that would rely on crisis resolution instruments.

**Interestingly, the "tail risk" scenario projected substantial commitments for members that would be likely to qualify for crisis prevention instruments under the proposed reforms**. The "tail risk" scenario from EB/CQuota/0/2 combined low rollovers of external debt, capital outflows from deposit withdrawals, and reduced inflows of portfolio and direct investment. Table I.2 reports this scenario with the original assumptions in the first two columns: the first showing the estimated financing need under the capital outflow assumptions, and the second the commitments associated with uniform access of 1000 percent of quota for all members with a financing need. Among the group of countries most likely to use crisis prevention facilities such as a FCL or PCL, positive financing needs (after drawing on reserve buffers) were estimated in 18 countries, or about three-quarters of

[7] The scenarios covered a subset of advanced economies, in particular, those identified as highly vulnerable in the Fall 2009 vulnerability exercise for advanced economies, and those with large financial sectors relative to their economic size.

this group.[8] In view of the substantial coverage of this group in this scenario, it seems reasonable to assume that the proposed reforms would serve to advance the timing of commitments to these members, or to make it more likely that they would occur in practice, rather than further broadening the potential scope of Fund commitments.[9]

Table II.2. Tail Risk Scenarios for Emerging Markets

| | Original Scenario 1/ | | Scenarios with Proposed Facilities Reforms | | |
|---|---|---|---|---|---|
| | Estimated Financing Gap 2/ | Access of 1000% of Quota 3/ | Unchanged Capital Outflows | Decline in Outflows by One-Quarter | Decline in Outflows by One-Half |
| | (In billions of SDR) | | | | |
| Total Resource Commitments | 399 | 378 | 462 | 421 | 386 |
| Crisis Prevention Arrangements 4/ 5/ | 225 | 237 | 288 | 288 | 288 |
| Number of Arrangements | 18 | 18 | 18 | 18 | 18 |
| Weighted Average Access (percent of quota) | 950 | 1000 | 1217 | 1217 | 1217 |
| Crisis Resolution Arrangements 6/ | 174 | 141 | 174 | 133 | 98 |
| Number of Arrangements | 26 | 26 | 26 | 25 | 22 |
| Weighted Average Access (percent of quota) | 1229 | 1000 | 1229 | 1104 | 1048 |
| Assumed shocks for emerging markets | (Percent deviation from baseline unless otherwise indicated) | | | | |
| FDI inflows | -20 | -20 | -20 | -15 | -10 |
| External debt rollover rate (percent) | 60 | 60 | 60 | 70 | 80 |
| Net portfolio inflows | -15 | -15 | -15 | -11.25 | -7.5 |
| Bank deposits, residents | -5 | -5 | -5 | -3.75 | -2.5 |
| Bank deposits, non-residents | -20 | -20 | -20 | -15 | -10 |

Source: staff calculations.

1/ In EB/Cquota/10/2, Annex 2, this "tail risk" scenario combines a sudden stop in capital inflows with deposit flight.

2/ The financing gap differs from the SDR 430 billion gap in Annex 2 of EB/Cquota/10/2 due to a correction in the rollover rate for medium- and long-term external debt for some members, which lowered the estimated financing gap by SDR 31 billion.

3/ The above correction of the rollover rate means one member in the original scenario no longer has a financing need, reducing total access modestly relative to the SDR 385 billion reported in paragraph 28 of EB/CQuota/10/2.

4/ For this analysis, it is assumed that "investment grade" rated members would pre-qualify for the FCL or PCL. In practice this assessment would be made at the time of a request, and some investment grade rated members may not qualify, while some members not rated as investment grade could qualify, e.g., Colombia is not rated as investment grate.

5/ For crisis prevention arrangements, the scenarios with proposed facilities reforms report commitments of a minimum of 1000 percent of quota. For a group of members assumed to be FCL qualified, the committment is higher if their estimated financing need exceeds 1000 percent of quota up to an assumed 2000 percent of quota--with additional financing needs assumed to be met from bilateral and regional sources. For the group of members assumed to be PCL qualified, the assumptions are equivalent but these members' access is effectively 1000% of quota given the ceiling in the proposed reforms.

6/ For crisis resolution arrangements, the scenarios with proposed facilities reforms report access based on members' estimated financing needs, with exceptional access assumed in cases where financing needs exceed the normal access limits.

8 In this analysis, countries that are assumed to be qualified for and FCL or PCL are those with an investment grade rating, but this is only a working assumption rather than a qualification requirement or a sufficient condition for qualification. This type of assumption is made because it avoids the need for staff to make any case-by-case evaluation and it generates an overall group size (40 percent of the 57 countries, with some 60 percent of the quota of this group) that appears broadly plausible.

9 As discussed in EB/CQuota/10/2, the scenarios do not assume that all these members would all have arrangements, rather the analysis indicates the scale of resources needed to give confidence that such support could be provided.

**Some increase in commitments for crisis prevention is estimated to result from removing the access cap on the FCL**. Among the group of members assumed to utilize crisis prevention facilities, about half are assumed to be FCL eligible. Assuming that these countries have access equal to their estimated financing need if that is above 1000 percent of quota, or access of 1000 percent of quota otherwise (as might be expected in such a "tail risk" scenario), total access would increase by about SDR 75 billion. If the burden of providing such financing were shared with bilateral and regional sources (limiting access to Fund resources to 2000 percent of quota at most) overall commitments would increase by about SDR 50 billion (third column of Table II.2).

**The scale of crisis resolution commitments could be reduced significantly, depending on the extent to which the proposed reforms moderate the depth of a crisis**. The group of members that are assumed to utilize crisis prevention instruments have overall financing needs of SDR 175 billion in the original scenario, reflecting potential arrangements with 26 members with average access of around 1200 percent of quota. By strengthening crisis prevention commitments, or by making it more credible that such support would be arranged when needed, the proposed reforms, in conjunction with bilateral swap lines and support from regional arrangements, are expected to contain spillovers across countries. The fourth and fifth columns of Table I.2 illustrate the impact of reducing outflows by one-quarter and one-half, respectively, where the fifth column with an 80 percent rollover rate remains a severe shock that is broadly consistent with experience of a number of EU member countries in the current global crisis.[10] With the decline in estimated financing needs, the implied number of arrangements and average access levels would also decline, reducing crisis resolution commitments by about SDR 40 billion and SDR 75 billion, respectively.

**Overall, the resource envelopes discussed in EB/CQuota/10/2 appear to be broadly sufficient to accommodate potential demand for Fund financing under the proposed reforms.** In the "tail risk" scenarios, a range for resource demand from emerging markets of SDR 400 to 450 billion would cover most of the potential outcomes discussed above taking into account the impact of the proposed reforms. It may be reasonable to focus on the lower end of this range to reflect contributions from other sources of exceptional financing as suggested by a number of Directors.[11] As noted, a doubling of quotas, together with the expanded NAB, would generate an overall financing capacity of SDR 610 billion, leaving scope for commitments to advanced economies, although there are significant downside risks to the availability of these resources.[12] Nonetheless, somewhat larger quota increases, as also

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[10] In 2009, estimates of average rollover rates of financial and corporate sector external debt in Romania, Latvia and Hungary are 85, 86, and 90 percent respectively. Rollover rates varied more at the sectoral level, from 75 percent for the external debt of Hungarian banks in 2009 up to 91 percent for Romanian banks in the context of the European Bank Coordination Initiative.

[11] Excluding the recent commitments to Greece, other sources of exceptional financing are estimated to have committed just over SDR 30 billion in the current crisis.

[12] Members drawing on crisis resolution arrangements would not be included in the FTP, reducing lending resources by a modest SDR 1.6 billion. However, some members with crisis prevention arrangements may also need to draw in a tail risk scenario—these members' total current quota and bilateral borrowing commitments amount to about SDR 50 billion, and they account for almost SDR 100 billion of the total lending resources from the expanded NAB and a doubling of post second round quotas.

discussed in EB/CQuota/10/2, could provide greater confidence that the Fund would continue to have adequate resources to cover potential later developments—the benefits of the proposed facilities reforms would be undermined if additional commitments for crisis prevention raised doubts about the adequacy of resources for other members, including advanced economies, that could potentially need Fund support later.

**In the interim period until the expanded NAB and quota resources become effective, the proposed reforms could, however, increase the likelihood that the Fund would need to bolster its resources temporarily**. The increase in resource demand resulting from the immediate reforms of the FCL and PCL proposed in this paper are difficult to assess and depend heavily on global economic developments. If there were significant new demand, the immediate protection is the SDR 100 billion trigger for review of the FCL/PCL, which would come into effect with additional FCL/PCL commitments (on top of the upcoming FCL for Poland) of SDR 52.5 billion. Based on current credit commitments (including the upcoming FCL for Poland), the remaining FCC would be reduced to SDR 96 billion when this trigger is reached. Given the need to retain sufficient resources for crisis lending, it may become necessary to seek additional borrowed resources. Until the expanded NAB becomes effective, the most likely avenue to generate such temporary supplementary resources would be to expand the amounts available under existing bilateral loan and note purchase agreements and to also add new agreements.

## C. Implications for the Composition of Fund Resources and Liquidity Management by Creditor Members

**The proposed reforms could also have implications for the appropriate composition of IMF resources between quotas and borrowing**. The proposed reforms are expected to accelerate demand for commitments, with a larger share of FCL-eligible members possibly seeking arrangements early in a crisis, the PCL possibly bringing forward requests from members which might have later had HAPAs or SBAs, and the GSM, if activated, also stimulating members to take up FCLs and SLLs earlier than otherwise. A larger share of quota resources would ensure that the Fund is better placed to meet the greater potential for a large surge in demand for commitments, as quota resources are more flexible than borrowing. For example, demand for FCLs and PCLs could arise outside of a systemic crisis, in which case the conditions for activation of the NAB may not be met.[13]

**By expanding potential precautionary commitments, the proposed reforms may have implications for liquidity management by creditor members**. With the introduction of the FCL, it has been necessary to expand the overall size of the quarterly FTP to provide for the possibility of drawings under the FCL, with the most recent FTP totaling SDR 50 billion, relative to SDR 10 billion in scheduled purchases. A larger volume of outstanding

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[13] The expanded NAB is a backstop to quotas, which when effective, can be activated by an 85 percent majority of credit arrangements once supplementary resources to quota resources are needed in order to forestall or cope with an impairment of the international monetary system. See *Proposed Decision to Modify the New Arrangements to Borrow* (SM/10/71, 03/25/10).

precautionary commitments would require a further expansion of the FTP, with the scale of the increase reflecting judgments regarding the potential for simultaneous drawings, which would depend on the regional concentration of such commitments among other factors. Table I.3 illustrates the effect if the FTP were doubled to a total of SDR 100 billion, assuming the current set of effective bilateral loan and note purchase agreements, and the current 1:1 ratio of quotas to borrowing. Amounts under the FTP become more significant relative to foreign exchange reserves, and although these ratios appear modest in most cases with a few exceptions, some adjustment in foreign exchange liquidity management may be required by members that do not issue a reserve currency. Some members finance Fund operations through public debt issuance, including some members that issue a reserve currency, such that their management of domestic debt and liquidity may also require adjustment to be prepared to meet the larger potential use of these resources.

**The potential for very large drawings on members' resources also raises issues for the Fund's own financial relationship with its members**. With a larger stock of outstanding precautionary commitments, there is greater potential for unscheduled large scale purchases, including from a bunching of purchases under a number of arrangements. Some members may face challenges in mobilizing resources when the Fund needs them in these circumstances. If so, there may be need to allow larger temporary deviations in the allocation of transfers in the FTP to rely to a greater extent on members with greater flexibility in such extreme events, while still achieving balanced positions among creditors over time.

Table I.3 Scenarios for Transfers in the Financial Transactions Plan 1/
(In billions of SDRs)

| | Present Quota | Total Borrowing Commitments | Total FX Reserves 2/ | Transfers Current FTP (SDR 50 bn) 3/ SDR Billion | Transfers Current FTP (SDR 50 bn) 3/ In percent of FX Reserves | Transfers in FTP of SDR 100 billion 4/ SDR Billion | Transfers in FTP of SDR 100 billion 4/ In percent of FX Reserves |
|---|---|---|---|---|---|---|---|
| Algeria | | | 97.7 | 0.2 | 0.2 | 0.3 | 0.4 |
| Australia | 0.1 | | 21.3 | 0.0 | 0.0 | 0.4 | 1.8 |
| Botswana | 0.0 | | 5.6 | 0.0 | 0.0 | 0.0 | 0.0 |
| Brazil | 0.0 | 6.6 | 159.1 | 1.0 | 0.6 | 1.9 | 1.2 |
| Brunei | 0.0 | | 0.6 | 0.0 | 0.0 | 0.0 | 0.0 |
| Canada | 0.2 | 6.6 | 30.1 | 1.0 | 3.2 | 3.0 | 9.8 |
| Chile | 0.0 | | 15.9 | 0.0 | 0.0 | 0.0 | 0.0 |
| China | 0.0 | 32.0 | 1,611.8 | 4.7 | 0.3 | 9.2 | 0.6 |
| Colombia | 0.0 | | 15.8 | 0.0 | 0.0 | 0.0 | 0.0 |
| Czech Republic | 0.0 | 0.9 | 24.7 | 0.1 | 0.6 | 0.3 | 1.1 |
| Denmark | 0.0 | 1.7 | 46.6 | 0.3 | 0.5 | 0.7 | 1.4 |
| India | 0.0 | 6.6 | 168.6 | 1.0 | 0.6 | 1.9 | 1.1 |
| Israel | 0.3 | | 41.7 | 0.0 | 0.0 | 1.3 | 3.2 |
| Japan | 0.0 | 65.9 | 652.7 | 9.8 | 1.5 | 19.0 | 2.9 |
| Korea | 0.0 | | 181.4 | 0.0 | 0.0 | 0.2 | 0.1 |
| Kuwait | 0.0 | | 11.3 | 0.0 | 0.0 | 0.2 | 1.4 |
| Libya | 0.0 | | 62.0 | 0.0 | 0.0 | 0.0 | 0.0 |
| Malaysia | 0.0 | | 61.0 | 0.0 | 0.0 | 0.0 | 0.0 |
| Mauritius | 0.0 | | 1.3 | 0.0 | 0.0 | 0.0 | 0.0 |
| Mexico | 0.2 | | 66.8 | 0.0 | 0.0 | 1.0 | 1.5 |
| New Zealand | 0.0 | | 9.9 | 0.0 | 0.0 | 0.2 | 1.8 |
| Norway | 0.0 | 3.0 | 32.5 | 0.4 | 1.4 | 0.9 | 2.7 |
| Oman | 0.0 | | 8.6 | 0.0 | 0.0 | 0.0 | 0.0 |
| Peru | 0.0 | | 21.8 | 0.0 | 0.0 | 0.0 | 0.0 |
| Poland | 0.0 | | 52.1 | 0.0 | 0.0 | 0.0 | 0.0 |
| Qatar | 0.0 | | 13.6 | 0.0 | 0.0 | 0.0 | 0.0 |
| Russia | 0.0 | | 281.3 | 0.0 | 0.0 | 0.2 | 0.1 |
| Saudi Arabia | 0.0 | | 268.4 | 0.0 | 0.0 | 0.2 | 0.1 |
| Singapore | 0.0 | | 128.2 | 0.0 | 0.0 | 0.2 | 0.1 |
| Sweden | 0.2 | 2.2 | 25.0 | 0.3 | 1.3 | 1.8 | 7.3 |
| Switzerland | 0.0 | | 96.4 | 0.0 | 0.0 | 0.0 | 0.0 |
| Thailand | 0.0 | | 94.3 | 0.0 | 0.0 | 0.0 | 0.0 |
| Trinidad and Tobago | 0.4 | | 5.6 | 0.0 | 0.0 | 2.0 | 35.0 |
| Tunisia | 1.0 | | 6.1 | 0.0 | 0.0 | 5.1 | 82.9 |
| United Arab Emirates | 1.0 | | 21.7 | 0.0 | 0.0 | 5.1 | 23.4 |
| United Kingdom | 0.0 | 9.9 | 27.8 | 1.5 | 5.3 | 2.9 | 10.3 |
| United States | 4.3 | | 31.9 | 0.0 | 0.0 | 22.3 | 69.8 |
| Uruguay | 0.0 | | 4.9 | 0.0 | 0.0 | 0.0 | 0.0 |
| **Euro area members** | | | | | | | |
| Austria | 0.0 | | 3.4 | 0.0 | 0.0 | 0.2 | 5.8 |
| Belgium | 0.1 | 4.2 | 5.2 | 0.6 | 11.9 | 1.9 | 37.2 |
| Cyprus | 0.0 | | 0.3 | 0.0 | 0.0 | 0.0 | 0.0 |
| Finland | 0.0 | 1.1 | 4.2 | 0.0 | 0.0 | 0.5 | 11.4 |
| France | 0.4 | 9.7 | 19.9 | 1.4 | 7.2 | 4.8 | 24.0 |
| Germany | 0.5 | 13.2 | 24.7 | 2.0 | 7.9 | 6.6 | 26.5 |
| Italy | 0.5 | | 22.8 | 0.0 | 0.0 | 2.6 | 11.5 |
| Ireland | 0.0 | | 0.3 | 0.0 | 0.0 | 0.0 | 0.0 |
| Luxembourg | 0.0 | | 0.2 | 0.0 | 0.0 | 0.0 | 0.0 |
| Malta | 0.0 | 0.1 | 0.2 | 0.0 | 7.3 | 0.0 | 14.2 |
| Netherlands | 0.0 | 4.7 | 6.5 | 0.7 | 10.6 | 1.4 | 20.6 |
| Portugal | 0.0 | 0.9 | 1.0 | 0.1 | 13.2 | 0.3 | 25.7 |
| Slovakia | 0.0 | 0.4 | 0.0 | 0.1 | 176.0 | 0.1 | 342.8 |
| Slovenia | 0.1 | | 0.3 | 0.0 | 0.0 | 0.3 | 106.2 |
| Spain | 0.1 | 3.5 | 8.5 | 0.0 | 0.0 | 1.6 | 18.6 |
| Sub-total Euro area | 1.8 | 37.8 | 97.6 | 4.9 | 5.1 | 20.2 | 20.7 |
| **Total** | **9.7** | **173.3** | **4,550.2** | **25.7** | **0.6** | **100.0** | **2.2** |

1/ Transfers include borrowed resources.
2/ As of April 2010 or latest available.
3/ The current FTP (May-July 2010) comprises SDR25 bn in quota resources and SDR25 bn in borrowed resources.
4/ Based on a 1:1 ratio of borrowed to quota resources.