

DOCUMENT OF INTERNATIONAL MONETARY FUND
AND NOT FOR PUBLIC USE

**FOR
AGENDA**

EBS/87/245

CONFIDENTIAL

November 25, 1987

To: Members of the Executive Board

From: The Secretary

Subject: Enhancement of the Structural Adjustment Facility -
Operational Arrangements

The attached paper on the operational arrangements that will govern the enhanced structural adjustment facility (SAF), will be brought to the agenda of the Executive Board for discussion on Friday, December 11, 1987. Draft decisions and a draft Instrument will be issued shortly.

Mr. Boorman (ext. 7858), Mr. Munzberg (ext. 6675), Mr. Leddy (ext. 8332) or Mr. Hino (ext. 8379) is available to answer technical or factual questions relating to this paper prior to the Board discussion.

Att: (1)

and principal on loans extended by the 1976 Trust Fund that are paid to the SDA after termination of lending under the SAF. In the forthcoming paper, a specific decision will be proposed for the transfer of SDA resources to the Trust's Reserve and their retransfer to the SDA. As described in EBS/82/228, pp. 6 and 7, such transfer of SDA resources to the Reserve is consistent with Article V, Section 12 (f). Transfers to the Reserve are an operation for the purpose of providing additional balance of payments assistance to developing countries. The following considerations are directly relevant:

(i) the Reserve is an essential part of the Trust, which provides such additional balance of payments assistance. It is a basis upon which creditors would be prepared to provide resources to the Trust in order to provide additional balance of payments assistance to developing countries;

(ii) the Trust and its Reserve would preserve the use of the resources of the SDA intact. The Reserve would need to be used only to the extent that developing countries did not repay Trust loans on time. In this case, the Reserve would be drawn upon to make a payment which should have been made by the borrower;

(iii) eventual payments by these borrowers will accrue to the Reserve and will constitute part of the retransfer of funds to the SDA (see below);

(iv) most of the resources placed to the Reserve are reflows of loans extended under the SAF. Their placement to the Reserve, therefore, does not reduce the resources available for additional balance of payments assistance to developing countries under the existing or enhanced SAF.

The decision that will be proposed for transfers and retransfer of funds between the SDA and the Trust will carefully define and circumscribe the scope of such transfers. It could not, without a further decision of the Fund, apply to any other resources that might accrue to the SDA.

2. Liquidity of claims on the Trust

a. Use of Fund resources

Questions were raised during the November 13 meeting concerning the issue of safeguards and conditionality that would be associated with members' access to the Fund's general resources arising from needs based on developments in their reserves (EBS/87/228, pp. 10 and 11a). Under Article V, Section 3(b)(ii), a member is entitled to purchase from the General Resources Account "if it represents that it has a need to make the purchase because of its balance of payments or its reserve position or developments in its reserves."

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INTERNATIONAL MONETARY FUND

Enhancement of the Structural Adjustment Facility--
Operational Arrangements

Prepared by the Exchange and Trade Relations,
Legal, and Treasurer's Departments

Approved by L.A. Whittome, F. Gianviti, and F.G. Laske

November 25, 1987

I. Introduction

In recent weeks, Executive Directors have discussed informally two papers relating to financial arrangements and access and monitoring procedures under the proposed enhancement of the Structural Adjustment Facility (SAF). ^{1/} In response to issues raised by Executive Directors in these areas, the staff has prepared the present paper for the further consideration of the Executive Board. The paper also provides a prototype of possible borrowing agreements that has recently been made available to prospective lenders as a basis for technical discussions between them and the staff. Each individual borrowing agreement will be brought to the Executive Board for its consideration and approval.

Draft decisions and a draft Instrument will be required for the enhanced SAF to take effect. These documents will be issued shortly in a separate paper.

Section II of this paper presents a summary of the proposed framework and identifies certain outstanding issues relating to access and monitoring procedures.

Section III discusses issues regarding financing arrangements on which further consideration has been requested or appeared necessary in light of the earlier Board discussions.

II. Procedures for Access and Monitoring

1. Summary of the proposed framework for enhanced SAF lending

During its informal discussion of EBS/87/230 (11/9/87) on November 20, the Executive Board generally endorsed most of the proposals relating to access and monitoring arrangements under the

^{1/} "Enhanced Structural Adjustment Facility (SAF)--Proposed Financial Arrangements" (EBS/87/228, 10/29/87) and "Enhancement of the Structural Adjustment Facility--Considerations Relating to Access and Monitoring Procedures" (EBS/87/230, 11/9/87).

enhanced SAF. The framework of the facility, as agreed by the Board, is summarized in this section. Several outstanding issues on which further Board guidance is required are discussed in the next section.

The basic structure of the existing SAF would be retained for the enhanced SAF. Thus, resources would be committed upon Board approval of the three-year arrangement and disbursements would be provided in accordance with the provisions specified in annual arrangements. The PFP process would continue to be a critical element of the enhanced facility and would be strengthened to reflect the summing up of the SAF review last June 1/ as well as ongoing discussions with the Bank, interested donors, and recipient countries.

Access to the enhanced resources would be differentiated according to the member's financing need and strength of its adjustment policies. The structure of members' external debt would be an important element in determining financing need. Access would be subject to global limits, which would be reviewed annually, while access in individual arrangements would be reviewed at the beginning of each of the annual arrangements. Access by a member using SAF resources to the Fund's other facilities would be examined carefully on a case-by-case basis in accordance with existing guidelines. Decisions in this regard would take into account the less concessional terms of facilities other than the SAF, differences in the terms of lending under the various facilities, and the speed and time profile of the adjustment anticipated in the balance of payments.

The basic objectives of the enhanced SAF are described in EBS/87/230. Directors stressed that these objectives need to be pursued in a balanced fashion. Monitoring under the enhanced SAF programs would be conducted by benchmarks. Financial benchmarks would be set quarterly as they have been in virtually all cases under the existing SAF and be limited to those considered to be the most important; structural benchmarks would be formulated in a concrete manner that, to the extent possible, could be monitored objectively. Some structural benchmarks would cover the three-year program period. Midyear reviews would be a standard feature in nearly all cases. Disbursements would be made semiannually, upon approval of an annual program, the observance of performance criteria, and, where applicable, completion of a midyear review. The performance criteria for the semiannual test date would comprise certain of the financial benchmarks and, where considered appropriate, some structural benchmarks. In all cases, however, performance criteria would be limited in number and would generally involve only a subset of the benchmarks. The use of prior actions would be warranted when considered essential to lay the basis for a long and difficult adjustment process, particularly where financial imbalances and structural distortions were considered acute, when the record of implementation under previous Fund-supported arrangements was

1/ Buff 87/11 (6/23/87).

implementation under previous Fund-supported arrangements was unsatisfactory, or when arrangements involved a frontloading of disbursements.

The existing SAF would continue to operate in its present form. Eligible countries that have already had a SAF arrangement approved could continue with that arrangement to its completion or could cancel the arrangement and request a three year arrangement under the enhanced SAF. Members that have not yet used SAF resources would have the option of choosing between an existing or enhanced arrangement prior to a specified cutoff date. It is expected that most members will find it preferable to request arrangements under the enhanced SAF rather than the existing SAF, and management and staff would recommend such an approach. Thus, eligible members would be encouraged to enter into a full three-year arrangement under the enhanced SAF as soon as it was practical.

Directors agreed that the discussion of the SAF enhancement on December 11 would be sufficient to satisfy the requirement for a review of the existing SAF. However, since this date would be somewhat early to evaluate the disposition of uncommitted SDA resources, it is proposed that a decision relating to the potential access of each eligible member in the third year of existing SAF arrangements be postponed until no later than September 1989.

Assumptions relating to the amount of resources available for lending under the enhanced SAF, the terms of this lending, and the eligible members that would wish to borrow under the facility, remain as described in EBS/87/230 (11/9/87).

Existing policies regarding disbursements to members with overdue obligations to the Fund would be retained; the issue would, however, be taken up in the context of a future review of overdue obligations.

2. Outstanding issues and points of clarification

There remain three issues that were not resolved during the Board discussion of November 20. In particular, Directors inquired (a) whether greater flexibility could be considered in the setting of the cutoff date for access to the enhanced resources; (b) whether resource availability would permit a higher maximum access limit than that suggested in the staff paper; and (c) what degree of frontloading would be feasible in light of the access limit and prevailing resource constraints. In addition, Directors requested clarification of a number of points relating to the relationship between the existing and enhanced facilities; and the conditions under which access during the period of an enhanced arrangement might be reduced.

a. Cutoff date

In EBS/87/230 (11/9/87), it was proposed that the cutoff date for the enhanced SAF be set at May 1989, while access to the existing SAF be continued and be reviewed before May 31, 1989. After providing for semiannual disbursements over three-year program periods and scope for delays in disbursements, this date would be consistent with the suggestion tentatively made by the staff that lenders' commitments run to mid-1992, which would represent the final possible date for disbursements by the Trust. A number of Directors have indicated that flexibility in setting the cutoff date would be desirable in order to provide members with sufficient time to undertake the necessary preparations for entering into an enhanced SAF arrangement. However, one Director considered that the final drawdown date for loans to the Trust should be end-1991 rather than mid-1992; this would require either an earlier cutoff date than that proposed or limiting the possibility for delays in disbursements.

On balance, the staff would consider it desirable to provide the maximum flexibility to borrowing countries and suggests that consideration be given to setting the cutoff date at November 1989, provided that contributing countries agree to a drawdown period through June 1992. It should be recognized, however, that with a mid-1992 date for completion of disbursements, any extension of the cutoff date beyond May 1989 would imply increasingly less scope for delays in disbursements under enhanced SAF programs the closer was the approval of an arrangement to the cutoff date. There would be virtually no scope for delays in concluding mid-term reviews or subsequent annual arrangements in those three-year arrangements that were approved in the final few months prior to November 1989. In consequence, if any significant delay in concluding discussions during the arrangement occurred, there would have to be either a permanent reduction in access for the borrowing member or adjustments to the amounts of subsequent disbursements. The staff seeks the Executive Board's guidance on this matter.

If a cutoff date of November 1989 for access under the enhanced facility was agreed upon, it would be proposed that the review of the existing SAF take place before that date.

b. Access limits

If the enhanced SAF is to be an effective instrument in addressing the balance of payments problems of the low-income countries, the facility must make available adequate resources in relation to the financing requirements required to support strong adjustment policies. At the same time, adequate access should be potentially open to as broad a range of eligible members as possible and access policy must ensure that the Trust is not exposed to undue risk by allowing its claims to be concentrated amongst a limited number of countries. It was with these

considerations in mind that the staff has addressed the issue of the maximum access limit.

In EBS/87/230, it was proposed that the access limit under the enhanced SAF be established at 250 percent of quota, to be exceeded in exceptional cases up to a maximum limit of 300 percent of quota. It will be recalled that the basis for calculating these limits were staff projections relating to members' financing requirements and the assumption that all eligible countries (other than China and India) would request the use of resources under the facility. Recognizing that the projections were made only to provide preliminary indications of global need and variations in requirements of individual countries, and that they have not been discussed with the authorities, a margin was also built into the access proposals to allow for the possibility that actual requirements for individual members might be significantly higher in some cases than those presently foreseen.

In response to comments of Directors, the staff has examined the implications for potential resource use up to a maximum of 350 percent in exceptional cases. On the basis of careful examination, it is proposed that (a) the guidelines on access in individual cases be judiciously applied so that the rate of access would still be expected to average around 150 percent of quota; (b) access near or at the limit of 250 percent of quota be permitted only in a limited number of cases, and not to be regarded as a norm; and (c) access at a maximum limit of 350 percent be considered in only a few highly exceptional cases.

It should be stressed that SAF resources are not intended to fill residual financing gaps. It is anticipated that even after taking into account funding provided under enhanced SAF arrangements, a number of countries would remain in need of additional assistance, some of it on a substantial scale. Concerted support from all members of the international community is therefore required to ensure that the funds necessary to support growth and adjustment in the low-income countries can be secured; the SAF, and the associated PFP process, should serve as a catalyst for mobilizing such resources.

For a number of countries in exceptional difficulties, including those that have experienced problems in meeting obligations to the Fund, the question of access to the Fund's general resources would need to be addressed on the same basis as for other Fund members. Such access would be justified when the member was in a position to proceed with an adjustment program sufficiently strong to safeguard the revolving character of the Fund's resources.

c. Phasing

A number of Directors have indicated that it would be desirable to maintain flexibility in decisions relating to the distribution of annual disbursements. Some frontloading in the first year of an annual arrangement might be called for in cases where, for example, the

liquidation of payments arrears or a rapid reconstitution of reserves was necessary. However, it has been suggested in EBS/87/228 (10/29/87) that, if necessary and at the request of individual contributors, the Trust would be prepared to limit its drawings on lending commitments to not more than one-third of the total amount before end-1988 and two-thirds before end-1989. The staff has examined the extent to which frontloading is feasible, given the possible constraints on the availability of resources to the Trust and also from the SDA.

While recognizing the need for frontloading, the staff continues to believe that a uniform distribution of disbursements should be the norm. In exceptional circumstances, it is suggested that, if the limits proposed above were to be adopted, consideration might be given to a pattern of phasing that resulted in disbursements in the first year of up to 40 percent of the total size of the loan. This would, in the staff's view, allow a flexible response to the up-front financing needs of most SAF members and still allow the Fund to provide adequate resources in support of the continuation of strong adjustment policies for the duration of the enhanced arrangement.

d. Relationship between the existing and enhanced SAF

Some Directors requested clarification of the proposed relationship between the existing and enhanced SAF, and in particular the procedures that would apply to cancellation of an arrangement under one facility and its replacement by an arrangement under the other.

Between the date of establishment of the enhanced SAF and the cutoff date for the enhanced facility, eligible members would have the option to switch between facilities. A member with an arrangement under the existing SAF approved after January 1988 could request cancellation of that arrangement and its replacement with a three-year arrangement under the enhanced SAF. In this case, use of resources by the member under the existing SAF arrangement would be taken into account in determining access to the enhanced SAF. This would be necessary because the proposed access limits under the enhanced SAF have been set, within only a small margin, with a view to exhausting available resources, including those from the SDA, on the basis of estimated financing needs covering only three years. Similarly, a member could request cancellation of an enhanced SAF arrangement and its replacement with a three-year arrangement under the existing SAF, up to an amount corresponding to the unused portion of the member's potential access to SDA resources under the existing SAF.

Members with existing SAF arrangements prior to the establishment of the new facility could request cancellation and replacement by a new three-year arrangement under the enhanced SAF. Usually this would take place at the expiration of an annual arrangement; however, cancellation prior to the expiration of an annual arrangement would be permitted in cases where a country faced a significant change in balance of payments need or had undertaken a policy program under the existing SAF in which

expenditure had been sharply curtailed because of severe external financing constraints. In this case, the amount of the enhanced arrangement for the first year would take into account the resources already disbursed under the existing SAF.

e. Commitment of access

One Director has suggested that, when warranted by exceptionally favorable circumstances, members be encouraged to reduce access during the period of an enhanced SAF arrangement. This might take the form either of a request for a reduction in access at the time of approval of an annual arrangement or foregoing in whole or in part a midyear disbursement. The staff finds merit in this suggestion and would propose that it be adopted as general practice. In any event, Directors generally agreed that while commitments relating to the size of the three-year arrangement would be made at the time of initial approval of the arrangement, access might be reduced during the course of the arrangement if balance of payments developments were substantially more favorable than originally envisaged, particularly because of improvements in the external environment.

III. Financial Arrangements

At its informal session on November 13, 1987, the Executive Board generally endorsed the staff's proposals with respect to the financial framework for the Trust's loans to eligible members and the associated borrowing and subsidy arrangements, which are intended essentially to permit loans under the enhanced SAF on terms comparable to those under the existing SAF. This section considers a number of questions raised by Executive Directors and potential lenders.

1. Security of claims on the Trust

Management and staff are continuing consultations regarding the suggested undertaking by the Fund that it would consider such initiatives as may be necessary to fulfill the Trust's obligations to lenders, as discussed at the meeting on November 13. It is hoped to provide a further report on these consultations at or before the meeting on December 11.

An Executive Director has raised a question regarding the legal authority for the Fund to make transfers from the Special Disbursement Account to the Reserve that has been proposed for the Trust. Some of the resources that would be involved in such transfers have already accrued to the SDA or will accrue to the SDA, and have been committed for use under the SAF. These include income from investment of the resources in the SDA that are available for SAF operations and interest (including from special charges) on SAF loans. Other resources will flow to the SDA in the future, and no decision has yet been taken on their use. These include repayments of loans under the SAF and interest

and principal on loans extended by the 1976 Trust Fund that are paid to the SDA after termination of lending under the SAF. In the forthcoming paper, a specific decision will be proposed for the transfer of SDA resources to the Trust's Reserve and their retransfer to the SDA. As described in EBS/82/228, pp. 6 and 7, such transfer of SDA resources to the Reserve is consistent with Article V, Section 12 (f). Transfers to the Reserve are an operation for the purpose of providing additional balance of payments assistance to developing countries. The following considerations are directly relevant:

(i) the Reserve is an essential part of the Trust, which provides such additional balance of payments assistance. It is a basis upon which creditors would be prepared to provide resources to the Trust in order to provide additional balance of payments assistance to developing countries;

(ii) the Trust and its Reserve would preserve the use of the resources of the SDA intact. The Reserve would need to be used only to the extent that developing countries did not repay Trust loans on time. In this case, the Reserve would be drawn upon to make a payment which should have been made by the borrower;

(iii) eventual payments by these borrowers will accrue to the Reserve and will constitute part of the retransfer of funds to the SDA (see below);

(iv) most of the resources placed to the Reserve are reflows of loans extended under the SAF. Their placement to the Reserve, therefore, does not reduce the resources available for additional balance of payments assistance to developing countries under the existing or enhanced SAF.

The decision that will be proposed for transfers and retransfer of funds between the SDA and the Trust will carefully define and circumscribe the scope of such transfers. It could not, without a further decision of the Fund, apply to any other resources that might accrue to the SDA.

2. Liquidity of claims on the Trust

a. Use of Fund resources

Questions were raised during the November 13 meeting concerning the issue of safeguards and conditionality that would be associated with members' access to the Fund's general resources arising from needs based on developments in their reserves (EBS/87/228, pp. 10 and 11a). Under Article V, Section 3(b)(ii), a member is entitled to purchase from the General Resources Account "if it represents that it has a need to make the purchase because of its balance of payments or its reserve position or developments in its reserves."

The following points should be emphasized:

(i) such a purchase would not affect the member's reserve tranche if it were made under a policy specified by the Fund under Article XXX (c). The prior use of the reserve tranche would not be a prerequisite for such a drawing;

(ii) a purchase under Article V, Section 3(b)(ii)--other than a reserve tranche purchase--is subject to charges and repurchase. It would be expected, in accordance with Article V, Section 7(b) (first sentence), that the member would repurchase as soon as permitted by subsequent developments in its balance of payments and reserves. The Fund may also adopt policies requiring early repurchase, after consultation with the member, when the member's balance of payments and reserve position has improved (Article V, Section 7(b), second sentence). These policies, which would need to be adopted by a majority of votes cast, could specify particular circumstances of the improvement, e.g., the reversal of the liquidity shortage or sale of the claim on the trust;

(iii) as noted in the commentary on the Second Amendment of the Articles of Agreement (page 21), a member is able to purchase the currencies of other members from the Fund under Article V, Section 3(b)(ii) "even though it does not have a deficit in its balance of payments according to accepted definitions of the balance of payments, if its balance of payments position or its reserve position is unfavorable, or if there is an unfavorable development in its reserves, e.g., because of an impending discharge of liabilities." The Articles thus make a distinction between "developments in reserves" and "balance of payments problems." Access to Fund resources may be provided even where there is no balance of payments problem (Article V, Section 3(b)(ii)). If, however, access is requested because the member wants to solve a balance of payments problem, the member must comply with the Fund's policies established for that purpose (Article V, Section 3(a)). If the member has both a liquidity problem and a balance of payments problem, but is immediately addressing only the liquidity problem, it would have to be decided whether the liquidity problem could be solved without addressing the balance of payments problem. If the liquidity problem in this case can be treated in isolation, Article V, Section 3(b)(ii) would be applicable. The judgment will have to be made, in particular, whether the member's payments difficulties are temporary and whether its ability to repurchase is likely to be affected by the balance of payments problem. In assessing the existence of a liquidity problem, account could be taken *inter alia* of the amount of access requested by the member and evidence that the problem is self-reversing;

(iv) as for any use of the Fund's general resources, adequate safeguards for the temporary use of these resources must be provided by the member (Article I, Section (v)). The adequacy of these safeguards would have to be judged on a case-by-case basis, but in any event the

adequacy relates to the nature of the problem to be solved, i.e., in this case a liquidity problem. Consequently, no adjustment program, as in the event of a balance of payments problem, would be required. The Fund would only have to determine whether the problem faced by the member is a temporary liquidity problem. In that respect, the existence of a claim on the Trust could be taken into account in this determination;

(v) only the representation of need for a reserve tranche drawing is exempted from the Fund's challenge. Accordingly, the Fund must examine the member's representation, for instance that the purchase is needed because of an impending discharge of liabilities. It does not mean, however, that the member would have to demonstrate that its existing reserves are insufficient to meet these liabilities.

b. "Electing lenders"

The prototype of borrowing agreements ^{1/} that has been circulated for discussion with potential lenders contains provisions, as outlined in EBS/87/228, relating to temporary suspensions of calls on lenders' arrangements and to temporary transfers of claims among "electing lenders." As noted by some Executive Directors, it would be necessary for a number of lenders to choose to participate as "electing lenders" in order for such transfer provisions to be effective and to provide a credible source of liquidity for claims on the Trust. To date, while a few potential lenders have indicated that they might be interested in such a scheme, the staff has as yet received no firm indications regarding willingness in principle to participate or amounts that might be associated with such participation. It would be most helpful if potential lenders could provide an early indication of their intentions in principle, subject to such qualifications as may be necessary regarding overall participation, in order to provide a basis for determination whether this suggested provision can indeed provide a source of liquidity for claims on the Trust.

As described in EBS/87/228, the ability to suspend calls against loan commitments was limited to those that were prepared to enter into mutual arrangements for the transfer of claims, on the assumption that these two possibilities would be of primary interest to the same lenders, mainly those lending reserves to the Trust. If it would be helpful to lenders, however, consideration could be given to permitting a temporary suspension of calls by any lender, without regard to participation in mutual arrangements for transfers of claims. In order to protect the Trust's operations and the interests of all lenders, suspension would have to be limited to circumstances of genuine liquidity need; subject to the Fund's agreement, though with the overwhelming benefit of any doubt given to the member's representation; and subject to accelerated calls on the lender, following termination of

^{1/} See Annex.

a suspension, in order to restore broad proportionality of calls on all lenders. The Executive Board's guidance on this issue is requested.

c. Encashment of claims by the Trust

The staff has again reviewed the question of encashment of claims by the Trust through utilization of amounts available in the Reserve. As pointed out in EBS/87/228, the resources available to the Reserve will not begin to build to substantial amounts until around the mid-1990s; and a number of Executive Directors indicated that in any event it would not be appropriate to impair the Reserve, and thus the security of lenders' claims, through encashments. Consideration could nonetheless be given to some limited provision for temporary encashments, if that would be helpful to lenders that are particularly concerned about the liquidity of their claims. Such provisions would need to ensure reversal of an encashment within a brief period, say, three months, and would need to be subject to determinations by the Trustee from time to time of the amounts that could be made available for encashment. The guidance of the Executive Board and potential lenders is sought on whether such a provision would be regarded as useful and appropriate.

3. Interest on overdue obligations to the Trust

Most Executive Directors endorsed the suggestion that overdue obligations to the Trust be subject to interest equivalent to the SDR interest rate, for the reasons explained in EBS/87/228, Sup. 1. Provision to this effect will be included in the documentation to be issued shortly. Questions were raised, however, as to whether overdue obligations in respect of the existing SAF and to the 1976 Trust Fund should be similarly treated. The staff would request the Executive Board's further guidance on the desired treatment of these latter obligations and would, if desired, propose the necessary decisions modifying the application of special changes to these obligations.

4. Rescheduling of obligations to the Trust

The SAF Regulations (Paragraph 7(3)) include the following provision:

"On the request of a member when repayment of an installment is due under a loan, the Fund may reschedule the repayment to a date not later than two years after the due date if the Fund finds that repayment on the due date would result in serious hardship for the member and that such rescheduling would not impair the ability of the Special Disbursement Account to meet the liabilities of the Facility."

The question has been raised by an Executive Director whether a similar provision should be included with respect to the Trust. As Executive Directors are aware, it is expected that loans to the Trust will be provided on maturities matching the 5 1/2-10 year maturities of

loans by the Trust. Any rescheduling of a loan extended by the Trust would thus imply a use of the proposed Reserve, which would need to be drawn upon to finance the Trust's repayments to lenders as they fall due. The result could thus be to impair the ability of the Trust to meet its obligations. Given the importance attached by lenders to the security of their claims on the Trust, it would not seem appropriate to envisage the possibility of any rescheduling of loans made by the Trust at least until the Reserve has become fully sufficient to meet the Trust's remaining obligations. At that point, any delays in payment by a borrower pursuant to a rescheduling would effectively delay retransfers of "excess" funds to the SDA.

In these circumstances the question would then arise as to whether the rescheduled portion of the loan would continue to be subject to subsidization by contributors during the extended period (which would imply a need for larger subsidy contributions); whether the cost of the subsidy would effectively be borne by the SDA, in the form of lower investment earnings, on balances either in the reserve or in the SDA, than otherwise might have been possible; or whether the borrower should pay a higher rate of interest on the rescheduled portion of the loan. On balance, and given the comparability of the effect with that of a rescheduling under the existing SAF, it is suggested in this case that the rescheduled amount continue to be subject to the subsidized rate and that any cost of the subsidy be borne effectively by the SDA.

It is for consideration by the Executive Board whether a provision for rescheduling comparable to that of the SAF should be included. If such a provision is desired, it is suggested that the provision make explicit that a request for rescheduling would not be considered until a determination had been made by the Fund that the Reserve had become fully sufficient to meet all of the Trust's remaining obligations.

5. Use of SDRs in transactions by the Trust

The question has been raised whether it would not be possible to make provision for use of SDRs in payments by and to the Trust. While it would not be legally possible for the Trust to accept and hold SDRs, arrangements have been made with respect to effective utilization of SDRs in connection with the operations of other such accounts, and the staff is pursuing the possibility of such arrangements with respect to the Trust. It is proposed that the Managing Director be authorized to establish such arrangements. Draft documentation giving effect to this proposal together with appropriate provisions relating to the use of SDRs in transactions by the Trust will be contained in the forthcoming paper.

6. Denomination

A lender has asked that its loans to the Trust be denominated in its domestic currency rather than in SDRs, as has been proposed, and another lender has indicated that it might have potential problems with

lending on the basis of SDR denomination. Borrowing on the basis of denominations other than the SDR could pose substantial risks for the Reserve or impose potential costs on borrowers, as well as create important variations in subsidy calculations and in the amount of subsidy contributions required. The staff is currently examining these issues as well as the possibilities for hedging by the Trust, in the event borrowing in currency denomination is unavoidable, either through operations with the private markets or through another official institution. If such operations were to prove feasible, they could nonetheless give rise to added costs, including the costs to the Fund of administering the hedging operations. The staff also notes in connection with the possibility of market operations that a number of Executive Directors have in the past expressed strong reservations about the Fund's involvement in such operations.

7. Interest rates

A few Executive Directors have expressed the view that interest rates on loans to the Trust should be more "market-oriented" than the interest rates suggested by the staff in EBS/87/228; one Executive Director has suggested that the rates should include a risk premium. The staff notes that with the exception of the U.S. Treasury bill, the instruments that are included in computation of the six-month combined domestic rate that has been suggested are private market instruments, while those included in the computation of the five-year combined domestic rate are public sector securities. Interest rates on private financial instruments with maturities longer than one year are not collected or reported to the Fund. A preliminary staff investigation has found that there would be significant technical difficulties in obtaining yields on such instruments that were consistent and comparable in quality, as well as substantial resistance to the collection and reporting of such rates by some of the Fund's reporting agencies. More importantly, the staff would stress that the SAF enhancement is an official and not a private operation, and that major efforts are being made to provide the fullest possible assurances to lenders regarding the security of their claims on the Trust. Finally, it must be borne in mind that a major objective of the proposed SAF enhancement is to obtain financing that will permit the onlending of funds to borrowers at an interest rate of 0.5 percent. Given this objective, any step that would tend to increase interest rates on some loans to the Trust would simultaneously increase the need for subsidies to achieve the targeted lending rate. The question would then arise whether those lenders suggesting the use of a risk premium or more market-oriented rates would be prepared to provide the additional subsidies required.

A further question has been raised about the appropriateness of a five-year interest rate in conjunction with lending at 5 1/2-10 year maturities, which results in an average maturity of 7 3/4 years. The staff has explored informally with the various reporting agencies the availability of instruments, comparable to those reported for the five-year series, in the maturity range of 7 1/2 years. While it appears

that collection of such rates would be technically feasible, some reporting agencies have noted reservations about assuming further reporting requirements and one has indicated that the collection, calculation, and reporting of such rates could cause considerable added administrative burdens.

In light of the foregoing considerations, the staff would hope that lenders and the Executive Board will find the suggestions that have been made regarding interest rates in EBS/87/228 acceptable.

A further question has been raised whether it would be possible to combine a fixed-term loan with the floating six-month combined domestic rate. The staff would not see difficulties in this regard and has included a reference to this possibility in the draft material recently provided to lenders.

8. Period for notice of call

It was suggested in EBS/87/228 that lenders be prepared to meet requests for drawings on five business days' notice; notice of call would be issued only after approval of disbursements to borrowers. One potential lender has indicated that this may not provide sufficient time for it to make necessary disbursement arrangements, and that a ten-day period for notice of call would be preferable. As explained in the earlier paper, if calls are made in advance of Executive Board approval of a disbursement to a borrower, there is a risk that a drawing will be made to finance a disbursement that does not take place or takes place only at some later date. In the meantime, the Trust may be exposed to net interest costs on the investment of borrowed funds pending disbursement, and to a mismatch between the effective maturity of the funds available and of the disbursement when it is eventually made.

In order to avoid the risk of such costs and loss of effective maturity, it would be necessary to delay disbursements to borrowers somewhat longer following Executive Board approval if there were an extension of the period for notice of call. While borrowers would be aware in advance of the prospective disbursement date and could plan accordingly, it would seem desirable to minimize delays to the extent possible. The staff is exploring possible approaches to deal with this problem and will report further.

DRAFT
11/19/87

Prototype--Enhanced SAF Borrowing Agreement

I have been authorized to propose on behalf of the International Monetary Fund (the "Fund") as Trustee of the [Enhanced Structural Adjustment Facility Trust] (the "Trust") that [lender] agree to lend to the Fund as Trustee for the purposes of that Trust, in accordance with the terms of the Instrument establishing the Trust (the "Instrument") adopted by the Executive Board of the Fund in its capacity as Trustee of the Trust by Decision No. xxxx-(xx/xxx), adopted December xx, 1987. The amount of the loan is to be the equivalent of SDR [amount] and the terms and conditions of this loan shall be as follows:

1. The Trustee may make drawings under this agreement at any time during the period from the effective date of this agreement through June 30, 1992, 1/ upon giving [lender] at least five business days (Washington, D.C.) notice by tested telex [, provided that total drawings may not exceed [one third of the total amount of the loan] until January 1, 1989 and [two thirds of the total amount of the loan] until January 1, 1990.] 2/

2. a. The amount of each drawing shall be denominated in [SDRs]. Unless otherwise agreed between the Trustee and [lender], the amount shall be paid by [lender], on the value date specified in the Trustee's notice, by transfer of the equivalent amount of [U.S. dollars] [currency] to the account of the Trust at the [Federal Reserve Bank of New York, New York] [depository of member issuing currency used in the transfer]. [Lender] agrees that, on request, it shall exchange [currency] provided hereunder for, at its option, a freely usable currency or SDRs.] 3/

b. Upon request, the Trustee shall issue to [lender] a non-negotiable certificate evidencing its claim on the Trust resulting from a drawing outstanding under this agreement.

1/ This date is suggested provisionally on the basis of the considerations discussed in EBS/87/228 and EBS/87/230, and on the assumption that the Trust's operations will begin on January 1, 1988.

2/ The bracketed limitation would be included if requested by the lender.

3/ This provision for exchange would be included if the currency specified is not a freely usable currency; inclusion of the reference to SDRs will depend on establishment of necessary operational arrangements for the Trust.

3. (Note: The following alternatives provide for (a) fixed maturities and (b) short-term renewable drawings together with provisions intended to assure the availability of funds for the full maturity required, as discussed in EBS/87/228. The choice between these alternatives would also affect the provisions of paragraph 6.)

Alternative A--Fixed-Term Drawings

3. a. Each drawing shall be repaid in ten equal semi-annual installments beginning five and one-half years and ending ten years after the date of the drawing.

b. By agreement between [lender] and the Trustee, any drawing or part thereof may be repaid by the Trustee at any time in advance of maturity.

c. If a drawing matures on a date that is not a business day of the Fund, the maturity date shall be on the next succeeding business day.]

Alternative B--Short-Term Renewable Drawings

[3. a. Drawings shall be for maturity periods of six months. The Trustee may request that all or part of each drawing be similarly renewed on giving notice as provided in paragraph 1, subject to the provisions of paragraph 3(b). [Lender] shall consider sympathetically and is expected to agree to such requests.

b. One tenth of the amount of each drawing shall become finally due and payable and no longer subject to renewal under paragraph 3(a) five and one-half years following the date of the drawing and a further one tenth will similarly become due and payable at the end of each succeeding period of six months through the tenth year following the date of the drawing.

c. If, notwithstanding the provisions of paragraph 3(a), [lender] is unable to agree to a requested renewal and the relevant part of the drawing is repaid, [lender's] commitment to make loans shall be restored pro tanto and [lender] shall provide a new drawing of an equal amount not later than six months following the date of repayment. Any such drawing under this paragraph 3(c) shall be subject to the terms applicable to the original drawing as if its renewal had been agreed.

d. By agreement between [lender] and the Trustee, any drawing or part thereof may be repaid by the Trustee at any time in advance of maturity.

e. If a drawing matures on a date that is not a business day of the Fund, the maturity date shall be on the next succeeding business day.

4. (Note: As discussed in EBS/87/228, it is anticipated that individual lenders may choose differing interest rate bases for their

loans. Alternative interest rate provisions are shown in Attachment I to the Annex.

5. a. Payments of principal and interest shall be made in U.S. dollars or in other media as may be agreed between the Trustee and [lender].

b. Payments in [U.S. dollars] shall be made by crediting the amount due to the account of the [lender] at the [Federal Reserve Bank of New York, New York]. Payments in SDRs shall be made by crediting [lender's] holdings account in the Special Drawing Rights Department. ^{1/} Payments in other currencies shall be made to an account specified by [lender].

6. a. [Lender] shall have the right to transfer at any time all or part of any claim to any member of the Fund, to the central bank or other fiscal agency designated by any member for purposes of Article V, Section 1 ("other fiscal agency"), or to any official entity that has been prescribed as a holder of SDRs pursuant to Article XVII, Section 3 of the Fund's Articles of Agreement.

Alternative A (Associated with fixed-term drawings)

[b. The transferee shall, as a condition of the transfer, acquire all the rights of [lender] under this agreement with respect to repayment of and interest on the transferred claim.] Alternative B (Associated with short-term renewable drawings)

[b. The transferee shall, as a condition of the transfer, notify the Trustee prior to the transfer that it accepts the obligations of [lender] relating to the transferred claim with respect to renewal and new drawings under paragraphs 3(a) and 3(c), and shall acquire all the rights of [lender] under this agreement with respect to repayment of and interest on the transferred claim.]

7. (Note: The following additional provisions regarding liquidity of claims would apply to "electing lenders," as discussed in Section III(2)(b) of EBS/87/228 (pp. 9-10). Transfers of claims among electing lenders would be subject to terms and conditions specified in a decision of the Fund or the Trust Instrument, and the relevant provisions referred to in the individual lending agreements. A draft of such provisions is provided in Attachment II to the Annex.

[a. At the request of [lender], its commitment to meet drawings may be suspended temporarily at any time prior to December 31, 1991 if [lender] represents to the Trustee that there is a liquidity need for such suspension and the Trustee, having given this representation the overwhelming benefit of any doubt, agrees.

^{1/} Utilization of SDRs will depend on establishment of necessary operational arrangements for the Trust.

b. Drawings under this commitment shall be resumed after a period of three months following a suspension under paragraph 7(a), provided that such period may be extended for further periods of three months by agreement between [lender] and the Trustee. No extension of periods of suspension shall be agreed which, in the judgment of the Trustee, would prevent drawing of the full amount of [lender's] commitment.

c. [Lender] shall have the right to transfer temporarily all or any part of any claim to other electing lenders, subject to the conditions set out in paragraph xx of [Decision or Instrument]. [Lender] stands ready to purchase claims from other electing lenders, subject to the conditions set out in paragraph xx of [Decision or Instrument] and provided that [lender's] holdings of claims accepted in such transfers shall at no time exceed SDR [amount]. 1/

8. Unless otherwise agreed between the Trustee and [lender], all transfers, exchanges, and payments of principal and interest shall be made at the exchange rates for the relevant currencies in terms of the SDR established by the Fund for the third business day of the Fund before the value date of the transfer, exchange or payment.

9. If the Fund changes the method of valuing the SDR, all transfers, exchanges and payments of principal and interest made three or more business days of the Fund after the effective date of the change shall be made on the basis of the new method of valuation.

10. Any question arising hereunder shall be settled by mutual agreement between [lender] and the Trustee.

If the foregoing proposal is acceptable to [lender], this communication and your duly authenticated reply accepting this proposal shall constitute an agreement between [lender] and the Trustee, which shall enter into effect on the date the Trustee acknowledges receipt of your reply.

1/ It has been suggested tentatively in EBS/87/228 that this amount be equivalent to (but separate from) the amount of the lender's commitment to make loans to the Trust.

Alternative Interest Rate Provisions of
Draft Agreements for Lending to Trust

(Paragraph 4 of Prototype Agreement)

As noted in EBS/87/228, it is anticipated that some lenders will provide loans on a fixed-term basis, repayable in ten equal semi-annual installments over 5 1/2-10 years, while others' loans will take the form of short-term renewable drawings under arrangements which provide effective assurance that, once drawn, the funds will remain available for the full 5 1/2-10 year maturity required to watch the maturity of *loans extended by the Trust*. The staff has envisaged that fixed-term lenders may prefer a fixed longer-term rate, ^{1/} and has suggested that the five-year combined domestic rate be used in other Fund borrowings be used also in this case. With respect to short-term renewable drawings, it has been suggested that a floating short-term rate be used, based on the six-month combined domestic rate used in other Fund borrowings.

The following provisions would apply under these alternatives. Alternative A specifies a fixed rate for all drawings, which could be either a concessional rate (e.g., the rate of 0.5 percent intended for onlending by the Trust) or a rate established at the outset in relation to, say, the five-year combined domestic rate prevailing at the time the loan commitment becomes effective. Alternative B specifies the instruments and procedures for calculation of the six-month combined domestic rate to be applied to drawings and renewals. Alternative C specifies the instruments and procedures for calculation of the five-year combined domestic rate at the time a drawing is made. Should a lender prefer, it would also be possible to associate the floating six-month combined domestic rate with a fixed-term loan (i.e., without the necessity for the renewal procedures required in connection with short-term drawings).

It has been assumed that interest would accrue with respect to any obligation of the Trust in the unlikely event payment by the Trust were delayed. The question arises whether lenders providing financing at a *concessional interest rate* would wish, in that contingency, that the rate to be applied be a market-related interest rate. In that case, the staff would suggest that contingency provision be made for application of the six-month combined domestic rate.

Alternative A--Fixed Rate for All Drawings

4. a. The amount outstanding in respect of each drawing shall bear interest at an annual rate of {x} percent.

^{1/} Which could be established at the outset for all drawings or for individual drawings on the basis of rates prevailing at the time of the drawing.

b. The amount of interest payable in respect of each drawing shall be calculated on an actual day basis and shall be paid on all outstanding drawings under this agreement as soon as the necessary computations are made following June 30 and December 31 of each year.
Alternative B--Floating Six-Month Combined Domestic Rate

4. a. The amount outstanding in respect of each drawing shall bear interest at an annual rate determined by the Trustee at the commencement of each maturity period, from the product of:

(i) the interest rates on domestic instruments in each currency included in the SDR basket, as reported to the Trustee by each reporting agency, on the business day of the Fund referred to in paragraph 8, as follows:

- the bond equivalent yield for six-month U.S. Treasury bills,
- the six-month interbank rate in Germany,
- the six-month rate for interbank loans against private paper in France,
- the average rate for newly issued bank CDs in Japan with a maturity of between 150 and 180 days,
- the six-month interbank rate in the United Kingdom, and

(ii) the percentage weight of that currency in the valuation of the SDR on that business day, calculated by using the same amounts and exchange rates for currencies as are employed by the Fund for calculating the value of the SDR in terms of the U.S. dollar on that day.

The applicable interest rate shall be the sum of the products so calculated, rounded to two decimal places.

b. The amount of interest payable in respect of each drawing shall be calculated on an actual day basis and shall be paid on all outstanding drawings under this agreement as soon as the necessary computations are made following June 30 and December 31 of each year.
Alternative C--Five-Year Combined Domestic Rate

4. a. The amount outstanding in respect of each drawing shall bear interest at an annual rate determined by the Trustee at the time each drawing is made from the product of:

(i) the interest rates on domestic instruments in each currency included in the SDR basket, as reported to the Trustee by each reporting agency, on the business day of the Fund referred to in paragraph 8, as follows:

"(a) for the French franc, the yield to maturity on a representative sample of securities of major French public sector enterprises with an average remaining life in the range of four and a half to five and a half years, based on market prices for the securities, as calculated by the Caisse des Depots et Consignations using the same method as it uses for the yield it publishes weekly;

(b) for the deutsche mark, the yield to maturity on notes and bonds of the Federal Republic, Railways and Post Office with a remaining period to maturity of five years as calculated by the Deutsche Bundesbank on the basis published in the Statistical Supplement (Series 2, Table 8D) to the Bundesbank's Monthly Report.

(c) for the Japanese yen, the yield to maturity of that ten-year Japanese Government bond with a remaining period to maturity closest to five years, based on the closing market price officially published by the Tokyo Stock Exchange;

(d) for the pound sterling, the calculated redemption yield on British Government securities, determined for a constant maturity of five years, as calculated by the Bank of England on the basis published in its Quarterly Bulletin;

(e) for the U.S. dollar, the yield to maturity on actively traded U.S. Government securities, determined for a constant maturity of five years, as calculated by the U.S. Treasury and presently published each week by the Federal Reserve Board in Statistical Release H. 15; and"

(ii) the percentage weight of that currency in the valuation of the SDR on that business day, calculated by using the same amounts and exchange rates for currencies as are employed by the Fund for calculating the value of the SDR in terms of the U.S. dollar on that day.

The applicable interest rate shall be the sum of the products so calculated, rounded to two decimal places.

b. The amount of interest payable in respect of each drawing shall be calculated on an actual day basis and shall be paid on all outstanding drawings under this agreement as soon as the necessary computations are made following June 30 and December 31 of each year.

Draft Provisions of Decision or Instrument Relating
to Transfers of Claims Among "Electing Lenders"

xx a. The following lenders ("electing lenders") have informed the Fund as Trustee that they stand ready, upon request by the Trustee, to purchase claims on the Trust from other electing lenders, provided that their holdings of claims so acquired shall at no time exceed the amounts specified below and subject to the other provisions of this paragraph xx.

<u>Electing Lenders</u>	<u>Maximum Holdings (in SDR millions)</u>
A	XX
B	XX
C	XX

b. An electing lender shall have the right to transfer temporarily to other electing lenders part or all of any claim arising from its loans to the Trust, if the electing lender represents to the Trustee that there is a liquidity need for such transfer and the Trustee, having given this representation the overwhelming benefit of any doubt, agrees.

c. The Trustee shall allocate each transfer by an electing lender under this provision to all other electing lenders in proportion to the amounts by which the respective maximum holdings listed in (a) above exceed actual holdings of claims acquired under this provision; provided, however, that an electing lender may be excluded from participation in a transfer if it represents that there is a liquidity need for its exclusion and the Trustee determines that such exclusion is justified, in which case allocations to the remaining electing lenders shall be adjusted accordingly.

d. The purchaser of any claim transferred under this provision shall assume, as a condition of the transfer, any obligation of the transferor, relating to the transferred claim, with respect to the renewal of drawings by the Trust and to new drawings in the event a renewal, having been requested, is not agreed.

e. Transfers of claims under this paragraph xx shall be made in exchange for freely usable currency and shall be reversed in the same media in not later than three months, provided that such transfers may be renewed, by agreement between the transferor and the Trustee, for further periods of three months up to a total of one year. Notwithstanding the above, the transferor shall reverse a transfer under this paragraph xx not later than the date on which the transferred claim is due to be repaid by the Trust.

f. Interest on claims transferred under this paragraph shall be paid by the Trust to the transferor in accordance with the provisions of the transferor's lending agreement with the Trust. The transferor shall pay interest to the transferee(s) on the amount transferred, so long as the transfer remains outstanding, at a daily rate equal to that set out in Rule T-1 of the Fund's Rules and Regulations. Such interest shall be payable three months following the date of a transfer or its renewal, or on the date the transfer is reversed, whichever is earlier.

