INFORMAL SESSION TO ENGAGE

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To: Members of the Executive Board

From: The Secretary

Subject: **Staff Note on Policy Safeguards for Countries Seeking Access to Fund Financial Support that Would Lead to High Levels of Combined GRA-PRGT Exposure**

Board Action:	**Informal session to engage** Executive Directors
Tentative Board Date:	**Friday, February 28, 2020**
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Questions:	Mr. Alper, SPR (ext. 35907) Mr. Steinberg, SPR (ext. 34808)

Policy Safeguards for Countries Seeking Access to Fund Financial Support that Would Lead to High Levels of Combined GRA-PRGT Exposure

During discussions around Ethiopia's recent program, Directors raised concerns that countries could seek access that would lead to high levels of combined PRGT-GRA exposure without triggering the Fund's exceptional access policy as prescribed under either the PRGT or GRA. This note proposes the case for a new policy establishing enhanced safeguards that would apply in cases where proposed Fund financing would entail combined access to Fund resources (from the GRA and the PRGT) that would result in the member's credit outstanding to the Fund exceeding specified thresholds.

The Board has established policies on heightened safeguards applicable to high-access cases. Exceptional access (EA) criteria and related procedures for high levels of financing from GRA resources were initially introduced in 2002 in response to concerns about the adequacy of scrutiny given to Fund lending decisions that entailed very high levels of access. A related (but distinct) set of criteria and procedures applicable to very high levels of access to PRGT resources were introduced in 2009; the criteria had the additional aim of rationing access to the Fund's scarce concessional resources.[1]

The policies governing EA in the GRA and under the PRGT have separate access level triggers and operate independently of each other. As a result, countries that are PRGT-eligible (or that still have credit outstanding to the PRGT) can obtain combined access to Fund resources (from the GRA and the PRGT) that exceeds both (i) the threshold levels that entail EA in the GRA (currently 145 percent of quota (annual)/435 percent of quota, net of scheduled repurchases (cumulative)) and (ii) the threshold levels deemed to entail EA to the PRGT (100 percent (annual)/300 percent of quota, net of scheduled repayments (cumulative)) without being subject to either of the exceptional access policies.

In a recent informal Board discussion on possible financing under ECF and EFF arrangements with Ethiopia that involved exceptional access in the PRGT, Directors urged staff to develop a new policy entailing higher scrutiny than is currently required for cases of very large combined exposure. Many Directors expressed concern that current policies resulted in a situation where countries with potentially very high levels of combined access are not subject to enhanced safeguards and called on staff to propose reforms that would ensure a more evenhanded application of policy safeguards across the membership.[2]

To address Directors' concerns, staff is proposing to strengthen the existing policy and introduce new safeguards that would apply in situations where <u>combined</u> access to GRA

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[1] Specifically, the criteria rule out exceptional access in the PRGT for countries with income above a specified level or access to capital markets.

[2] Under current policies, access to Fund resources (including the sum of GRA and PRGT resources made available) should be determined case by case on the basis of the standard criteria, including balance of payments need, program strength, and capacity to repay the Fund, informed by debt sustainability analysis. (See *The Acting Chairman's Summing Up- Financing for Development: Enhancing the Financial Safety Net for Developing Countries- Further Considerations*. BUFF/16/84, November 21, 2016.)

and PRGT resources exceed specified thresholds. The purpose would be to help mitigate financial risks that arise from a member having high outstanding credit with the Fund, consistent with the general principle under the Fund's multilayered framework for financial risk management that the strength of policies and safeguards should be higher for members with higher levels of access to Fund resources. Specifically, the proposed policy safeguards would need to be satisfied for Board approval of a request for Fund financing (including augmentation) that would result, at any point, in (i) annual access to the sum of GRA and PRGT resources exceeding a specified level or (ii) the cumulative access, net of scheduled repurchases and repayments, to the sum of GRA and PRGT resources exceeding a specified level. This new set of safeguards would apply in addition to and in parallel with existing GRA and PRGT EA policies (i.e., criteria and procedures) and existing PRGT high-access policies, as specified below, both of which would remain unchanged.

The Executive Board has taken the view that access to GRA resources in excess of 145 (annual)/435 (cumulative) percent of quota constitutes "exceptional access." Consistent with the view that access above these levels generates heightened credit risk for the Fund, it is proposed that the new set of policy safeguards (henceforth *high combined credit exposure safeguards*) would also use these threshold levels. Elements of the procedural requirements that apply under the GRA EA policies would also apply to the new policy safeguards.[3]

The specific criteria that would need to be met to support Fund financing involving a combined credit exposure to the Fund above the applicable thresholds are specified in Box 1. Such criteria would need to be met at each program review.

1. The member is experiencing or has the potential to experience very large balance of payments pressures on the current account or capital account, resulting in a need for Fund financing that cannot be met without giving rise to combined access to PRGT and GRA resources equivalent to more than 435 percent of quota cumulatively, net of scheduled repurchases and repayments, and/or to more than 145 percent of quota on an annual basis.

2. Risks to the sustainability of public debt are adequately contained. This would be evidenced by:

    - For members for whom use of the LIC-DSF is warranted:[4, 5]

        - The member is assessed to be at moderate or low risk of debt distress; or

[3] These include early Board involvement on program discussions, higher requirements for program documentation, an assessment of financial risks to the Fund arising from the proposed access, and discussions of alternative forecast scenarios.

[4] PRGT eligible countries that have access to IDA resources and all countries that are eligible for IDA grants should use the LIC-DSF template (Staff Guidance Note on the Bank-Fund LIC DSF, December 26, 2017, for a description of the criteria see paragraphs 7-9).

[5] The assessment of GRA EA2 for countries for whom use of the LIC-DSF is warranted would be normally guided by similar principles.

- Where the member is assessed to be at high risk of debt distress or in debt distress, there is a clear expectation that, with support from debt relief or a debt operation,[6] the assessed risk of debt distress will decline to moderate or low i) within 36 months from Board approval in the case of a new financing request or ii) within 36 months from Board approval of an augmentation or rephasing request or the remaining period of the arrangement (whichever is earlier). Consistent with the objective of protecting Fund resources, high combined access would be justified only if financing provided from sources other than the Fund, including debt relief or a debt operation, sufficiently enhances the safeguards for Fund resources. Such safeguards should be sufficient to ensure the member's capacity to repay the Fund if the debt outlook deteriorates relative to the program baseline and further debt relief or restructuring are needed.[7]

- *For members for whom use of the MAC DSA is warranted*: the debt sustainability requirements for providing exceptional access to GRA resources are met.

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

The market access criterion cannot be applied for a significant majority of PRGT-eligible members. Applying a criterion on market access (such as GRA EA3) as an additional safeguard would not be appropriate for countries that have little or no market access and instead rely in good part on official sector financial support. Thus, no such safeguard is proposed.

Cases may arise where proposed access levels would constitute EA under the GRA and/or PRGT while also meeting the thresholds for high combined credit exposure safeguards: this would not create significant duplication/overlap issues as it is proposed that:

- Where the GRA EA policy is triggered, the high combined credit exposure safeguards would not be applied because meeting the GRA EA criteria is deemed to be a sufficient safeguard.

- Where the PRGT EA policy is triggered and the financing request also triggers the high combined credit exposure safeguards, both sets of safeguards would be applied: the PRGT EA criteria have to be met for access to PRGT resources in excess of 300 percent (but not exceeding 400 percent) of quota, as per existing policy, while the new safeguards (which

[6] As is the case with all debt restructurings under Fund-supported programs, a debt operation, where it is needed, should ideally be undertaken before the approval of the Fund arrangement. However, there may be circumstances under which more flexibility is warranted, so that the conclusion of the debt operation is contemplated at a later date. Against this background, it would not be necessary to hold up Fund support until there is complete clarity regarding the terms of this financing. The general practice in these matters has been that member countries should complete (or be close to completing) the relevant debt operation by the time of the first review.

[7] The PRGT Handbook will provide guidance on the design of an adverse scenario and the types of debt that generate safeguards.

impose a higher standard) would need to be met only when combined access would exceed 435 percent of quota.[8, 9]

Grandfathering. The proposed new policy safeguard for high combined credit exposure to the Fund would take effect immediately following the adoption of the Board Decision and would apply to any **new** requests for (i) a Fund arrangement, (ii) an augmentation under an existing arrangement, or (iii) a drawing under the Rapid Credit Facility or Rapid Financing Instrument, to the extent that such new requests trigger the combined credit exposure safeguards. The policy would not apply to completion of reviews under existing arrangements unless the member requests an augmentation of access under such arrangements which triggers the combined credit exposures safeguards.

[8] Close to half of PRGT-eligible countries are potentially eligible for PRGT EA, with the remainder being ruled out based on income levels or access to capital markets.

[9] If the debt criterion (EA2) under the high combined credit exposure safeguard is met, the relevant PRGT EA criterion will be deemed to be met.

Box 1. Comparing Criteria for GRA and PRGT Exceptional Access with Proposed New Safeguards for High Combined Credit Exposures

	GRA	PRGT	High Combined Credit Exposure Safeguards
Criterion 1	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.	[Countries that] experience an exceptionally large balance of payments need that cannot be met within the normal limits.	The member is experiencing or has the potential to experience very large balance of payments pressures on the current account or capital account, resulting in a need for Fund financing that cannot be met without giving rise to a combined access to PRGT and GRA resources equivalent to more than 435 percent of quota cumulatively, net of scheduled repurchases and repayments, and/or to more than 145 percent of quota on an annual basis.
Criterion 2	A rigorous and systematic analysis indicates that there is a high probability that the member's public debt is sustainable in the medium term. Where the member's debt is assessed to be unsustainable ex ante, exceptional access will only be made available where the financing being provided from sources other than the Fund restores debt sustainability with a high probability. Where the member's debt is considered sustainable but not with a high probability, exceptional access would be justified if financing provided from sources other than the Fund, although it may not restore sustainability with high probability, improves debt sustainability and sufficiently enhances the safeguards for Fund resources. For purposes of this criterion, financing provided from sources other than the Fund may include, inter alia, financing obtained through any intended debt restructuring.	The member has a comparatively strong adjustment program and ability to repay the Fund.* *This criterion would generally not be met for countries with a high risk of debt distress or those that are in debt distress as defined under the joint Bank-Fund DSA, unless expected debt relief or restructuring is projected to reduce the risk of debt distress to a moderate level or low level (IMF Policy Paper "A New Architecture of Facilities for Low-Income Countries" June 26, 2009, Footnote 62).	Risks to the sustainability of public debt are adequately contained. This is evidenced by • *For members for whom use of the LIC-DSF is warranted*: ○ The member is assessed to be at moderate or low risk of debt distress; or ○ Where the member is assessed to be at high risk of debt distress or in debt distress, there is a clear expectation that, with support from debt relief or a debt operation*, the assessed risk of debt distress will decline to moderate or low i) within 36 months from Board approval in the case of a new financing request or ii) within 36 months from Board approval of an augmentation or rephasing request or the remaining period of the arrangement (whichever is earlier). Consistent with the objective of protecting Fund resources, high combined access would be justified only if financing provided from sources other than the Fund, including debt relief or a debt operation, sufficiently enhances the safeguards for Fund resources. Such safeguards should be sufficient to ensure the member's capacity to repay the Fund if the debt outlook deteriorates relative to the program baseline and further debt relief or restructuring are needed.**

Box 1. Comparing Criteria for GRA and PRGT Exceptional Access with Proposed New Safeguards for High Combined Credit Exposures (concluded)

	GRA	PRGT	High Combined Credit Exposure Safeguards
			• *For members for whom use of the MAC DSA is warranted*: the debt sustainability requirements for providing exceptional access to GRA resources are met. * As is the case with all debt restructurings under Fund-supported programs, a debt operation, where it is needed, should ideally be undertaken before the approval of the Fund arrangement. However, there may be circumstances under which more flexibility is warranted, so that the conclusion of the debt operation is contemplated at a later date. Against this background, it would not be necessary to hold up Fund support until there is complete clarity regarding the terms of this financing. The general practice in these matters has been that member countries should complete (or be close to completing) the relevant debt operation by the time of the first review. ** The PRGT Handbook will provide guidance on the design of an adverse scenario and the types of debt that generate safeguards.
Criterion 3	The member has prospects of gaining or regaining access to private capital markets within a timeframe and on a scale that would enable the member to meet its obligations falling due to the Fund.	Countries that have not had sustained past access to international financial markets, and have income at or below the prevailing operational cutoff for assistance from IDA.	
Criterion 4	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.		The policy program of the member provides a good prospect of success, including not only the member's adjustment plans but also its institutional and political capacity to deliver that adjustment.