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April 6, 2020
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INTERNATIONAL MONETARY FUND

Minutes of Executive Board Meeting 19/26-3

2:30 p.m., April 5, 2019

3. Review of the Fund's Income Position for FY 2019 and FY 2020

Documents: EBS/19/16 and Supplement 1

Staff: Bradbury, FIN; Nana, FIN; Hukka, FIN

Length: 25 minutes

Executive Board Attendance

T. Zhang, Acting Chair

Executive Directors	Alternate Executive Directors
	A. Abdullahi (AE), Temporary
M. Raghani (AF)	
	C. Moreno (AG), Temporary
N. Ray (AP)	
	P. Fachada (BR)
	Y. Zhao (CC), Temporary
	A. Del Cid-Bonilla (CE), Temporary
	A. McKiernan (CO)
	S. Benk (EC)
	M.Gilliot (FF), Temporary
	K. Merk (GR)
	P. Dhillon (IN), Temporary
D. Fanizza (IT)	
	Y. Saito (JA)
J. Mojarrad (MD)	
	M. Merhi (MI), Temporary
	V. Rashkovan (NE)
	J. Sigurgeirsson (NO)
	S. Potapov (RU), Temporary
M. Mouminah (SA)	
	U. Latu (ST), Temporary
P. Inderbinen (SZ)	
	M. Chen (UK), Temporary
	P. Pollard (US), Temporary

G. Bauche, Acting Secretary
K. Hviding, Summing Up Officer
J. Acheson/A. Lalor, Board Operations Officers
L. Nagy-Baker, Verbatim Reporting Officer

Also Present
Asia and Pacific Department: D. Kihara. Finance Department: P. Attie, S. Bradbury, M. Brennan, C. Gumbanjera, J. Hukka, M. Manno, D. Moore, D. Nana, A. Ndiaye, B. Oliveira, Y. Sun, A. Tweedie, O. Unteroberdoerster. Information Technology Department: L. Abello, T. Rolim. Legal Department: H. Pham. Office of Budget and Planning: J. Tyson. Office of Risk Management: A. Jamaludin. Executive Director: L. Villar (CE). Alternate

Executive Director: F. Sylla (AF). Senior Advisors to Executive Directors: B. Alhomaly (SA), N. Jost (NE), S. Keshava (SA), J. Shin (AP), M. Sidi Bouna (AF), T. Sitima-wina (AE), J.Weil (CO). Advisors to Executive Directors: F. Al-Kohlany (MI), R. Lopes Varela (AF), A. Tola (SZ), J. Montero (CE).

3. REVIEW OF THE FUND'S INCOME POSITION FOR FY 2019 AND FY 2020

Mr. Fachada and Mr. Fuentes submitted the following statement:

We thank staff for the report. While we can go along with all seven proposed decisions, we would like to reiterate our concern about the reimbursement to the General Resources Account (GRA) of the costs of administering the Poverty Reduction and Growth Trust (PRGT), as proposed in Decision 2. The estimated PRGT administrative expenses for FY2019 remain high and above earlier estimates, and continue to overburden its financial capacity. Going forward, we would suggest that the Executive Board establishes a maximum annual reimbursement limit.

Our chair has historically supported allocating larger parts of net income to the general reserves. However, the principles laid out in 2018 to guide the framework for annual allocation decisions remain useful and we agree with the proposal to allocate the net income in equal proportions into both reserve accounts. Retaining flexibility over future allocations remains important to tackle changing circumstances. We take note that the current level and the indicative medium-term target of precautionary reserves remain appropriate in light of current credit outstanding.

The effect of the pension-related (IAS 19) position on the net operational income has been traditionally volatile. Operational income for FY2019 is significantly stronger than estimated in April 2018, reflecting new lending arrangements and other streams of non-lending income. However, the downward effect of current estimates of the pension-related adjustment on net income is quite significant this year. This is attributable to underlying actuarial assumptions, particularly to the discount rate, which add considerable volatility to the Fund’s financial results. In view of recent market developments, can staff provide any updated estimation of the IAS 19 adjustment? While these adjustments should be monitored closely, we are comforted that pension-related gains and losses tend to offset each other over time.

We support maintaining the current margin for the rate of charge. In parallel, overdue obligations have fallen consistently since the implementation of the Strengthened Cooperative Strategy on Overdue Financial Obligations in the early 1990s. This favorable evolution has improved the Fund risk profile and has reduced the importance of special charges. Nonetheless, we support staff proposal to retain the current framework in place. We also agree with the proposal to have future reviews combined with the review of the Fund's arrears strategy on a five-year basis.

Mr. Saito, Mr. Ozaki and Mr. Minoura submitted the following statement:

We thank staff for the informative paper on the review of the Fund's income position for FY 2019 and FY 2020, as well as for the very useful outreach. We also appreciate staff's more detailed discussions on Review of Special Charge, reflecting our comment last year. As we broadly agree with the staff's analyses, we support all the proposed decisions and will provide some comments as follows:

FY2019 Income Position

We note that net operational income for FY 2019 is significantly higher than estimated in April 2018, reflecting increase in lending income from the new arrangements and higher than anticipated income from the Fixed-Income Subaccount (FI). On the other hand, estimates of the pension-related (IAS 19) adjustment to end-January is expected to offset a substantial portion of the Fund's net operational income for FY 2019. Given the equity markets recovery since February, we would like to know developments of IAS 19 adjustment to date. Staff's comments are welcome.

Decision 1 and 2: Reimbursements to the General Resources Account (GRA)

We welcome refinements to the methodology for estimating the costs incurred in administering concessional lending activities and the SDR department, while appropriateness of estimates should be monitored continuously. As self-sustainability of the PRGT is not eroded, we support the reimbursements to the GRA as proposed in the decision 1 and 2, in line with the Articles of Agreement and the three-pillar strategy endorsed by the Board in 2012.

Decision 3: Transfer of Investment Income to the GRA

As we aim for further accumulation of reserves, we support the proposed transfer of the income of the FI for FY 2018 to GRA. At the same time, we welcome the proposal that the income of the Endowment Subaccount (EA) for FY 2019 shall be retained in the EA, which is in line with the discussion of the Review of the Investment Account board in March 2018.

Decision 4: Allocation of Income Between the Special and General Reserve

Given the fact that the precautionary balances (PB) remain short of the agreed target, we see merit in placing the Fund's net income in the reserves. As for the allocation between the reserves, we support the staff's proposal - distributing net income equally between the special and general reserves. As the special reserve is the first line of defense against the Fund's income losses, it is important to maintain adequate holdings in the special reserve to strengthen the balance sheet and create buffers. At the same time, we should retain sufficient flexibility for future Board judgments in light of evolving circumstances. In this regard, we prefer continuing the approach of allocating a share of total net income to both the special and general reserve. At the current juncture, staff's proposal of maintaining the recent 50/50 split remain appropriate. We also underscore that the Executive Board should continue to review the allocation of the net income and determine an appropriate balance between the special and general reserves annually, to retain flexibility to consider many factors including both the Fund's finance and market conditions.

Decision 5: Transfer of Currencies to the Investment Account

Regarding the decision 5, we support the staff's proposal to transfer currencies equivalent to the increase in reserves from the GRA to the Investment Account (IA) for investment in the Fixed-Income Subaccount, aiming for higher return than the SDR interest rate.

Decision 6: Margin for the Rate of Charge

While lending income is expected to remain substantially in excess of intermediation costs in FY 2019–2020, investment income remains not enough to cover the Fund's non-lending activities as the low global interest rate environment continues and payout of EA incomes would be delayed for FY 2021. Furthermore, PBs at end-FY 2020 would still remain short of the medium-term target and the cost of Fund credit at the current margin remains broadly in line with the benchmarks for long-term credit market conditions. Against this background, we agree with staff that that there has been no fundamental change in the underlying factors relevant for setting the margin since the last review, and thus no modification is needed for FY 2020 as the exceptional circumstances clause remains applicable.

Going forward, it is projected that PB could reach the indicative medium-term target of SDR 20 billion in FY 2021, three years earlier than previously projected. As staff rightly pointed out, a discussion of margin or the rate of charge is closely interlinked with those of the PB target and the EA payout policy. Noting that we will have an opportunity to review the appropriate medium-term target for precautionary balances again in early 2020 and the EA payout policy framework in 2021, we would like to know how staff see appropriate packages of the margin, the PB target and the EA payout in the coming years, assuming that baseline scenario is materialized. Could staff share initial thoughts on levels of the three targets?

Decision 7: System of Special Charges

We appreciate the staff's review of special charges, responding to our comment at the board last year. Noting that the current policy continues to serve cost recovery function if new arrears emerge and short-term arrears cases have become rare, we can go along with the staff's proposal to amend Section VI of the 1985 decision on special charges to shift the requirement for regular review from the annual review of the Fund's income position to the five-yearly Review of the Fund's Strategy on Overdue Financial Obligations.

Having said that, the special charges should not only serve cost recovery function, but also give an incentive to settle members' financial obligations in a timely manner while avoiding too much financial burdens on members. Moreover, special charges on overdue repurchases have no longer become operationalized under the current system for setting the basic rate of charge, which is always in excess of the SDR interest rate. Against this back ground, we welcome staff's comments on possible alternative frameworks of the special charges, which address shortcomings of the current system and strengthen incentives. While the next review of the special charges framework in the five-yearly Review of the Fund's Strategy on Overdue Financial Obligations would be due by 2022, we strongly urge staff to come back to the board sooner with a concrete analysis/proposal if circumstances warrant.

Mr. Merk and Ms. Lucas submitted the following statement:

We thank staff for the informative paper on the Review of the Fund's Income Position for FY 2019 and FY 2020, as well as for their helpful outreach. We support the set of proposed decisions and would to provide the following comments and questions.

We welcome that Staff has opted for a holistic approach in implementing IFRS, taking account of the unique nature of the Fund's work and mandate. In our understanding this approach somewhat lowers the likelihood of significant ECL-volumes. We remain to be convinced that expected credit losses (ECL) can be avoided in the future and we would like to learn more how Fund envisages dealing with such a scenario and how it might impact future decisions on IMF programs. Are there any preparations to deal with potentially higher volatility in income? Is there any plan/framework yet to deal with the politically sensitive assessment of country's cooperation with the Fund in this context?

We can go along with the proposed equal allocation of net income to both the special and general reserves. However, we would have preferred to place a higher share into the special reserve as it resembles a first line of defense in the event of income losses, in particular against the expected heightened uncertainties around the volatility of income due to the implementation of IFRS.

With regard to the envisaged development of the precautionary balances in FY 2019, we are taking note of the small increase to SDR 17.7 billion. In particular, we welcome that the threshold of SDR 20 billion, although originally targeted for FY 2020, is now expected to be passed already in FY 2021 instead of FY 2024 as projected last year. We would still caution against satisfaction regarding the precautionary balances as we wonder whether the need for them might be higher than foreseen in earlier years given the Funds more concentrated credit portfolio recently. Can staff elaborate more on these points?

We take note of the substantial IAS 19 timing adjustment of SDR 486 million that deals with the accounting for pension and other employee benefits and contributes negatively to the Fund's income position in FY 2019. We notice that this very volatile component constitutes a significant source of uncertainty for the Fund's income and reserves. While we understand that the adjustment is difficult to project, we wonder if the income position as a signal of Fund's business strength is devalued, if relatively minor swings in the discount rate are sufficient to almost cause losses in an otherwise successful year for the fund. The fact, that over time profits and losses of this component tend to even out is of no help regarding the signaling effect. Staff might want to comment on whether there are ways to highlight the exceptional and reversible character of this component even more.

We support staff's proposal to maintain the margin unchanged. We recognize that non-lending income is expected to only cover some two thirds of non-lending activities in the next few years. According to the report, the necessity to cover non-lending activities by lending income is expected to dwindle in coming years. Could staff elaborate more, at what time the necessity to make use of the exceptional circumstances clause (Rule I-6(4)) can be expected to run out?

We agree that the current margin remains in line with market conditions (para 25). We wonder, however, if the used metric (median of the quarter of relevant countries with the best credit conditions) is still as useful as it once probably was. At several recent points in time, the spreads of the "bad" quarter of debtors over the "best" quarter of debtors were significantly bigger than at other times. Given these circumstances, we wonder whether the focus solely on the quarter with the best loan conditions is appropriate. We acknowledge that the Fund programs are designed to be also attractive for these countries, but if the spreads between the countries in the best quarter and the worst quarter suddenly narrows or widens significantly we see a non-negligent risk that a wrong signal of underpricing or overpricing might occur. Could staff address this issue with more information?

Mr. Sigurgeirsson and Ms. Skrivere submitted the following statement:

We thank staff for the informative paper on the Review of the Fund's Income Position for FY 2019 and FY 2020. We support the proposed decisions and would like to provide the following comments for emphasis.

We support the decision that the FY 2019 General Resources Account (GRA) net income be placed equally to the special and general reserves (Decision 4). We continue to support the principles to guide the framework for future allocation to the special and general reserves that were developed last year. We see merit in maintaining Board flexibility in determining future income allocations.

We agree that there are no fundamental changes to warrant any adjustment to the current rate of charge at 100 basis points over the SDR interest rate for FY 2020 (Decision 6).

We see merit in shifting the review of special charges from an annual review to a five-yearly review in conjunction with the Review of the Fund's Strategy on Overdue Financial Obligations (Decision 7). We note that special charges have played a diminishing role in the Fund's risk management framework, in particular as protracted GRA arrears have fallen sharply, non-technical short-term arrears have become rare, and other Fund policies have been revised.

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

We thank staff for the informative paper on the Review of the Fund's Income Position for FY 2019 and FY 2020. We support the proposed decisions. Specifically:

We agree with the proposal to continue to equally divide the net income of the General Resources Account (GRA) to the Special and the General Reserves. The principles listed in Box 2 remain appropriate for guiding the allocation decision.

Given the importance of maintaining an adequate level of precautionary balances, we support staff's proposal to place all FY 2019 GRA net income to reserves. This would increase precautionary balances by SDR 0.2 billion to SDR 17.7 billion at the end of FY 2019.

We note that the pension-related (IAS 19) adjustment is expected to remain unpredictable, and any volatility in the underlying actuarial assumptions, such as the discount rate, would translate into volatility in the Fund's income and reserves. However, as noted by staff, past experience suggests that gains and losses tend to offset each other over time.

In line with the EA payout policy framework endorsed by the Board in April 2018, we agree that investment income earned in the EA in FY 2020 be fully retained and not be transferred to the GRA for administrative expenses.

We consider it appropriate that the rate of charge for FY 2020 be kept unchanged at 100 basis points over the SDR interest rate. There has been no fundamental change in the underlying factors relevant for setting the margin since the April 2018 decision that set the rate for FY 2019-2020.

Mr. Jin and Ms. Zhao submitted the following statement:

We thank staff for the well-written report. We support the proposed decisions and would like to provide the following points for emphasis.

On Decision 4

In light of the downside risks facing the global economy, it is desirable to build adequate special reserves as the first line to cover administrative losses. While we would prefer faster accumulation of special reserves, we can go along with equal placement between the special and the general reserves. We reiterate our call for retaining the Board flexibility to decide on future income allocations in light of evolving circumstances to avoid mechanistic application.

On Decision 7

We take note that arrears to the Fund are significantly lower and special charges have played a diminishing role in the Fund's risk management framework. Retaining the current special charges framework at this time seems appropriate, and we agree with staff's proposal to amend the 1985 decision to conduct the next review of the framework in the context of the wider review of the Fund's strategy on overdue obligations. Conditions permitting, the next review of the special charges framework can take place before scheduled.

Mr. Agung, Mr. Tan, Mr. Abenoja and Ms. Latu submitted the following statement:

We thank staff for the insightful report. We support the proposed decisions and would like to offer the following remarks.

We appreciate that the FY2019 and FY2020 projected income would remain generally healthy and able to support the near-term financial sustainability of the Fund. In the context that the net operational income may fall below the February 2019 and the April 2018 estimates, staff has clarified that the pension-related adjustment is within expectations based on past experience and is not indicative of a structural shift toward greater volatility. Nonetheless, we note that projections continue to be sensitive to underlying assumptions and subject to considerable uncertainty. In this regard, the prudent management of the Fund's financial assets should be complemented with the careful management of expenditures as set out in the FY2020-FY2022 Medium-Term Budget. We also encourage staff to maintain close monitoring of budget-related developments such as the global interest rates, and, where necessary, keep the Board updated of any significant adverse impact on the Fund's income and reserve positions.

We concur with the proposed income disposition and reimbursement actions to help preserve the adequacy of the Fund's resources and its ability to carry out its mandate effectively. This is based on the expectation that the current rules would continue to support the accumulation of the Fund's precautionary balances in meeting the medium-term target of SDR 20 billion. Being consistent with the New Income Model, we note that the proposed decisions would also help diversify the Fund's income position and strengthen the Fund's balance sheet to absorb losses going forward.

We agree that there has not been any fundamental change in the underlying factors relevant for setting the margin since the last review and the basic rate of charge at 100 basis points remains appropriate. Against the backdrop of low arrears to the GRA in recent times and the diminishing role of special charges in the Fund's risk management framework, we also support retaining the current special charges framework, which would continue to serve cost recovery purposes if new arrears emerge. While we further agree to align the next review of the framework with the five-yearly review of the Fund's arrears strategy in 2022, staff should have in place an appropriate process to trigger an earlier review if warranted by circumstances.

We welcome the ongoing efforts to review the appropriateness of the budget-related rules and policies in a timely manner. In this respect, we look forward to staff's work on the methodology for estimating Special Disbursement Account related reimbursements and the review of the Endowment Account payout policy framework in FY2021. At the same time, we note that the existing rules and policies have been formulated and reviewed at different points in time. As and when appropriate, we encourage staff to re-evaluate and align the frequency of reviews where there is scope to undertake the reviews in a more coherent and systematic manner.

Mr. Inderbinen and Mr. Tola submitted the following statement:

We thank staff for the review of the Fund's income position. We take good note that expected total net income for FY2019 is broadly in line with last year's forecast and welcome the strong outlook for the medium term. That said, projections both for the near and medium term remain subject to high uncertainty. We support the proposed decisions and would like to make the following points for emphasis:

We reiterate the importance of a continued build-up of precautionary balances. The indicative medium-term target of SDR 20 billion for precautionary balances is now expected to be attained in FY2021, three years earlier than previously projected. However, the improvement in the outlook for income and reserve accumulation is mainly due to higher lending. This implies a higher projected path for credit outstanding, which, in turn, poses risks to the Fund. Continued prudence is thus warranted, and we support placing all FY2019 GRA net income to reserves.

We can go along with the proposed equal apportionment of net income to the special and general reserve. This preserves future flexibility and appears to reflect a compromise of differing views. With that being said, we continue to see merit in a greater allocation of income to the special reserve, relative to the general reserve, given the role of the former as a first line of defence against loan losses.

Changes in the defined benefit pension liabilities and related IAS 19 adjustments are a key source of uncertainty for the Fund's income and finances. The defined benefit obligations are highly sensitive to actuarial assumptions, such as the discount rate. This can result in large remeasurement gains or losses. As a consequence, IAS 19 adjustments remain volatile and difficult to predict, as illustrated by the sharp increase in the expected IAS 19 loss for FY2019—relative to the projection in the staff paper of February 2019 on the Consolidated Medium-Term Income and Expenditure Framework. This underlines the risks to the Fund that are associated with maintaining a defined-benefits pension scheme.

We continue to support delaying payouts from the endowment account (EA) until FY2021. This delay and the proposed full retention of investment income earned in the EA are appropriate to build a cushion and protect the real value of the endowment.

We agree that the margin for the rate of charge should be maintained at 100 basis points. We see no need for adjustment, absent fundamental changes in the underlying relevant factors. Moreover, the cost of Fund credit remains broadly in line with the updated benchmarks for long-term credit market conditions.

Finally, we concur that changes to special charges are unnecessary at this point. We support the proposal to undertake future reviews as part of the wider reviews of the Fund's strategy on overdue obligations.

Mr. Mojarrad and Mr. Nadali submitted the following statement:

We thank staff for an insightful report, and welcome the Board's review of the Fund's income position for FY 2019 and FY 2020. The FY 2019 net income of about SDR 0.5 billion, despite the pension-related (IAS 19) downward adjustment of about SDR 0.5 billion, is broadly in line with the April 2018 estimate, and the income outlook for FY 2020 is strong. We support the proposed decisions, and wish to highlight the following points:

We continue to have reservations on reimbursing the GRA for PRGT administrative expenses (Decision 2), which are expected to remain above SDR 60 million with many countries in or near program status. While the reimbursement is said to be an important element of the Fund's new income model, a suspension of this reimbursement should not be ruled out if demand for PRGT resources exceeds available supply. We, however, welcome further work on strengthening the methodology and controls for Special Disbursement Account (SDA) related reimbursements and look forward to staff findings and recommendations next year.

Consistent with the endowment account (EA) payout policy framework, the EA income for FY 2019 should be retained and the cumulative EA retained earnings of about SDR 917 million reinvested to allow for a greater cushion against adverse return scenarios. Excluding the EA investment income, the FY 2019 net income of SDR 205 million should be allocated equally between the general and special reserves, as has been the case for the past three years. While we prefer to maintain this approach going forward, we agree to retain Board flexibility to decide on future income allocations in light of evolving circumstances.

The unchanged margin of 100 basis points for the basic rate of charge in FY 2020 is appropriate to cover the Fund's intermediation costs, help build up reserves, and remain aligned with long-term credit market conditions. The margin should again be set under the exceptional circumstances clause of Rule I-6(4), given that Fund's lending income continues to cover a significant portion of its non-lending expenses.

Based on an unchanged margin of 100 basis points, the precautionary balances are expected to reach the indicative medium-term target of SDR 20 billion in FY 2021, three years earlier than previously projected. While projections remain subject to considerable uncertainty, we look forward to reviewing the appropriate medium-term target for precautionary balances again in early 2020 in light of developments in credit and other financial risks.

Finally, we agree to retain the current special charges framework for now as well as amend section VI of the 1985 decision on special charges to shift the requirement for regular review from the annual review of the Fund's income position to the five-yearly review of the Fund's strategy on overdue financial obligations.

Mr. Raghani, Mr. Sylla and Mr. Sidi Bouna submitted the following statement:

We thank staff for the report on the review of the Fund's income position for FY 2019 and FY 2020.

We note that the Fund's operational income for FY 2019 is significantly above the April 2018 estimate (more than double) driven by both investment and lending income. However, the sizeable volatility in the projected pension-related (IAS 19) adjustment continues to weigh on the Fund's projected net income position while also increasing its uncertainty. This not only affects the Fund's net income but also ultimately the level of reserves and precautionary balances. On the projected "net pension asset/(liability)" for FY 2020, in Table 2, we understand the difficulty in estimating a complex and volatile item such as the pension-related (IAS 19) adjustment. However, we wonder whether the use of the average "net pension" over the previous three or five years would not represent a more realistic assumption than not having any estimate at all?

We agree with the proposed reimbursement of the GRA for the costs of conducting the business of the SDR department (Decision 1) and for administering the PRGT (Decision 2). We continue to support the allocation of the net income of the GRA in equal parts to the special and general reserves, consistent with the 2018 framework guiding the allocation of net income between the two reserves (Decision 4). However, the framework should be monitored closely and reviewed regularly.

We approve the proposed decisions pertaining to investment income for FY 2019. Consistent with the proposed policy framework established last year guiding payouts from the Endowment Subaccount to the GRA, we support the full retention of the FY 2019 income of the Endowment Subaccount (Decision 3). We also endorse the transfer of income from the Fixed-Income Subaccount to the GRA for use in meeting FY 2019 administrative expenses. As authorized by the Articles of Agreement when reserves are above the amount of previous transfers of currencies from the GRA to the Investment Account, we agree with Decision 5.

We share the staff's assessment that there are no fundamental changes in the underlying factors that guide the establishment of the margin of the rate of charge, and therefore, we support maintaining the margin for the rate of charge at 100 basis points over the SDR interest rate for FY 2020 (Decision 6). We also note that the current level of the margin is broadly aligned with long-term credit market conditions and that the pace of accumulation of precautionary balances remains adequate.

Finally, we take note of the staff's proposal to amend Section VI of the 1985 decision on special charges (Decision 7). Considering that short term arrears have declined significantly over the past decades, we concur with staff that the one-year review of the special charges in the context of Review of the Income Position is no longer warranted. We agree with the proposal to review these charges every five years of the Fund's Strategy on Overdue Financial Obligations.

Ms. Pollard and Mr. Vitvitsky submitted the following statement:

We thank staff for the interesting paper, which indicates a much higher projected operational income path and the accumulation of precautionary balances than a year ago. Some of the topics in the paper are very technical in nature, including the pension-related IAS-19 adjustment, and we appreciate the opportunity to clarify them. We support the seven proposed decisions as outlined on page 29.

The paper lays out a significantly higher operational income path, in part due to recently initiated large programs. Indeed, lending income, including surcharge income and commitment fees, are expected to substantially increase in FY2020. As a result, the precautionary balance target will likely be met sooner than expected. Still, we continue to strongly value budget discipline amid rising operational income given the Fund's public mission and objectives.

Despite rising operational income, the pension-related IAS-19 adjustment brings down net income considerably, mirroring upward adjustments in recent years. We appreciate the paper's explanation on pages 8 and 9, which helps explain the accounting framework that led to the adjustment. That said, we would be grateful for further elaboration from staff, including pinpointing the precise reason for the shift (e.g., change in the discount rate), so that the Board can better comprehend this issue.

On a related note, we echo Mr. Inderbinen and Mr. Tola's gray that the Fund's defined benefit obligations are highly sensitive to actuarial assumptions, resulting in volatile gains and losses that are difficult to predict. This indeed underscores the risks to the Fund that are associated with maintaining a defined-benefits pension scheme.

Finally, we would appreciate elaboration from staff on how the SCA-1 account is effectively the first line of defense if there are overdue obligations and/or no repayments to the Fund.

Mr. Di Tata and Ms. Moreno submitted the following statement:

We thank staff for a well-written report and for the helpful outreach before this meeting. We agree with the proposed decisions; hence, we only have a few comments and questions for staff.

The updated projections reflect the sizable new arrangements in place since April 2018, as well as advance repurchases. As a result, net operational income for FY2019 shows a significant upward revision.

Regarding investment income, the projections for both the fixed income and the endowment accounts are higher, with the latter having to do with a revaluation of the portfolio following the strengthening of the US dollars against the SDR. We support the retention decision proposed by staff, which is based on a policy agreed in April. We do not see any strong reasons to change such policy.

Regarding the use of the exceptional circumstances clause which allows lending income to cover non-investment expenses, we understand it mostly reflects the low global interest rate environment since 2009, which has prevented investment yields (non-lending income) to be sufficiently high. Even though staff's projections show that the coverage ratio as well as the endowment subaccount payouts are expected to recover, the sensitivity to the low interest rate return environment appears to be high. Could staff explain what path of interest rates would suggest a possible revision of the margin which has been kept constant at 100 bps?

Given that GRA arrears are low and not currently a pressing issue, staff's recommendation of maintaining the framework of special charges, as well as extending the review period from yearly to every five years, seems reasonable. Could staff clarify what circumstances would trigger an earlier revision of the special charges framework, and how such revision would be undertaken if done before 2022?

Mr. de Villeroché, Mr. Castets and Ms. Gilliot submitted the following statement:

We thank staff for their informative report and the timeliness of the information shared to the Board. As underlined in our past statements, we reiterate our interest to have a global document that would encompass the different components of the Fund's financial situation and strategy. That said, we broadly agree with the decisions proposed for adoption and would like to make the following remarks.

We would like to thank staff for the clarity of the presentation of the 2019 income position and the disposition decisions. On the composition of the income position and more specifically on the pension-related adjustment, we understand that, in the first place, the implementation of IFRS 9 is underway and may heighten uncertainty around the volatility of income. The report stresses that the adoption of the new standard is not expected to significantly impact the FY 2019 annual financial statements. However, the adoption of IFRS would be reflected in the significant net actuarial remeasurements losses projected for this year being recognized as Other Comprehensive Income instead of being in the profit and loss account and would not impact the net income position. Could staff go into more details about the conversion to IFRS?

We also understand that the additional adjustment of SDR 122 million made represents the difference between the actuarial service cost and the pension funding for the year and is recognized as an expenditure. This difference can nonetheless be anticipated in so far as the service cost stems from an ex ante calculation. By the beginning of its accounting year, the Fund is able to evaluate the service cost on the basis of 4.05 percent discount rate. Consequently, and in line with the above, we find that it could be interesting to integrate this difference, at least on the medium term to the Fund's projections. Staff's comment on this aspect would be welcome.

We take note of the reimbursement to the General Resources Account (GRA) for the amount of the cost of administering the PRGT in FY 2019. While we approve the decision 2 and acknowledge the footnote 6 on expenses related to SDA resources, we would be interested in knowing the underlying elements behind the expenses of administering the PRGT that are said to be slightly above earlier estimates in SDR terms.

As in the past, we continue to support the placement of the net income of the GRA in equal parts to the Fund's special reserve and general reserve as proposed in decision 4. These two reserves are available to absorb future losses. We underscore, as detailed in the report, the role of the general reserve in allowing more flexibility for the Board to consider alternative uses of reserves but would like more precisions on the qualifying condition stated as "in the event that reserves are viewed as more than adequate to cover potential risks of financial losses". We would appreciate more prevision on what the "adequate" level stands for.

Finally, we support decision 6 to maintain the level of the margin for the rate of charge in FY 2020 as we agree that no fundamental change has occurred in the underlying factors since last April 2018 that could affect the pace of the Fund's reserve accumulation. This level is still aligned with long-term credit market conditions and will contribute to the generation of lending income to finance a part of the Fund's non-lending activities.

Mr. Fanizza, Ms. Levonian, Mr. Ray, Ms. Riach, Ms. McKiernan and Mr. Rashkovan submitted the following joint statement:

We thank staff for their paper and for their constructive engagement on this subject. We welcome the healthy state of the Fund's income position and the sound reserves position, which help bolster the Fund's resilience. Staff estimates show that precautionary balances will reach their indicative target of SDR 20 billion in FY2021, three years earlier than previously projected. We broadly support staff's proposed approach to income set out in this paper and will vote in favor of the decisions set out, with one exception.

Last year, we set out in a joint statement that we did not feel that staff had made the case for establishing a precedent for allocating net income equally between the special and general reserves and stressed that this should remain under ongoing annual review by the Board. Staff propose such a 50/50 split once again in FY2019. We continue to consider that this method lacks a clear prudential justification, given that it is not based on an assessment of the adequacy of existing balances in the special reserve. For this reason, we will be abstaining on Decision 4. We note that the Board will have an opportunity to review this framework again next year. For that review, we urge staff to consider evidence-based alternative approaches for allocating net income. For example, we could implement a ceiling for the special reserve, defined as a multiple of the Fund's annual expenses. We look forward to a full consideration of these and other options next year.

Regarding the review of the margin for the rate of charge, we support the decision to maintain the margin at 100 bps for FY2020 based on staff's assessment that there are no fundamental changes in the relevant underlying factors compared to last year, namely credit market conditions and the Fund's intermediation costs. Looking ahead, even if we assume that investment income remains constrained, it will be important for staff to closely examine the margin for the rate of charge for FY2021-22, given that the Fund is set to hit reserves targets a full three years sooner than anticipated.

Despite the Fund outperforming income projections for all income types since late-2018, net operational income has taken a significant hit due to a relatively large pension-related adjustment under IAS 19. As figure A.2.1 illustrates, changes in actuarial assumptions have caused volatility in net income for several years. For this year, the report briefly explains that one of the main reasons for the negative IAS 19 adjustment is a change in the discount rate used to calculate the present value of future staff benefits, driven by a drop in US interest rates. The various pension-related reconciliations are quite complex, so we would appreciate if staff could provide more details. We would be grateful if staff could explain the nature and impact of the variables outlined in the table on page 8. In addition, could staff elaborate on the key drivers of net actuarial remeasurement losses following two years of large gains, in addition to those related to discounting?

While we understand that staff cannot predict IAS 19 adjustments, we are interested in exploring options to improve financial planning in this context given the importance of pension-related developments on the overall financial results of the Fund. One potential option is to conduct sensitivity analysis around key pension remeasurement variables, including discount rates. Such an approach would help illustrate to the Board the degree of volatility and uncertainty linked to pension fund developments and increase the Board's ability to take informed financial decisions. Does staff believe that computing a sensitivity analysis would be feasible? If not, what are the main obstacles? Does staff see other ways to improve financial planning in this context?

Mr. Kaya, Mr. Benk, Mr. Just and Mr. Stradal submitted the following statement:

We thank staff for their comprehensive report and helpful outreach to our office. The Fund has maintained its strong financial position despite a decrease in net income in FY 2019 relative to FY 2018. This should allow the Fund to operate in line with its mandate in an unconstrained manner. We note the significant downward adjustment stemming from accounting for the pension benefits, taking into account the inherent volatility which nets out over a longer time span. We appreciate Annex II which explains the nature of the adjustments and provides their twenty-year history. We do not see the defined benefit pension system as a major risk to the Fund's income and finances if proper safeguards are in place to insulate the year-to-year volatility. We support all seven decisions pertaining to the FY 2019 and FY 2020 as proposed by staff.

We continue to see a strong case for building up precautionary balances to reinforce the Fund's balance sheet. We are encouraged by the updated projections showing that the indicative target of SDR 20 billion could be reached sooner than previously expected. However, we acknowledge the significant multifaceted uncertainties around the central forecast which compound over time.

The compromise reached last year on equal allocation of income between the special and general reserve remains a reasonable middle ground between the diverse views expressed in the past. We see merit in upholding it this year, while acknowledging the Board's flexibility to decide on future income allocations.

We concur that no adjustment to the margin for the rate of charge set at 100 basis points over the SDR interest rate is needed for the period of FY 2019-2020. The cost of Fund credit at the current margin remains well aligned with the market conditions and the Fund's income model.

We welcome the alignment of the Review of Special Charges, which has so far been performed annually, with the five-yearly Review of the Fund´s Strategy on Overdue Financial Obligations. We see merit in streamlining these issues and assessing them in a holistic manner in 2022 with the possibility for earlier reconsideration should conditions change. We concur with staff, however, that the current special charges be kept unchanged for the time being.

We welcome the Annex III detailing the implementation of IFRS9. We take note of the limited impact of this new accounting standard on the FY 2019 financial statements. Reflecting the unique character of the Fund, we see merit in continued caution when assessing the credit quality of the GRA and PRGT portfolios to avoid negative signaling effects. We would welcome further executive Board updates on the developing framework for measuring the expected credit losses.

Mr. Mouminah, Mr. Alkhareif and Mr. Keshava submitted the following statement:

We support the proposed decisions. We would limit our remarks to the following issues.

The pension-related (IAS 19) gains and losses remain unpredictable and continue to add volatility to annual income. Indeed, we note that if the current trend persists through the end of the financial year, it would negate a substantial portion of the Fund's net operational income for FY 2019. In this connection, while we welcome staff's analysis presented in the text table on page 8 of the paper, we would have appreciated a more detailed discussion of each element of pension cost accrual vs. pension funding and remeasurement gains/losses. Staff had indicated last year that "while the IAS 19 gains and losses have been fairly volatile over time, the cumulative IAS 19 gains and losses were projected to be slightly positive at end-April 2018". We would welcome information regarding the actual cumulative IAS 19 gains and losses at end-2018. Given the projected losses in FY 2019, will it turn negative?

We support allocating net income again equally to the general and special reserves in FY 2019. It is important to maintain Board flexibility in deciding future allocation of net income and, in this context, we look forward to the review of the framework in 2020.

We agree that the margin for the rate of charge set at 100 basis points for the two years, FY 2019 and FY 2020, should be maintained. Indeed, we concur that there is no fundamental change in the underlying factors relevant for the establishment of the margin since the last review.

We welcome the continued build-up of precautionary balances. In this regard, we are pleased by the updated projections, which indicate that precautionary balances could reach the indicative medium-term target of SDR 20 billion in FY 2021, three years earlier than previously projected. We look forward to review of the medium-term target in 2020 in light of developments in credit and other financial risks.

Finally, we welcome the discussion in Annex III on the implementation of IFRS 9 in the Fund. We take note of the assessment that the adoption of the new standard is not expected to significantly impact the FY 2019 annual financial statements, but the final assessment will be available only at the end of the year. Since the Fund has never recognized any loan loss provisions due to the impairment of its assets, we concur that the Board will have to revisit this issue if the credit risk assessment would result in expected credit losses (ECLs) that require recognition in the financial statements.

Mr. Mozhin, Mr. Palei and Mr. Potapov submitted the following statement:

We thank staff for the informative report on the Review of the Fund’s Income Position for FY 2019 and FY 2020. We can support the proposed decisions.

According to staff, the Fund’s net income position remains strong and does not pose any significant risks to the Fund’s business in the short and medium term. Net operational income for FY 2019 is significantly higher than projected in April 2018. The pace of reserves accumulation is projected to be much stronger than what was estimated last year, with the current indicative target of SDR 20 billion to be reached in FY 2021. At the same time, we agree with staff that the outlook for the Fund’s income position is subject to some uncertainty and it is also sensitive to changes in the assumptions.

The pension-related (IAS 19) adjustment seemingly adds volatility to the Fund’s income and reserves. The projections in the report of a negative outcome of SDR 486 billion under this adjustment could negate a substantial portion of the Fund’s net operational income for FY 2019. At the same time, these risks are mitigated by the fact that IAS 19 gains or losses are a book entry and distinct from the funding of the staff retirement plan and the budgetary process. Moreover, IAS 19 gains and losses are expected to offset each other in the long run. Could staff provide any updates on their projections for the IAS 19 adjustment?

We can go along with the proposed equal allocation of net income to the special and general reserve. This approach is broadly in line with the guiding principles in this area. It is also a reasonable compromise, given the diverse views expressed over the recent years. At the same time, we would highlight the importance of preserving the Board’ role in deciding on future income allocations.

On the margin for the rate of charge on the use of Fund resources, we support keeping it unchanged at 100 bps over the SDR interest rate. As illustrated in the report, the pace of accumulation of precautionary balances has improved. The cost of Fund credit at the current margin remains broadly aligned with the long-term credit market conditions.

Staff's analysis of special charges points to their diminishing role in the Fund's risk management framework. Protracted GRA arrears have fallen sharply over the recent years, and they are now limited to only two countries. Moreover, the Fund's membership is not subject to special charges on their overdue repurchases under the current arrangement for setting the basic rate of charge, which is always higher than the SDR interest rate. Against this background, we agree with staff that no changes are needed in the current special charges framework, as it is difficult to decide ex ante on a new system that would be most relevant in the context of possible new arrears. We can also support staff's proposal to conduct the next review under the wider review of the Fund's strategy on overdue obligations (Decision 7). At the same time, we would highlight the need to closely monitor risks in this area and revisit this approach, if circumstances warrant.

Mr. Mahlinza and Mr. Abdullahi submitted the following statement:

We thank staff for the informative paper on the Review of the Fund's Income Position for FY 2019 and FY 2020. We broadly agree with staff's analysis and support all the proposed decisions. We offer following comments for emphasis.

We take positive note that the Fund's net operational income for FY 2019 is significantly higher than the 2018 estimate driven mainly by lending income from the recent increase in lending activities. Similarly, the investment income is projected to be higher than the April 2018 estimate, mainly due to revaluation gains on the endowment subaccount portfolio in SDR terms on the back of a stronger US dollar against the SDR and higher than expected income from fixed income account. However, based on the current 2019 projections, we note that the volatile pension related (IAS 19) expenses would consume nearly 70 percent of the net operational income. We are concerned about the level of uncertainty that these annual swings from the IAS 19 adjustment introduce to the Fund income position and reserve accumulation.

We take note of the improvements made to the Poverty Reductions and Growth Trust (PRGT) reimbursement mechanism to the General Resources Account (GRA), which is now based on lagged actual data instead of forecasts. In this respect, and consistent with past Board decisions, we support Decision 2 to transfer SDR 62.82 million from PRGT reserve account to the GRA. However, we are of the view that the Fund should not be charging the full administrative expenses on this trust fund.

We continue to view maintaining an adequate level of precautionary reserve balances as important and believe that the SDR 20 billion medium-target remains appropriate. Thus, consistent with past practice and the April 2018 Executive Board decision, we support Decision 3 to transfer Investment account for FY 2019 to the GRA. In this context, the proposed decision to fully allocate all FY2019 GRA net income to reserves would bring precautionary balances closer to the indicative medium-term target of SDR 20 billion. With the strong earnings expectation, the precautionary balances target will be achieved by 2021, three years earlier than previously projected. Similarly, consistent with the previously Board endorsed set of principles which guide the allocation of the net income of the GRA, we support Decision 4 to equally divide the GRA net income between the special and general reserves.

Finally, we appreciate the detailed review of the margin for the rate of charge on the use of Fund resources. We take note that for FY 2020 the lending income is expected to remain higher than the Fund's intermediation costs and the precautionary balances reserve is expected to be accumulated at a faster rate than originally envisioned. Further, the cost of Fund credit at the current margin is in line with staff benchmark for long term market conditions. Against this backdrop, we concur with Decision 6 to maintain the margin for the rate of charge for FY 2020.

Mr. Gokarn and Ms. Dhillon submitted the following statement:

We thank staff for the review of the Fund's income position for the FY 2019 and FY 2020. We broadly agree with the proposed decisions and will restrict our gray to the following remarks.

The overall income position of the Fund remains robust and resilient. The net operational income for FY 2019 is significantly higher than estimated in April 2018. But, the downward adjustments from the pension-related impacts do need to be factored in. With many new arrangements in place, projections for total operational lending income and the Investment income is higher than last year. We positively note that the income outlook for FY 2020 is expected to be strong.

We can go along with the net income being allocated equally to the general and special reserves in FY 2019 (proposed Decision 4). At the last review of the Fund's income position in April 2018, the Board had broadly endorsed a set of principles, which staff has alluded to in the report. It would have been useful to view possible alternate scenarios for this allocation along with a well-reasoned basis for choosing to allot it equally. Could staff offer such alternate allocation scenarios?

Staff does not propose any change in the level of the margin for the basic rate of charge at 100 basis points in FY 2020, as there has been no fundamental change in the underlying factors relevant for setting the margin since the last review. We do note that the projections for the Net income for FY 2020 assume that the margin is maintained at 100 basis points. Beyond the sensitivity of the outlook to global interest rates and the US dollar/SDR exchange rate, could staff elaborate on the sensitivity of the income outlook to the deviations from the 100 basis points margin?

Finally, we concur with the retaining of the current special charges framework at this time. We support the proposal to undertake the next review as part of the wider reviews of the Fund's strategy on overdue obligations.

Mr. Villar, Mrs. Del Cid-Bonilla and Mr. Montero submitted the following statement:

We thank staff for its report on the review of the Fund's income position for FY2019 and FY2020. We can go along with the seven proposed decisions. As expressed in other occasions, we would appreciate the possibility in the future of having a comprehensive discussion of the Fund's financial situation. We offer the following comments for emphasis and to provide some qualifications.

The net operational income (NOI) in FY2019 was significantly above the initial projection, reflecting mainly the large new arrangements approved since April 2018, and a positive evolution of investment income. However, we take note that current estimates of the pension-related (IAS 19) position may significantly reduce the NOI, to the extent that a negative outcome could result. On a positive note, the current NOI does not include revenues from Ecuador's program and, potentially, from the one currently negotiated with Pakistan, which can provide a boost to operational income.

The pension-related position has been highly volatile over the last years, which generates a substantial degree of uncertainty and volatility in the Fund's resulting income and reserves. As staff highlights, on the liability side the defined benefit obligation is very sensitive to the underlying actuarial assumptions, in particular, the discount rate—a 100 basis point (bp) change can induce a variation of pension liabilities of around 18 percent. In this setting, we wonder whether more weight should be put on the Special Reserves account when allocating net income, as it is the first line of defense against income losses. Staff´s comments are welcome. Additionally, in view of the recent important shifts in yield curves in the main financial markets, could staff provide an updated estimate of the pension-related adjustment?

In view of the environment of low global interest rates, we expect investment income to remain constrained over the next few years, so we agree to continue applying the exceptional circumstances clause when setting the margin for the basic rate of charge. In this context, the Fund will need to rely on its lending income to cover a portion of its non-lending operational costs. Moreover, we concur with staff that the margin of 100 basis points is aligned with long-term credit market conditions, as required by Rule I-6(4). However, we take note that an unchanged margin of 100 bp would contribute to boost lending income over the next few years, in a context where substantial increases in income are also expected from commitment fees and surcharges. Thus, provided these conditions prevail in the following years, a comprehensive review would be warranted to ensure that the levels of the margin, surcharges, special charges and precautionary balances continue to be adequate to cover operating costs and to build reserves. Relatedly, could staff provide, under reasonable assumptions, a rough estimate of the level of PB/IA required to yield enough income to cover non-lending activities and avoid the use of the exceptional circumstances clause?

We support placing all net income to reserves, allowing precautionary balances to reach SDR 17.7 billion. Although we agree with an equal distribution between the general and special reserves, we believe that the increased volatility imparted by the application of some accounting standards (e.g. IAS 19 or IFRS-9) may call for reconsidering this decision going forward. Moreover, we take positive note of the fact that precautionary balances could reach the indicative target of SDR 20 bn in FY2021, three years earlier than previously projected. We look forward to reviewing the appropriate medium-term target in early 2020 considering the developments in financial markets and in the different sources of income.

We agree with staff's proposal to retain the current special charges framework to prevent unintended signals about prospective arrears. We also concur with further reviews to take place in conjunction with reviews of the Fund's strategy on overdue obligations in the understanding that the Board will be able to review it sooner if circumstances warrant.

Finally, we welcome the detailed explanation on the progress of implementing IFRS9, under which loan loss provisions must be recognized using the criteria of expected credit losses (ECL). As highlighted by staff, the

Fund's unique institutional characteristics and its multilayered risk management framework reduces the likelihood of incurring credit losses. However, the possibility of ECL in the future cannot be completely ruled out. Thus, the Board may have to revisit its stance on the issue of loss recognition and provisioning at some point. We look forward to the early circulation of the draft FY2019 annual financial statements, with a complete set of IFRS9 disclosures.

Mr. Rashkovan made the following statement:

I thank the staff for the outreach before the meeting and the answers to our technical questions. We issued a joint gray statement with other Directors. To continue the morning discussion on budget, we welcome the recent efforts on streamlining the process around the medium-term budget, the income position, risk report, and policy priorities. At the same time, this chair would still highlight three points.

First, as stated in our common gray statement, we would like to abstain on Decision 4. While we welcome the prudent financial management and the sound reserves, which will help to deal with uncertainties and risk in the medium and long-term, we remain unconvinced on the methods of allocating net income equally between the special and general reserves 50/50. Like last year, we continue to consider that this approach lacks a clear rationale. We look forward to discussing this matter further and invite the staff to consider alternative approaches for allocating net income going forward.

Second, as this year's report illustrates, pension-related developments can have important results on the Fund's bottom line. While we admit that certain data cannot be accurately forecasted, we believe that in the present context, more efforts could be helpful to improve the Board's overview of the key risk drivers, which lead to non-negligible financial risks. It is in this context that we asked the staff how to improve at least the financial planning—not yet speaking about the mitigation actions—and in their written responses, the staff reiterated that the market fluctuations would make projection difficult. I am not sure the staff proposed another way of addressing uncertainties which lead to important fluctuations of the net income position that impact the overall finances. If the Finance Department (FIN) cannot do it, maybe the Risk Management Unit should assess if the current situation is satisfactory from their perspective. We believe that in order for the Board to take informed financial decisions, including on the medium-term budget, the Big Five capital intensive projects, or the Comprehensive Compensation and Benefits Review (CCBR), such uncertainties need to be taken into account, and we look forward to exploring options together with the staff on how to adequately address these risks affecting the income position.

Mr. Saito made the following statement:

We thank the staff for the informative paper and helpful outreach. We support all the proposed decisions and would like to offer two comments for emphasis.

First, on the margin for the rate of charge, as the staff rightly pointed out, the discussion of margin on the rate of charge is closely interlinked with the discussions of the precautionary balance target and the Endowment Subaccount payout policy. Moreover, the precautionary balance could lead to the indicative target in FY2021, three years earlier than previously projected. Against this background, as Mr. Villar indicated in his gray statement, the comprehensive review on the level of the margin, the precautionary balance target, and the Endowment Subaccount payout policy will be warranted in the coming years. We expect the staff to develop future proposals in a well-coordinated manner given the close connection between these three issues.

Second, on the reserves targets, noting that the current policy continues to serve a cost recovery function when new arrears emerge, and the cases of short-term arrears have become rare, we can go along with the staff's proposal. However, the special charges should not only serve a cost recovery function but also give an incentive to settle members' financial obligation in a timely manner. Moreover, we note that specific charges on overdue repurchases have no longer become operationalized under the current rate-setting framework. In this light, while the next review of the special charges would be due by 2022, we urge the staff to come back to the Board sooner with a concrete analysis and proposal on possible alternatives if circumstances warrant.

Mr. Merk supported the proposed decisions. He remarked this his chair could go along with the proposed equal allocation of net income to both the special and general reserves. However, we would have preferred to place a higher share into the special reserves, as it resembled a first line of defense against income losses and the expected heightened uncertainties around the volatility of income due to the implementation of International Financial Reporting Standards (IFRS) 19.

Ms. Zhao made the following statement:

We thank the staff for the well-written report. We issued a gray statement supporting all the proposed decisions and would like to provide one comment for emphasis. Like Mr. Merk, we would like to offer a comment on Decision 4 regarding the General Resources Account (GRA) net income to the special reserve and the general reserve.

In light of the downside risks facing the global economy, it is desirable to build adequate special reserves as the first line to cover administrative losses. We have discussed early in the morning that capacity development has largely been financed by external financing. This implies that the current internal resources cannot fully satisfy all the legitimate needs of the Fund. In this regard, while we can go along with equal placement between the special and the general reserves, we prefer greater accumulation of special reserves for a better guarantee of the Fund resources. We also call for giving the Board flexibility to decide on further income allocations in light of evolving circumstances.

Mr. Fanizza remarked that his chair had abstained from Decision 4 because the staff had not provided a reason why the GRA income had been allocated equally between the general reserve and the special reserve. He looked forward to receiving an explanation in next year's paper. He also looked forward to a fruitful discussion on changing the margin for the rate of charge.

The staff representative from the Finance Department (Mr. Bradbury), in response to questions and comments from Executive Directors, made the following statement:[1]

I thank Directors for their gray statements and their support for the decisions. I was also pleased that despite being in the run-up to the Spring Meetings, we were able to schedule bilateral meetings with all those Directors' offices who requested one. I thank Directors for those detailed discussions, which I hope managed to clarify any technical issues.

Our written responses addressed the bulk of Directors' questions, but I would like to comment on the issue of income allocation between the general and special reserve, and then I would also just like to emphasize our comments on IFRS 19 and to say a word on the reimbursement of Poverty Reduction and Growth Trust (PRGT) expenses.

[1] Prior to the Board meeting, SEC circulated the staff's additional responses by email. For information, these are included in an annex to these minutes.

The question of the allocation of income to the general and the special reserve, the Board has discussed this several times in recent years, and as we have heard in this meeting today, remains divided on the issue. A year ago, most Directors agreed with the staff's proposal to maintain a 50/50 apportionment between the two reserves. Most Directors also agreed to shifting to a two-yearly review cycle, which will provide an opportunity to review the apportionment next calendar year, which aligns with the reviews of the Fund's precautionary balances and also the setting of the margin for the rate of charge. As noted in the paper, the staff plans to revisit this issue in greater detail in early 2020.

With a view to that work, the five chairs abstaining on this decision suggested in their joint gray statement possibly establishing a ceiling for the special reserve, maybe defined as a multiple of the Fund's annual administrative expenses. We take note of this, and we will consider a range of options to guide the future allocation decisions based on the full suite of feedback that we have received from Directors to date.

On this specific suggestion, I would say that the Fund's reserves protect it against all financial risks, including, importantly, credit risk on lending; and so the risks and potential losses are not directly linked or limited to the level of administrative expenses and could vary significantly without any change in the administrative budget, so we will have to take a further close look at that.

Most gray statements commented in some way on the pension asset liability loss of SDR 486 million. We have covered most of the issues raised in our technical responses, but I want to just make a few observations.

As was noted, it has not been our practice to attempt to make projections of this item given the uncertainties in forecasting key variables such as the discount rate, but we can certainly do more in terms of modeling sensitivity analyses, which we will be doing in any case in the context of the CCBR, to show the impact on the Fund's income of specified changes in those variables. We will do more work on that before next year's presentation.

The second point on pension accounting, some chairs noted that this year's pension loss underscores the risks associated with maintaining a defined benefit pension plan. I would be cautious in drawing that conclusion on the basis of a single year's results, which is largely driven by investment performance. If one looks at the period since 2014, for example, these pension gains have contributed significantly to the Fund's income. One of the gray statements noted that what we see here is book entries. For a more comprehensive picture of the health of the plans, I would recommend looking at the financial statements of the General Department, which have much more detailed information than is in this paper; and maybe also the plan's own financial statements, which will be forthcoming after the end of the financial year.

A few chairs expressed concern about reimbursing the GRA for the expenses of administering the PRGT. The self-sustaining PRGT financing framework adopted in 2012 explicitly assumed reimbursements of that nature, and they are also a significant pillar of the Fund's income model. Suspending the GRA reimbursement is not contemplated as a permanent financing mechanism, but that being said, a time-limited suspension of GRA reimbursement is possible as a contingency measure in the event that concessional financing needs exceed the base envelope by a substantial margin for an extended period. This condition is not presently satisfied, as capacity exceeds targeted average annual capacity of SDR 1.25 billion, as was highlighted in last month's Board presentation on the Low-Income Countries Facilities Review, but we will keep this under review as those gray statements requested.

The following summing up was issued:

Executive Directors welcomed the review of the Fund's income position and broadly supported all the proposed decisions pertaining to FY 2019 and FY 2020. They noted that the projected net income outcome for FY 2019 is in line with the April 2018 estimate, and that the income projections for FY 2020 are sensitive to the underlying assumptions. In particular, Directors noted that the historically volatile pension-related (IAS 19) gains and losses are difficult to forecast with any degree of certainty and some Directors encouraged staff to explore options, including sensitivity analysis, to improve financial planning in this context.

Directors supported the proposed income disposition decisions. Specifically, they supported the transfer of income from the Fixed-Income Subaccount of the Investment Account to the GRA for use in meeting FY 2019 administrative expenses, and the retention of the income of the Endowment Subaccount for FY 2019 in line with the agreed payout policy. They also supported the transfer of currencies from the GRA to the Investment Account equivalent to the increase of the special and the general reserves, following the placement of FY 2019 net income.

Building on the framework agreed at last year's review, most Directors supported the proposal to allocate the FY 2019 net income of the General Resources Account (GRA) in equal parts to the Fund's special and general reserves, while preserving flexibility for future reassessment. While willing to go along with the proposal, a few Directors would have preferred a higher allocation to the special reserve. Some other Directors questioned the case for the even split between general and special reserves and called for consideration of alternative approaches in the context of the framework's next review in 2020.

Directors supported maintaining the margin for the rate of charge at 100 basis points over the SDR interest rate for FY 2020. While recognizing the increase in projected lending income and the pace of the Fund's reserve accumulation over the medium-term, they concurred that there has been no fundamental change in the factors relevant for setting the margin since its last review in April 2018. A number of Directors stressed the need to review the adequacy of the margin in the future, in light of developments in lending income, reserve accumulation, and financial markets.

Directors agreed to reimburse the GRA for the costs of administering the PRGT and of conducting the business of the SDR department. A few Directors had reservations about fully reimbursing the GRA for administrative expenses of the PRGT due to the importance of PRGT resources to members.

Directors also concluded the review of the system of special charges on short-term overdue financial obligations to the GRA. Directors agreed that future reviews are more appropriately conducted in the context of the five-yearly Review of the Fund's Strategy on Overdue Financial Obligations, or earlier, if warranted by circumstances.

The Executive Board took the following decisions:

Review of the Fund's Income Position for FY 2019 and FY 2020—Assessment Under Article XX, Section 4 for FY 2019

Pursuant to Article XVI, Section 2 and Article XX, Section 4 of the Articles of Agreement and Rule T-2 of the Fund's Rules and Regulations, it is decided that:

(i) The General Department shall be reimbursed for the expenses of conducting the business of the SDR Department for the period of May 1, 2018 through April 30, 2019; and

(ii) An assessment shall be levied on all participants in the SDR Department. The special drawing right holdings accounts of participants shall be debited on April 30, 2019 with an amount equal to 0.00156151 percent of their net cumulative allocations of special drawing rights. The total assessment shall be paid into the General Department. (EBS/19/16,03/19/19).

Decision No. 16496-(19/26), adopted
April 5, 2019

Review of the Fund's Income Position for FY 2019 and FY 2020—Poverty Reduction and Growth Trust Reimbursement for FY 2019

In accordance with paragraph 3 of Decision No. 8760-(87/176), adopted on December 18, 1987, an amount equivalent to SDR 62.83 million, representing the cost of administering the Poverty Reduction and Growth Trust (PRGT) for FY 2019, shall be transferred from the Reserve Account of the PRGT (through the Special Disbursement Account) to the General Resources Account. (EBS/19/16, 03/19/19).

Decision No. 16497-(19/26), adopted
April 5, 2019

Review of the Fund's Income Position for FY 2019 and FY 2020—Transfer of Investment Income for FY 2019 to General Resources Account

The income of the Fixed-Income Subaccount of the Investment Account for FY 2019 shall be transferred to the General Resources Account for use in meeting the expenses of conducting the business of the Fund during FY 2019. The income of the Endowment Subaccount for FY 2019 shall be retained in the Endowment Subaccount and invested according to the Rules and Regulations for the Investment Account. (EBS/19/16, 03/19/19).

Decision No. 16498-(19/26), adopted
April 5, 2019

There was an abstention by the office of Mr. Ray (AP) , an abstention by the office of Ms. Levonian (CO) , an abstention by the office of Mr. Fanizza (IT) , an abstention by the office of Mr. De Lannoy (NE) and an abstention by the office of Ms. Riach (UK) on the following decision:

Review of the Fund's Income Position for FY 2019 and FY 2020—Placement of FY 2019 Net Income of the General Resources Account to the Special Reserve and General Reserve

The net income of the General Resources Account for FY 2019 shall be placed in equal parts to the Fund’s Special Reserve and General Reserve. (EBS/19/16, 03/19/19).

Decision No. 16499-(19/26), adopted
April 5, 2019

Review of the Fund's Income Position for FY 2019 and FY 2020—Transfer of Currencies to the Investment Account for FY 2019

Pursuant to Article XII, Section 6(f)(ii) of the Articles of Agreement, the Fund shall transfer from the General Resources Account to the Investment Account currencies in an amount equivalent to the difference between the Fund’s general and special reserves as of April 30, 2019 and the cumulative amount of previous transfers of currencies from the General Resources Account to the Investment Account. This transfer of currencies to the Investment Account shall be effected in the context of the Financial Transactions Plan covering the period May – October 2019. The currencies transferred to the Investment Account pursuant to this decision shall be used for immediate investment in the Fixed-Income Subaccount in accordance with the Rules and Regulations for the Investment Account. (EBS/19/16, 03/19/19).

Decision No. 16500-(19/26), adopted
April 5, 2019

Review of the Fund's Income Position for FY 2019 and FY 2020—The Rate of Charge on the Use of Fund Resources for FY 2020

Pursuant to Rule I-6(4)(a), the Fund has completed the review of the Fund’s income position and concluded that for FY 2020 there are no fundamental changes to warrant any adjustment to the margin for the basic the rate of charge as determined by Decision No. 16363-(18/36), adopted April 25, 2018. (EBS/19/16, 03/19/19).

Decision No. 16501-(19/26), adopted
April 5, 2019

Review of the Fund's Income Position for FY 2019 and FY 2020—Review of the System of Special Charges

1. The Fund has conducted the annual review required under Decision No. 8165-(85/189) G/TR, adopted December 30, 1985, effective February 1, 1986, as amended, on Special Charges on Overdue Financial Obligations to the Fund.

2. Section VI of the above-referenced Decision is hereby deleted.

3. It is expected that the review of the above-referenced Decision will take place in conjunction with each Review of the Fund's Strategy on Overdue Financial Obligations. (EBS/19/16, 03/19/19)

Decision No. 16502-(19/26), adopted
April 5, 2019

APPROVAL: April 13, 2020

JIANHAI LIN
Secretary

Annex

The staff circulated the following written answers, in response to technical and factual questions from Executive Directors, prior to the Executive Board meeting:

Decision 2: Reimbursement of the GRA for PRGT Expenses

1. We would be interested in knowing the underlying elements behind the expenses of administering the PRGT that are said to be slightly above earlier estimates in SDR terms.

- The increase in the PRGT reimbursement is largely attributable to the average SDR/U.S. dollar exchange rate used to translate the dollar-based expenses. The April 2018 projections assumed an average exchange rate of US$1.46/SDR in FY 2019 compared with US$1.41/SDR that is now expected following the strengthening of the U.S. dollar against the SDR during the year. Notwithstanding a slight decrease in the U.S. dollar value of the reimbursement costs, the stronger U.S. dollar increases costs in SDR terms.

Decision 4: Placement of GRA Net Income

2. We underscore, as detailed in the report, the role of the general reserve in allowing more flexibility for the Board to consider alternative uses of reserves but would like more precision on the qualifying condition stated as "in the event that reserves are viewed as more than adequate to cover potential risks of financial losses". We would appreciate more precision on what the "adequate" level stands for.

- Assessment of reserve adequacy is a matter of judgment by the Board. It reviews the adequacy of the Fund's precautionary balances biennially on the basis of a comprehensive assessment of the financial risks facing the Fund, and in this context sets an indicative medium-term target for the level of the precautionary balances. The next review is set to take place in early 2020.

3. It would have been useful to view possible alternate scenarios for this allocation along with a well-reasoned basis for choosing to allot it equally. Could staff offer such alternate allocation scenarios?

- The Board paper for last year's review of the Fund's income position included a more detailed assessment of various allocation options, and included medium-term projections. At the time, most Directors agreed with staff's proposal to maintain the equal allocation to the special and general reserve, and to revisit the allocation framework in alignment with the reviews of the adequacy of the Fund's precautionary balances and for setting the margin for the rate of charge. Accordingly, staff will revisit the allocation options again in more detail in early 2020, taking into account the views expressed by the Board to date.

Decision 6: Margin of Rate of Charge

4. ***According to the report, the necessity to cover non-lending activities by lending income is expected to dwindle in coming years. Could staff elaborate more, at what time the necessity to make use of the exceptional circumstances clause (Rule I-6(4)) can be expected to run out?***

5. ***Could staff provide, under reasonable assumptions, a rough estimate of the level of PB/IA required to yield enough income to cover non-lending activities and avoid the use of the exceptional circumstances clause?***

- The current use of the exceptional circumstances clause in setting the margin for the basic rate of charge to also cover a portion of the Fund's non-lending expenses is dependent on the level of the Fund's non-lending operational income, consisting primarily of investment income. The level of investable resources required to yield non-lending income sufficient to cover the Fund's non-lending expenses would depend on the level of interest rates. Under the staff projections presented in the Board paper, non-lending operational income would remain below the Fund's non-lending expenses over the medium-term. Under the assumptions underlying staff's longer-term (low-lending environment) projections in Annex VI, non-lending income would be expected to broadly cover the non-lending expenses.

6. ***Could staff explain what path of interest rates would suggest a possible revision of the margin which has been kept constant at 100 bps?***

- Notwithstanding continued application of the exceptional circumstances clause, the decision on the level of the margin under the Rule I-6(4) should consider its coverage of the Fund's intermediation costs, contribution to reserve accumulation and alignment with long-term credit market conditions. The rule is not to be applied mechanistically, and each review of the margin should assess all the underlying factors in combination based on conditions prevailing at the time.

7. ***Beyond the sensitivity of the outlook to global interest rates and the U.S. dollar/SDR exchange rate, could staff elaborate on the sensitivity of the income outlook to the deviations from the 100 basis points margin?***

- Table 4 of the Board paper (page 19) illustrates projected margin income for FY 2019-20 under a margin of 80, 100 and 120 basis points. A 20 basis point increase (decrease) in the level of the margin would raise (reduce) the projected margin income by about US$200 million in FY 2020 (about SDR 140 million).

- This is further illustrated in Figure 2 on page 20 which shows the impact on the level of precautionary balances accumulation over the medium term of a 20 basis point increase or decrease in the margin.

8. Could staff address this issue with more information? [Regarding the use of the median of the quarter of more creditworthy EMBI countries as a benchmark for long-term credit market conditions]

- To inform Directors' assessment, the Board paper provides information on both the composite EMBI spreads and the EMBI spreads for the lowest quartile of the sample. The median spreads for each of these measures have remained relatively stable over the recent five-year periods. The lowest quartile benchmark in the assessment is not intended to focus the assessment on any country group with a specific risk profile. It rather serves as a proxy measure to account for the lower credit risk the Fund faces as a cooperative public policy institution relative to market borrowing, where spreads also reflect a credit risk premium.

Noting that we will have an opportunity to review the appropriate medium-term target for precautionary balances again in early 2020 and the EA payout policy framework in 2021, we would like to know how staff see appropriate packages of the margin, the PB target and the EA payout in the coming years, assuming that baseline scenario is materialized. Could staff share initial thoughts on levels of the three targets?

- Under the framework approved in 2010, the Board sets the indicative medium-term target for the Fund's precautionary balances biennially on the basis of a comprehensive assessment of the financial risks facing the Fund. The next review is set to take place in early 2020 and would need to consider credit and other financial risk conditions prevailing at the time. Similarly, the EA payout policy will be revisited in 2021 under the framework endorsed by the Board in April 2018, where the key consideration is the longer-term sustainability of the endowment as a stable income source for the Fund. The decision on the initial payout at that time would be informed by EA performance and retained investment income, as well as prevailing market conditions. The Board has an opportunity to review the level of the margin on the basic rate of charge again before end-FY 2020, which will then be informed by the review of the adequacy of the Fund's precautionary balances, developments in Fund income and expenses, as well as the margin's alignment with the prevailing longer-term credit market conditions.

Decision 7: Special Charges Framework

9. We welcome staff's comments on possible alternative frameworks of the special charges, which address shortcomings of the current system and strengthen incentives.

- Any alternative frameworks for special charges would need to take into account: first, the framework's core objective of cost recovery; and, second, consistency with the broader Cooperative Strategy for addressing overdue financial obligations as well as the Fund's broader risk management framework. At the current juncture, as discussed in the paper, the special charges framework remains consistent with its original primary purpose of cost recovery, and arrears are not a pressing issue. Determining the appropriate design of any alternative framework would also be challenging without clarity over the nature of possible future arrears. Staff also sees a risk, if an alternative framework were pursued at this time, of sending unintended signals that the Fund considers prospective arrears a problem and considers its existing policies for addressing arrears as inadequate.

10. Could staff clarify what circumstances would trigger an earlier revision of the special charges framework, and how such revision would be undertaken if done before 2022?

- If new protracted arrears to the GRA emerge on a significant scale, staff could revisit the adequacy of the existing Fund policies to address arrears—including the special charges framework—in advance of the next scheduled review in 2022 of the Strategy on Overdue Obligations.

Level of Precautionary Balances

11. We would still caution against satisfaction regarding the precautionary balances as we wonder whether the need for them might be higher than foreseen in earlier years given the Funds more concentrated credit portfolio recently. Can staff elaborate more on these points?

- The Board will have an opportunity to review the adequacy of the Fund's precautionary balances in early 2020, which will be supported by an updated comprehensive assessment of financial risks facing the Fund.

Pension Related (IAS 19) Adjustment

12. In view of recent market developments, can staff provide any updated estimation of the IAS 19 adjustment?

13. Given the equity markets recovery since February, we would like to know developments of IAS 19 adjustment to date. Staff's comments are welcome.

14. Could staff provide any updates on their projections for the IAS 19 adjustment?

15. Additionally, in view of the recent important shifts in yield curves in the main financial markets, could staff provide an updated estimate of the pension-related adjustment?

- The IAS 19 valuation in the paper incorporates the Plan assets as of January 31, 2019 and projections for the remainder of the year; and uses the end-February discount rate. Based on investment performance numbers reported to the Investment Committee for end-February and assuming no changes in any of the other assumptions, the overall net pension loss would be lower by around SDR 50 million, largely reflecting improved returns on Plan assets.

- However, short-term volatility in financial markets, and the associated implications for discount rates, means that the actual pension-related loss outturn for the full year remains subject to considerable uncertainty and, depending on changes in the discount rate and Plan asset performance, could ultimately be significantly larger than currently projected.

16. We wonder whether the use of the average "net pension" over the previous three or five years would not represent a more realistic assumption than not having any estimate at all?

17. Staff's comment on this aspect would be welcome [believe that the additional adjustment representing the difference between the actuarial service cost and the pension funding for the year can be projected in advance, and are interested in integrating into the medium-term Fund projections]

18. Does staff believe that computing a sensitivity analysis would be feasible? If not, what are the main obstacles? Does staff see other ways to improve financial planning in this context?

- Changes in the Plan assets and the pension liability or defined benefit obligation (DBO) are key to determining the IAS 19 remeasurement adjustment. On the liability side, the DBO is highly sensitive to the underlying discount rate. The rule of thumb applied by the Fund's actuary indicates that for a 100 basis point change in the discount rate, the value of the DBO is expected to change by 17-19 percent. The DBO is also susceptible to changes in other economic and demographic assumptions (e.g.

inflation rate, salary increases, etc.). Furthermore, the sizeable values of the pension assets and liabilities means that the even slight deviations of any of the underlying assumptions from projections is likely to have a significant impact on net income.

- As such any attempt to project gains and losses of Plan assets over the medium term is very difficult and forecasting an average three- or five-year "net pension" based on past performance would pose similar challenges to having no projections, given the unpredictable nature of market fluctuations.

19. We would be grateful if staff could explain the nature and impact of the variables outlined in the table on page 8. In addition, could staff elaborate on the key drivers of net actuarial remeasurement losses following two years of large gains, in addition to those related to discounting?

20. We would be grateful for further elaboration from staff, including pinpointing the precise reason for the shift (e.g., change in the discount rate), so that the Board can better comprehend this issue.

- In general, the key drivers of actuarially determined gains and losses are the underlying demographic (e.g. mortality, termination, disability) and economic assumptions (e.g. discount rate, inflation, salary increases). In addition, the returns on the Plan assets also affect the remeasurement gains and losses. For FY 2017 and FY 2018 the main drivers were the discount rate, returns on Plan assets and the mortality rate, as illustrated in the text table on page 8 of the paper.

- Overall pension costs increase each year as a result of the additional year of service by staff, and the interest cost on the liability. These costs are typically offset by income from the Plan assets. The actuarial revaluation of the liability, which is driven by changes in the discount rate, may also result in either a gain or loss. However, for FY 2019 the flat actual and projected asset performance is not expected to contribute any income to meet total pension costs. This results in an overall projected shortfall of SDR 486 million. Other factors (such as changes in the discount rate) are only expected to make a minimal contribution to the overall outcome this year.

21. We would welcome information regarding the actual cumulative IAS 19 gains and losses at end-2018. Given the projected losses in FY 2019, will it turn negative?

- The cumulative pension-related adjustments to FY 2018 are represented by the positive funded position of SDR 452 million at April 30, 2018. Based on a projected pension-related loss outturn for FY 2019 the funded position could be balanced or slightly negative at end-April 2019. Based on past experience this is not an unusual occurrence as the funded position has shifted between a positive and negative position over time.

22. Staff might want to comment on whether there are ways to highlight the exceptional and reversible character of this component even more.

- As in previous years, the net pension asset/liability gains/losses have resulted in a substantial adjustment to the Fund's net income position. In FY 2019 this has been a loss; in the three preceding fiscal years there have been substantial gains. This is highlighted in the second paragraph of the Executive Summary, and explained in detail over pages 8 and 9 of the paper, as well as in Annex II, which includes a chart (Figure A2.1) illustrating the volatility of these gains and losses. On balance, staff considers that an appropriate degree of prominence is given in the paper to the exceptional and reversible nature of this item.

IFRS 9 Implementation

23. Are there any preparations to deal with potentially higher volatility in income? Is there any plan/framework yet to deal with the politically sensitive assessment of country's cooperation with the Fund in this context?

24. However, the adoption of IFRS would be reflected in the significant net actuarial remeasurements losses projected for this year being recognized as Other Comprehensive Income instead of being in the profit and loss account and would not impact the net income position. Could staff go into more details about the conversion to IFRS?

- Staff does not expect that the implementation of IFRS 9, *Financial Statements* will result in the need for greater recognition of credit losses than under the predecessor standard, and accordingly does not expect higher volatility in income. The implementation of IFRS 9 does not change the IMF's unique institutional status, which has sheltered it from the need to recognize credit losses. Specifically:

- The IMF's unique relationship with its member countries, all of which are shareholders in the institution.
- The linking of IMF financing to regular reviews of performance under a program of economic policies that the member commits to in order to overcome balance of payments problems, return to external viability, and repay the IMF.
- The IMF's employment of a comprehensive set of measures to mitigate credit risk.
- The IMF's de facto preferred creditor status, which has been recognized by the official community and generally accepted by private creditors.

- A member's non-co-operation with the Fund would be one of many factors to take into account in determining if credit risk has increased significantly to a point that could lead to a need to recognize any expected credit losses. In making this determination, staff would not disclose any information that was not already in the public domain, to minimize the risk of any political sensitivities.

- In the event of an impairment provision being recognized this would be recorded in other comprehensive income (OCI) in the Fund's audited financial statements, however it would continue to form part of the Fund's total net income that is placed to reserves.

25. We would appreciate elaboration from staff on how the SCA-1 account is effectively the first line of defense if there are overdue obligations and/or no repayments to the Fund.

- The SCA-1 was established in 1987 by the Fund as a precautionary measure to protect its financial position against the ultimate failure by members in protracted arrears to settle their overdue obligations, including overdue repurchases. For financial reporting purposes, the SCA-1 balance is presented as a liability and any losses arising from overdue obligations, e.g., after a repudiation of indebtedness by a member that withdraws from the Fund—would first be charged against the SCA-1, thus insulating the Fund's income. Only losses in excess of the balance in the SCA-1 would affect income in the event that such a loss is recorded.