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**Statement by Mr. Kaya, Mr. Benk, Mr. Just, Mr. Palotai, and Mr. Zaborovskiy on Review of the Adequacy of the Fund's Precautionary Balances (Preliminary) Executive Board Meeting October 30, 2020**

We thank staff for the informative paper on the adequacy of the Fund's precautionary balances. The existing rules-based framework to mitigate credit, income, and other financial risks has been tested over time and proved to be instrumental. However, the unprecedented level of uncertainty caused by the COVID-19 pandemic, as well as a rapidly evolving global debt landscape and growing demand for Fund resources calls for a heightened risk-management function, and a gradual increase in the Fund's financial buffers. We therefore **support the proposal to raise the indicative medium-term target for precautionary balances from SDR 20 billion to SDR 25 billion, while keeping the minimum floor unchanged at SDR 15 billion**. The indicative target increase would reflect a higher projected growth of the Fund's lending and help protect the Fund's income position and balance sheet against growing credit and other financial risks.

**The accumulated precautionary balances have played an important role in mitigating the negative impact of already materialized risks on the Fund's income statement.** The decision of the 2018 Review to keep the medium-term target for precautionary balances at SDR 20 billion, while the formal metrics suggested a lower medium-term target range, proves to have been prudent and effectively insulated the Fund's income against unforeseen developments. We note that for the first time in over a decade the Fund's precautionary balances have decreased by SDR 1.7 billion in FY 2020 compared to the previous fiscal year, mainly due to a GRA income loss of SDR 1.6 billion, stemming from the large pension-related expense. Overall, precautionary balances stood at SDR 16 billion at end-FY 2020, a decline of SDR 0.8 billion since the last review in 2018.

**The growing credit risks and concentration of the Fund's loan portfolio call for continued risk monitoring and mitigation measures, including a higher medium-term**

**target for precautionary balances**. We welcome staff's scenario-based approach to calibrating the adequate level of the medium-term target and acknowledge the judgement-based nature of the assessment. While the baseline scenario based on the existing arrangements supports the current medium-term target, the forward-looking scenarios, incorporating staff's estimates and model-based projections, clearly justify raising the level of precautionary balances. Based on the formal metrics and being mindful of the opportunity costs of reserves, we find staff's proposal to increase the indicative medium-term target and keep the minimum floor for precautionary balances unchanged to be balanced and well-grounded against the unprecedented economic uncertainty. Overall, concerted efforts across all elements of the Fund's multilayered framework are needed to address a rapidly worsening risk profile in the post-COVID-19 environment. We emphasize, in particular, strong program design with adequate policy ambition, as well as a lending strategy that continues to mitigate risk.

**The level and pace of the Fund's precautionary balances accumulation should be closely monitored and adjusted as risks evolve**. We note staff's conclusions that the proposed SDR 25 billion target would be reached in FY 2026 under the desk survey scenario, and no additional steps are needed at this point to speed up accumulation. Nevertheless, there are substantial risks around the Fund's income position and the projected path of precautionary balances' buildup. *In this regard, can staff comment on the possible measures to speed up the precautionary balances accumulation, as well as on the main factors that would trigger the decision to take such measures.* We are open to staff's proposal to revisit the minimum floor for precautionary balances after the next Review of the Investment Account scheduled for FY 2022

**A holistic assessment of the composition of precautionary balances in relation to different types of risks the Fund's income position and balance sheet face would strengthen risk-management**. In a low-rate economic environment risks such as stemming from the pension-related liabilities and significantly reduced investment income, are growing fast and the Fund's burden-sharing capacity is diminishing. Liquidity risks could become more prevalent due to bunching of repurchases, possible FCL drawings, larger repurchase. Also, the role and level of balances in the SCA-1 have not been explicitly discussed for several years. Though the Board considers the appropriate distribution of net income between the special and general reserves as a part of the annual review of the Fund's income position, a more holistic discussion about the composition of the Fund's precautionary balances, possible provisioning under IFRS 9, as well as on the burden-sharing mechanism would be warranted. *Staff's comments on their plans in this regard are welcome.*