GRAY/20/3189

October 28, 2020

Statement by Mr. De Lannoy, Mr. Scholer, and Mr. Hanson on Review of the Adequacy of the Fund's Precautionary Balances (Preliminary) Executive Board Meeting October 30, 2020

We thank staff for the insightful and comprehensive paper. In view of the overall rise in risks, compounded by the COVID-19 crisis, we **support both of staff's proposals to increase the medium-term target for precautionary balances to SDR 25 billion and maintaining the floor at SDR 15 billion**. Coverage ratios appear low compared to previous crisis periods, while risks and uncertainty have increased, as illustrated by the alternative scenarios.

Regular reviews of the Fund's precautionary balances are a crucial part of the Fund's risk mitigation framework, which is all the more critical at the current juncture. In this sense, **we welcome staff's commitment to closely monitor the situation and report to the Board as required, but would prefer plans for an interim review in one year**.

In addition, we wish to make the following points:

- We continue to believe that **the current framework for determining the adequacy of precautionary balances is appropriate**, as it allows for judgment and Board discretion, while building on an objective and comprehensive analysis by staff.
- We concur with staff that at this stage **no additional steps are needed to progress towards the increased medium-term target**, as lending income will automatically pick up. However, as this additional income is linked to a substantial increase in credit risk, **we would welcome more detailed analysis in future reviews on the unique risks of the COVID-19 crisis**, notably as regards (i) the large rise in RFIs and associated lower conditionality; (ii) the large number of precautionary commitments and the increased likelihood of drawings under them; (iii) the geographical risk concentration; (iv) the risk of arrears; and (v) the increased access limits.
- In this context, we note that **much of the analysis is based on end-August 2020 data, excluding more recent programs**, such as the EFF for Ecuador. *We would welcome staff's comments on the approximate impact if those programs had been included.*

- Moreover, should an accelerated accumulation of precautionary balances be deemed necessary in the future, we **would caution against achieving this through increasing the cost of borrowing for program countries**, which is already high. *Could staff elaborate on the various options available to achieve a faster accumulation of precautionary balances, if needed?*

- Furthermore, we welcome staff's analysis of risk-related considerations to inform the Board's decision beyond the indicative range. We would add the **potential negative impact that the prolonged freeze of surveillance can have on credit risk**. *Staff's comments are welcome.*

- More broadly, as precautionary balances constitute only one – although important – element of the Fund's broader risk mitigation framework, we believe that **the Fund should continue to limit its risk exposure where feasible and desirable through the other layers of the framework**, which notably includes program design and conditionality. Should risks related to the level and concentration of precautionary arrangements increase going forward, a review of the Fund's precautionary lending strategy may be warranted.