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October 28, 2020

Statement by Ms. Levonian and Mr. Weil on Review of the Adequacy of the Fund's Precautionary Balances
(Preliminary)
Executive Board Meeting
October 30, 2020

Thanks to staff for adapting their insightful report to the context of the COVID-19 crisis. We recognize that circumstances effectively forced a delay in the review of precautionary balances. Staff's comprehensive framing of the issue, which included the innovative use of market-based indicators, validated the decision to delay the review from our perspective.

The Fund has increased lending and taken on more risk as part of the response to the COVID-19 crisis that calls for particularly close attention to precautionary balances. We agree with staff's assessment of the credit risks facing the Fund, in particular that credit risks have increased significantly, and that the lending portfolio has become more concentrated since the last review. In parallel, the Fund has (appropriately) loosened elements of the multi-layered framework that mitigate financial risks in order to support the membership in this unprecedented crisis. For instance, normal annual access limits have been temporarily increased and unconditional emergency facility access has been temporarily doubled. In addition, program design and conditionality are expected to become flexible as part of the Fund's pandemic lending strategy, including through more parsimonious structural benchmarks, a review-centric approach, greater use of front-end loaded access, and more selective use of quantitative performance criteria. From our perspective, these two parallel trends of increasing credit risk and loosened safeguards clearly call for an increased target for precautionary balances.

We support staff's proposal to set the target at SDR 25 billion and request an interim review given the exceptional uncertainty. Staff's recommended target balances a comprehensive assessment of forward-looking credit with a pragmatic view of the pace of new Fund lending in the medium-term. Like staff, we could also see a reasonable case for setting the target at SDR 30 billion, in particular as this would align with the midpoint of estimated credit outstanding under a scenario consistent with the WEO baseline. However, we see little risk in setting a more pragmatic target based on the desk survey which can be revisited. As the floor is based on longer-term considerations and given considerable uncertainty about the duration of the current crisis, we are also inclined to support staff's proposal for the floor to be kept at SDR 15 billion. Given the exceptional uncertainty surrounding the expected demand for Fund lending and increased credit risks, we request an interim review of precautionary balances in one year. We recognize the resource implications of an interim review and expect them to be considered at the time of the next discussion of the Fund's administrative budget. We also welcome the identification of lower priority work that can reasonably be deferred to accommodate this request.

The pace of reserve accumulation is highly uncertain in the current environment. We welcome staff's use of multiple scenarios to estimate forward-looking credit, which we see as a best practice. We would welcome updates on each of these scenarios at the time of the next discussion of demand for Fund resources. A major complicating factor in estimating the path of credit outstanding in the current crisis is the treatment of commitments under precautionary arrangements. The cases of Colombia and Morocco illustrate that commitments can easily become credit outstanding. We therefore strongly support staff's assumption in the adverse scenario that all FCL arrangements would be tapped. Staff could reasonably have assumed partial purchases under precautionary arrangements in the other scenarios, including in the baseline.

Uncertainty due to volatile IAS 19-driven pension gains and losses should be isolated to the extent permitted by accounting standards. We wonder whether there is scope for the Fund to maintain a separate reserve for accumulated IAS 19 remeasurements, or to adopt an accumulated comprehensive income account, rather than transfer IAS 19 gains and losses to retained earnings in each reporting period. Such an approach could allow the Fund to largely ignore unpredictable IAS 19 gains and losses for the purposes of estimating the path of accumulation of precautionary balances. *Staff comments are welcome.*