SU/20/158

November 9, 2020

The Acting Chair's Summing Up
Review of the Adequacy of the Fund's Precautionary Balances
Executive Board Meeting 20/105
October 30, 2020

Executive Directors welcomed the opportunity to review the adequacy of the Fund's precautionary balances for the first time since the onset of the global COVID-19 pandemic. They emphasized the importance of maintaining an adequate level of precautionary balances to mitigate financial risks, safeguard the strength of the Fund's balance sheet, and protect the value of members' reserve positions in the Fund. Directors considered that an adequate level of precautionary balances would thus continue to play an integral part of the Fund's ability to lend in crises such as the current one.

Directors agreed that the current rules-based framework adopted in 2010 for assessing the adequacy of precautionary balances remains broadly appropriate. They emphasized that judgment and Board discretion remain an important part of the framework. Directors noted that the First Special Contingent Account (SCA-1) has been instrumental in protecting the Fund against potential losses from overdue obligations and ensuring its compliance with international financial reporting standards. In this regard, a number of Directors looked forward to an opportunity to consider options on the role of the SCA-1.

Directors noted that Fund credit exposure and related risks have increased significantly since the last review in 2018, with trends compounded by the COVID-19 crisis. Credit outstanding has nearly doubled, including a surge in emergency financing without conditionality, and commitments under precautionary arrangements are higher than at the last review. Credit concentration has also increased and scheduled repurchases are larger and more bunched. In addition, the current target for precautionary balances of SDR 20 billion is likely to fall below the indicative range in this and the next fiscal year.

In light of these developments, Directors broadly agreed to raise the indicative medium-term target for precautionary balances to SDR 25 billion, while a few Directors would have preferred setting a higher target. With uncertainty due to the pandemic still very high, Directors underscored the need for close monitoring. They agreed that the Board should reassess the adequacy of precautionary balances before the next regular review.

Directors supported keeping the minimum floor for precautionary balances at SDR 15 billion for now and stood ready to revisit the issue, preferably after the FY 2022 review of the Investment Account.

Directors broadly agreed that there is no need for additional measures to accelerate the pace of reserve accumulation at this stage but urged continued close monitoring. While subject to uncertainty, the increased level of Fund credit is expected to generate sufficient lending income for precautionary balances to reach their new target over the medium term. A few Directors nevertheless called for consideration of options to speed up reserve accumulation.

Directors noted that precautionary balances are only one element of the Fund's multi-layered risk management framework. They emphasized in particular the role of program design, conditionality, lending policies, and the Fund's preferred creditor status in limiting the Fund's risk exposure. To help inform the assessment of the adequacy and composition of precautionary balances, some Directors noted the benefits of a more holistic approach that takes account of other related Fund policies. Directors looked forward to considering options to isolate the impact of pension-related adjustments on the Fund's precautionary balances to reduce their volatility.