INTERNATIONAL MONETARY FUND

The Fund's Income Position for FY 2012—Midyear Review

Prepared by the Finance Department

In consultation with the Legal Department and the Office of Budget and Planning

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I. INTRODUCTION

1. **This paper updates the outlook for the Fund's income position for FY 2012**. The overall outlook is broadly unchanged, with the FY 2012 net operational income now projected at SDR 500 million compared with the projection of SDR 482 million in April 2011. This primarily reflects additional lending activity, which is partially offset by lower implicit returns on the Fund's interest-free resources owing to the prevailing interest rate environment.[1] The actual outcome is subject to considerable uncertainty in light of conditions in the global economy, which could affect the timing and amounts of disbursements under current and potential new arrangements and the performance of the Investment Account (IA).

2. **The paper also provides the basis for the FY 2012 midyear review of the Fund's income position.** In April this year, the Executive Board set the FY 2012 margin for the rate of charge at 100 basis points. The Board will shortly consider a proposed amendment to Rule I-6(4) to allow for the margin to be set so as to cover the Fund's intermediation costs and allow for a build-up of reserves, in line with Board-endorsed principles for the new income model.[2] The margin for FY 2012 was adopted on the basis of the exceptional circumstances clause of the current Rule I-6(4), which requires a review of the Fund's income position at midyear (see Box 1).

3. **This paper is structured as follows**: Section II provides an update on the FY 2012 income position based on the actual outturn for the first half of the financial year and projected developments in the second half of the year, Section III discusses the margin for the rate of charge, and Section IV provides an update on recent burden sharing adjustments. A draft decision for the midyear review then follows.

II. UPDATED FY 2012 INCOME POSITION

4. **Net operational income for FY 2012 is projected at about SDR 500 million, compared with SDR 482 million at the beginning of the financial year (see Table 1)**. Key factors that affect the updated projections are:

- **Lending income**. Projected lending income increased by SDR 27 million from the level projected at the beginning of the financial year. This reflects an increase in service charges (SDR 38 million) and commitment fees (SDR 8 million), and a decrease in income from the margin (SDR 19 million).

    - *Service charges.* Service charges are levied at 50 basis points for each disbursement. Projected purchases have increased by a net amount of SDR 7 billion owing to new arrangements approved after April 2011, offset by rephasing of scheduled

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[1] See *Review of the Fund's Income Position for FY 2011 and FY 2012*.

[2] See *A New Rule for Setting the Margin for the Basic Rate of Charge*. Under the proposal, the new rule would become effective from FY 2013 onwards.

disbursements under existing arrangements and the expiration of some arrangements with undrawn balances.[3]

- *Margin.* Despite this projected increase in purchases, which largely occurs in the second half of the financial year, average credit outstanding in FY 2012 is slightly lower than projected earlier. As a result, projected income from the margin is also lower.[4]

- *Commitment fees.* Commitment fees are refunded when disbursements under an arrangement take place, so income arises only if planned disbursements under an arrangement are not made. The increase in commitment fees reflects arrangements that expired with undrawn balances.

Table 1. Projected Income Position—FY 2012
(In millions of SDRs)

1. Net operational income projected (EBS/11/53)	**482**
2. Income variances (A+B+C)	**8**
Changes due to:	
A. Lending income	27
Service charges	38
Margin	-19
Commitment fees	8
B. Investment Account returns	-1
Gold profits portfolio	-27
Non-gold portfolio	26
C. Income from interest-free resources	-18
3. Expenditure variance	**10**
4. Net operational income position now projected (1+2+3)	**500**

- **Investment income.** The updated investment income for FY 2012 is SDR 143 million, broadly in line with the initial projection. Following the transfer of currencies equivalent to the gold profits from the GRA to the IA in March 2011, the IA effectively has two portfolios: (i) a new portfolio funded by the gold profits and invested in short-term deposits as an interim measure pending further Board discussions to implement a broadened investment mandate; and (ii) the original portfolio funded by transfer of currencies from the GRA in amounts equivalent to the Fund's total reserves in June 2006, plus subsequent transfers of GRA net income not associated with gold profits.

[3] New arrangements approved after April 2011 amounted to SDR 25 billion, of which disbursements scheduled for FY 2012 amount to SDR 16 billion. Rephasing of disbursements into future periods amounted to SDR 7 billion, and some arrangements expired with undrawn balances of about SDR 2 billion.

[4] Average FY 2012 credit outstanding is now projected at SDR 81.6 billion compared with SDR 83.5 billion previously (see Table 2).

- *Gold profits portfolio.* The short-term deposits for the gold tranche returned SDR 18 million, about 26 basis points (bps) unannualized, to end-October reflecting the low interest rate environment. The updated projection for this portfolio is SDR 28 million, about SDR 27 million lower than the initial estimate. The updated projections reflect the assumption that the SDR interest rate will average 0.4 percent in FY 2012 (compared with an initial assumption of 0.8 percent) and take account of the actual returns in the first half.[5] Based on the work program, the gold endowment is expected to become operational in calendar year 2012, at which time investment returns should see an enhancement reflecting the adopted investment strategy.

- *Second (non-gold) portfolio.* In the six months through October 2011, this portfolio returned SDR 88 million, almost equaling the initial full year projection of SDR 89 million. The investments benefited from market concerns on the global economy, which led to yields of high-rated government bonds reaching historic low levels. The portfolio returned 137 bps to end-October (net of fees), exceeding the 3-month SDR interest rate by 114 bps (unannualized). The updated projection for the portfolio is SDR 115 million, some SDR 26 million higher than the initial projection.[6]

- **Implicit returns on interest-free resources**. The implicit returns on interest-free resources are projected to be lower by some SDR 18 million as a result of the current low interest rate environment. As noted, the average SDR interest rate for FY 2012 is now projected at 0.40 percent (previously 0.80 percent).

- **Expenditures.** Expenditures are projected to be about SDR 10 million (US$17 million) below the initial projection primarily due to savings in personnel expenditures.

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[5] The short-term deposits are assumed to broadly earn the SDR interest rate, which is projected at 0.4 percent for FY 2012 as a whole. The projection is based on market forward rates for the underlying three-month financial instruments in the SDR basket.

[6] Consistent with past practice, the updated projection takes account of actual performance in the first half of the financial year and assumes the investments earn 50 basis points over the SDR interest rate during the second half. The assumed added value of 50 basis points is based on historical performance and is intended to provide a relatively conservative indication of the additional returns from these investments over the medium term. Actual performance will vary year to year based on market conditions.

Box 1. Decisions in Effect Related to the FY 2012 Income Position[1]

The Executive Board has taken the following decisions affecting the Fund's income position for FY 2012:

Rate of Charge
The margin for calculating the basic rate of charge in FY 2012 was set at 100 basis points. This decision was adopted under the *exceptional circumstances* clause of Rule I-6(4), which, in exceptional circumstances, allows the margin for calculating the basic rate of charge to be set on a basis other than the estimated income and expense of the Fund and a target amount of net income for the year. A midyear review of the income position shall be held to review any change in the exceptional circumstances and to decide by December 15 whether the margin over the SDR interest rate determined at the beginning of the financial year should be changed as of November 1 in light of the actual income position for the first six months of the financial year.

Poverty Reduction and Growth Trust (PRGT) Administrative Expenses
For financial years 2010 through 2012, no reimbursement shall be made to the General Resources Account (GRA) from the Reserve Account of the PRGT for the cost of administering the PRGT. The estimated cost of administering the PRGT shall be transferred after the end of each such financial year from the PRGT Reserve Account (through the Special Disbursement Account) to the General Subsidy Account of the PRGT.

Burden Sharing for Deferred Charges
Income losses resulting from unpaid charges are shared equally between debtor and creditor members under the burden sharing mechanism largely pursuant to a decision taken in 2000. Unless amended by the Board, this mechanism will continue for as long as overdue obligations to the Fund exist.

[1] See *Review of the Fund's Income Position for FY 2011 and FY 2012*.

5. **Table 2 provides updated projections for FY 2012 and the outturn for the first half of the year**. The projections do not include any provision for potential purchases under (i) arrangements not yet approved since the timing and amounts involved for these are uncertain or (ii) existing or potential precautionary arrangements.[7] Repurchases of outstanding Fund credit, and disbursements under arrangements already approved, are assumed to take place as scheduled (see Annex II).

[7] The projections, however, include income from the commitment fees for the precautionary Flexible Credit Line (FCLs) arrangements at their expiration.

Table 2. Projected Income and Expenditures
(In millions of SDRs)

	FY 2012		
	Actual to end-Oct 2011 1/	Initial Projections 2/	Updated Projections
A. Operational income	**586**	**1,160**	**1,168**
Lending income	**466**	**975**	**1,002**
Margin for the rate of charge	376	835	816
Service charges	77	135	173
Commitment fees	13	5	13
Investment income	**106**	**144**	**143**
Interest free resources	**12**	**37**	**19**
SCA-1 and other	6	16	8
Gold book value	6	21	11
Reimbursements	**2**	**4**	**4**
MDRI-I, PCDR Trusts and SDR Department	2	4	4
B. Expenses	**324**	**678**	**668**
Net administrative expenditures	309	635	625
Capital budget items expensed	1	9	9
Depreciation	14	34	34
C. Net operational income position (A-B)	**262**	**482**	**500**
Surcharges	395	981	926
Net income position	**657**	**1,463**	**1,426**
Memorandum Items:			
Fund credit (average stock, SDR billions)	74.6	83.5	81.6
SDR interest rate (in percent)	0.5	0.8	0.4
US$/SDR exchange rate	1.59	1.55	1.55
Precautionary balances (end of period, SDR billions)	8.8	9.6	9.5

1/ Actual expenses to end-October reflect the accrual basis used for financial reporting.
2/ See *Review of the Fund's Income Position for FY 2010 and FY 2011.*

6. **The FY 2012 surcharges are now projected to be about SDR 55 million lower than previously projected.** The updated surcharges projection of about SDR 926 million largely reflects the lower average credit outstanding for FY 2012 resulting from the offsetting effects of a new large arrangement approved after April 2011 and the rephasing of purchases under existing arrangements (see paragraph 4). Consistent with past practice, surcharges are assumed to be placed directly to reserves to help build the Fund's precautionary balances, which are projected to reach SDR 9.5 billion at the end of FY 2012.[8]

III. FY 2012 MIDYEAR REVIEW

7. **The Board adopted a margin for calculating the basic rate of charge for FY 2012 of 100 basis points under the exceptional circumstances clause of Rule I-6(4)**. The rule in effect for FY 2012 requires that the Board review at midyear any change in the exceptional circumstances and decide whether the margin over the SDR interest rate determined at the beginning of the year shall be changed in light of the actual income position for the first six

[8] In the December 2008 discussion on precautionary balances, Directors noted that once the Fund returned to a positive net income position, surcharges should again be placed directly to reserves to help accelerate the pace of reserve accumulation. This practice was resumed in FY 2011.

months of the financial year.[9] Consistent with the Board's previous discussions on the approach to setting the margin on the rate of charge under the new income model, staff considers that the exceptional circumstances under which the margin may be set on a basis other than the estimated income and expenses for the year still exist. Accordingly, no change in the margin is proposed.

IV. Burden Sharing Mechanism

Burden sharing adjustments in FY 2012 have remained low in the prevailing high lending and low interest rate environment (see Table 3 below). At the midyear review for FY 2010, the burden sharing decision was amended to allow for no adjustments in quarters where the minimum adjustment of 1 basis point to the rate of charge and the rate of remuneration (in prior quarters) had generated sufficient excess amounts to offset deferred charges in subsequent quarters.[10] Projections for the second half of FY 2012 indicate continuing similar levels of burden sharing adjustments.

Table 3. Recent Average Burden Sharing Rates and FY 2012 Quarterly Rates
(In basis points unless otherwise stated)

	FY06	FY07	FY08	FY09	FY10	FY11				FY12			
						Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4
												(projected)	
Rate of Remuneration 1/													
Total average adjustment	23	23	14	3	1	–	1	–	–	1	–	–	1
Deferred charges	5	13	14	3	1	–	1	–	–	1	–	–	1
SCA-1	18	10	–	–	–	–	–	–	–	–	–	–	–
Rate of Charge 1/													
Total average adjustment	19	23	16	3	1	–	1	–	–	1	–	–	1
Deferred charges	4	13	16	3	1	–	1	–	–	1	–	–	1
SCA-1	15	10	–	–	–	–	–	–	–	–	–	–	–
Average SDR interest rate (in percent) 2/	2.93	3.96	3.64	1.79	0.29	0.27	0.33	0.36	0.43	0.55	0.35	0.30	0.30
Average basic rate of charge (in percent)	4.00	5.04	4.72	2.79	1.29	1.27	1.33	1.36	1.43	1.55	1.35	1.30	1.30

1/ The average rates have been calculated using the quarterly burden sharing rates and SDR interest rates.
2/ The SDR interest rates are projected to average 0.4 percent in FY 2012.

[9] Prior to the changes contemplated under the new income model, the margin for the basic rate of charge was established on the basis of a target amount of net income for the year, with a midyear review as a safeguard for instances when the updated income position fell below initial projections, and the Board would then need to consider whether to increase the margin. The rule was changed in April 2006 to allow the Executive Board to set the margin on a different basis in exceptional circumstances (see Box 1).

[10] See *The Fund's Income Position for FY 2010—Midyear Review* paragraphs 8–10.

PROPOSED DECISION

The following decision, which may be adopted by a majority of the votes cast is proposed for adoption by the Executive Board:

> Pursuant to Rule I-6(4)(b)(ii) of the Fund's Rules and Regulations, the Fund has conducted the midyear review of its income position for FY 2012 and decides to leave unchanged the rate of charge established by Decision No. 14900-(11/37)—adopted April 20, 2011.

Annex 1. Restructuring Costs

In accordance with International Financial Reporting Standards (IFRS), the Fund established a restructuring provision of SDR 68 million in FY 2008 for costs for which no rendered services were expected (e.g., the modified SBF payments) and outplacement and retraining of separating. Costs related to services from which the Fund would benefit, such as salaries during the staff delay period of up to 12 months under the separation plan were not included in the provision; these costs have been recognized as expenditures were incurred. The provision had a balance of SDR 8 million at April 30, 2011 reflecting remaining estimated costs.

At end-October 2011, the restructuring provision amounted to SDR 3 million, after taking account of costs of SDR 3 million charged against the provision during the current financial year and a reduction of SDR 2 million in the estimate for outsourcing costs. A summary of the movements in the provision is shown below.

Table 4. Restructuring Provision as at end-October 2011
(In millions of SDRs)

Restructuring provision at April 30, 2011 1/	**8**
Amounts utilized	-3
Reversals	-2
Restructuring provision at October 31, 2011	**3**

1/ See *Audited Financial Statements for the Financial Years Ended April 30, 2011 and 2010*.

FY 2012 costs incurred toward the staff delay period were less than SDR 0.5 million. SRP contributions for separating staff amounted to about SDR 0.5 million. Thus, total restructuring spending in the first half of FY 2012, including the above SBF costs totaled about SDR 4 million (about US$ 6 million).

Annex II. Assumptions Underlying the FY 2012 Projections

	Actual through end-October 2011	FY 2012 Initial Projections	FY 2012 Current Projections
		(In billions of SDRs)	
Regular Facilities:			
1. Purchases (excl. reserve tranche purchases)	15.4	27.0	34.6
2. Repurchases	0.9	3.3	3.3
3. Average balances subject to charges	74.6	83.5	81.6
4. Average SDR holdings	9.0	4.3	9.0
5. Average remunerated positions	52.4	46.1	54.0
6. Average investment account assets - reserves 1/	6.9	6.1	6.9
7. Average investment account assets - gold profits	6.8	6.8	6.8
8. Average borrowings and issued notes	25.9	29.2	31.4
		(In percent)	
Return on investments 2/	1.37	1.3	0.9
Return on investments - gold profits	0.26	0.8	0.4
Average interest rates:			
SDR interest rate and basic rate of remuneration	0.45	0.8	0.4
Basic rate of charge	1.45	1.80	1.40
Margin on the rate of charge	1.00	1.00	1.00

1/ The figures are based on a general assumption that investment income is transferred annually to the GRA.
2/ End-October figure is unannualized.