INTERNATIONAL MONETARY FUND

IMF POLICY PAPER

REVIEW OF THE FUND'S INCOME POSITION FOR FY 2016 AND FY 2017-2018

May 13, 2016

IMF staff regularly produces papers proposing new IMF policies, exploring options for reform, or reviewing existing IMF policies and operations. The following documents have been released and are included in this package:

- The **Staff Report** on the Review of the Fund's Income Position for FY 2016 and FY 2017-2018 was prepared by IMF staff and completed on April 8, 2016 for the Executive Board's consideration on April 22, 2016.
- A **Staff Supplement**, on the Consolidated Medium-Term Income and Expenditure Framework.
- A **Press Release**.

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INTERNATIONAL MONETARY FUND

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Washington, D.C. 20431 USA

IMF Executive Board Reviews the Fund's Income Position for Financial Years 2016 and 2017-2018

The Executive Board of the International Monetary Fund (IMF) completed its annual review of the Fund's income position for the financial year ending April 30, 2016 (FY 2016) and set the margin for the lending rate for IMF credit for FY 2017 and FY 2018, on April 22, 2016.

FY 2016 Income Position

Total FY 2016 net income, including income from surcharges applied to higher-access borrowing from the IMF, is estimated at SDR 1 billion (US$1.4 billion). Net income excluding the retained earnings of the gold endowment will be added to the IMF's precautionary balances, which are projected to reach SDR 15.2 billion (US$21.1 billion) at end-FY 2016. Net income for FY 2016 was higher than estimated at the start of the year as revised actuarial assumptions resulted in a positive adjustment under International Accounting Standard 19, which relates to the reporting of employee benefits.

FY 2017-2018 Lending Rate and Income Position

The IMF charges member countries a basic rate on the use of IMF credit, which is determined as the SDR interest rate, plus a margin expressed in basis points. Following a comprehensive review of the underlying factors relevant for the establishment of the margin and taking into account the impact of the inclusion of the renminbi in the SDR basket on Fund income and borrowing costs, the Board decided to maintain the margin at 100 basis points.

Projections for FY 2017 and FY 2018 point to annual net income of SDR 1 billion (US$1.4 billion) and SDR 0.7 billion (US$1 billion), respectively. The projections are subject to a high degree of uncertainty and are sensitive to the timing and amounts of disbursements under approved arrangements included in the projections, possible new arrangements, and the performance of the Fund's investment portfolio. The projected net income will enable the IMF to continue to add to its precautionary balances.

The Executive Board also adopted a number of other decisions that have a bearing on the Fund's finances. These included decisions to transfer income from the Fixed-Income Subaccount of the Fund's Investment Account (IA) to the GRA, to place the net income of the GRA for FY 2016 in equal parts to the Fund's special and general reserve, and to transfer currencies from the GRA to the IA of amounts attributable to net operational income and surcharges previously retained from FY 2014 and FY 2015, and also from FY 2016. Decisions were also adopted to reimburse costs to the GRA and to continue special charges on certain overdue obligations.

April 8, 2016

REVIEW OF THE FUND'S INCOME POSITION FOR FY 2016 AND FY 2017-2018

EXECUTIVE SUMMARY

The Fund's total net income for FY 2016 including surcharges is projected at about SDR 1.0 billion or some SDR 0.15 billion higher than expected in April 2015. Lending income continues to be the main source of income and is in line with April 2015 estimates. Investment income has fallen reflecting the decline in equity markets that exceeded the modest returns on fixed income securities. As a result of the 5-yearly review of key actuarial assumptions, the IAS 19 adjustment (relating to reporting of employee benefits) is expected to contribute about SDR 0.3 billion to net income in FY 2016.

The paper recommends that GRA net income of SDR 1.1 billion for FY 2016 (which excludes projected losses of the gold endowment), be placed equally to the special and general reserve. After the placement to reserves, precautionary balances are projected to reach SDR 15.2 billion at the end of FY 2016.

Following the completion of the Board's review of the investment strategy for the Fixed-Income Subaccount, the paper further proposes to transfer currencies equivalent to the increase of the Fund's reserves for FY 2014 and FY 2015 (totaling SDR 2.6 billion) and FY 2016 (estimated at SDR 1.1 billion), from the GRA to the Investment Account.

The paper proposes that the margin for the rate of charge be set at 100 basis points for the two years FY 2017 and FY 2018. This follows a comprehensive review of the underlying factors relevant for the establishment of the margin this year and also takes into account the impact of the inclusion of the renminbi in the SDR basket on Fund income and borrowing costs.

The projections for FY 2017 and FY 2018 point to a net income position of SDR 1 billion and SDR 0.7 billion, respectively. These projections are subject to considerable uncertainty and are sensitive to a number of assumptions.

Approved By
Andrew Tweedie

Prepared by the Finance Department in consultation with the Legal Department and the Office of Budget and Planning

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ANNEXES

INTRODUCTION[1]

1. **This paper reviews the Fund's income position for FY 2016 and FY 2017-2018**.[2] The paper updates projections provided in April 2015, and proposes decisions for the current year. In addition, the paper includes a proposed decision to set the margin for the rate of charge under Rule I-6 (4) for financial years 2017 and 2018.[3]

2. **The paper is structured as follows**: The first section reviews the FY 2016 income position and the main changes from the previous projections; the second section makes proposals on the disposition of FY 2016 net income and placement to reserves; the third section discusses the margin on the rate of charge for FY 2017-2018, updates the income projections for that period, and reviews the projected burden sharing adjustments; and the last section reviews special charges.

REVIEW OF THE FY 2016 INCOME POSITION

3. **FY 2016 net income is now projected at SDR 1 billion compared with an initial estimate of SDR 0.85 billion (see Table 1).[4]** Key factors affecting the updated projections are as follows:

Total lending income is broadly as projected earlier. Operational lending income (from the margin, service charges, and commitment fees) is projected at SDR 0.64 billion, about SDR 30 million or 5 percent higher than the earlier estimate. Surcharge income is projected to be about SDR 0.79 billion, some SDR 40 million or 5 percent below the previous estimate:

- *Margin income* is slightly lower than projected in April 2015 as delays in disbursements were broadly offset by the slower than expected pace of early repurchases.

- *Service charges* are in line with the previous estimate.

- *Commitment fees* are higher by about SDR 40 million following the cancellation of Greece's EFF arrangement in FY 2016.[5]

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[1] Prepared by a team comprising Dannah Al-Jarbou, Sergio Rodriguez-Apolinar, Alexander Attie, Rina Bhattacharya, Sonja Davidovic, Mohammad Hasnain, Mary Hoare, Farhan Khawaja, Lukas Kohler, Donal McGettigan, Diviesh Nana (lead), Amadou Ndiaye, Breno Oliveira, Ezgi Ozgul Ozturk, Vidhya Rustaman, Yan Sun-Wang, and Vera Zolotarskaya, under the guidance of David Andrews (all FIN).

[2] A companion paper provides an update on *The Consolidated Medium-Term Income and Expenditure Framework* (04/14/2016).

[3] A *New Rule for Setting the Margin for the Basic Rate of Charge* (11/23/11), was adopted by the Executive Board in December 2011 and was first applied in April 2012 when the margin for the rate of charge was set for the FY 2013–2014 period.

[4] See *Review of the Fund's Income Position for FY 2015 and FY 2016* (04/06/15).

[5] Commitment fee income is only recognized at the expiration or cancellation of an arrangement in accordance with accounting principles.

- *Surcharge income* in FY 2016 is about SDR 40 million lower than the April 2015 projections mainly due to the adjustment of time and level-based surcharge thresholds following the effectiveness of the 14th General Review of Quotas.[6]

Investment income is SDR 98 million lower than projected earlier reflecting losses on the endowment that more than offset higher returns on the Fixed-Income Subaccount:

- *The Fixed-Income Subaccount:* While negative returns had been anticipated in April 2015 given market expectations of rising yields, interest rates declined further and in the 10 months through end-February 2016 the subaccount returned SDR 50 million. For the full year, returns from the subaccount are projected at about SDR 59 million, but with yields projected to persist at very low levels and offering limited income protection, an uptick in interest rates could result in significantly lower returns.[7]

- *The Endowment Subaccount*: The three-year phased investment into the endowment's strategic asset allocation began in March-2014, and SDR 3.2 billion or 70 percent of the portfolio has now been invested, with the balance of the portfolio largely held in short-term fixed deposits. Total returns are expected to be significantly lower than projected for FY 2016 largely as a result of the decline in equity markets. The portfolio is now expected to yield negative returns of about SDR 58 million, which will be charged against retained earnings for the Endowment Subaccount. However, the final outcome for FY 2016 remains subject to considerable market uncertainty.

Reimbursements to the General Resources Account (GRA): The GRA is reimbursed annually for the expenses of conducting the business of the SDR Department, of administering the PRG Trust, and of administering Special Disbursement Account (SDA) resources in the CCR Trust.[8] The expenses of conducting the business of the SDR Department in FY 2016, which are recovered through an assessment on participants in the SDR Department are estimated at SDR 7.146 million (proposed Decision 1).[9] The expenses for administering SDA resources in the CCR Trust are estimated at SDR 0.331 million (proposed Decision 2). The estimated PRGT administrative expenses for FY 2016 are

[6] Following the Board discussion of the *Review of Access Limits and Surcharge Policies* (01/20/2016) paper on February 17, 2016, the trigger for time-based surcharges for outstanding credit resulting from purchases under the Extended Fund Facility was moved to 51 months and the surcharges threshold for level-based surcharges was set at 187.5 percent of quota. The trigger for the time-based surcharge for other GRA credit was kept at 36 months. Commitment fee thresholds are set at 115 percent, 116-575 percent, and greater than 575 percent of quota for charges of 15 basis points, 30 basis points, and 60 basis points, respectively.

[7] In August 2015 the IMF's Executive Board agreed to modify the current investment strategy of the Fixed-Income Subaccount through an evolution of the current approach that seeks to generate income while protecting the Fund's balance sheet. The new strategy is expected to be implemented from FY 2017 onwards and is discussed further in Annex IV.

[8] Reimbursement to the GRA from the CCR (formerly PCDR) Trust is for expenses not already attributable to other accounts or trusts administered by the Fund, or to the GRA.

[9] Consistent with paragraph 5(b) of Schedule M to the Articles of Agreement, the SDRs taken into account for purposes of calculating the assessment do not include SDR 87 million that, due to the overdue financial obligations of certain members, are being held in an escrow account pursuant to paragraph 5(a) of Schedule M.

SDR 49.79 million (proposed Decision 3), slightly below earlier estimates.[10] The total reimbursements of SDR 57.27 million are broadly in line with earlier estimates mainly reflecting higher expenses for conducting the SDR department business related to the cost of the of the 2015 SDR valuation review.

Expenses are estimated to be about SDR 32 million higher than previously projected mainly as a result of the depreciation of the SDR relative to the U.S. dollar. Net administrative expenditures in FY 2016 are estimated to be only slightly lower than projected earlier in U.S. dollar terms, reflecting a near 99 percent utilization of the approved budget.[11] However, based on the outcome for the first 10 months of the year, these expenses are converted at a rate of US$1.39 per SDR, compared with a rate of US$1.48 per SDR assumed in the earlier projection. The capital projects expense is higher by about SDR 2 million than estimated in April 2015 although this is offset by the depreciation charge which is expected to be lower by SDR 5 million.[12]

The IAS 19 adjustment in FY 2016 is expected to contribute about SDR 296 million to net income. IAS 19 "Employee Benefits" is the International Financial Reporting Standard (IFRS) that deals with accounting for pension and other employee benefits (Annex III). The expected gain for the IAS 19 adjustment this year, which will partially reverse the loss recorded in FY 2015, stems mainly from a decline in the obligations of the staff retirement plan that reflect the outcome of a comprehensive review of actuarial assumptions.

4. In FY 2016, the Fund undertook a 5-yearly review of the demographic and financial assumptions used to establish the actuarially determined contribution rate for its pension plans.[13] For financial reporting purposes under IAS 19, the actuarial assumptions are set by management, but the practice has been to establish consistency between the actuarial assumptions for funding and accounting purposes.[14]

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[10] Starting in FY 2013, the practice of reimbursing the GRA for the expenses of conducting the business of the PRG Trust was resumed. The reimbursement is an important element of the Fund's new income model endorsed in 2008. See *Review of the Fund's Income Position for FY 2013 and FY 2014* (04/15/13).

[11] The projected outturn is approximately US$12 million lower than budgeted. See *FY2017-FY2019 Medium-Term Budget* (03/24/16).

[12] Additional expenses of about US$132 million for the HQ1 renewal project will be recognized in future years. The impact of the increased costs will be discussed in *The Consolidated Medium-Term Income and Expenditure Framework* (4/14/2016).

[13] Periodic reviews of actuarial valuation assumptions are performed to determine if the assumptions selected are consistent with the actual experience underlying the pension obligations being valued. The review resulted in changes to several key assumptions to better reflect the plan experience during the past 5-10 years along with expectations about the future.

[14] Under IAS 19, the discount rate must be marked to market at the end of the financial year.

5. The SDR 296 million projected gain from the IAS 19 adjustment in FY 2016 is made up as follows:

- Net actuarial gains projected at SDR 524 million that are immediately recognized in the Fund's income statement. These gains can be attributed mainly to a decline in the defined benefit obligation reflecting a downward revision of the inflation rate and salary scale projections, and a modest rise in the discount rate from 3.92 percent at the beginning of the year to 4.07 percent at end-February. These factors both offset a marked-to-market decline in the value of the pension plan assets during the year, reflecting developments in equity markets.

Text Table. Reconciliation of IAS 19 Timing Adjustment
(In millions of SDRs)

		FY 2016
		Projected
A	**Accounting vs. Funding**	**-228**
	Pension cost (accrual basis)	-346
	Pension funding (cash basis)	118
B	**Actuarial gains**	**524**
C	**Total IAS 19 timing adjustment (A+B)**	**296**

Source: Willis Towers Watson and IMF Finance Department

- This is partly offset by a loss of SDR 228 million representing the difference between (i) the actuarially determined annual IAS 19 expense that measures the increase in obligations under the staff retirement plan stemming from an additional year of staff service of SDR 346 million; and (ii) the funding (cash appropriation) for the year projected at SDR 118 million.

Table 1. Projected Income and Expenditures—FY 2016
(in millions of SDRs)

	FY2016	
	Initial Projections 1/	Current Projections
A. Operational income	**660**	**767**
Lending income	**611**	**643**
Margin for the rate of charge	521	515
Service charges	32	32
Commitment fees 2/	58	96
Investment income	**-24**	**59**
Fixed-Income Subaccount (Reserves)	-24	59
Interest free resources 3/	**15**	**8**
SCA-1 and other	15	8
Reimbursements	**58**	**57**
CCR Trust and SDR Department	4	7
PRG Trust	54	50
B. Expenses	**763**	**795**
Net administrative expenditures	713	748
Capital budget items expensed	18	20
Depreciation	32	27
C. Net operational income position (A-B)	**-103**	**-28**
Surcharges 2/	830	788
IAS 19 timing adjustment 4/		296
Endowment Subaccount (gold profits) investment income	123	-58
Net income position 5/	**850**	**998**
Memorandum Items:		
Fund credit (average stock, SDR billions)	52.1	51.5
SDR interest rate (average, in percent)	0.2	0.1
US$/SDR exchange rate (average)	1.48	1.39
Precautionary balances (end of period, SDR billions)	14.8	15.2

Source: Finance Department and Office of Budget and Planning

1/ Review of the Fund's Income Position for FY 2015 and FY 2016 (04/06/2015).

2/ For current projections, surcharges and commitment fees are projected on the basis of quota increases following the 14th General Review of Quotas and new time and level-based surcharge thresholds and commitment fee thresholds. See *Review of Access Limits and Surcharge Policies* (01/20/2016).

3/ Interest free resources reduce the Fund's costs and therefore provide implicit returns. Since the Fund invests its reserves in the IA to earn a higher return, the interest free resources retained in the GRA are mainly attributable to the SCA-1, unremunerated reserve tranche positions not represented by gold holdings, and GRA income for the year not transferred to the IA. These resources reduce members' reserve tranche positions and the Fund's remuneration expense resulting in implicit income for the Fund.

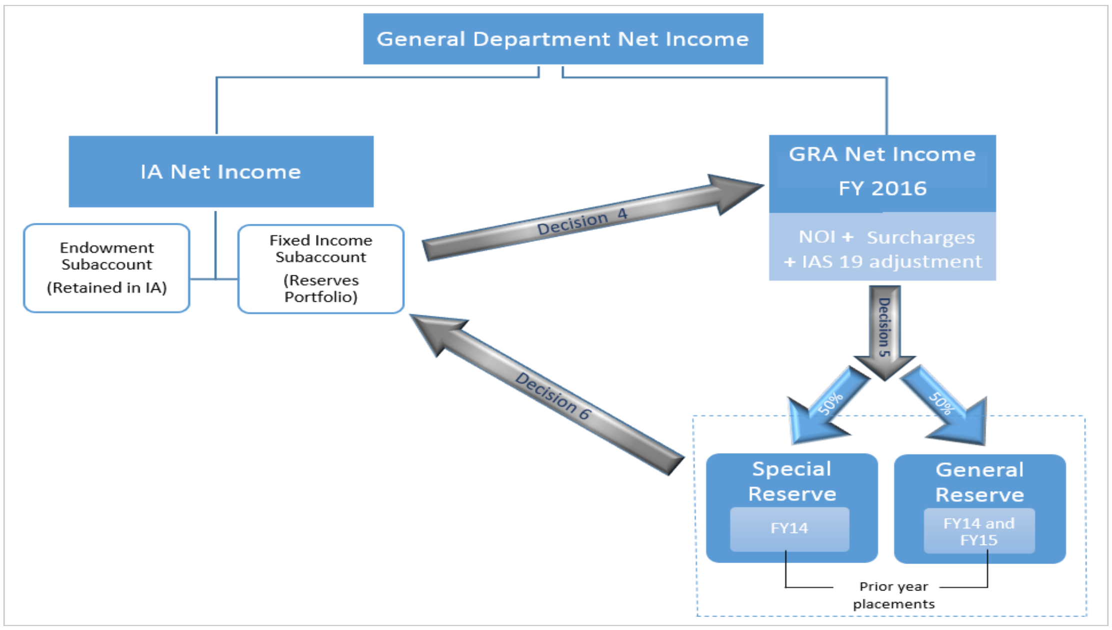
4/ IAS 19 is the accounting standard that prescribes the accounting treatment of pensions and employee benefit expenses, and involves actuarial valuations.

5/ Net income on the basis presented in the Fund's IFRS annual financial statements.

DISPOSITION DECISIONS

6. As in previous years, the Executive Board needs to consider a number of decisions on the disposition of income for FY 2016. These cover the use of IA investment income earned in FY 2016, which impacts the determination of GRA net operational income in FY 2016; the placement of net income to reserves; and the transfer of currencies from the GRA. These elements are discussed below, and presented in Figure 1, beginning with the disposition of IA investment income.

Figure 1. Summary of Proposed Disposition Decisions



Source: Finance Department

7. The use of IA income is guided by the Fund's Articles. Under the Articles, investment income from the IA may be invested, held in the IA, or used for meeting the expenses of conducting the business of the Fund.[15] Article XII, Section 6(f)(ii), permits the transfer of additional GRA currencies to the IA if, at the time of the decision to make such transfer, the Fund's reserves are above the cumulative amount of previous transfers of currencies from the GRA to the IA.[16]

8. Staff proposes that income in the subaccounts of the IA be used as follows:

- **Fixed-Income Subaccount:** Consistent with past practice, staff proposes that the estimated FY 2016 income of SDR 59 million be transferred to the GRA to be used towards meeting the expenses of the Fund (proposed Decision 4). By so doing the IA income will contribute to the GRA net income, which will be placed to the Fund's reserves as indicated in Figure 1.

[15] Article XII, Section 6 (f)(iv). The Board could also, by a 70 percent majority of the total voting power, decide to reduce the amount of the investment in the IA (Article XII, Section 6 (f)(vi)).

[16] The cumulative amount is derived net of transfers out of the IA. In the past windfall gold sales profits of SDR 2.45 billion had been transferred to the IA but these were subsequently transferred out during FY 2013 and FY 2014, following a distribution of the general reserve to the membership.

- **Endowment Subaccount:** The projected loss of SDR 58 million for FY 2016 will be charged against the retained earnings, lowering the cumulative retained earnings of the IA to about SDR 170 million. No income from the Endowment Subaccount may be used for meeting the expenses of the Fund pending the completion of the phased investment of the endowment under the new asset allocation strategy which began in March 2014.[17] No Board decision is required for the reinvestment of these earnings.

9. The Articles permit the Fund's net income of the GRA to be either distributed to members or placed to the general or special reserve (see Box 1). At the recent 2016 biennial review of the Fund's precautionary balances, Directors underlined the importance of maintaining an adequate level of precautionary balances and supported retaining the current medium term indicative target of SDR 20 billion.[18,19] While noting the most recent projections that, regrettably, precautionary balances would not reach the SDR 20 billion target over the medium term, Directors nevertheless did not see a compelling case at this time for taking additional steps to reach that target, recognizing that a significant build-up of reserves is projected in the next few years.

10. Directors also considered the allocation of Fund income between the special and the general reserve. Many Directors saw merit in the staff's proposal to allocate total future net income to both reserves, and could support as a guiding principle initially, an allocation of one-half to two-thirds to the special reserve, given its role as the first line of defense against net income losses. A number of Directors, noting legal constraints on the distribution of special reserves to members, did not see a strong rationale for moving away from the current practice of allocating surcharge income to the general reserve and net operational income to the special reserve. While expressing different preferences, some Directors remained open to alternative allocation approaches and shares, and could go along with the consensus.

[17] The retention of gold endowment investment income in the IA is in keeping with the Rules and Regulations for the IA, and consistent with the presentation in the Fund's annual IFRS financial statements. Retained earnings totaled SDR 228 million at end-FY 2015.

[18] See the *Review of the Adequacy of the Fund's Precautionary Balances* (01/26/16) and *The Acting Chair's Summing Up* (02/25/16).

[19] Precautionary balances comprise the special and general reserves, as well as SCA-1 balances, except for amounts in the special reserve attributed to profits from the 2009-2010 gold sales of SDR 4.4 billion.

Box 1. The Fund's Reserves

Article XII, Section 6(a) requires the Fund's net income to be distributed to members or placed to the general or special reserve.

Special Reserve. This reserve–established in 1957–was initially funded by the proceeds from a gold investment program set up to address the deficits accumulated from annual losses the Fund suffered from its inception to April 1956. Income from the investment program was placed to the special reserve each year until the program was terminated in 1972. The Board also decided in 1957 when the reserve was established that any administrative losses would first be written off against the special reserve. The special reserve is therefore the first line of defense against income losses. In symmetric fashion, it has been the Fund's practice to place its annual net operational income (not attributable to surcharge income) to the special reserve since the termination of the gold investment program. Under the Fund's Articles, no distributions (dividends) can be made from the special reserve.

General Reserve. In 1958, it was decided that the reserve contemplated in Article XII, Section 6(a) of the Articles, prior to the Second Amendment, would be referred to as the general reserve to distinguish it from the special reserve. Net operational income was placed to this reserve while the gold investment program was active, i.e., during FY 1958–72, as the Fund had returned to profitability from its operations. The general reserve can be used to absorb capital losses, to meet administrative losses or for distribution. Placements of Fund net income were made to the general reserve in FY 1998 to FY 2006 as follows: (i) net operational income generated under the Supplemental Reserve Facility (SRF), after meeting the cost of administering the PRGF Trust (FY 1998–2001); and (ii) surcharges on purchases under the SRF, credit tranches and EFF (FY 2002 to FY 2006). During FY 2007–2008, the Fund experienced net income shortfalls and subsequently, the Board agreed to resume the practice of placing net income equivalent to surcharge income in the general reserve in FY 2011. Pursuant to Article XII, Section 6(d) of the Articles, reserves accumulated in the general reserve may be distributed to members, in proportion to their quota, if the Board approves such decision by a 70 percent majority of the total voting power.

11. Staff has revisited the proposed allocation of net income to the special and the general reserve in light of Directors' views at the February meeting. Staff continues to see merit in updating the allocation methodology to be more consistent with the approach to setting the rate of charge under the new income model, and proposes that one half of total GRA net income for FY 2016 be allocated to the special and one half to general reserve (proposed Decision 5). This would be at the lower end of the range discussed in the recent review of precautionary balances in February 2016, recognizing the misgivings expressed by some Directors about moving away from the current approach of allocating net operational income to the special reserve.[20] Allocating FY 2016 net income (including surcharge income) equally to the two reserves would increase the special reserve by just over SDR 0.5 billion to SDR 4.5 billion, while the general reserve would rise by the same amount to SDR 9.5 billion. In contrast, maintaining the current practice of allocating only net operational income to the special reserve would entail placing SDR 268 million or about one-quarter of total net income in FY 2016 to the special reserve.[21] The divergence between the two approaches is projected to increase over the medium term, as allocating net income equally

[20] See the *Review of the Adequacy of the Fund's Precautionary Balances* (1/26/16) and *The Acting Chair's Summing Up* (02/25/16).

[21] Net operational income placed to reserves comprises net operational income together with the IAS 19 adjustment.

between the two reserves would allow the special reserve to rise to about SDR 5.9 billion by FY 2021, still well below the precautionary balance floor of SDR 15 billion which includes both special and general reserves, compared with only about SDR 4.4 billion under the current allocation practice (as net operational income is projected to be modest or negative going forward). Following the above transfers, total precautionary balances at the end of FY 2016 are projected at SDR 15.2 billion after including the SCA-1 balance of SDR 1.2 billion.

12. The placement of FY 2016 GRA net income to the special and general reserve provides scope for further transfer of currencies to the Fixed-Income Subaccount. Article XII, section 6(f)(ii) provides that the transfer of currencies from the GRA to the IA shall not, at the time of the decision, exceed the total amount of the general and special reserves. After the above placement, the combined balance in the special reserve (excluding amounts attributed to gold sales profits) and the general reserve would total SDR 14 billion. This would remain above the net cumulative amount of transfers made thus far to the IA from the GRA of SDR 10.3 billion.[22] The difference includes GRA currency amounts equivalent to net income in FY 2014 and FY 2015, which were not transferred to the IA pending the Board review of the strategic asset allocation for the fixed income subaccount.[23] Now that this review has been completed, staff proposes to proceed with the transfer of the maximum amount permitted under the Articles.

13. Accordingly, staff proposes to transfer currencies amounting to SDR 3.7 billion from the GRA to the IA for investment in the Fixed-Income Subaccount (proposed Decision 6). This amount is made up from currencies equivalent to net income of SDR 1.1 billion for FY 2016 and an amount of SDR 2.6 billion comprising currencies retained in the GRA in FY 2014 and FY 2015. This is equivalent to the increase in the general and special reserves since the end of FY 2013, following the temporary suspension of currency transfers relating to GRA income in FY 2014 and FY 2015. It is envisaged that the proposed transfer would be timed to take place shortly before the introduction of the new SDR valuation basket on October 1, 2016 to minimize operational costs, and will provide sufficient liquidity to facilitate the planned rebalancing of the IA-FI portfolio to reflect the new SDR weights.[24]

[22] These totals exclude special reserves attributed to profits from the 2009-2010 gold sales of SDR 4.4 billion, which are not part of the Fund's precautionary balances, and corresponding transfers to establish the gold endowment. For further discussion see *Review of the Adequacy of the Fund's Precautionary Balances* (01/26/16).

[23] A total net amount equivalent to SDR 14.7 billion was transferred from the GRA to the IA since its establishment including net transfers of SDR 10.3 billion from the GRA and the transfer of SDR 4.4 billion attributable to gold sales profits, which were used to fund the Endowment Subaccount (constituting part of the special reserve).

[24] The investment strategy for the Fixed-Income Subaccount is aimed at protecting the Fund's balance sheet and generating income. The objective of the subaccount return is to exceed the SDR interest rate over time while minimizing the frequency and extent of negative returns and underperformance over an investment horizon of three to four years. Pursuant to Rule 16(d)(ii) of the Rules and Regulations for the Investment Account, as adopted in August 2015, transfers from the GRA to the Fixed-Income Subaccount attributed to net income for FY 2014 and FY 2015 will be placed to Tranches 1 and 2 of this subaccount in the same proportion as the assets in these two tranches on August 31, 2015.

FY 2017-2018 INCOME OUTLOOK

14. The income outlook for FY 2017-2018 remains positive. Projected net income is estimated at SDR 1 billion and SDR 0.7 billion for FY 2017 and FY 2018, respectively (Table 2). This net income comprises operational income together with surcharge income and retained earnings in the gold endowment. These income projections assume that the margin for the rate of charge is maintained at the level of 100 basis points in place since 2008 (see below). The projections are also sensitive to a number of factors including the level of global interest rates; the timing of purchases and repurchases under existing arrangements; possible new arrangements; the U.S. dollar/SDR exchange rate and the annual pension expense as determined under the amended IAS 19.[25]

[25] Consistent with past practice, the projections only take account of arrangements, approved through end-March 2016 and not possible new arrangements.

Table 2. Projected Income Sources and Uses—FY 2016–2018
(in millions of SDRs)

		FY2016	FY2017	FY2018
A.	**Operational income 1/**	**767**	**1,014**	**848**
	Lending income	**643**	**901**	**500**
	Margin for the rate of charge	515	494	474
	Service charges	32	19	9
	Commitment fees 2/	96	388	17
	Investment income	**59**	**41**	**260**
	Fixed-Income Subaccount (Reserves)	59	41	117
	Gold endowment pay-out 3/	0	0	143
	Interest free resources 4/	**8**	**17**	**33**
	SCA-1 and other	8	17	33
	Reimbursements	**57**	**55**	**55**
	CCR Trust and SDR Department	7	5	4
	PRG Trust	50	50	51
B.	**Expenses**	**795**	**833**	**846**
	Net administrative expenditures	748	766	783
	Capital budget items expensed	20	30	23
	Depreciation	27	37	40
C.	**Net operational income position (A-B)**	**-28**	**181**	**2**
	Surcharges 2/	788	639	581
	IAS 19 timing adjustment 5/	296	0	0
	Endowment Subaccount (gold profits) investment income 3/	-58	198	95
	Net income position 6/	**998**	**1,018**	**678**
Memorandum Items:				
	Fund credit (average stock, SDR billions)	51.5	49.4	47.4
	SDR interest rate (average, in percent)	0.1	0.3	0.6
	US$/SDR exchange rate (average)	1.39	1.40	1.40
	Precautionary balances (end of period, SDR billions)	15.2	16.1	16.7

Source: Finance Department and Office of Budget and Planning

1/ Surcharges are excluded from operational income.
2/ Surcharges and commitment fees are projected on the basis of quota increases following the 14th General Review of Quotas and new time and level-based surcharge thresholds and commitment fee thresholds. See Review of Access Limits and Surcharge Policies (01/20/2016).
3/ The projections reflect the phase in of investments to the endowment with the gold profits being invested in short-term deposits during the interim period. Payouts from the endowment to the GRA are not expected to start until FY 2018.
4/ Interest free resources reduce the Fund's costs and therefore provide implicit returns. Since the Fund invests its reserves in the IA to earn a higher return, the interest free resources retained in the GRA are mainly attributable to the SCA-1, unremunerated reserve tranche positions not represented by gold holdings, and GRA income for the year not transferred to the IA. These resources reduce members' reserve tranche positions and the Fund's remuneration expense resulting in implicit income for the Fund.
5/ The IAS 19 timing adjustment is actuarially determined and is finalized shortly after the end of the financial year.
6/ Net income on the basis presented in the Fund's IFRS annual financial statements.

A. Margin for the Rate of Charge

15. The Board needs to set the margin for the basic rate of charge. Based on amended Rule I-6(4), which came into effect on May 1, 2012, the Executive Board is required to set the margin over the SDR interest rate for the next two financial years, FY 2017 and FY 2018. Under the rule, the margin should be set to cover the Fund's intermediation costs and help build up reserves. The rule provides for a cross-check of the alignment of the margin to long-term credit market conditions (see Box 2). The rule also permits that, in exceptional circumstances, the margin may be set at a level other than that which is adequate to cover estimated intermediation expenses of the Fund and to generate an amount of net income for placement to reserves and for the accumulation of precautionary balances ("exceptional circumstances clause").

Box 2. The Rule for Setting the Margin for the Basic Rate of Charge

Effective May 1, 2012, Rule I-6(4) reads as follows:

"(4) The rate of charge on holdings (i) acquired as a result of a purchase under a policy that has been the subject of an exclusion under Article XXX(c), or (ii) that exceed the amount of the member's quota after excluding any balances referred to in (i), shall be determined in accordance with (a) and (b) below.

(a) The rate of charge shall be determined as the SDR interest rate under Rule T-1 plus a margin expressed in basis points. The margin shall be set at a level that is adequate (i) to cover the estimated intermediation expense of the Fund for the period under; (b) below, taking into account income from service charges; and (ii) to generate an amount of net income for placement to reserves. The appropriate amount for reserve contribution shall be assessed taking into account, in particular, the current level of precautionary balances, any floor or target for precautionary balances, and the expected contribution from surcharges and commitment fees to precautionary balances; provided, however, that the margin shall not be set at a level at which the basic rate of charge would result in the cost of Fund credit becoming too high or too low in relation to long-term credit market conditions as measured by appropriate benchmarks. Notwithstanding the above, in exceptional circumstances, the margin may be set at a level other than that which is adequate to cover estimated intermediation expenses of the Fund and to generate an amount of net income for placement to reserves.

(b) The margin shall be set for a period of two financial years. A comprehensive review of the Fund's income position shall be held before the end of the first year of each such two-year period and the margin may be adjusted in the context of such a review, but only if this is warranted in view of fundamental changes in the underlying factors relevant for the establishment of the margin at the start of the two-year period."

16. Since amended Rule I-6(4) was first implemented, the Executive Board has consistently set the margin under the exceptional circumstances clause. The new Rule I-6(4), which was amended as part of the Fund's New Income Model, was designed to move away from the reliance on lending income for the financing of the Fund's non-lending activities i.e., non-lending income was expected to cover non-lending activities of the Fund while lending income was to cover intermediation costs and contribute to a build-up of reserves.[26] However, investment income, the main source of the Fund's non-lending income, remains constrained by the historically low level of

[26] Annex II provides an update on the Implementation of the New Income Model.

global interest rates, which determine the returns from the Fixed-Income Subaccount. Over the longer term, the gold-funded endowment is also expected to contribute more to Fund income, but payouts from the endowment are not expected to start until at least FY 2018. As a result, in the near term, lending income is expected to continue to cover a significant portion of the Fund's non-lending operating costs.

17. Against this background, the margin for FY 2017–2018 will again need to be set under the exceptional circumstances clause.[27] Although non-lending income is projected to rise moderately, as in the last two years, it would only cover about one-fifth of the Fund's non-lending activities. As such, an important implication of the use of the exceptional circumstances clause is that the contribution of the margin to reserve accumulation is significantly less than it would be if non-lending activities were covered by non-lending income, i.e., income from the margin will also be required to cover a significant part of the costs of the Fund's non-lending activities.

18. The rest of this section discusses issues relevant to setting the margin for FY 2017–2018. It begins with a discussion of the potential impact of the expansion in the SDR currency basket to include the Chinese renminbi (RMB) with effect from October 1, 2016. When the Board took the decision to include the RMB in the SDR basket, Directors noted that the SDR interest rate was likely to be affected, as on past occasions, and looked forward to a comprehensive discussion of the implications of any such changes in the SDR interest rate in the context of the next review of the Fund's income.[28] The discussion then considers other relevant factors under Rule I-6(4), including the coverage of intermediation costs by margin income and the contribution of margin income to reserve accumulation in FY 2017-2018. As required under the rule, the discussion also includes a cross-check to ensure that the margin on the rate of charge is not too high or too low in relation to long-term market conditions.

Impact on the SDR Rate of Including the RMB in the SDR basket

19. As recognized when the decision was taken to include the RMB into the SDR basket, there was likely to be some impact on the SDR interest rate. Staff estimated based on forward rates at the time that including the RMB in the basket on October 1, 2016 would increase the SDR interest rate by about 27 basis points, with the marginal impact declining slightly over a five-year horizon.[29] This impact was expected to be modest compared with the larger impact of the expected normalization of interest rates among existing basket currencies, particularly the U.S. dollar.

20. The interest rate outlook has changed substantially since last November. Most notably, expectations of interest rate normalization have been revised down in the face of weaker economic

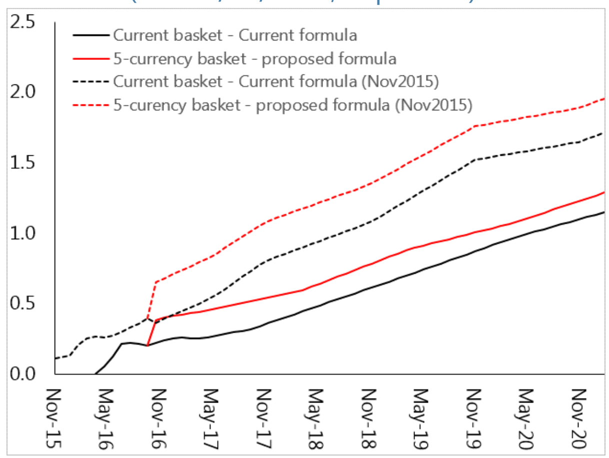
[27] The margin for the basic rate of charge for the period FY 2015 and FY 2016 was adopted under the exceptional circumstances clause (see *Review of the Fund's Income Position for FY 2014 and FY 2015–2016* (4/7/14)).

[28] See *Review of the Method of Valuation of the SDR* (11/13/2015).

[29] See *Review of the Method of Valuation of the SDR* (11/13/2015).

data and heightened concern about downside risks. As a result, market forward rates now indicate a much more gradual rise in the SDR interest rate to about 1.2 percent over the next five years (including the RMB), down from about 2.0 percent expected last November (Figure 2).[30] In addition, market expectations of the marginal impact of including the RMB in the basket have also declined from 27 basis points last November to about 17 basis points currently. The level of the SDR interest rate in October 2016 following the inclusion of the RMB is now expected to be about 37 basis points, which is actually lower than the rate expected last November under the old four currency basket.

Figure 2. SDR Interest Rate Implied by Forward Rates
(as of 3/29/2016, in percent)



Source: Bloomberg and IMF Staff calculations.

21. The change in the outlook for the SDR interest rate has implications both for Fund income and for Fund creditors and borrowers. For the Fund, the impact of a higher or lower SDR rate on lending income is essentially neutral, as the higher SDR interest rate charged to borrowers would also be paid to creditors in the form of higher remuneration on reserve tranche positions or borrowed resources. The main impact of changes in the SDR interest rate on Fund income is on investment returns, and to a lesser extent, the implicit returns on the Fund's interest free resources. While the marginal income effect of a 17 basis point increase in the SDR interest rate would be modestly positive (about SDR 35 million in FY 2018); this impact is expected to diminish over time as forward markets suggest the marginal impact of RMB inclusion on the SDR interest rate could decline to about 10 basis points by 2020 (Figure 3.A). Moreover, to the extent that interest parity holds, the higher interest rate on RMB claims could be reflected in a depreciation of the RMB over time (Figure 3.B), thereby reducing the Fund's income relative to its predominantly U.S. dollar denominated administrative expenses.[31] More importantly, the significantly lower path now expected for the SDR interest rate is estimated to reduce the Fund's cumulative investment income over the next five years by about SDR 400 million.

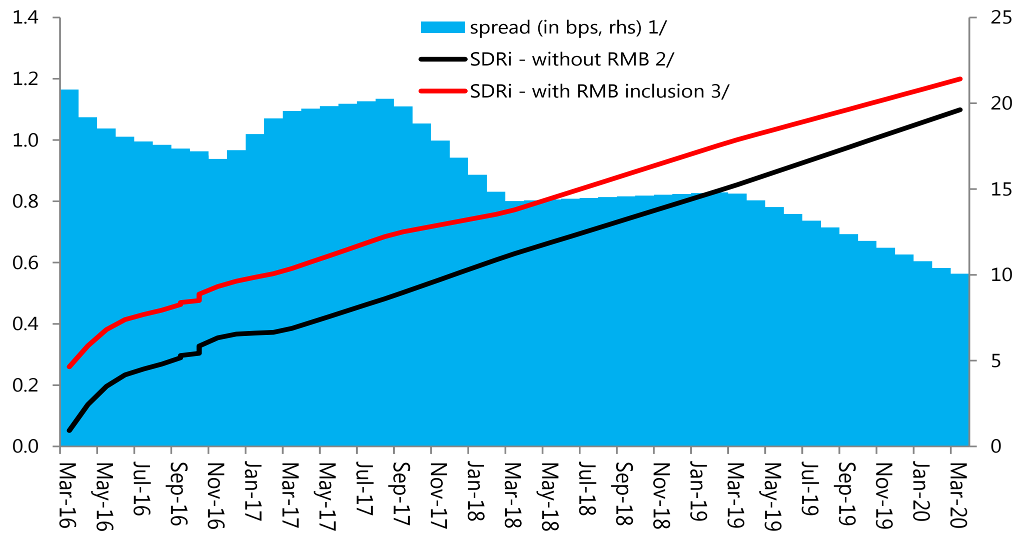
[30] The RMB will be represented in the SDR interest rate basket by the three-month benchmark yield for China Treasury bonds. The interest rate on the three-month Treasury bills of the United States, United Kingdom, and Japan, and the three-month spot rate for euro area central government bonds with a rating of AA and above (published by the European Central Bank) will continue to serve as the representative interest rates for the U.S. dollar, pound sterling, Japanese yen, and euro, respectively.

[31] Market forward exchange rates imply a depreciation of the new basket of about 1 to 1½ percent relative to the old basket over the medium term.

Figure 3. SDR Interest Rate and Exchange Rate

Figure A. SDR interest rate implied by forward rates

(in percent)



Source : Bloomberg and IMF Staff calculations.

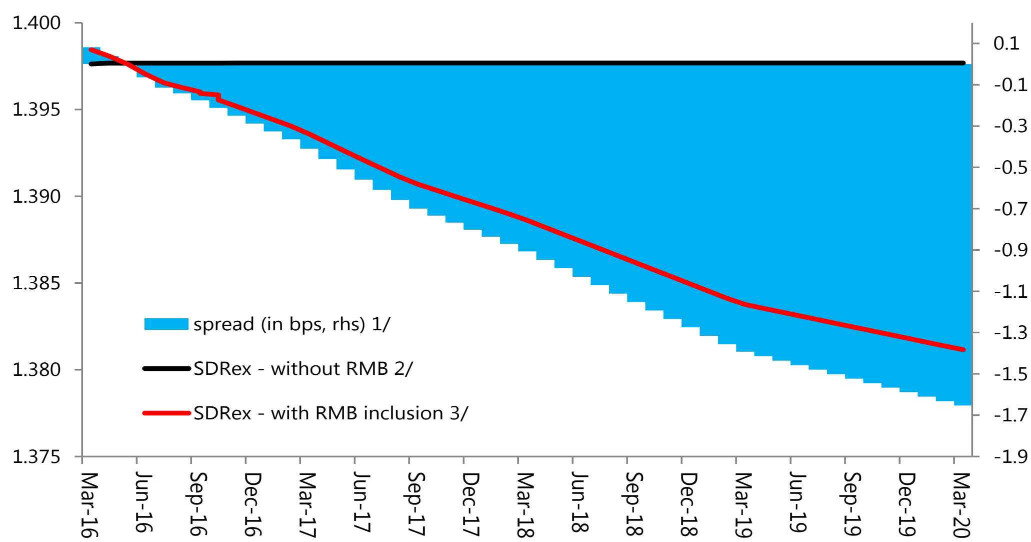
1/ Difference between two SDR interest rates, in basis points.

2/ Based on the 4-currency basket and 2011 currency amounts.

3/ Based on the 5-currency basket and new currency amounts.

Figure B. SDR exchange rate implied by forward rates

(U.S. dollars per SDR)



Source : Bloomberg and IMF Staff calculations.

1/ Difference between two SDR exchange rates, in basis points.

2/ Based on the 4-currency basket and 2011 currency amounts.

3/ Based on the 5-currency basket and indicative new currency amounts.

22. **Other things equal, a higher SDR rate would raise both the rate of charge for Fund borrowers and the rate of remuneration for creditors.** As noted, however, the SDR rate (and therefore the basic rate of charge with an unchanged margin) is now expected to be below the rate projected last November, and the overall expected path of the SDR rate is significantly lower than previously anticipated, notwithstanding the RMB's inclusion in the basket. Moreover, the marginal impact of the new SDR basket is also less than anticipated last November, and is within the historical range of changes in the SDR interest rate observed at the time of previous reviews of the valuation basket (Table 3). Also, interest rate parity suggests that the marginal impact of RMB inclusion in the basket on the SDR interest rate could imply a gradual depreciation of the RMB against other SDR basket currencies over time, reducing the relative cost of future repurchases.

Table 3. Change in SDR Interest Rate in Past Reviews [1/]

	SDR interest rate (in percent)	**Change** (in basis points)
1985 Review	7.49	
	7.61	12
1990 Review	8.97	
	8.63	-34
1995 Review	3.97	
	4.15	18
2000 Review	4.60	
	4.42	-18
2005 Review	3.06	
	3.17	11
2010 Review	0.31	
	0.33	2

Source: IMF staff calculations.
1/ For each review, the table shows the last weekly SDR interest rate calculated with the old basket and the first SDR interest rate calculated with the new basket.

23. **The longer-term outlook for Fund income and reserve accumulation has weakened further as a result of the downward revisions in market expectations for interest rate normalization.**[32] At the time of the April 2015 income review, the Fund's precautionary balances were expected to reach about SDR 19 billion by FY 2022, moderately below the SDR 20 billion medium term target (Figure 4, Panel A). This picture still broadly held at the time of the recent review of precautionary balances in February 2016, depending on the outcome of discussions on the new surcharge thresholds that would apply following the effectiveness of the 14th Review quota increases. The most recent projections, which incorporate the outcome of the review of access and surcharges (including the new level-and time-based surcharge thresholds) and the lower expected interest rate path, now suggest that precautionary balances would only reach about SDR 18.1 billion by FY 2022, based on an unchanged margin of 100 basis points. If the margin was reduced to, say, 80 basis points, to broadly offset the marginal impact of the RMB's inclusion in the SDR basket, there would be an additional cumulative income loss through FY 2022 of about SDR 500 million, and projected precautionary balances in FY 2022 would decline further to SDR 17.6 billion (Figure 4, Panel B).

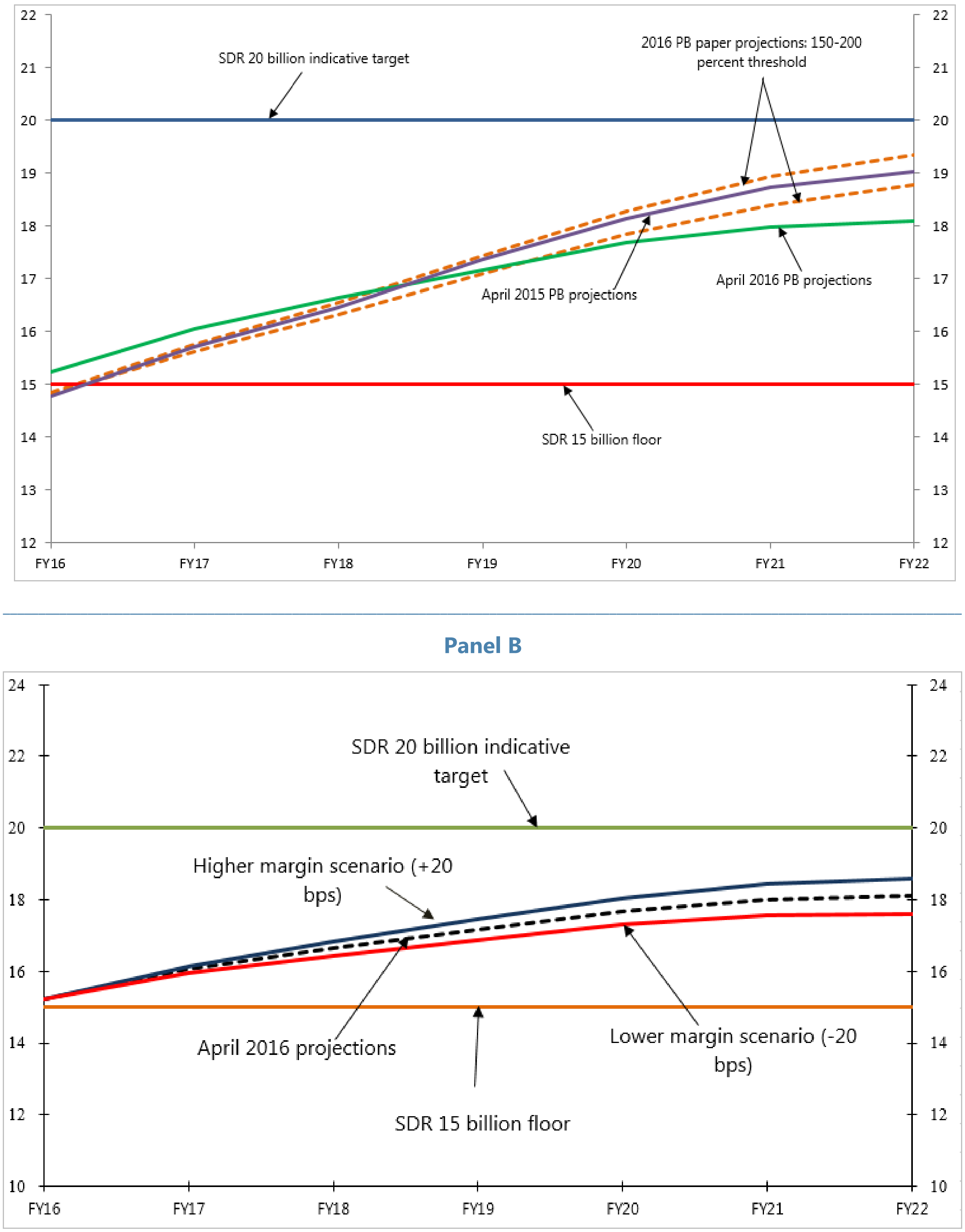
[32] *The Consolidated Medium-Term Income and Expenditure Framework* (04/14/2016).

Figure 4. Projected Reserve (PB) Accumulation

(in billions of SDRs)

Panel A

Panel B



Source: Finance Department

24. A reduction in the margin would also affect the Fund's estimated steady state income position. These estimates seek to measure the sustainability of the Fund's income position with a relatively low level of lending (conservatively set at SDR 20 billion) and with precautionary balances at the floor of SDR 15 billion. While only indicative, these estimates suggest that the Fund's steady state income position remains moderately positive at the current margin of 100 basis points, even in a relatively low interest rate environment (SDR rate in the 2½-3 percent range). However, if the margin were lowered to 80 basis points, available buffers would be reduced and the steady state position could be negative if interest rates remained close to 2 percent (Text Table).

Text Table

Estimated Steady State Net Operational Income Position

Margin for the Basic Rate of Charge	SDR Interest Rate 2.0%	2.5%	3.0%
(In basis points)		*(In US$ millions)*	
80	-68	66	200
100	-13	121	256
120	44	178	313
		(In SDR millions)	
80	-49	47	143
100	-9	87	183
120	31	127	224

Source: Finance Department

25. Based on the above considerations, staff considers that no adjustment should be made to the margin as a result of the pending inclusion of the RMB into the SDR basket. The projected marginal impact of the RMB's inclusion on the SDR interest rate has declined and is within the range observed at the time of previous basket revisions. Moreover, the overall path for expected interest rates has been revised down substantially and the projected SDR rate in October 2016 after the inclusion of the RMB is now actually lower than the rate projected last November based on the current SDR basket. A reduction in the margin would lead to a further significant reduction in Fund income on top of that already expected from lower interest rates and the recent adjustment in surcharge thresholds. In addition, available buffers for adverse developments in the Fund's steady state income position would be significantly reduced. The remainder of this section provides additional analysis of the outlook in FY 2017-2018 in line with the considerations set out in Rule I-6(4). The focus is on an unchanged margin of 100 basis points, but sensitivity analysis is also presented for a margin of 80 and 120 basis points, consistent with Figure 4 (Panel B).

Coverage of intermediation costs

26. Intermediation costs are estimated at US$99 million and US$101 million in FY 2017 and FY 2018, respectively (Table 4). Fund-wide intermediation costs related to generally available facilities (GAF) are derived in consultation with departments using the Fund's Analytic Costing and Estimation System (ACES). They cover direct personnel, travel and other administrative expenses, as well as indirect support and governance costs.

27. Income is expected to remain substantially in excess of intermediation costs in FY 2017-2018.[33] The income from service charges at US$27 million and US$13 million (Table 4, row B) is projected to cover a portion of the intermediation costs in FY 2017 and FY 2018, respectively. An

[33] Commitment fees are included in the analysis as a source of income that contributes to reserve accumulation. Under this approach, the analysis in setting the margin is insulated from the unpredictability of commitment fees.

unchanged margin of 100 basis points would provide further income of about US$692 million (SDR 494 million) and US$664 million (SDR 474 million) in FY 2017 and FY 2018, respectively.

28. In addition to the margin and service charges on disbursements, commitment fees for non-drawing arrangements and surcharges contribute to the Fund's income.

- The expected income from commitment fees is about US$543 million (SDR 388 million) and US$24 million (SDR 17 million) in FY 2017 and FY 2018, respectively. Commitment fees are refundable in the event of drawings and thus income from these fees is only recognized at the expiration or cancellation of arrangements. The projected commitment fee income for FY 2017-2018 includes the two-year commitment fees earned on two FCL arrangements and a PLL arrangement scheduled to expire in FY 2017; and commitment fees from an FCL approved in FY 2016 which are expected to be recognized in FY 2018.
- Surcharge income is projected at about US$895 million (SDR 639 million) in FY 2017 and about US$813 million (SDR 581 million) in FY 2018, lower than previously projected.

Reserve accumulation

29. Reserve accumulation is projected to remain relatively strong in FY 2017 and FY 2018, though lower than in previous years. Table 4 first illustrates the potential reserve accumulation that would result if lending income were required solely to cover intermediation costs and provide for additional reserves (Rows G and H). In this hypothetical scenario, potential reserve accumulation with a margin of 100 basis points would equal almost 10 percent of reserves in FY 2017 and over 6 percent in FY 2018. Projected actual reserve accumulation (after taking into account the need to cover non-lending expenditures) would be 5.4 percent of reserves in FY 2017 and 3.6 percent in FY 2018 (Rows I and J). As a result, precautionary balances are projected to reach SDR 16.7 billion by end-FY 2018.

Table 4. Income from the Margin and Reserve Accumulation[1]
(in millions of U.S. Dollars, unless otherwise indicated)

	Actual			Projected		
	FY 2013	FY 2014	FY 2015	FY 2016	FY 2017	FY 2018
A. Intermediation costs 2/	95	96	96	97	99	101
Less						
B. Service charges	80	90	88	44	27	13
C. Costs to be covered by income from margin (A-B)	15	6	7	53	72	88
D. Income from margin 3/						
80 basis points	…	…	…	…	553	531
100 basis points	1,386	1,297	1,091	716	692	664
120 basis points	…	…	…	…	830	796
E. Commitment fees 4/	714	44	770	133	543	24
E.1 FCL/PLL	654	29	726	25	543	24
E.2 Other	60	15	44	108	-	-
F. Surcharges 5/	1,874	2,125	2,151	1,095	895	813
G. Potential reserve accumulation 6/ (D+E+F-C)						
80 basis points	…	…	…	…	1,918	1,280
100 basis points	3,959	3,460	4,004	1,892	2,057	1,413
120 basis points	…	…	…	…	2,195	1,545
H. Potential reserve accumulation (as a percent) 7/						
80 basis points	…	…	…	…	9.0%	5.7%
100 basis points	27.6%	19.8%	21.4%	9.6%	9.6%	6.3%
120 basis points	…	…	…	…	10.3%	6.9%
I. Actual reserve accumulation 8/						
80 basis points	…	…	…	…	1,009	683
100 basis points	3,017	4,005	2,142	1,468	1,148	816
120 basis points	…	…	…	…	1,286	948
J. Actual reserve accumulation (as a percent) 8/						
80 basis points	…	…	…	…	4.7%	3.0%
100 basis points	21.0%	22.9%	11.5%	7.4%	5.4%	3.6%
120 basis points	…	…	…	…	6.0%	4.2%
K. Precautionary balances at the end of FY (in SDR billions) 9/						
80 basis points	…	…	…	…	16.0	16.6
100 basis points	11.5	12.7	14.2	15.2	16.1	16.7
120 basis points	…	…	…	…	16.2	16.8
Memorandum items						
Average Fund credit outstanding (in SDR billions)	91.8	85.3	74.2	51.5	49.4	47.4
Number of active arrangements (average) 10/	18	13	13	14	…	…
Average exchange rate US$/SDR	1.51	1.52	1.47	1.39	1.40	1.40

Source: Finance Department and Office of Budget and Planning
1/ For analytical purposes, surcharges and commitments fees are considered for reserve accumulation only.
2/ Costs related to the Fund's "generally available facilities."
3/ Derived by applying the margin against average Fund credit outstanding at the average US$/SDR rate.
4/ Includes commitment fees for expired or cancelled arrangements.
5/ Surcharges are projected on the basis of current quotas and surcharge thresholds.
6/ Potential reserve accumulation is derived by assuming other sources of income are sufficient to cover non-intermediation costs.
7/ Potential reserve accumulation as a percent of precautionary balances at the beginning of the financial year.
8/ Additions to reserves based on net income for the year (excluding retained gold endowment investment income).
9/ Precautionary balances include the Fund's reserves and SCA-1 balance less the gold endowment of SDR 4.4 billion.
10/ Excludes FCL and PLL arrangements.

Alignment of Fund borrowing costs with market conditions

30. Rule I-6(4) includes a mechanism to cross-check the alignment of the margin to long-term credit market conditions.[34] This mechanism aims to ensure that the costs of borrowing from the Fund are not too high or low in relation to the long-term credit market conditions. The market cross-check the staff has developed provides a useful guide but is not mechanistic, requiring judgment, particularly on the global financial context and future developments. As in the past, staff employs EMBI spreads as the main basis for the comparison with market borrowing rates.[35] Typically two adjustments are made to the metric measuring long-term market conditions:

- *Risk premium adjustment*—an adjustment to take account of the lower credit risks the Fund faces as a cooperative public policy institution. The Fund's preferred creditor status and its lending policies are key factors in reducing these risks. To reflect this, the measure compares the margin to market borrowing spreads applying for the most creditworthy Fund members, approximated by the lowest quartile of EMBI spreads; and

- *Term premium adjustment*—an adjustment is made to account for the difference between the SDR interest rate (based on a floating rate composed of three-month instruments) and the comparator EMBI measure (based on five year fixed interest rate instruments).[36]

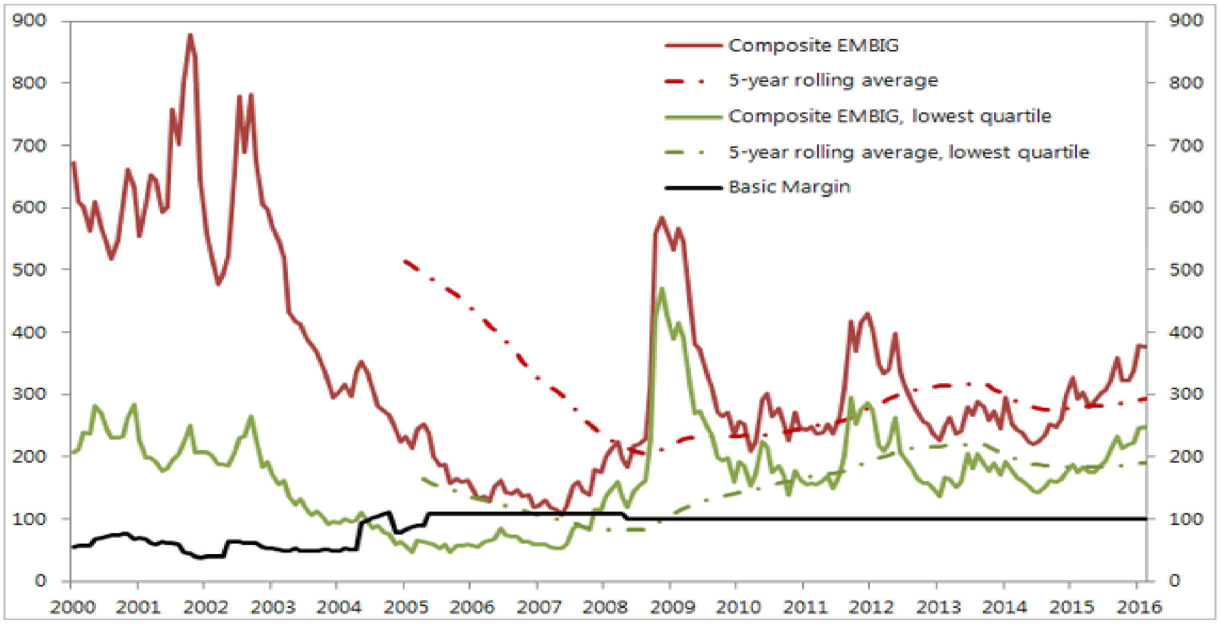
31. The adjusted market comparator suggests that the cost of Fund credit at the current margin of 100 basis points continues to be below long-term credit market costs, and that this gap is widening. Emerging market spreads have risen since early 2013, although they are still well below their recent peak at the outset of the global financial crisis in 2008 (see Figure 5). In the most recent five-year period ending in February 2016, the lowest quartile of the EMBI adjusted for the term premium was about 62 basis points higher than the current margin (See Table 5). This differential is wider than that prevailing during the first decade of this century (2001-2010) of about 30 basis points but is broadly in line with the range since 2011 of about 55 to 70 basis points. Thus, there is no basis to conclude that the cost of Fund credit has become too high relative to long-term market conditions. While there could be a question as to whether it has become too low, this conclusion maybe premature given that some of the factors driving the current differential maybe temporary (notably, the unusually low level of the basic rate of charge at present given the historically low SDR rate).

[34] See *A New Rule for Setting the Margin for the Basic Rate of Charge* (11/23/2011).

[35] EMBI spreads do not include data for advanced countries, some of which are currently borrowing from the Fund (66 percent of total GRA credit outstanding down from 79 percent in March 2014). However, in the absence of suitable alternative measures of spreads of U.S. dollar-based sovereign bonds issued by advanced countries, staff continues to view the EMBIG-based measure as the most appropriate metric of long-term market conditions (see Annex II, *Review of the Fund's Income Position for FY 2014 and FY 2015–2016* (04/07/14)).

[36] Due to data limitations this adjustment does not include the RMB. However, given the relatively low weight of the RMB in the basket and the low relative costs of rolling over 3 month instruments for 5 years, this omission is not expected to impact the analysis.

Figure 5. EMBIG Spreads: Total Composite and Bottom Quartile (in basis points)[1]



Source: Bloomberg and Staff calculations.
1/ SDR-equivalent rates are calculated using the currency weights in the SDR basket.

Table 5. Long-Term Credit Market and Comparator Spreads (in basis points)

Longterm Credit Market and Comparator Spreads (in basis points)

	2001 - 2005	2006 - 2010	Jan 2011 - Feb 2016
	(Median spread, in SDR-equivalent basis points) 1/		
Country risk spread--EMBI-based measures 2/			
Composite EMBI	401	219	280
Risk adjusted (lowest quartile)	121	150	177
Term premium 3/	1.5	13	15
Term premium adjusted country risk spread			
Composite EMBI	400	206	265
Countries in the lowest quartile	**119**	**137**	**162**
Memorandum item			
Past users of Fund resources 4/	247	213	266
Margin on the basic rate of charge 5/	69	104	100

Source: Bloomberg, JP Morgan and Fund staff calculations.
1/ SDR-equivalent rates are calculated using the currency weights in the SDR basket.
2/ Table reports linear combination of spreads in EMBIG-U.S. dollar and EMBIG-Euro composites. Series were combined using the weights of the U.S. dollar and Euro in the SDR basket (normalized to 100). During the sample period, the combined EMBIG indices contained spreads for a total of 40 countries.
3/ Difference in yields between a five-year fixed-rate SDR bond and the five-year average 3-month SDR interest rate as implied in futures market contracts, adjusted for the higher risk premium of instruments in future markets.
4/ Median level of the SDR weighted U.S. dollar and euro EMBIG spreads for the members with Fund arrangements between 1996 and 2011, excluding advanced countries.
5/ Margin reduced to 100 bps from 108 bps in May 2008. Between 1989 and 2005, the rate of charge was determined by a coefficient to the SDR interest rate that was adjusted with the Fund's total administrative expenses and the volume of Fund credit outstanding. Since May 2005, the margin has been defined in absolute basis points over the SDR interest rate.

32. **Based on the foregoing analysis, including the cross-check on alignment with long-term market conditions, staff proposes that the margin for the rate of charge be kept at 100 basis points for FY 2017–18 (proposed Decision No. 7).** At this level, the margin will cover

intermediation costs, generate a substantial contribution to reserves, and is not significantly out of line with long-term market conditions. Such a decision would also be in line with the conclusion of the recent review of precautionary balances, where Directors did not see a compelling case for taking additional steps to reach the SDR 20 billion target at this time.[37] Since the margin is also expected to cover part of the Fund's non-intermediation costs in the next two financial years, the proposed decision is based on the exceptional circumstances clause of the new Rule I-6(4).

B. FY 2017- 2018 Income Outlook

33. Key factors that affect the FY 2017-2018 income outlook are discussed below and presented in Table 2. A sensitivity analysis on the income effects of changes in some of the assumptions is also presented in Table 6.

Lending income. The projected increase in operational lending income of about 40 percent in FY 2017 reflects mainly income from commitment fees following the expiration of two large FCL arrangements. Lending income also reflects the projected decrease in average Fund credit outstanding in FY 2017 and FY 2018 to SDR 49.4 billion and SDR 47.4 billion, respectively.

IA investment income

- **Fixed-Income Subaccount**: In August 2015 the Board discussed the broadened investment mandate for the Fixed-Income Subaccount. It was agreed that FI resources would be split between a shorter-duration tranche (Tranche 1) and a longer-duration tranche (Tranche 2). Tranche 2 is to be funded with the resources of the MTI holdings held in the FI and any remaining FI resources are to be placed in Tranche 1. In FY 2017 and FY 2018 this subaccount is expected to realize gains of about SDR 41 million and SDR 117 million, respectively.[38] As noted, interest rates are expected to rise even more gradually than was anticipated in April 2015 reflecting the downward shift of the forward curve of the SDR interest rate in FY 2016. Under the gradual implementation of the broadened investment mandate and a rising interest rate environment as implied by forward markets, the subaccount is projected to yield about 29 basis points in FY 2017 or about 1 basis point less than the SDR interest rate. Income projections over the medium term remain conservative and the revised medium-term projections assume a broadening of the investment mandate starting in FY 2017. This is expected to translate into a gradual rise in returns from this subaccount with current projections assuming a modest 50 basis point premium being achieved by FY 2021. Annex IV provides further discussion on the sensitivity of the returns in this portfolio to changes in global interest rates.

- **Endowment Subaccount:** The three-year funding period of the passively-managed portion of the gold endowment began in March 2014 and the projected income for the gold endowment is

[37] See the *Review of the Adequacy of the Fund's Precautionary Balances* (1/26/16) and *The Acting Chair's Summing Up* (02/25/16).

[38] The balance of the Fixed-Income Subaccount corresponds to the investment of the Fund's reserves except for the gold profits and currencies retained in the GRA.

expected to be about SDR 198 million in FY 2017 and SDR 238 million in FY 2018.[39] Pending their investment in accordance with the strategic asset allocation benchmark for the endowment, gold sale profits will continue to be invested in SDR denominated short-term fixed deposits broadly earning the SDR interest rate.[40] During the funding period, investment income earned from the subaccount is assumed to be retained in the endowment in accordance with the Rules and Regulations of the Investment Account (IA) and is therefore not included in the Fund's operating income. The projections currently assume that payouts of 3 percent from the invested portion of the endowment will commence in FY 2018 once the endowment is fully invested; staff plans to return to the issue of an appropriate payout rule toward the end of the phase-in period of the passively-managed portfolio.[41]

Interest-free resources and reimbursements. Income from interest-free resources is expected to remain subdued owing to the low interest rate environment. Projected reimbursements are based on the FY 2016 estimates.

Expenditures. Net administrative and capital expenditures are consistent with those set in the medium-term budget paper.[42]

Surcharges. Surcharges are projected to decline to SDR 639 million and SDR 581 million in FY 2017 and FY 2018, respectively; in line with the lower credit path projections. This mainly reflects the lowering of the level-based threshold to 187.5 percent of quota and extending of the time-based trigger to 51 months for purchases under the Extended Fund Facility, which does not fully offset the impact of the overall doubling of quotas under the 14th General Review of Quotas.[43,44]

[39] It is expected that the Executive Board will consider the payout policy for the endowment toward the end of the phase-in period. The payout of the endowment is expected to be based on U.S. dollar returns and may differ from returns in SDR terms.

[40] Given the agreed floor on the SDR rate, actual returns on short-term deposits could fall short of the SDR rate in the near-term.

[41] See Press Release No. 13/37 on the new rules and regulations of the Investment Account.

[42] See *FY 2017–FY 2019 Medium-Term Budget* (03/24/16).

[43] https://www.imf.org/external/np/sec/pr/2016/pr1625a.htm.

[44] Following the Board discussion of the *Review of Access Limits and Surcharge Policies* (01/20/2016) paper on February 17, 2016, the trigger for time-based surcharges was moved to 51 months for purchases under the Extended Fund Facility and the surcharges threshold for level-based surcharges was set at 187.5 percent of quota.

Table 6. Sensitivity Analysis-
Effect of Changes in Selected Assumptions on FY 2017 Projected Income
(in millions of SDRs)

Change in:	
SDR interest rate by 50 basis points	
Implicit returns 1/	28
Credit tranche purchases (non-FCL) by SDR 10 billion 2/	275
U.S. dollar exchange vis-à-vis SDR by five percent	36
Investment income margin by 50 basis points	93

1/ Implicit returns on GRA interest-free resources.
2/ Assumes May 1 transaction with full drawing of SDR 10 billion and access of 500 percent of quotas. Includes service charges, margin on the basic rate of charge and level based surcharges (commitment fees are excluded).

34. In October 2014, Rule T-1 and the burden sharing mechanism were amended as the SDR interest rate fell below the minimum required for the mechanism to operate.[45] Notably, a 5 basis point floor on the SDR interest rate was set, the rounding rules on the SDR interest rate and the burden sharing adjustment were changed, and the 1 basis point minimum of the burden sharing adjustment, introduced in FY 2010, was reduced to 0.1 basis point. These measures aim to preserve a minimal capacity of equal burden sharing for protecting the Fund's balance sheet, while limiting potential departures of the SDR interest rate from market interest rates.

35. Given current levels of overdue obligations and lending, and the prevailing low interest rate environment, burden sharing adjustments remain at very low levels. The burden sharing decision allows for a "carry-forward" of excess amounts generated from a minimum adjustment to the rate of charge and the rate of remuneration.[46] If the amounts brought forward are sufficient to offset deferred charges in subsequent quarter(s), no adjustments are necessary for such quarters. This was the case for the adjustments to the rate of charge in FY 2016 (see Table 7).

[45] Under the burden sharing mechanism, where creditors and debtors as a group generate equal amounts to cover deferred charges, a minimum positive SDR interest rate is required for the mechanism to operate. During FY 2015 the SDR interest rate hit historical lows, falling below that minimum level, affecting the functioning of the burden sharing mechanism for deferred charges. See *Recent fall in the SDR Interest Rate – Implications and Proposed Amendments to Rule T-1* (10/16/2014).

[46] See *The Fund's Income Position for FY 2010—Midyear Review* (12/8/2009), paragraphs 8–10.

Table 7. Recent Burden Sharing Adjustment Rates
(in basis points, unless otherwise stated)

	FY09	FY10	FY11	FY12	FY13	FY14	FY15 [4]	FY16 Projected
Rate of Remuneration 1/								
Total average adjustment	5	1	–[2]	–[2]	–[2]	–[2]	0.300	0.575
Deferred charges	5	1	–[2]	–[2]	–[2]	–[2]	0.300	0.575
SCA-1	–	–	–	–	–	–	–	–
Rate of Charge 1/								
Total average adjustment	5	1	–[2]	–[2]	–[2]	–[2]	–	–
Deferred charges	5	1	–[2]	–[2]	–[2]	–[2]	–	–
SCA-1	–	–	–	–	–	–	–	–
Average SDR interest rate (in percent) 3/	1.79	0.29	0.35	0.30	0.09	0.09	0.061	0.059
Average basic rate of charge (in percent)	2.79	1.29	1.35	1.30	1.09	1.10	1.061	1.059

1/ The average rates have been calculated using the quarterly burden sharing rates and SDR interest rates.
2/ Annual average rate less than 0.5 basis points. Based on minimum burden sharing adjustment rate of 1 basis point.
3/ The SDR interest rates are projected to average 0.325 percent in FY 2017.
4/ In October 2014 (FY 2015), the minimum for the quarterly burden sharing rate adjustment of 1 basis point was reduced to 0.1 basis point.

REVIEW OF SPECIAL CHARGES

36. **The decision on special charges on overdue financial obligations in the GRA and the Trust Fund calls for an annual review**. Under the decision, special charges equal to the SDR interest rate apply to charges that are in arrears for more than 10 days but not beyond six months.[47] While the decision also includes a regime for special charges on overdue repurchase obligations, such charges can only arise in circumstances where the basic rate of charge is below the SDR interest rate. Since under the current system for setting the basic rate of charge that rate is always in excess of the SDR interest rate, members are not subject to special charges on their overdue repurchases.[48] In application of this system no special charges have arisen during FY 2016.[49] At this

[47] Special charges were established to provide members with an incentive to settle their financial obligations to the Fund in a timely manner. It was also recognized that these charges may complicate the efforts of a member in protracted arrears and those of its donors and creditors to resolve its arrears problem, by increasing the financing needs and making it more difficult for the member to make payments to the Fund equivalent to obligations falling due.

[48] For overdue repurchases, the special rate of charge is set to equal the excess, if any, of the SDR interest rate over the basic rate of charge. Pursuant to Rule I-6(4), the basic rate of charge "shall be determined at the beginning of each financial year as the SDR interest rate under Rule T-1 plus a margin expressed in basis points". As such, the basic rate of charge would always be in excess of, or at least equal to, the SDR interest rate. Hence, members with overdue obligations are currently not subject to an additional special charge on their overdue repurchases.

[49] In late June and early July 2015 Greece temporarily fell into arrears to the GRA, failing to meet repurchases of SDR 1.6 billion. Additional charges (from basic rate of charge and surcharges) were incurred on these late payments. Although these obligations were overdue for more than 10 days, no special charges were levied, given that the basic rate of charge was higher than the SDR interest rate. There were no overdue charges that would have been subject to a special charge equal to the SDR interest rate. .

stage, no changes are proposed to the current system (proposed Decision 8), but staff could revisit this issue at a later date if warranted by developments.

Proposed Decisions

Decisions Pertaining to FY 2016

- Decision 1 provides for the assessment on SDR Department participants for the reimbursement of the General Department for the expenses of conducting the business of the SDR Department in FY 2016.

- Decision 2 provides for the reimbursement to the General Resources Account for the cost of administering SDA resources in the CCR (formerly PCDR) Trust in FY 2016.

- Decision 3 provides for the reimbursement to the General Resources Account for the cost of administering the PRGT in FY 2016.

- Decision 4 provides for the transfer of income from the Fixed-Income Subaccount of the Investment Account to the General Resources Account for use in meeting FY 2016 administrative expenses.

- Decision 5 provides for the placement of FY 2016 General Resources Account net income to the Fund's Special Reserve and the General Reserve.

- Decision 6 provides for the transfer of currencies from the GRA to the Investment Account equivalent to the increase of the special and general reserves following the placement of FY 2014, FY 2015, and FY 2016 net income.

Decisions Pertaining to FY 2017–2018

- Decision 7 sets the rate of charge on the use of Fund resources for FY 2017-2018 at 100 basis points over the SDR interest rate.

- Decision 8 reviews the system of special charges.

Decisions 1, 2, 3, 4, 5, and 8 may be adopted by a majority of the votes cast. Decisions 6 and 7 may be adopted by a 70 percent majority of the total voting power.

1. Assessment under Article XX, Section 4 for FY 2016

Pursuant to Article XVI, Section 2 and Article XX, Section 4 of the Articles of Agreement and Rule T-2 of the Fund's Rules and Regulations, it is decided that:

(i) The General Department shall be reimbursed for the expenses of conducting the business of the SDR Department for the period of May 1, 2015 through April 30, 2016; and

(ii) An assessment shall be levied on all participants in the SDR Department. The special drawing right holdings accounts of participants shall be debited on April 30, 2016 with an amount equal to 0.00350162 percent of their net cumulative allocations of special drawing rights. The total assessment shall be paid into the General Department.

2. CCR Trust Reimbursement for FY 2016

In accordance with paragraph 3 of Decision No. 14649-(10/64), adopted June 25, 2010, as amended, the General Resources Account shall be reimbursed an amount equivalent to SDR 0.331 million by the CCR Trust in respect of the expenses of administering SDA resources in the CCR Trust during FY 2016.

3. PRG Trust Reimbursement for FY 2016

In accordance with paragraph 3 of Decision No. 8760-(87/176), adopted on December 18, 1987, an amount equivalent to SDR 49.79 million, representing the cost of administering the Poverty Reduction and Growth Trust (PRGT) for FY 2016, shall be transferred from the Reserve Account of the PRGT (through the Special Disbursement Account) to the General Resources Account.

4. Transfer of Investment Income for FY 2016 to General Resources Account

The income of the Fixed-Income Subaccount of the Investment Account for FY 2016 shall be transferred to the General Resources Account for use in meeting the expenses of conducting the business of the Fund during FY 2016.

5. Placement of FY 2016 net income of the General Resources Account to the Special Reserve and General Reserve

The net income of the General Resources Account for FY 2016 shall be placed in equal parts to the Fund's Special Reserve and General Reserve.

6. Transfer of Currencies to the Investment Account for FY 2016

Pursuant to Article XII, Section 6(f)(ii) of the Articles of Agreement, the Fund shall transfer from the General Resources Account to the Investment Account currencies in an amount equivalent to the difference between the Fund's general and special reserves as of April 30, 2016 and the cumulative amount of previous transfers of currencies from the General Resources Account to the Investment Account. This transfer of currencies to the Investment Account shall be effected in the context of the Financial Transactions Plan covering the period August- October 2016. The currencies transferred to the Investment Account pursuant to this decision shall be used for immediate investment in the Fixed Income Subaccount in accordance with the Rules and Regulations for the Investment Account.

7. The Rate of Charge on the Use of Fund Resources for FY 2017 and FY 2018

Pursuant to Rule I-6(4)(a), last sentence of the Fund's Rules and Regulations, the rate of charge for FY 2017 and FY 2018 shall be 100 basis points over the SDR interest rate under Rule T-1 of the Fund's Rules and Regulations.

8. Review of the System of Special Charges

The Fund has reviewed Decision No. 8165-(85/189) G/TR, adopted December 30, 1985, effective February 1, 1986, as amended, on Special Charges on Overdue Financial Obligations to the Fund.

Annex I. Decisions in Effect Related to the FY 2016 Income Position[1]

Decisions in Effect

The Executive Board has taken the following decisions affecting the Fund's income position for FY 2016:

Rate of Charge

The margin for calculating the basic rate of charge in FY 2016 was set in 2014 at 100 basis points for a period of two years (FY 2015-16). This decision was adopted under the *exceptional circumstances* clause of Rule I-6(4), which allows the margin for calculating the basic rate of charge to be set at a level other than that which is adequate to cover the estimated intermediation expenses of the Fund and to generate an amount of net income for placement to reserves.

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 decisions taken in 2000 and 2009. Unless amended by the Board, this mechanism will continue for as long as overdue obligations to the Fund persist.[2]

Special Charges

For overdue repurchases, the special rate of charge is set to equal the excess, if any, of the SDR interest rate over the basic rate of charge. Pursuant to Rule I-6(4), the basic rate of charge "shall be determined at the beginning of each financial year as the SDR interest rate under Rule T-1 plus a margin expressed in basis points". Since under the current system for setting the basic rate of charge, that rate is always in excess of the SDR interest rate, members are not subject to special charges on their overdue repurchases.

[1] See Review of the Fund's Income Position for FY 2014 and FY 2015–2016 (4/7/14).

[2] See Recent fall in the SDR Interest Rate – Implications and Proposed Amendments to Rule T-1 (10/16/2014).

Annex II. Implementation of the New Income Model

In April 2008, the Executive Board endorsed a New Income Model (NIM) aimed at diversifying the Fund's sources of income and reducing the institution's overreliance on income from lending to finance its diverse activities. The NIM reflected many of the measures that had been proposed in early 2007 by the Committee of Eminent Persons chaired by Andrew Crockett, and was designed to develop broader and more sustainable income sources in recognition of the public good aspects of many of the Fund's activities.[1] Adoption of the NIM would require an intensive work program for the Fund over several years. The table below summarizes the main elements of the NIM and the status of their implementation.[2]

Completed	In progress	Not started

Main Element	Implementation	Status
An amendment to the Articles of Agreement to broaden the Fund's investment authority.	The amendment to the Articles came into effect in February 2011 following ratification by three-fifths of IMF members representing 85 percent of the total voting power. The amendment aimed at providing the Fund with flexibility to enhance the expected return on its investments and adapt its investment strategy over time.	
Creation of an endowment funded with profits from the sale of 403.3 metric tons of the Fund's gold holdings.	Gold sales required an 85 percent majority vote of the Executive Board. The gold sales were completed in December 2010 and realized total profits of SDR 6.85 billion.[3] Initial sales were conducted through off-market transactions with central banks and official holders followed by on-market sales.	
Adoption of new rules and regulations for the Investment Account (IA)—a requirement for the Fund to exercise its expanded investment authority under the amended Articles.	In January 2013, the Executive Board approved new rules and regulations for the IA.	
Full implementation of the endowment	The Executive Board has established the strategic asset allocation (SAA) for the endowment and agreed that the investment into this SAA will be phased over three years (funding started in March 2014). During FY 2017, the Executive Board will return to the payout policy for the endowment to determine how much of the endowment's returns will be made available to help cover the Fund's administrative expenses.	
Adopting a new rule for the margin for the basic rate of charge. Previously, the margin was set to generate sufficient income for the Fund to cover all of its administrative expenses and to meet a specific net income target.	In December 2011, the Fund adopted a new rule for setting the margin on the rate of charge. Under the new rule, the margin should be set to cover only the Fund's intermediation (lending) costs and help build-up reserves. However, given the low interest rate environment and phasing of the endowment, the margin has so far been set under the exceptional circumstances clause.	
Reimbursement of PRG Trust expenses.	In FY 2013, the practice of reimbursing the Fund for the expenses of conducting the business of the PRG Trust was resumed.	

Review of the investment mandate for the reserves portfolio	The staff paper Review of Investment Strategy for the Fixed-Income Subaccount of the Investment Account issued on August 5, 2015 reviewed the investment strategy of the IA-FI. The scope for setting a specific numerical target, as envisaged under the NIM, is to be revisited at a later stage.	

Significant progress has been made in implementing the NIM and many of the main elements are now in place. In the meantime, however, the global economic and market environment has changed dramatically. The global financial crisis has increased the Fund's lending income sharply, but non-lending income has been highly constrained by very low global interest rates. In 2008, projected FY 2014 income from investment of the Fund's reserves and interest free resources was expected to be around SDR 386 million (equal to over 60 percent of expenditures). In contrast, actual FY 2014 income from these sources was only about one-tenth of this estimate, largely reflecting an average SDR interest rate of about 0.1 percent compared with a projected rate of 3.5 percent. In FY 2015 income from the investment of reserves and interest free resources (excluding profits retained in the Endowment Subaccount) totaled SDR 90 million covering about 12 percent of expenditures. Notwithstanding the above, the current income projections indicate that following the full implementation of the NIM, and assuming that global interest rates revert towards more normal historical levels, broad objectives of the NIM remain within reach.

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[1] *Final Report of the Committee to Study Long-Term Financing of the Fund* (1/31/07).

[2] In addition to these elements geared to broadening the Fund's income, the NIM envisioned that in the event the Fund's precautionary balances are considered to be adequate, the Executive Board could consider making dividend payments to members. The Fund is still accumulating precautionary balances towards the current agreed target of SDR 20 billion. As such, this issue will need to be revisited at a later date.

[3] SDR 4.4 billion of the gold profits was used to fund the endowment. In accordance with two decisions adopted by the Board, the remaining profits of SDR 2.45 billion were distributed to members to help finance concessional lending to low-income countries in October 2012 and October 2013.

Annex III. IAS 19 Accounting for Employee Benefits

IAS 19 is the International Financial Reporting Standard (IFRS) that deals with accounting for pension and other employee benefits, including the timing adjustment, in the financial statements of the Employer. Under IAS 19, an employer's balance sheet, inter alia, shows the funded status of the defined benefit pension plan. The funded status, which is either a net pension asset (or liability), is the difference between the fair value of plan assets and the net present value of the defined benefit obligation. The change in the funded status from one period to the next is a function of demographic and financial assumptions underpinning the defined benefit obligation, as well as changes in the fair value of plan assets.

Background

Since the adoption of IFRS in FY 2000, the Fund has followed IAS 19 in accounting for employee benefits. The objective of IAS 19 is to ensure that the liability associated with services provided by employees in exchange for benefits to be paid in the future and the related annual expense is properly recognized by the employer in its financial statements. IAS 19 prescribes the accounting by employers for (i) short-term employee benefits (e.g., salaries and wages); and (ii) post-employment benefits (e.g., pension, post-retirement health benefits, and termination grants). The employer recognizes an expense for short-term employee benefits in the period in which an employee has rendered services. Cash outflows associated with long-term benefits are subject to a high degree of uncertainty and are actuarially determined.

Accounting for post-employment and long-term benefits

To meet the benefit obligations associated with post-employment and long-term benefits, the Fund has sponsored a defined benefit plan (Staff Retirement Plan) and a separate Retired Staff Benefits Investment Account. The Fund reports on the balance sheet a net asset or liability equal to the difference between the fair value of plan assets and the net present value of the defined benefit obligation. To determine the present value of the defined benefit obligation, the Fund discounts projected future cash outflows by applying demographic assumptions (e.g., mortality and employee turnover), and financial assumptions (e.g., the discount rate, inflation rate, salary increases, inflation rate, and future medical costs). Changes in underlying assumptions from year to year give rise to actuarial gains or losses (e.g., a reduction in the discount rate, and all else being equal, would result in a higher defined benefit obligation and an actuarial loss). The change in the net asset (or liability), after taking into account the employer's contributions to the plans and actuarial gains and losses, determines the IAS 19 expense for the year. The full impact of actuarial gains and losses incurred during the year is reflected in the annual IAS 19 adjustment.

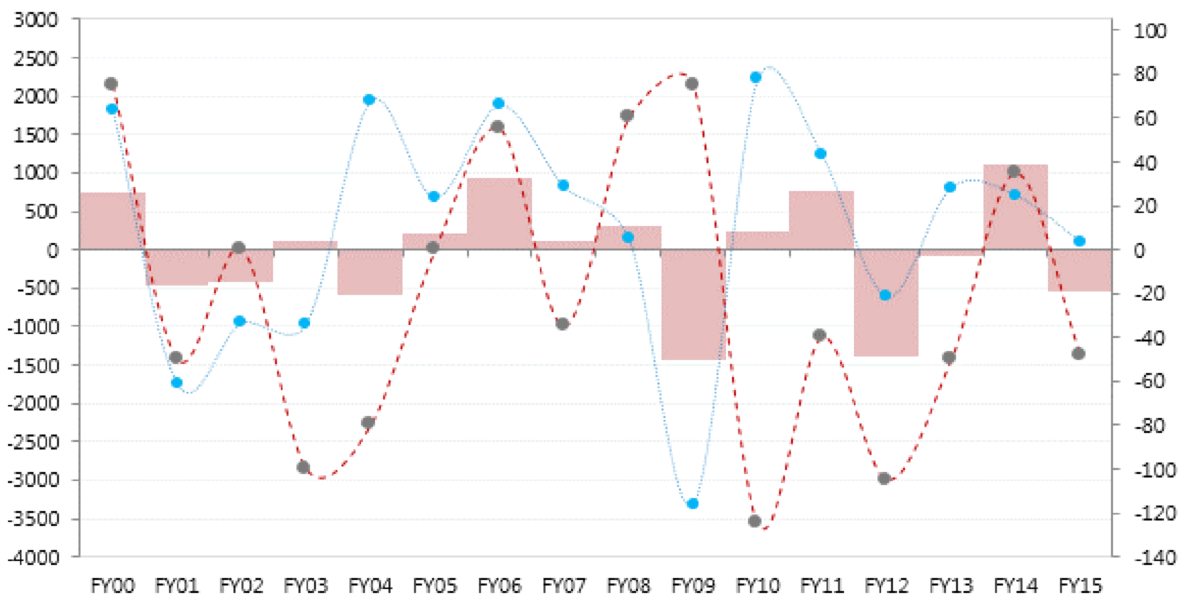
Accounting vs. funding basis

The actuarial methods under IAS 19 to measure the IAS 19 expense in the Fund's financial statements are different from the actuarial method used to determine the Fund's annual contribution for the pension plans (i.e., the funding requirement). Therefore, the accounting for employee benefits differs between the Fund's financial statements (accrual basis) and the administrative budget (cash basis for employer's contributions). The resulting timing differences can be substantial but should net to zero over the life of the pension and benefit plans, as from an accounting perspective the IAS 19 adjustments necessarily equal the employer's funding over time.

Additional volatility in Fund income

The amended IAS 19 has introduced an additional source of volatility to Fund income. Historically, variances in the discount rate used to derive the net present value of pension obligations and movements in the fair value of pension assets have had the largest impact on changes in the funded status of the defined benefit pension plan. Figure 6 illustrates the Fund's actuarial gains and losses for FY 2000-15 (restated under Amended IAS 19 for FY 2000-13). Going forward, the timing adjustment is expected to remain unpredictable and any volatility in the underlying actuarial assumptions would translate into volatility in the Fund's income and reserves. As such, the IAS 19 timing adjustment has not been projected beyond FY 2016.

Figure 6. Key Factors affecting Amended IAS 19 Actuarial Gains/Losses (FY 2000-15)



Source: IMF staff.

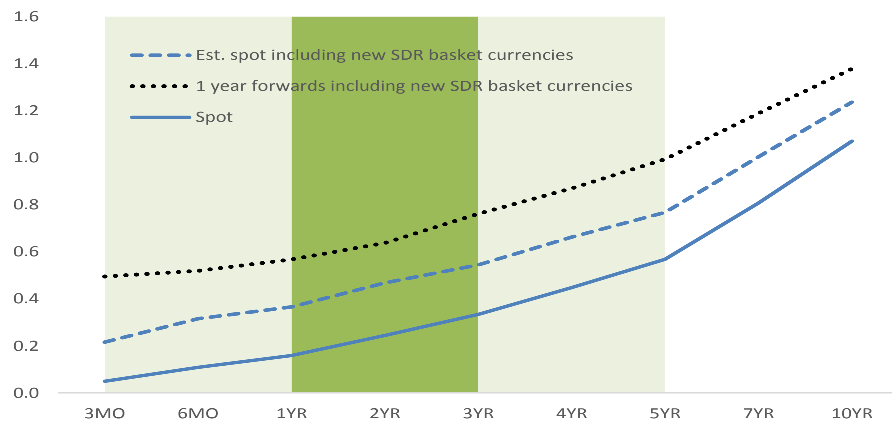
Actuarial gains/losses (in SDR million)-left axis
Annual excess return/loss on plan asset (basis point)-left axis
Y-to-Y movement in discount rate (basis point)-right axis

Annex IV. Investment Account (IA) Performance Scenarios

Fixed-Income Subaccount (FI) [50]

Government bond yields in markets of the SDR basket were volatile during FY 2016. Despite starting the year on an upward path, developed market government bond yields fell sharply in January 2016, in response to lower commodity prices and an accompanying decline in inflation expectations, as well as renewed concerns over global growth prospects. Towards the end of FY 2016, yields were marginally higher in the 1 to 3 year maturity range compared to last year, while yields on longer term maturity government bonds were lower. Divergence in the path of rates within the SDR basket continued, with the Federal Reserve increasing rates in December, while the Bank of Japan announced a surprise cut in rates and ECB implemented further easing. Going forward, the risk of rising rates remains. As of end-February 2016, investors anticipate a much more gradual increase in bond yields compared to last year: one-year forward yields are about 21 basis points higher than the current estimated level of rates including the new SDR basket currencies (Figure 7).[51] This is less than half the magnitude implied by forward yields one year ago.

Figure 7. Current Levels of SDR-Weighted Yields and Market-Implied Forward Rates (in percent)



Sources: Bloomberg, Staff calculations

[50] In implementation of the expanded investment authority under the Fifth Amendment, the Executive Board concluded a review of the FI investment strategy and adopted revised Rules and Regulations for the IA in August 2015. The eligible fixed-income universe was expanded considerably. Once fully transitioned to the new strategy in the course of FY 2017, the FI portfolio will initially be split into two broadly equal tranches to improve diversification benefits and portfolio resilience amid challenging market conditions. A first Tranche 1 will have a relatively shorter duration portfolio compared to the previous 1–3 year strategy and will include an expanded set of high-quality fixed-income assets beyond government bonds managed actively by external managers and broadly guided by a 0-3 year government bond benchmark. The longer-duration Tranche 2 investments will be more passively managed, based on a 0-5 year government bond benchmark, and phased in over a five year horizon.

[51] These estimates show the level of rates assuming the upcoming composition of the SDR basket. In the November 2015 review of the SDR basket, the Executive Board decided that, effective October 1, 2016, the Chinese renminbi (RMB) will be included in the SDR basket as a fifth currency, along with the U.S. dollar, euro, Japanese yen, and pound sterling. See *Review of the Method of Valuation of the SDR* (11/13/15).

The new FI investment strategy, once fully implemented, is expected to improve diversification benefits and portfolio resilience amid challenging market conditions through the establishment of the two tranches, and an expansion in assets that will enable external managers to better manage the portfolio's downside risk. That said, over the short to medium term, and in light of current market conditions, absolute returns are likely to be lower than in the past and a short-term risk of capital loss or underperformance against the 3-month SDR rate remains elevated if yields rise, owing to the very low yields in underlying SDR basket investments and limited income protection.[52] While there may be some short-term periods of underperformance as yields increase, higher average yields will benefit the FI's performance both in absolute terms and also relative to the SDR rate.

In line with past reviews of the Fund's income position, the analysis below outlines return scenarios for the FI through end-FY 2016 and in FY 2017 to illustrate the impact of the following yield scenarios on performance relative to the 3-month SDR:

1. Yields increase in line with market implied forward rates (as in Table 8);
2. Yields increase to a level 25 basis points above market forward rates;
3. Yields decrease to a level 25 basis points below market forward rates;
4. Yields revert to bond yield trough of August 2012.

The results of the analysis suggest that total portfolio returns would be positive but modest compared to previous years under each of the scenarios. The FI would generate positive excess returns relative to the 3-month SDR rate if yields stay unchanged, decrease or rise by less than that implied by market forwards. The FI would underperform the 3-month SDR rate if yields increase to a level higher than that implied by market forwards. Compared to previous estimates, it should be noted that with the expanded discretion afforded to external managers under the new investment strategy, returns can no longer be projected with a high level of certainty and the results provided in Table 8 are based on general assumptions.

[52] To illustrate such an adverse scenario, based on a current yield of approximately 24 basis points, the FI bond portfolio could sustain a gradual annual rate increase of about 56 basis points (4.7 basis points per month) before recording a one-year negative return, higher than the magnitude of rate increase priced in by market forwards. This estimate incorporates additional income cushion from the RMB and shorter expected duration of the FI (without the RMB, the breakeven would be approximately 10 basis points lower).

Table 8. Investment Account Performance Scenarios (unannualized returns in percent)

	Unchanged yields 1/	Trough Bond Yields 2/	Forwards -25bp	Forwards 3/	Forwards +25 bp
Actual returns FYTD (May 2015-February 2016)					
3-month SDR	0.05	…	…	…	…
Tranche 1	0.36	…	…	…	…
Tranche 2	0.67	…	…	…	…
IA	0.51	…	…	…	…
Excess Return	0.46	…	…	…	…
FY 2016 (May 2015-April 2016)					
3-month SDR	0.05	0.05	0.05	0.05	0.05
Tranche 1	0.41	0.72	0.70	0.64	0.58
Tranche 2	0.71	0.37	0.35	0.30	0.26
IA	0.56	0.53	0.51	0.46	0.40
Excess return	0.51	0.48	0.46	0.41	0.35
FY 2017 (May 2016-April 2017)					
3-month SDR	0.28	0.06	0.20	0.37	0.54
Tranche 1	0.58	0.49	0.53	0.39	0.25
Tranche 2	0.42	0.26	0.36	0.32	0.29
IA	0.50	0.38	0.45	0.36	0.27
Excess Return	0.22	0.32	0.25	-0.01	-0.27
Memo Items					
Assumed yields	Spot	Target yields		1 year forward	
3-month SDR	0.05	0.06		0.50	
1 year SDR	0.16	0.07		0.57	
2 year SDR	0.24	0.08		0.64	
3 year SDR	0.33	0.20		0.76	

Sources: State Street data, Bloomberg, and staff calculations.
1/ Estimated based on end-February levels and including the new SDR composition from October 2016
2/ Assumption is to reach historical lows over the next 12 months.
3/ Estimates of forward rates incorporates the new SDR composition
Note: Actual returns are based on audited performance data provided by State Street. Projections are based on current market levels on SDR weighted 3-month bills and SDR government bonds. Total return assumes a 2 basis points roll down per month. Tranche 1 returns include a 2 basis points monthly excess return over the 0-3 year government bond index from 2017 and Tranche 2 incorporates gradual phasing over 5 years.

Income of the Endowment Subaccount

The passively managed tranche of the Endowment Subaccount (EA) began its three-year phased implementation in the first quarter of 2014. The portfolio has a diversified asset allocation with a 65 percent share in global fixed-income assets and 35 percent share in equities. Short-term return projections for these investments are subject to considerable uncertainty given the higher volatility of the asset classes in which the EA is invested. So far, in FY 2016 (through February), the invested share of the endowment (about $^{2}/_{3}$) lost 4.9 percent in U.S. dollars after having gained 6.9 percent in FY 2015. The share of gold sales profits waiting to be invested in the endowment is placed in fixed-term SDR deposits with the BIS and returned about 7 basis points during the same period.

Compared with the FI, assets invested in the Endowment Subaccount are exposed to greater market risks, particularly at short horizons. The estimated worst case loss for the invested share of the endowment based on a one-year 95 percent Value-at-Risk (VaR) is about 9 percent in U.S. dollar terms vs. less than 1 percent for the FI.[53] Although market and credit risks are to some extent mitigated by the diversification of the portfolio, these risks are significantly larger than for the FI given the higher duration of the SAA's bond allocation (on average 7.5–8 years) and the allocation to equities and REITs. In addition, only non-U.S. dollar developed-market currency fixed-income assets are required and allowed to be hedged, leaving approximately 25 percent of the passive (invested) portion unhedged to the U.S. dollar base currency. Going forward, rising U.S. rates and possible global equity market corrections remain key risks for the EA. The current running yield of the endowment is 1.65 percent (2.2 percent for the invested share and 0.1 percent for the share placed in BIS deposits).

[53] These VaR estimates are calculated by the Fund's custodian, State Street. State Street's VaR methodology uses simulated 3-year historical data. VaR is calculated by first modeling the entire returns distribution for all asset classes and a portfolio level, then calculating the value at the percentile corresponding to the desired confidence level.

Annex V. Assumptions Underlying the Income Projections

	Actual through end-February 2016	FY2016 Current Projections	FY2017	FY2018
		(In billions of SDRs)		
Regular Facilities:				
1. Purchases (excl. reserve tranche purchases)	4.3	6.3	3.7	1.8
2. Repurchases	10.9	12.1	4.1	4.4
3. Average balances subject to charges	52.1	51.5	49.4	47.4
4. Average SDR holdings	14.9	17.6	31.4	31.4
5. Average remunerated positions	38.2	38.2	38.3	36.5
6. Average investment account assets-reserves 1/	10.4	10.4	14.1	15.0
7. Average investment account assets-gold profits	4.5	4.6	4.7	4.9
8. Average borrowings and issued notes	32.5	32.5	33.2	33.0
		(In percent)		
Return on investments-reserves 2/	0.49	0.53	0.29	0.78
Return on investments-gold profits 3/	-1.72	-1.27	4.25	4.88
Average interest rates:				
SDR interest rate and basic rate of remuneration	0.10	0.10	0.30	0.60
Basic rate of charge	1.10	1.10	1.30	1.60
Margin on the rate of charge	1.00	1.00	1.00	1.00

1/ Currencies available for transfer to the IA were retained in the GRA in FY 2014 and FY 2015 and are expected to be transferred during FY 2017.
2/ End-February figure is unannualized.
3/ The projected returns for the gold endowment reflect the phase in of investments under the strategic asset allocation and the earnings from the short-term deposits held in the interim.

Annex VI. Projected Income and Expenses—FY 2016

Linking the analytical presentation with the Fund's income statement

The purpose of this Annex is to prepare a reconciliation between the analytical framework presented in Table 1 of this paper and the traditional format used to prepare the Fund's income statement under IFRS.[54] The formulation of the Fund's income and expense flow results in the same projected net income position. However, the analytical framework is preferred in discussing the income position for two reasons. First, it succinctly captures the main variables that drive the Fund's income position. To this end, the presentation focuses on the net contribution made by the Fund's income-earning assets. Second, the framework is used to reflect certain aspects of the Fund's practices, e.g., surcharge income is not included in the net operational income because it is assumed to be placed directly to reserves to help build up precautionary balances.

The starting point to move from the traditional format in the Fund's financial statements to the analytical framework in the paper is to net the financing costs (remuneration and interest on borrowings) against the income generated from Fund credit and the GRA's SDR holdings. This provides the income from the margin and interest free resources by eliminating the flows from the SDR interest rate between the debtor and creditor members of the Fund. Thereafter, the main adjustments involve re-arranging the various line items on the Fund's IFRS financial statements to the analytical framework. This includes:

- Allocation of surcharges from interest and charges to below the net operational income line reflecting the current Fund practice of placing surcharge income directly to reserves.
- Allocation of retained gold endowment income from investment income since this amount is retained in the investment account.
- Folding-in the reimbursements and the IAS 19 timing adjustments into administrative expenses.

Table 9 below highlights this reconciliation process.

[54] The Annex is prepared in response to requests by Directors to simplify/explain the process of reconciling various aspects of the Fund's financial structure.

Table 9. Reconciliation of the Accounting and Analytical Presentations of Projected Income and Expense—FY 2016

	Actual to end-Feb 2016	FY 2016 Projections	Adjustments: Financing costs	Adjustments: Expenses	Adjustments: Surcharges and endowment income	Adjustments: IAS 19 expense re-allocation	Analytical presentation
			(In millions of SDRs)				
A. Operational income							
Interest and charges	1,138	1,339	-36		-788		515
Interest on SDR holdings	6	10	-10				0
Net income from investments	-30	1			58		59
Service charges and commitment fees	117	128					128
Total income	**1,231**	**1,478**					
B. Operational expenses							
Remuneration 1/	9	16	-24				-8
Interest expense on borrowings	15	22	-22				0
Administrative expenses 2/	757	966		57		-228	795
Total expenses	**781**	**1,004**					
Other reconciling items:							
IAS 19 timing adjustment		524				-228	296
Reimbursements				57			57
Surcharges					788		788
Endowment Subaccount investment income					-58		-58
C. Net income 3/	**450**	**998**					**998**

1/ Interest free resources lower the Fund's costs by reducing members' reserve tranche positions and the Fund's remuneration expense resulting in implicit income for the Fund. At the present time, the interest free resources retained in the GRA comprises the SCA-1, unremunerated reserve tranche positions not represented by gold holdings, and GRA income for the year not transferred to the IA.

2/ Administrative expenses presented on an IFRS basis include net administrative expenditures, capital budget items expensed, and depreciation. This is partially offset by reimbursements to the GRA. The IAS 19 timing adjustment at end-February 2016 is excluded.

3/ Income statement on the basis presented in the Fund's annual IFRS financial statements.

Annex VII. Cumulative Burden Sharing Adjustments at end–January 2016[1] (in millions of SDRs)

	Adjustments for Deferred Charges				Adjustments for SCA-1			
Member	Charges	Remuneration	Total	Percentage of total	Charges	Remuneration	Total	Percentage of total
Albania	0.1	0.0	0.1	0.0	0.1	0.0	0.1	0.0
Algeria	7.4	0.5	7.9	1.1	13.2	0.5	13.6	1.1
Angola	0.1	0.0	0.1	0.0	-	0.0	0.0	0.0
Antigua and Barbuda	0.0	-	0.0	0.0	-	-	-	-
Argentina	31.0	-	31.0	4.3	64.7	-	64.7	5.4
Armenia	0.2	0.0	0.2	0.0	0.2	0.0	0.2	0.0
Australia	-	3.0	3.0	0.4	-	7.0	7.0	0.6
Austria	-	4.6	4.6	0.6	-	7.6	7.6	0.6
Azerbaijan	0.3	-	0.3	0.0	0.9	-	0.9	0.1
Bahamas, The	-	0.0	0.0	0.0	-	0.0	0.0	0.0
Bahrain	-	0.7	0.7	0.1	-	0.9	0.9	0.1
Bangladesh	3.1	-	3.1	0.4	2.9	-	2.9	0.2
Barbados	0.1	0.0	0.2	0.0	0.2	0.0	0.2	0.0
Belarus	0.8	-	0.8	0.1	1.0	-	1.0	0.1
Belgium	-	6.3	6.3	0.9	-	12.3	12.3	1.0
Belize	0.0	0.0	0.1	0.0	0.0	0.0	0.1	0.0
Bhutan	-	0.0	0.0	0.0	-	0.0	0.0	0.0
Bolivia	0.9	-	0.9	0.1	0.9	-	0.9	0.1
Bosnia and	0.6	-	0.6	0.1	0.8	-	0.8	0.1
Botswana	-	0.2	0.2	0.0	-	0.3	0.3	0.0
Brazil	23.8	0.2	24.0	3.4	57.4	-	57.4	4.8
Brunei Darussalam	-	0.1	0.1	0.0	-	0.3	0.3	0.0
Bulgaria	3.7	0.1	3.8	0.5	8.2	0.1	8.3	0.7
Burkina Faso	-	0.1	0.1	0.0	-	0.1	0.1	0.0
Burundi	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Cambodia	0.0	-	0.0	0.0	0.0	-	0.0	0.0
Cameroon	0.7	-	0.7	0.1	0.8	-	0.8	0.1
Canada	-	6.3	6.3	0.9	-	14.3	14.3	1.2
Cabo Verde	-	0.0	0.0	0.0	-	-	-	-
Central African	0.1	-	0.1	0.0	0.1	-	0.1	0.0
Chad	0.1	-	0.1	0.0	0.1	-	0.1	0.0
Chile	5.8	0.5	6.4	0.9	5.7	1.6	7.3	0.6
China	4.0	7.9	11.9	1.7	3.5	16.2	19.7	1.7
Colombia	-	1.3	1.3	0.2	-	2.3	2.3	0.2
Comoros	0.0	0.0	0.0	0.0	-	0.0	0.0	0.0
Congo, D.R.	3.4	-	3.4	0.5	3.9	-	3.9	0.3
Congo, Rep.	0.1	-	0.1	0.0	0.2	-	0.2	0.0
Costa Rica	0.4	0.1	0.5	0.1	0.5	0.1	0.6	0.0
Côte d'Ivoire	2.5	-	2.5	0.3	2.4	-	2.4	0.2
Croatia	1.1	-	1.1	0.2	1.6	-	1.6	0.1

Cumulative Burden Sharing Adjustments at end–January 2016
(in millions of SDRs)
(continued)

Member	Adjustments for Deferred Charges: Charges	Remuneration	Total	Percentage of total	Adjustments for SCA-1: Charges	Remuneration	Total	Percentage of total
Cyprus	0.0	0.2	0.2	0.0	-	0.4	0.4	0.0
Czech Republic	2.2	0.3	2.5	0.3	2.7	0.6	3.3	0.3
Denmark	-	3.6	3.6	0.5	-	6.2	6.2	0.5
Djibouti	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Dominica	0.0	-	0.0	0.0	0.0	-	0.0	0.0
Dominican Republic	2.5	-	2.5	0.3	2.2	-	2.2	0.2
Ecuador	2.0	0.1	2.1	0.3	2.6	0.1	2.7	0.2
Egypt	1.4	0.1	1.5	0.2	1.5	0.2	1.7	0.1
El Salvador	0.0	-	0.0	0.0	0.0	-	0.0	0.0
Equatorial Guinea	0.0	0.0	0.0	0.0	0.0	-	0.0	0.0
Estonia	0.1	0.0	0.1	0.0	0.3	-	0.3	0.0
Ethiopia	0.2	0.0	0.2	0.0	0.2	0.0	0.2	0.0
Fiji	0.0	0.1	0.1	0.0	0.0	0.2	0.2	0.0
Finland	-	2.7	2.7	0.4	-	4.6	4.6	0.4
France	-	19.1	19.1	2.7	-	33.5	33.5	2.8
Gabon	0.7	-	0.7	0.1	1.0	-	1.0	0.1
Gambia, The	0.1	-	0.1	0.0	0.1	-	0.1	0.0
Georgia	0.3	-	0.3	0.0	0.4	-	0.4	0.0
Germany	-	38.7	38.7	5.4	-	59.1	59.1	5.0
Ghana	1.7	0.0	1.7	0.2	1.8	0.0	1.8	0.2
Greece	2.0	1.2	3.2	0.4	-	2.1	2.1	0.2
Grenada	0.0	-	0.0	0.0	0.0	-	0.0	0.0
Guatemala	0.4	0.0	0.4	0.1	0.3	0.0	0.3	0.0
Guinea	0.1	-	0.1	0.0	0.1	-	0.1	0.0
Guinea-Bissau	0.0	-	0.0	0.0	0.0	-	0.0	0.0
Guyana	0.4	-	0.4	0.1	0.4	-	0.4	0.0
Haiti	0.2	-	0.2	0.0	0.3	-	0.3	0.0
Honduras	0.4	0.0	0.5	0.1	0.6	0.0	0.7	0.1
Hungary	7.3	0.4	7.7	1.1	6.9	1.3	8.2	0.7
Iceland	0.2	0.1	0.3	0.0	0.0	0.1	0.1	0.0
India	24.0	2.6	26.6	3.7	28.4	3.4	31.9	2.7
Indonesia	14.7	0.9	15.6	2.2	42.5	1.6	44.0	3.7
Iran, I. Rep. of	-	0.1	0.1	0.0	-	0.0	0.0	0.0
Iraq	0.7	0.5	1.2	0.2	0.6	0.3	0.9	0.1
Ireland	1.4	2.0	3.4	0.5	-	3.3	3.3	0.3
Israel	0.6	0.4	0.9	0.1	0.9	0.9	1.7	0.1
Italy	-	17.9	17.9	2.5	-	28.2	28.2	2.4
Jamaica	2.6	-	2.6	0.4	2.9	-	2.9	0.2
Japan	-	40.0	40.0	5.6	-	64.5	64.5	5.4
Jordan	1.7	0.0	1.7	0.2	3.1	0.0	3.1	0.3
Kazakhstan	0.8	0.0	0.8	0.1	1.7	-	1.7	0.1
Kenya	1.2	0.0	1.2	0.2	1.1	0.0	1.1	0.1
Kiribati	-	0.0	0.0	0.0	-	-	-	-
Korea	7.8	3.5	11.3	1.6	19.6	5.0	24.6	2.1
Kosovo	0.0	0.0	0.0	0.0	-	-	-	-

Cumulative Burden Sharing Adjustments at end–January 2016
(in millions of SDRs)
(continued)

	Adjustments for Deferred Charges				Adjustments for SCA-1			
Member	Charges	Remuneration	Total	Percentage of total	Charges	Remuneration	Total	Percentage of total
Kuwait	-	2.8	2.8	0.4	-	4.2	4.2	0.4
Kyrgyz Republic	0.1	-	0.1	0.0	0.3	-	0.3	0.0
Lao P.D.R	0.0	-	0.0	0.0	0.0	-	0.0	0.0
Latvia	0.4	-	0.4	0.1	0.5	-	0.5	0.0
Lebanon	0.1	0.3	0.4	0.1	-	0.3	0.3	0.0
Lesotho	-	0.0	0.0	0.0	-	0.0	0.0	0.0
Liberia	2.4	-	2.4	0.3	3.1	-	3.1	0.3
Libya	-	5.1	5.1	0.7	-	6.4	6.4	0.5
Lithuania	0.5	-	0.5	0.1	1.2	-	1.2	0.1
Luxembourg	-	0.3	0.3	0.0	-	0.6	0.6	0.0
Macedonia, F.Y.R.	0.3	-	0.3	0.0	0.5	-	0.5	0.0
Madagascar	0.4	-	0.4	0.1	0.4	-	0.4	0.0
Malawi	0.3	-	0.3	0.0	0.3	-	0.3	0.0
Malaysia	-	3.3	3.3	0.5	-	5.8	5.8	0.5
Maldives	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Mali	0.2	0.1	0.2	0.0	0.2	0.1	0.2	0.0
Malta	-	0.4	0.4	0.1	-	0.5	0.5	0.0
Mauritania	0.2	-	0.2	0.0	0.2	-	0.2	0.0
Mauritius	0.2	0.0	0.2	0.0	0.1	0.1	0.2	0.0
Mexico	38.3	0.8	39.1	5.5	57.0	1.2	58.2	4.9
Micronesia	-	0.0	0.0	0.0	-	0.0	0.0	0.0
Moldova	0.5	-	0.5	0.1	1.1	-	1.1	0.1
Mongolia	0.1	-	0.1	0.0	0.1	-	0.1	0.0
Montenegro	-	0.0	0.0	0.0	-	-	-	-
Morocco	2.8	0.2	2.9	0.4	2.8	0.3	3.0	0.3
Myanmar	0.1	-	0.1	0.0	0.1	-	0.1	0.0
Namibia	-	0.0	0.0	0.0	-	0.0	0.0	0.0
Nepal	0.1	0.0	0.2	0.0	0.1	0.0	0.1	0.0
Netherlands	-	9.8	9.8	1.4	-	17.7	17.7	1.5
New Zealand	-	0.7	0.7	0.1	-	1.8	1.8	0.2
Nicaragua	0.1	-	0.1	0.0	0.1	-	0.1	0.0
Niger	0.2	0.1	0.3	0.0	0.2	0.1	0.3	0.0
Norway	-	6.4	6.4	0.9	-	9.2	9.2	0.8
Oman	-	0.5	0.5	0.1	-	0.7	0.7	0.1
Pakistan	7.1	-	7.1	1.0	9.4	-	9.4	0.8
Panama	1.2	0.0	1.2	0.2	1.5	0.0	1.6	0.1
Papua New Guinea	0.3	0.0	0.3	0.0	0.6	0.0	0.6	0.0
Paraguay	-	0.2	0.2	0.0	-	0.2	0.2	0.0
Peru	7.1	0.0	7.2	1.0	9.4	-	9.4	0.8
Philippines	9.2	0.4	9.6	1.3	14.4	0.6	15.0	1.3
Poland	3.4	0.6	4.0	0.6	4.1	1.5	5.6	0.5
Portugal	2.2	2.0	4.2	0.6	0.8	3.8	4.6	0.4
Qatar	-	0.4	0.4	0.1	-	0.7	0.7	0.1
Romania	5.9	-	5.9	0.8	7.4	-	7.4	0.6
Russian Federation	23.7	0.4	24.1	3.4	61.9	-	61.9	5.2

Cumulative Burden Sharing Adjustments at end–January 2016
(in millions of SDRs)
(continued)

Member	Adjustments for Deferred Charges: Charges	Remuneration	Total	Percentage of total	Adjustments for SCA-1: Charges	Remuneration	Total	Percentage of total
Rwanda	0.0	0.0	0.1	0.0	0.1	0.0	0.1	0.0
Samoa	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
San Marino	-	0.0	0.0	0.0	-	0.0	0.0	0.0
Saudi Arabia	-	10.9	10.9	1.5	-	17.1	17.1	1.4
Senegal	0.5	-	0.5	0.1	0.6	-	0.6	0.0
Serbia	1.9	-	1.9	0.3	3.2	-	3.2	0.3
Seychelles	0.0	0.0	0.0	0.0	-	0.0	0.0	0.0
Sierra Leone	0.5	-	0.5	0.1	0.5	-	0.5	0.0
Singapore	-	1.9	1.9	0.3	-	3.2	3.2	0.3
Slovak Republic	1.6	0.0	1.6	0.2	2.5	0.0	2.5	0.2
Slovenia	0.4	0.1	0.6	0.1	0.4	0.4	0.8	0.1
Solomon Islands	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Somalia	1.1	-	1.1	0.2	1.5	-	1.5	0.1
South Africa	1.7	0.0	1.7	0.2	2.9	-	2.9	0.2
Spain	-	11.2	11.2	1.6	-	16.3	16.3	1.4
Sri Lanka	2.2	0.1	2.3	0.3	2.1	0.1	2.3	0.2
St. Kitts and Nevis	0.0	-	0.0	0.0	0.0	-	0.0	0.0
St. Lucia	0.0	-	0.0	0.0	-	-	-	-
St. Vincent and the	-	0.0	0.0	0.0	-	0.0	0.0	0.0
Sudan	6.1	-	6.1	0.9	8.3	-	8.3	0.7
South Sudan	-	0.0	0.0	0.0	-	-	-	-
Suriname	-	0.0	0.0	0.0	-	0.0	0.0	0.0
Swaziland	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Sweden	-	4.6	4.6	0.6	-	8.2	8.2	0.7
Switzerland	-	4.4	4.4	0.6	-	10.8	10.8	0.9
Tajikistan	0.0	-	0.0	0.0	0.1	-	0.1	0.0
Tanzania	0.3	-	0.3	0.0	0.3	-	0.3	0.0
Thailand	4.1	1.3	5.4	0.8	9.0	2.0	11.0	0.9
Togo	0.2	-	0.2	0.0	0.2	-	0.2	0.0
Tonga	-	0.0	0.0	0.0	-	0.0	0.0	0.0
Trinidad and Tobago	1.5	0.2	1.7	0.2	1.5	0.3	1.7	0.1
Tunisia	2.4	0.0	2.5	0.3	2.8	0.1	2.8	0.2
Turkey	26.3	0.3	26.6	3.7	50.9	0.5	51.4	4.3
Tuvalu	-	0.0	0.0	0.0	-	-	-	-
Uganda	0.4	-	0.4	0.1	0.3	-	0.3	0.0
Ukraine	6.6	-	6.6	0.9	12.2	-	12.2	1.0
United Arab Emirates	-	2.3	2.3	0.3	-	3.3	3.3	0.3
United Kingdom	-	13.5	13.5	1.9	-	25.8	25.8	2.2
United States	-	102.6	102.6	14.3	-	157.9	157.9	13.3
Uruguay	2.2	0.0	2.2	0.3	5.8	0.0	5.9	0.5
Uzbekistan	0.3	-	0.3	0.0	0.8	-	0.8	0.1
Vanuatu	-	0.0	0.0	0.0	-	0.0	0.0	0.0
Venezuela, R. B. de	15.4	2.1	17.5	2.4	19.8	2.4	22.2	1.9
Vietnam	0.6	-	0.6	0.1	0.9	-	0.9	0.1
Yemen, Rep. of	0.3	0.0	0.3	0.0	0.7	0.0	0.7	0.1

Cumulative Burden Sharing Adjustments at end–January 2016
(in millions of SDRs)
(concluded)

	Adjustments for Deferred Charges				Adjustments for SCA-1			
Member	Charges	Remuneration	Total	Percentage of total	Charges	Remuneration	Total	Percentage of total
Zambia	5.2	-	5.2	0.7	5.5	-	5.5	0.5
Zimbabwe	0.8	-	0.8	0.1	1.6	-	1.6	0.1
	358.2	357.1	715.2	100.0	603.8	583.9	1,187.7	100.0

Values of 0.0 represent amounts of less than SDR 0.1 million; "-" denotes no adjustments.
1/ Adjustments to charges and remuneration are billed quarterly.

INTERNATIONAL MONETARY FUND

CONFIDENTIAL

THE CONSOLIDATED MEDIUM-TERM INCOME AND EXPENDITURE FRAMEWORK

April 14, 2016

EXECUTIVE SUMMARY

The medium-term income projections have been updated from the April 2015 outlook and the February review of the adequacy of precautionary balances. The main changes to the outlook stem from a more gradual rise in the SDR interest rates and lower surcharge income following the lowering of the surcharges threshold.

The revised projections still show a positive forecast for net operational income (and surcharges) over the medium term, albeit lower than projected a year ago. Lending income (excluding surcharges) is marginally higher compared with earlier estimates. Surcharge income is estimated to be lower, reflecting the adjustment of the surcharges thresholds following the implementation of quota increases under the 14th General Review. Projected income from the Fixed-Income Subaccount of the Investment Account and interest-free resources are expected to increase more gradually over the medium-term as market indicators now point to a slower rise in interest rates from their current low levels. The expenditure path includes an increase in real terms of about ½ percent in the net administrative budget for FY 2017 to accommodate rising costs for physical and IT security. Moreover, reflecting further upward pressure over the medium term and uncertainty about the scope for offsetting savings, the traditional baseline assumption of a constant real spending envelope in the outer years is complemented by an alternative scenario with a further moderate spending increase of 1½ percent, phased in over FY 2018–19. In addition, a lower projected U.S. dollar/SDR exchange rate increases the expenses in SDR terms.

The steady state analysis which illustrates the Fund's income position in a future low-lending environment has been updated and now reflects the recently endorsed floor for precautionary balances of SDR 15 billion. Assuming an SDR interest rate of 2.5-3.0 percent, the steady state projection yields a positive income-expenditure position.

A slower pace of reserve accumulation is now expected. Assuming an unchanged margin for the rate of charge, precautionary balances are now projected to reach about SDR 18 billion by FY 2022 compared with SDR 19 billion projected a year ago and at the time of the review of precautionary balances. This reflects mainly the effect of lower interest rates over the medium term, coupled with the impact of the changes in surcharges thresholds following the 14th General Review of Quotas.

Approved By
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Prepared by the Finance Department and the Office of Budget and Planning

CONTENTS

INTRODUCTION

1. **This paper updates the consolidated income and expenditure outlook from April 2015 and the recent review of the adequacy of precautionary balances.**[1,2] The paper incorporates and extends the income and budget projections in the companion papers.[3]

2. **The paper is organized as follows.** The first part of the paper presents the updated outlook for the Fund's consolidated income and expenditure through FY 2022. It begins with a review of the outlook for the Fund's medium-term income from lending and non-lending income sources, highlighting key changes since the last update in April 2015.[4] The paper then describes the medium-term expenditure outlook. The discussion of consolidated income and expenditures concludes with an update of the long-run income-expenditure position which, as in the past, provides an illustration of the steady state income position when lending income has returned to low levels as envisaged at the time the Fund's New Income Model was developed. The second part of the paper provides an update on the projected pace of accumulation of precautionary balances over the medium term including changes since the February review of the adequacy of precautionary balances.[5]

CONSOLIDATED INCOME AND EXPENSES

A. Medium-Term Income

3. **The medium-term income outlook remains positive despite a decline in projected income from surcharges and expectations for a more gradual rise in investment returns.** Net operational income before surcharges is now expected to provide only a modest buffer over expenditures through FY 2021, while net income including surcharges remains positive through FY 2022.

[1] See *The Consolidated Medium-Term Income and Expenditure Framework* (04/10/15).

[2] In February 2016 the IMF's Executive Board discussed the adequacy of the Fund's precautionary balances. See *The Review of the Adequacy of the Fund's Precautionary Balances* (1/26/16).

[3] See *Review of the Fund's Income Position for FY 2016 and FY 2017-2018* (04/08/16) and *FY 2017-2019 Medium-Term Budget* (03/24/16).

[4] Lending income comprises i) operational lending income earned from the basic rate of charge, service charges, and commitment fees; and ii) income from surcharges which is not included in operational income.

[5] See *The Review of the Adequacy of the Fund's Precautionary Balances* (1/26/16). Precautionary balances comprise the general and special reserves (except for amounts in the special reserve attributed to profits from the 2009-2010 gold sales of SDR 4.4 billion), and the Special Contingent Account (SCA-1). An adequate level of precautionary balances is an essential element in the strategy to mitigate credit risk and thereby protect the value of reserve assets that members place with the Fund.

4. Operational lending income is projected to be marginally higher over the medium term than projected in April 2015. One additional Stand-By Arrangement (SBA) and one outright purchase (under the RFI) with total access amounting to SDR 1 billion, have been approved by the Executive Board since April 2015.[6] The revised projections also reflect some rephasing of purchases and lower than expected early repurchases. In aggregate, these changes have increased the projected credit path by an average of SDR 0.9 billion a year, or about 2 percent, over the period FY 2016-21, thus increasing projected annual average income from the margin and service charges by about SDR 10 million over the medium term.[7,8]

5. Non-lending income which is comprised of investment income, the implicit returns on the Fund's interest-free resources, and reimbursements to the General Resources Account (GRA) is expected to rise more gradually over the medium term than projected earlier.

- **Income from the Fixed-Income Subaccount is expected to be significantly lower over the medium term than projected in April 2015.**[9] The rise in yields as implied by forward markets is now more gradual; the forward curve of the SDR interest rate, which takes into account the impact of the inclusion of the Chinese renminbi (RMB) in the SDR basket implies a rate of only 1.2 percent in FY 2021, compared with 1.5 percent estimated in April 2015; more recently, an SDR interest rate of close to 2 percent in FY 2021 was implied by market forwards at the time of the reviews of the SDR basket and the adequacy of precautionary balances.[10] In addition the projections now embody more conservative assumptions on the gains to be made from a broadened investment mandate for this portfolio.[11] While this downward revision in projected investment income from the subaccount of SDR 400 million over the next five years compared

[6] Excludes arrangements treated as precautionary by the authorities upon approval of the program.

[7] See *Review of Access Limits and Surcharge Policies* (01/27/16).

[8] Commitment fee income is only recognized at the expiration or cancellation of an arrangement. The fees for the two-year FCL and Precautionary and Liquidity Line (PLL) arrangements are included in income at the end of the two-year period.

[9] The Fixed-Income Subaccount has investments equivalent to the Fund's general and special reserves except for (i) amounts attributed to gold sales profits in the special reserve and (ii) amounts of the general and special reserve attributed to net income for which no currency transfer have been made from the GRA to the IA in FY 2014 and FY 2015, totaling SDR 2.6 billion. These amounts were retained in the GRA as an interim measure providing the Fund with time to review the strategic asset allocation for the Fixed-Income Subaccount. The review was completed in August 2015 and staff now proposes to transfer currencies equivalent to net income for FY 2016 and the prior two years, from the GRA to this subaccount.

[10] On November 30, 2015, the Executive Board completed the quinquennial review of the method of valuation of the SDR, and determined that the RMB will be added to the SDR basket effective from October 1, 2016. The RMB will be represented in the SDR interest rate basket by the three-month benchmark yield for China Treasury bonds.

[11] The April 2015 projections assumed that the fixed-income subaccount would attain a premium of 100 basis points over the SDR rate, as originally expected when the Fund's New Income Model was developed, by FY 2021. In August 2015 the Executive Board modified the investment strategy of the fixed income subaccount that had been in place since 2006. The objective for the subaccount return is to exceed the SDR interest rate over time while minimizing the frequency and extent of negative returns. The updated projections assume that a premium of 50 basis points is attained by FY 2021.

with the April 2015 projection mainly reflects lower expected returns, a slower build up in reserves over the medium term, due mainly to the decline in projected surcharge income (see below), also contributes to lower investment income.

- **The Endowment Subaccount is expected to incur a loss in FY 2016 but the medium term outlook is broadly unchanged.** The current negative returns stem largely from volatility in the equity markets during the year including the large fall in equity prices in January 2016. However, the medium term outlook is relatively unchanged and remains positive. The three-year funding period of the passively-managed portion of the gold endowment began in March 2014; the projections continue to reflect the expectation that the endowment will be phased-in quarterly and thus be fully operational during FY 2018 with the illustrative assumption of 3 percent payouts commencing in that year.[12,13] During the funding period, investment income earned from the subaccount is assumed to be retained in the endowment in accordance with the Rules and Regulations of the Investment Account (IA) and is therefore not included in the Fund's operating income.

- **Projected income from interest-free resources has been lowered in line with expected interest rate developments.**[14] The implicit returns on interest-free resources follow the downward shift in the projected path for the SDR interest rates thereby lowering projected interest-free income through FY 2021 by some SDR 70 million compared with the estimates made in April 2015, or by more than SDR 90 million from the estimates at the time of precautionary balances review.

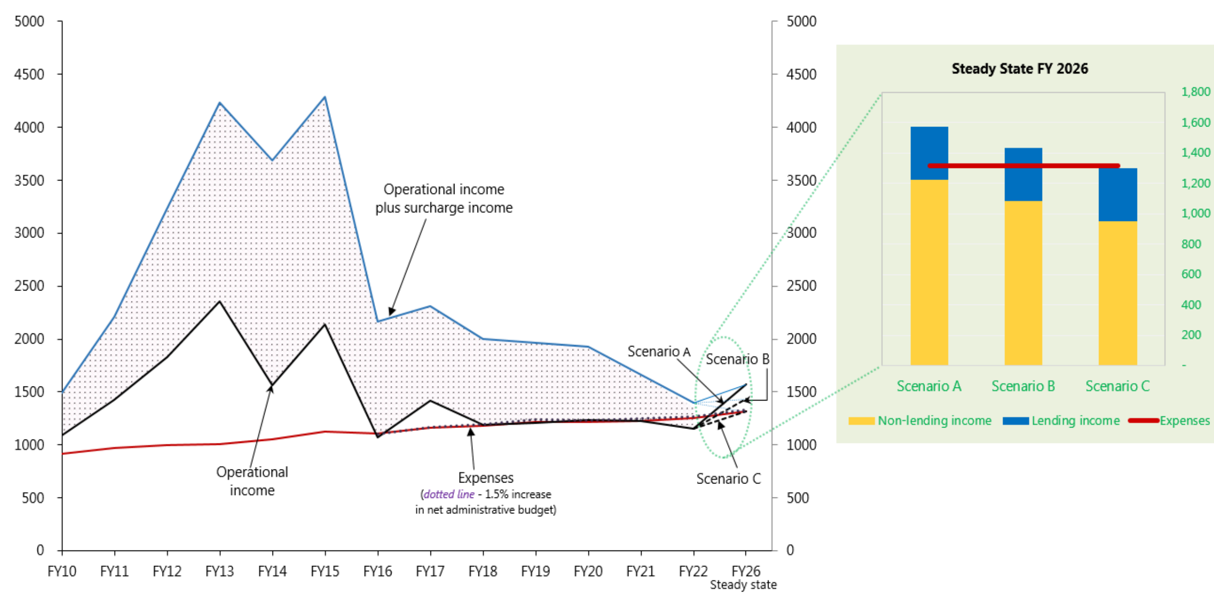
6. **The more gradual increase in investment income described above combined with a rise in expenses in SDR terms has lowered projected net operational income over the medium term.** In FY 2016, estimated expenses are expected to marginally exceed income (before surcharges) and result in a small operational loss for the period. Commitment fees from two precautionary arrangements approved in FY 2015 will contribute significantly to operational income in FY 2017. Thereafter a steady, albeit slower, increase in investment income is expected to broadly offset a decline in income from the margin as the stock of credit outstanding declines, to yield a small positive net operational income on average through FY 2021 (Figure 1).

[12] It is expected that the Executive Board will consider the payout policy for the endowment toward the end of the phase-in period.

[13] The SDR rate is subject to a floor of 5 basis points (see *Recent fall in the SDR Interest Rate – Implications and Proposed Amendments to Rule T-1* (10/16/2014)), and as the low interest rate environment continues to prevail, actual returns on short-term deposits could fall short of the SDR rate in the near-term.

[14] GRA interest-free resources comprise primarily the SCA-1, unremunerated reserve tranche positions not represented by gold holdings, and GRA net income not transferred to the IA. These resources generate implicit income for the Fund by reducing members' reserve tranche positions and the remuneration expense thereon.

Figure 1. Actual and Projected Income and Expenses – FY 2010-2026
(in millions of U.S. dollars)



7. Surcharge income is projected to be significantly lower than the April 2015 estimates. Following the quota increases under the 14th General Review of Quotas, the Executive Board approved the adjustment of surcharge thresholds to 187.5 percent of quota and a shift of the time-based surcharge trigger for EFF arrangements to 51 months for all members with GRA credit outstanding.[15] As a result of these adjustments and the rephasing of purchases and the other assumptions noted above, annual surcharge income is projected to be lower by an average of about SDR 0.1 billion over the medium term compared with April 2015. Cumulative surcharge income over the period FY 2016-21 is now projected at SDR 3.3 billion.

8. The above projections include the expected impact of the inclusion of the Chinese renminbi (RMB) in the SDR basket. The Fund's lending income will not be affected by the increase in the SDR interest rate following the inclusion of the RMB in the SDR basket**.** The modestly higher rate of charge on Fund borrowings reflecting the increase in the SDR interest rate would be offset by the higher remuneration paid to Fund creditors on their reserve tranche positions or borrowed resources. However, the Fund’s income position is expected to benefit marginally from a higher SDR interest rate as it translates into higher returns on the Fixed-Income Subaccount and to a lesser degree higher implicit returns on interest free resources. On this basis, a 17-20 basis point increase in the SDR interest rate would initially increase the Fund’s income (through the investment account and implicit returns on interest free resources) by about SDR 35-40 million in FY 2018, the first full year following the inclusion of the RMB in the SDR basket.[16]

[15] See *Review of Access Limits and Surcharge Policies* (01/27/16).

[16] For a fuller discussion of the impact on the Fund’s income of the inclusion of the RMB in SDR basket see *Review of the Fund’s Income Position for FY 2016 and FY 2017-2018* (04/08/16).

9. The income projections outlined above remain highly uncertain and are sensitive to a number of key assumptions. Lending income is particularly susceptible to the timing of purchases and repurchases under existing arrangements, early repurchases, and possible new arrangements. Other key factors affecting the Fund's income position include fluctuations in global interest rates and the U.S. dollar/SDR exchange rate (Box 1 provides further details), and changes in actuarial assumptions that impact the annual pension expense under the amended International Accounting Standard 19 (IAS 19).[17]

B. Medium-Term Expenditures

10. The medium-term expense projections reflect a small increase in the net administrative budget in real terms, starting in FY 2017, to accommodate rising security costs. An additional $6 million is built into the FY 2017 administrative budget baseline to meet mounting costs for physical and IT security, which previously were met through reallocation and temporary financing. However, because the structural increase in the net administrative budget is mostly offset by a lower price deflator, the nominal expense path projections for the medium- and longer-term—assuming no further changes in spending volumes—are virtually unchanged from last year.[18]

11. The budget outlook, however, is subject to upward pressures. Additional resources will be required to implement the Global Policy Agenda, focused on strategically important initiatives in the areas of surveillance and capacity development. Also, in light of growing economic vulnerabilities in many member countries, the demand for Fund financing could continue to rise. Finally, future needs for physical and IT security and prospective revenue losses could also exert pressures on existing resources. As savings that can potentially be achieved through further reprioritization might not be sufficient to offset the higher spending, Figure 1 also shows an alternative scenario incorporating an additional permanent 1.5 percent increase in the net administrative budget, phased in over FY 2018-19. As illustrated, the impact of such an increase on the net income position would be marginal.

12. Capital expenditures remain elevated due to the HQ1 renovation. The expense path is slightly higher than assumed last year, as a result of the supplemental funding that was approved in January. However, the increase in capital expenses reflected in the Fund's income statement is

[17] IAS 19 (amended) is the International Financial Reporting Standard that deals with accounting for pension and other employee benefits, including the timing adjustment. The actuarially determined timing adjustment in FY 2016 results in a projected gain of about SDR 296 million, and stems mainly from a decline in the obligations of the staff retirement plan that reflect the outcome of a comprehensive review of actuarial assumptions. As discussed in the *Review of the Fund's Income Position for FY 2016 and FY 2017-2018* (04/08/16), the new standard was expected to introduce an additional source of volatility in the Fund's income over the medium-term; following the elimination of the corridor method, gains or losses arising from changes in actuarial assumptions are to be recognized in the year incurred.

[18] For FY 2017-19, the applied Global External Deflator is 1.9 percent, 2.2 percent, and 2.3 percent, respectively (For specific details, see *FY2017-2019 Medium-Term Budget* (March 24, 2016)). A five-year backward-looking average of the GED is used for the nominal long-term expense path.

projected to be moderate, as the major building renovations are depreciated over the remaining useful life of the building.

C. The Long-Run Income-Expenditure Position

13. The steady state outlook continues to point to a balanced position in a future low credit environment. In 2008, when the Board endorsed the New Income Model (NIM), a long-term goal was to broaden income sources to provide sustainable financing for the institution. In the current environment of very low interest rates, the Fund remains reliant on income from lending to cover the bulk of its activities. Against this background, the updated illustrative steady state outlook is intended as a cross-check on the consistency of the projected budgetary envelope with Fund income when lending income is assumed to be again at low levels. As such, the scenarios take into account the progress that has been made in implementing the NIM and the recent review of the adequacy of the Fund's precautionary balances. While all elements of the NIM are now in place or in progress, the global economic and market environment remains very different from that assumed when the NIM was agreed, indicating some risks if returns remained at low levels for a prolonged period.

14. The illustrative steady state is assumed to be reached in FY 2026 when drawings under current arrangements have been largely repurchased. The conservative assumptions underlying the steady state are intended to illustrate a possible floor level of income providing an indication of the Fund's ability to generate a net positive income position even when credit is low. Following the discussion of the adequacy of the Fund's precautionary balances in February 2016, a higher but still conservative credit level of SDR 20 billion is assumed in this illustrative low-lending environment (see Table 1).[19] Commitments under contingent lending facilities are also assumed to decline from current levels to SDR 10 billion (see Box 1). Assuming a margin of 100 basis points, lending income would, depending on the buoyancy of investment income, contribute in the range of 22 to 26 percent of total income.

15. Investment income would under most scenarios cover the bulk of expenses (Table 1). Investment income would be in the form of payouts from the Endowment Subaccount, currently assumed at 3 percent, and returns from the Fixed-Income Subaccount. The scenarios also assume precautionary balances at the new higher floor of SDR 15 billion that was broadly endorsed in the recent review, implying that the resources available to invest in the Fixed-Income Subaccount and thus investment income would both be higher at given rates of return.[20] On this basis, assuming a SDR interest rate of 3 percent and investment returns on the Fund's Fixed-Income Subaccount of an additional 50 basis points, the steady state projection yields a positive income-expenditure position with a relatively comfortable buffer of over SDR 180 million (over US$250 million) or about 20 percent of expenditures and, as also envisaged under the NIM, the Fund would not be relying on lending

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[19] See *Review of the Adequacy of the Fund's Precautionary Balances* (1/26/16).

[20] Since the floor is below the projected level of precautionary balances over the medium term, the longer term steady state projection implicitly assumes a prior distribution of reserves that lowers precautionary balances to the level of the floor.

income to finance its non-lending activities (Scenario A). Assuming an SDR interest rate of 2.5 percent in keeping with the current low interest rate environment and the more gradual rise in interest rate projections, the steady state projection maintains a positive income-expenditure position but with a reduced margin of under SDR 90 million or about US$120 million (Scenario B). At an SDR interest rate of 2 percent, which would imply a near zero real interest rate (Scenario C) the steady state projection yields a slightly negative income-expenditure position. Under the alternative scenario, incorporating an additional permanent 1.5 percent increase in the net administrative budget, the impact on the steady state net income position is expected to be marginal (Figure 1 above).

Table 1. Consolidated Income and Expenses, FY2016–26
(in millions of U.S. dollars, unless otherwise stated)

	FY 16	FY 17	FY 18	FY 19	FY 20	FY 21	FY 22	FY 26	FY 26	FY 26
								Scenario		
								A (3%)	**B** (2.5%)	**C** (2%)
Based on updated thresholds following effectiveness of the 14th General Review of Quotas 1/										
I. Operational income	1,066	1,418	1,187	1,213	1,236	1,231	1,156	1,570	1,434	1,300
Lending income	893	1,260	700	638	554	441	308	347	347	347
Non-lending income	173	158	487	575	682	790	848	1,223	1,087	953
II. Expenses 2/	1,106	1,165	1,185	1,221	1,215	1,229	1,250	1,314	1,314	1,314
Of which: Net administrative budget 3/	1,040	1,072	1,096	1,127	1,138	1,155	1,178	1,245	1,245	1,245
III. Net operational income (I - II)	-40	253	2	-8	21	2	-94	256	120	-14
IV. Surcharges	1,095	895	814	752	690	430	242	0	0	0
V. Net income plus Surcharges (III + IV)	1,055	1,148	816	744	711	432	148	256	120	-14
Memorandum items:										
Fund credit (average stock, SDR billions)	51.5	49.4	47.4	44.9	39.6	31.5	22.0	20.0	20.0	20.0
US$/SDR exchange rate	1.39	1.40	1.40	1.40	1.40	1.40	1.40	1.40	1.40	1.40
Precautionary balances (end of period, SDR billions) 4/	15.2	16.1	16.7	17.2	17.7	18.0	18.1	15.0	15.0	15.0

1/ Following the Board discussion of the *Review of Access Limits and Surcharge Policies* (01/20/2016) paper on February 17, 2016, the trigger for time-based surcharges was moved to 51 months for EFF arrangements and the surcharges threshold for level-based surcharges was set at 187.5 percent of quota. Commitment fee thresholds are set at 115 percent, 116-575 percent, and greater than 575 percent of quota for charges of 15 basis points, 30 basis points, and 60 basis points, respectively.
2/ Includes: (i) net expenditures made from the administrative budget; (ii) expenditures made from the capital budget for items that are not depreciated; and (iii) depreciation charges for expenditures made from the current or previous capital budgets.
3/ FY 2016 net administrative budget is updated for the estimated outturn.
4/ Annual net operational income and surcharges add to the level of precautionary balances each year.

16. The steady state remains sensitive to other key assumptions, including the margin. While expenditures are assumed to be constant in real terms, the outlook remains sensitive to movements in the U.S. dollar/SDR exchange rate. The scenarios also assume that none of the credit outstanding in a low lending environment would be subject to surcharges. As such, a change in the margin could have a significant impact on the net income position particularly if interest rates were to remain low. Lowering the margin by 20 basis points to 80 basis points would reduce steady state income by SDR 40 million or US$56 million.

PRECAUTIONARY BALANCES OUTLOOK

17. The projected contribution of total lending income to the Fund's medium-term finances has been lowered from earlier estimates reflecting a steady decline in Fund credit outstanding. However, lending income including surcharges continues to contribute significantly to the accumulation of precautionary balances and net income (excluding projected losses of the gold endowment) is projected at about SDR 1.1 billion in FY 2016 (see Table 2). When placed to reserves, this would increase precautionary balances to reach about SDR 15.2 billion by end-FY 2016.

18. The slower projected pace of reserve accumulation over the medium term largely reflects reduced income from surcharges and a more gradual rise in investment income. The April 2015 baseline projections, which assumed a margin on the rate of charge of 100 basis points (the current level), and no change in quotas or surcharge thresholds had indicated that precautionary balances would reach about SDR 19 billion in FY 2022, slightly below the SDR 20 billion indicative target (Figure 2, Panel A). An updated medium-term path for precautionary balances was discussed in February 2016 in the context of the review of the adequacy of precautionary balances.[21] Although projections at the time of that review factored in a reduction of surcharge income on the assumption that thresholds were not set to fully offset the impact of the quota increase, (Figure 2, Panel A), the projected accumulation of precautionary balances remained broadly in line with the April 2015 projections. Expected losses from lower surcharge income were largely offset by slightly higher investment income reflecting a more rapid rise in the SDR rate implied by market futures at the time.

19. The April 2016 income projections have been further lowered compared with prior projections. This reflects a downward adjustment in the SDR interest rate path since the February precautionary balances review lowering investment income returns over the medium term, and the higher expenses in SDR terms following the medium-term U.S. dollar/SDR exchange rate projection being revised from US$1.48 per SDR to US$1.40 per SDR. Against this backdrop, the pace of reserve accumulation has slowed down further.[22] At the reduced pace of reserve accumulation currently projected, precautionary balances are expected to reach SDR 18.1 billion in FY 2022 (Figure 2, Panel A), remaining below the indicative medium-term target of SDR 20 billion. Under a scenario where the margin is increased to 120 basis points precautionary balances would rise to about SDR 18.6 billion, but still remain at least SDR 1 billion below the target over the medium term (see Figure 2, Panel B). Conversely, if the margin were reduced to 80 basis points, projected accumulation of precautionary balances would be lowered by about SDR 500 million to SDR 17.6 billion. The IAS 19

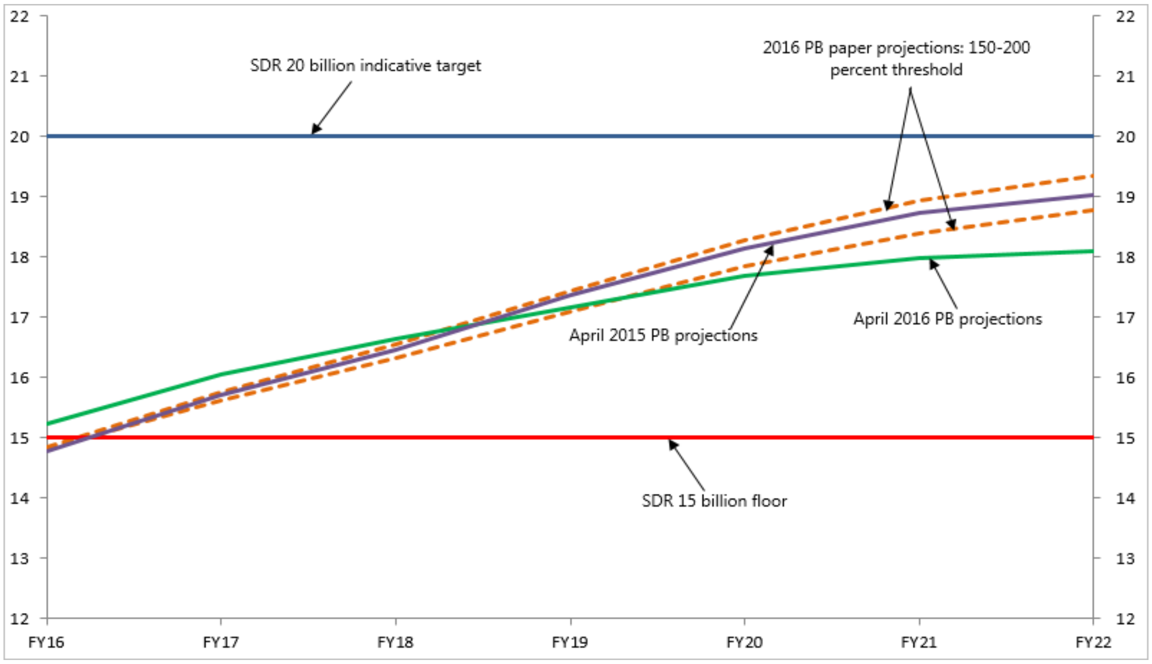
[21] At the review the Board agreed to maintain the indicative medium-term target of SDR 20 billion. See *Review of the Adequacy of the Fund's Precautionary Balances* (1/26/16) and *The Acting Chair's Summing Up Review of the Adequacy of the Fund's Precautionary Balances Executive Board Meeting 16/15 February 19, 2016* (02/25/16).

[22] The pace of reserve accumulation has been impacted by the changes in the Fund's structure and thresholds of surcharges and commitment fees following the effectiveness of the 14th General Review of Quotas. See *Review of Access Limits and Surcharge Policies* (01/27/16).

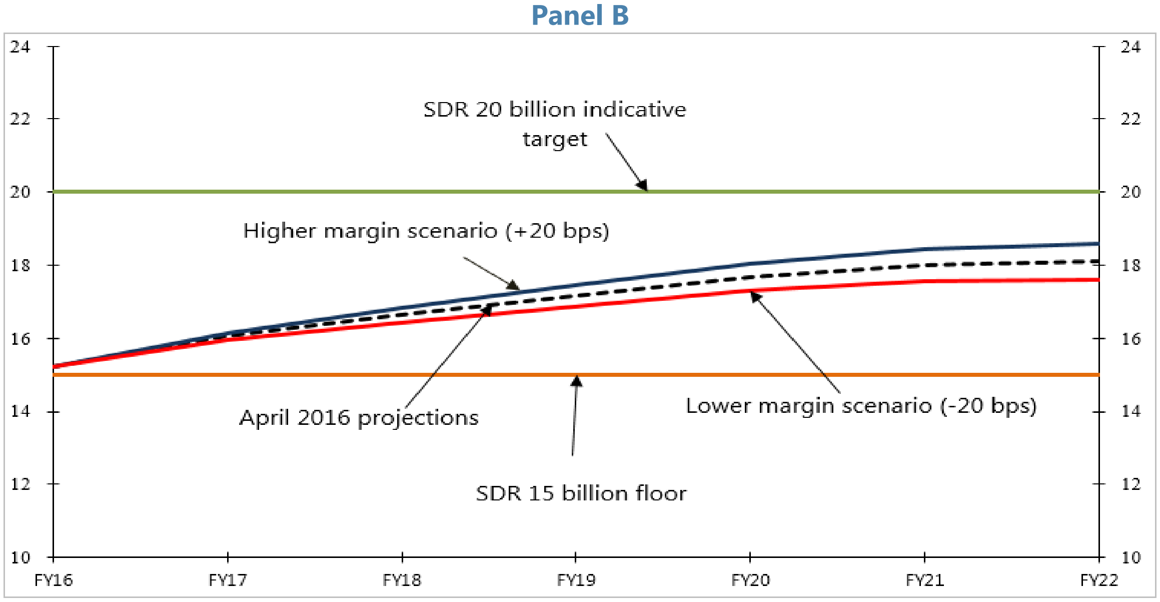
timing adjustment is also expected to remain volatile and affect the pace of reserve accumulation over the medium term.[23]

Figure 2. Precautionary Balances Accumulation
(in billions of SDRs)

Panel A



Panel B



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[23] Since the IAS 19 timing adjustment is sensitive to changes in the discount rate and the fair value of pension assets, the effects of which are highly unpredictable over the medium term, no projections are made beyond the current financial year-end (FY 2016).

Table 2. Consolidated Income and Expenses, FY2016–26
Updated thresholds following 14th General Review of Quotas [1]

	FY16	FY17	FY18	FY19	FY20	FY21	FY22	Scenario A SDRi 3% FY26	Scenario B SDRi 2.5% FY26	Scenario C SDRi 2% FY26
	(in SDR millions)									
A. Operational income 2/	**767**	**1,014**	**848**	**866**	**884**	**879**	**826**	**1,121**	**1,025**	**929**
Lending income	643	901	500	456	396	315	220	248	248	248
Margin for the rate of charge	515	494	474	449	396	315	220	200	200	200
Service charge	32	19	9	7	0	0	0	24	24	24
Commitment fees	96	388	17	0	0	0	0	24	24	24
Investment income	59	41	260	310	376	441	473	651	582	513
Fixed-Income Subaccount 3/	59	41	117	165	228	290	319	484	415	346
Gold endowment pay-out	0	0	143	145	148	151	154	167	167	167
Interest free resources 4/	8	17	33	43	54	64	73	157	130	103
SCA-1 and other	8	17	33	43	54	64	73	157	130	103
Reimbursements	57	55	55	57	58	59	60	65	65	65
CCR Trust and SDR Department	7	5	4	4	4	4	4	6	6	6
PRG Trust	50	50	51	53	54	55	56	59	59	59
B. Expenses	**795**	**833**	**846**	**872**	**869**	**877**	**893**	**938**	**938**	**938**
Net administrative budget 5/	748	766	783	805	813	825	841	889	889	889
Capital budget items expensed	20	30	23	25	12	7	7	6	6	6
Depreciation	27	37	40	42	44	45	45	43	43	43
C. Net operational income (A-B)	**-28**	**181**	**2**	**-6**	**15**	**2**	**-67**	**183**	**87**	**-9**
Surcharges	788	639	581	537	493	307	173	0	0	0
IAS 19 timing adjustment	296	0	0	0	0	0	0	0	0	0
Endowment (Gold Profits) Subaccount 6/	-58	198	95	97	99	101	103	112	112	112
Net income	**998**	**1,018**	**678**	**628**	**607**	**410**	**209**	**295**	**199**	**104**
	(in US$ millions)									
D. Operational income 2/	**1,066**	**1,418**	**1,187**	**1,213**	**1,236**	**1,231**	**1,156**	**1,570**	**1,434**	**1,300**
Lending income	893	1,260	700	638	554	441	308	347	347	347
Investment income	82	57	363	435	527	619	663	912	815	718
Interest free resources	12	23	46	61	75	89	102	220	181	144
Reimbursements	79	78	78	79	80	82	83	91	91	91
E. Expenses	**1,106**	**1,165**	**1,185**	**1,221**	**1,215**	**1,229**	**1,250**	**1,314**	**1,314**	**1,314**
Net administrative budget	1,040	1,072	1,096	1,127	1,138	1,155	1,178	1,245	1,245	1,245
Capital budget items expensed	28	41	33	35	16	10	9	9	9	9
Depreciation	38	52	56	59	61	64	63	60	60	60
F. Net operational income (D-E)	**-40**	**253**	**2**	**-8**	**21**	**2**	**-94**	**256**	**120**	**-14**
Memorandum Items:										
Fund credit (average stock, SDR billions)	51.5	49.4	47.4	44.9	39.6	31.5	22.0	20.0	20.0	20.0
SDR interest rate (in percent)	0.1	0.3	0.6	0.8	1.0	1.2	1.4	3.0	2.5	2.0
US$/SDR exchange rate	1.39	1.40	1.40	1.40	1.40	1.40	1.40	1.40	1.40	1.40
Surcharges (US$ millions)	1,095	895	814	752	690	430	242	0	0	0
New income measures (US$ millions) 7/	73	82	307	334	362	391	405	478	478	478
Precautionary balances (end of period, SDR billions)	15.2	16.1	16.7	17.2	17.7	18.0	18.1	15.0	15.0	15.0

[1] Following the Board discussion of the *Review of Access Limits and Surcharge* Policies (01/20/2016) paper in February 2016, the trigger for time-based surcharges was moved to 51 months for EFF arrangements and the surcharges threshold for level-based surcharges was set at 187.5 percent of quota. Commitment fee thresholds are set at 115 percent, 116-575 percent, and greater than 575 percent of quota for charges of 15 basis points, 30 basis points, and 60 basis points, respectively.

[2] Excludes surcharges. The payout from the endowment funded by gold profits is assumed to begin in FY 2018, when the endowment is fully funded under the agreed investment mandate.

[3] The current projections assume that a premium of 50 basis points over the SDR rate is attained by FY 2021 and that the premium remains at this level thereafter.

[4] Interest free resources reduce the Fund's costs and therefore provide implicit returns. Since the Fund invests its reserves in the IA to earn a higher return, the interest free resources retained in the GRA are mainly attributable to the SCA-1, unremunerated reserve tranche positions not represented by gold holdings, and GRA income for the year not transferred to the IA. These resources reduce members' reserve tranche positions and the Fund's remuneration expense resulting in implicit income for the Fund.

[5] For FY 2016, the figure represents estimated net administrative expenditures, which are slightly lower than the budget.

[6] From FY 2018 when the endowment is fully in place, it is assumed that the endowment is to make an annual payout to the GRA and that a portion of the income is to be retained to preserve the real value of the gold endowment.

[7] The effect on operational income of broadening investments, creating an endowment funded by profits from gold sales, the reduction in remuneration from proceeds equal to the book value of gold, and reimbursement of PRGT expenses.

Box 1. Income Projections

Key Parameters	Key Parameters	Key Parameters
US$/SDR exchange rate	1.40	Assumed unchanged from recent levels. A 10 percent rise (fall) in the US$/SDR exchange rate would raise (lower) annual income in FY 2022 by US$120 million.
SDR interest rate	Rising to 3.0 percent by FY 2026 from 0.1 percent in FY 16	A 10 basis point higher (lower) average SDR interest rate would raise (reduce) annual income in FY 2022 by US$34 million. In the steady state a 10 basis point higher/lower SDR interest rate would raise/reduce income by SDR 27 million.
Margin for rate of charge (basis points)	100	Assumed unchanged from current level. A 20 basis point higher (lower) margin would increase (reduce) income in FY 2017 and FY 2018 by US$138 million and US$134 million, respectively. A 20 basis point higher (lower) margin effective from FY 2017 would increase (lower) precautionary balances in the period to end-FY 2022 by some SDR 0.5 billion.

Operational lending income (US$347 million or SDR 248 million by FY 2026)

Fund credit is assumed to decline to an average steady state level of about SDR 20 billion by FY 2026, upon which a margin of 100 basis points would generate income of about SDR 200 million. Commitments under contingent lending facilities are assumed to also decline to an average of SDR 10 billion in the steady state, yielding some SDR 24 million in annual commitment fees. Average annual disbursements of about SDR 5 billion from FY 2023 generate about SDR 24 million in annual service charges (at 50 basis points).

Investment income (US$912 million or SDR 651 million by FY 2026)

Currency amounts equivalent to net operational income plus surcharges are assumed to be transferred annually to the Fixed-Income Subaccount for investment in the subsequent year. Phased investments under the broadened investment mandate for the Fixed-Income Subaccount is assumed to be begin in FY 2017, allowing average investment returns in this portfolio to exceed the SDR interest rate by 50 basis points from FY 2021 onwards. This would yield annual income of about SDR 484 million in the steady state (FY 2026) assuming an SDR interest rate of 3 percent (Scenario A) and precautionary balances floor of SDR 15 billion endorsed in the recent review of the adequacy of precautionary balances.

The updated projections assume that implementation of the proposed investment strategy for the endowment (SDR 4.4 billion, equivalent to an average gold price of US$850 per ounce, plus earnings during the interim period) will continue to be phased-in gradually with assumed annual payouts of 3 percent beginning in FY 2018.[1/]

Interest free resources (US$220 million or SDR 157 million by FY 2026)

The interest free resources retained in the GRA are mainly attributable to the SCA-1, unremunerated reserve tranche positions not represented by gold holdings, and GRA net income not transferred to the Investment Account. These resources reduce members' reserve tranche positions and the Fund's remuneration expense resulting in implicit income for the Fund.

Reimbursements (US$79 million or SDR 57 million in FY 2016)

Reimbursements from the SDR Department and CCR (formerly PCDR) Trust, are projected at about SDR 7 million in FY 2016 and reimbursement of the GRA for the expenses of administering the PRGT is assumed to be SDR 50 million in FY 2016. Administrative costs and the associated reimbursements are assumed to be stable in real terms in the medium term.

1/ Staff plans to return to the issue of an appropriate payout policy before the end of the phase-in period of the passively-managed portfolio.