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ADEQUACY OF THE GLOBAL FINANCIAL SAFETY NET—REVIEW OF THE FLEXIBLE CREDIT LINE AND PRECAUTIONARY AND LIQUIDITY LINE, AND PROPOSALS FOR TOOLKIT REFORM—REVISED PROPOSALS

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:

- A **Press Release** summarizing the views of the Executive Board as expressed during its December 6, 2017 consideration of the staff report.
- The **Staff Report**, prepared by IMF staff and completed on November 7, 2017 for the Executive Board's consideration on December 6, 2017.
- A **Staff Supplement**.

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IMF Executive Board Discusses Proposals for Toolkit Reform, Concludes Review of the Flexible Credit Line and Precautionary and Liquidity Line

The Executive Board of the International Monetary Fund (IMF) has been discussing during the past year proposals to reform the Fund's lending toolkit, with the aim of further strengthening the Global Financial Safety Net (GFSN). In this context, the Board has considered a proposal for a new liquidity facility, as well as improvements to the Fund's existing instruments for crisis prevention as part of the Review of the Flexible Credit Line (FCL) and Precautionary and Liquidity Line (PLL). The reforms stemming from these discussions are part of the Fund's broader agenda to strengthen the GFSN, which also includes the recent introduction of a new Policy Coordination Instrument and an enhanced framework for cooperation with Regional Financing Arrangements.

The discussions were informed by three staff papers: "Adequacy of the Global Financial Safety Net—Considerations for Fund Toolkit Reform" (discussed by the Board on November 9, 2016), "Adequacy of the Global Financial Safety Net—Review of the Flexible Credit Line and Precautionary and Liquidity Line, and Proposals for Toolkit Reform" (discussed by the Board on June 30, 2017), and "Adequacy of the Global Financial Safety Net—Review of the Flexible Credit Line and Precautionary and Liquidity Line, and Proposals for Toolkit Reform—Revised Proposals" (discussed by the Board on December 6, 2017).

The Review of the FCL and PLL found that the instruments have been effective in providing precautionary support against external risks, and that successor FCL arrangements and associated access levels have been appropriately tailored to country circumstances. To enhance crisis prevention, staff developed a proposal for a new facility, called the Short-term Liquidity Swap (SLS), to provide members with very strong policies with predictable and renewable liquidity support against potential, short-term, moderate capital flow volatility. The SLS was designed as a revolving credit line, and included several other innovative features. However, the proposal was not adopted by the IMF's Executive Board. The Review also covered a possible role for a new Time-Based Commitment Fee (TBCF) in response to concerns about prolonged use of high-access arrangements on a precautionary basis, but this proposal was also not adopted. Finally, the Review introduced refinements to the qualification framework for the FCL and the PLL to make it more transparent and predictable for actual and potential users.

Executive Board Assessment—November 9, 2016

Executive Directors welcomed the preliminary discussion of potential reform to the Fund's toolkit as part of the broader work stream on the adequacy of the global financial safety net (GFSN). They noted that the recent reforms to the GFSN have helped address the challenges of a more volatile and interconnected global economy. Since the global financial crisis, the GFSN has been strengthened considerably and become more multi-layered, with the overhaul of the Fund's lending toolkit, the set-up and augmentation of regional financing arrangements (RFAs), and the establishment of standing bilateral swap arrangements (BSAs) among reserve-currency issuing central banks.

These positive developments notwithstanding, most Directors shared the assessment that the current GFSN still provides uneven coverage. Many countries do not have reliable access to BSAs or RFAs, while very few take advantage of the new Fund instruments available on a precautionary basis. At the same time, while reserves provide an important line of defense, some countries may be relying unduly on them for self-insurance. Meanwhile, coordination among different layers of the GFSN leaves room for improvement. Noting the Fund's central role in ensuring a strong, effective GFSN, Directors broadly agreed that the Fund could help contribute to filling some of these gaps.

To this end, most Directors supported further work on revisiting and enhancing the Fund's toolkit for crisis prevention, with a view to improving its predictability and appeal to users, while continuing to promote sound policies. Many Directors noted that a comprehensive review of the existing toolkit would have provided useful insight, with some preferring further analysis of options for the Fund to support countries affected by commodity price shocks. Directors observed that stigma, which may in part explain the limited interest in the Fund's precautionary financing, is a complex issue that deserves deeper examination. While recognizing the need to address stigma concerns, Directors emphasized the importance of maintaining incentives for strong policies, minimizing moral hazard, safeguarding Fund resources, and avoiding overlap and a proliferation of instruments. They also underscored that strong frameworks and prudent macroeconomic policies are the first line of defense against crises.

Directors considered the merits of a new liquidity instrument to complement other layers of the GFSN and possible design features. Most Directors were open to considering further details, including annual re-qualification, revolving access, and a clause that would trigger a Board review if aggregate commitments under the instrument exceed a predetermined threshold. In considering the access limit, a number of Directors urged careful consideration of the tradeoff between providing effective liquidity support for members and protecting the Fund's financial position and credibility. Many Directors remained to be convinced of the need for introducing a new instrument for liquidity purposes, noting, inter alia, scope for modifying existing precautionary instruments, the risk of overlap among Fund facilities, reputational risks, and the potential for repeated use with no exit expectations that could have a negative impact on the Fund's liquidity position. A few of these Directors also pointed to its feature akin to a swap line offered by central banks, which, in their view, risks departing from the Fund's traditional role under its mandate.

Directors expressed a range of views on the prequalification feature of a possible liquidity instrument. Many Directors saw the benefits of applying strong and transparent criteria to prequalify interested members with strong economic fundamentals and policy frameworks, which would eliminate the need for ex-post conditionality and, together with an opt-in option, help reduce stigma. Some Directors considered that qualification standards should be aligned with those for the Flexible Credit Line. Most Directors noted with some concern the signaling effects of prequalification and disqualification, which could lead to another form of stigma. While there may be merits in aligning the periodic prequalification process with members' Article IV consultation cycles, Directors emphasized the need to maintain separation between voluntary prequalification assessments and bilateral surveillance under Article IV. They urged staff to reflect more carefully on how to operationalize the idea of prequalification, if pursued, in order to preserve the quality and candor of Fund surveillance, maintain the Fund's role as a trusted advisor, and mitigate concerns about the signaling effects and a rating or tiering of the membership.

Directors highlighted the importance of maintaining coherence within the Fund's toolkit. They welcomed the staff's plan to develop specific modalities for a possible new liquidity instrument and clarify the role of each instrument in the reformed toolkit in the context of the forthcoming review of the Flexible Credit Line (FCL) and the Precautionary and Liquidity Line (PLL), taking into account Directors' views and concerns. Directors also called for a deeper assessment of potential demand and implications for the Fund's resources and liquidity position. Some Directors suggested that pricing options for insurance-type instruments also be explored to better rationalize scarce Fund resources. Directors took note of the staff's intention to also consider modifying the existing instruments available on a precautionary basis for the purpose of liquidity provision.

Directors broadly supported further work on a new policy monitoring instrument that could help countries better coordinate their access to the multiple layers of the GFSN and signal their commitment to a policy reform agenda. They generally concurred that the instrument could build on the existing Policy Support Instrument (PSI), with consideration of features such as: availability to the entire membership, upper credit tranche conditionality, a more flexible review schedule, and possibly a review-based monitoring of conditionality.

Some Directors felt that further work on this front would benefit from the discussion of the Fund's cooperation with RFAs. A few Directors expressed doubts about the potential demand for this instrument.

In light of today's discussion, and following additional consultations and outreach, including to RFAs as necessary, staff will return to the Board in the coming months with two separate papers. One paper would review the experience with the FCL and PLL, set out a more refined proposal for a new liquidity instrument, and discuss possible implications for the existing facilities and Fund resources. The second paper would propose a new policy monitoring instrument and provide further considerations for the future of the PSI.

Executive Board Assessment—June 30, 2017

Executive Directors welcomed the discussion of the review of the Flexible Credit Line (FCL) and Precautionary and Liquidity Line (PLL), and proposals for toolkit reform, as part of the Fund's broader work stream to strengthen the global financial safety net (GFSN). They recognized the complementarity of key reform proposals, and appreciated the staff's efforts and outreach to build consensus around a reform package. They welcomed the significant progress that has been made since the Board last discussed the issue in November 2016.

Directors generally endorsed the main conclusions of the FCL and PLL review. They broadly concurred that the FCL has provided effective precautionary support against external tail risks, and that successor arrangements and access levels have been consistent with the assessment of external risks and potential balance of payments needs. Nevertheless, most Directors remained concerned about the prolonged use of high-access precautionary arrangements and thus saw scope for strengthening price-based incentives. Many of them saw merit in introducing time-based commitment fees, some favored steepening the commitment fee structure to discourage unnecessarily high precautionary access, and a few saw scope for a combination of both options. Some other Directors reiterated that exit should continue to be state-dependent and did not see a case for stronger price-based incentives. Directors emphasized the need to ensure that staff reports for successor arrangements are explicit about the expectation of exit and exit strategies.

Directors broadly supported the proposal to use the core indicators and thresholds set out in Box 3 of the main paper to help guide judgment on FCL qualification by both staff and the Board. They agreed that this would help improve the transparency and predictability of the FCL qualification framework, ensuring that the FCL's high qualification standard is fully preserved, although a few Directors emphasized the need for flexibility in assessing qualification against certain benchmarks. Directors also welcomed the staff's plan to update the FCL guidance note to strengthen the implementation of the external stress index, with a few Directors suggesting a broader set of considerations to help inform discussions on access and exit. A number of Directors saw merit in considering additional reserve drawdown in adverse scenarios as a way to support lower access levels, while a few others were concerned about its possible negative consequences.

Directors recognized that the proposal for a new liquidity instrument represents an important step toward strengthening the GFSN, complementing other layers. Most Directors supported the creation of a new Short-term Liquidity Swap (SLS) as a special facility to provide liquidity support for potential balance of payments needs of a short-term, frequent, and moderate nature, resulting from volatility in international capital markets. Most Directors considered that the proposed key design elements are broadly reasonable, with some calling for swift implementation of the new instrument. A number of Directors had reservations about some key features that, in their view, depart significantly from current Fund principles and policies, and hence warrant further reflection.

Directors welcomed the proposal to align the SLS qualification criteria and indicators with those of the FCL to ensure that it is used by members with very strong fundamentals and policies. While the alignment of qualification would facilitate transition from the FCL to the SLS (and vice versa) as external risks evolve, Directors stressed that it will be important that a request for any arrangement follow the respective processes for full qualification and approval. Directors noted that the proposal to make SLS qualification available year-round, like the FCL, helps address the concern that prequalification in the context of Article IV consultation could risk undermining the quality and candor of surveillance.

Regarding the proposed specific features of the SLS, most Directors could support revolving access capped at 145 percent of quota, with a 12-month repurchase obligation. A few Directors would prefer higher access for the facility to be more attractive and useful for member countries facing larger potential liquidity needs. Most Directors also considered the proposed service charge and non-refundable commitment fee as broadly reasonable, noting that given the special balance of payments need and revolving nature of the SLS, the overall pricing is comparable to that applied to other Fund facilities. Some other Directors were not convinced that the proposed differential fee structure is warranted or provides the right incentives.

Directors appreciated staff efforts and suggestions to minimize the perceived stigma of Fund support, which many Directors could support. Nevertheless, there remained concerns over the possibility of a central bank sole signatory, the absence of exit expectations, and the extension of an offer or the conditional approval of an SLS arrangement. Some Directors were also concerned about the negative signaling effect of de-qualification, particularly in the case of synchronized extension of offers, although others shared the staff's assessment that these risks should be manageable.

Directors reiterated the importance of maintaining a streamlined and coherent toolkit. To this end, they generally supported eliminating the PLL. While some Directors were concerned that elimination may be premature and would create a new gap in the Fund's toolkit, most considered that the benefits outweigh the costs, given the low use of the PLL and broader concerns about tiering and proliferation of instruments.

Directors welcomed the analysis on the resource implications of the proposals. They noted the staff's expectation that the SLS could be accommodated comfortably within the Fund's existing quota-based resource envelope. Some Directors pointed to constraints facing the Fund's resource envelope and the potential that demand for the new instrument could be large. In this regard, some felt that staff estimates may be on the low side, considering also a possibility that potential SLS users could also request higher access under the FCL. A few Directors expressed concern that encumbering the Fund's balance sheet with insurance-type instruments, for a subset of the members that would qualify, could squeeze the resource envelope available for financing actual balance of payments needs.

Directors broadly supported the proposal to review the SLS after two years, or sooner if aggregate outstanding credit and commitments under the SLS and FCL exceed SDR150 billion. Given the innovative nature of the SLS and the potential effects on Fund resources, many Directors favored a clause establishing a timeframe for the Board to consider whether to renew or terminate the facility. A few other Directors did not see a need for such a clause, noting that it would undermine the usefulness of the new facility. On balance, most Directors were willing to go along with an emerging consensus. Directors generally supported full scoring of precautionary arrangements in calculating the Fund's forward commitment capacity (FCC) to provide clear assurance that committed resources will be available to the membership in all circumstances. Nevertheless, a few Directors saw some scope for flexibility in scoring these commitments against the FCC, given the low probability of drawing under such arrangements.

Directors encouraged staff to revisit outstanding issues and refine the proposals in light of today's discussion. They looked forward to a follow-up meeting to consider the package of reforms. They recognized that the reform proposals discussed today, if adopted, would require consequential changes to existing Fund policies.

Executive Board Assessment—December 6, 2017

Directors welcomed the opportunity to further discuss the review of the Flexible Credit Line (FCL) and Precautionary and Liquidity Line (PLL), and proposals for Fund toolkit reform, as part of the Fund's work to strengthen the global financial safety net (GFSN). They also highlighted other recent achievements in this work stream, particularly the establishment of the non-financing Policy Coordination Instrument (PCI) and the operational principles and framework for future Fund engagement with regional financing arrangements (RFAs).

Many Directors regretted that there was insufficient support to establish the Short-Term Liquidity Swap (SLS) at this juncture, particularly given heightened global uncertainty and ongoing geopolitical risks. They noted that this type of liquidity facility could be an important addition to the Fund's lending toolkit and that several proposed features of the SLS could serve as a blueprint for further consideration of such a facility in the future. Some Directors recalled their reservations regarding the SLS proposal. Many Directors encouraged further consideration of the coherence of the lending toolkit and coverage of the GFSN going forward.

Directors agreed to complete the scheduled review of the FCL and PLL. A few Directors expressed preference to eliminate the PLL on the basis of its low usage, perceived tiering vis-à-vis the FCL, and overlap with precautionary Stand-By Arrangements (SBAs). Other Directors reiterated concerns that eliminating the PLL could open up a new gap in the toolkit. On balance, most Directors supported the retention of the PLL.

With the PLL remaining part of the toolkit, Directors supported the proposal to extend to the PLL the use of the same core indicators and thresholds already adopted as part of the FCL qualification framework, as set out in Box 1 of the Board paper. They noted that these indicators and thresholds will help guide assessments on PLL qualification by staff and the Board without changing the PLL qualification standards. Directors stressed that judgment should continue to be applied in FCL and PLL qualification assessments. Directors welcomed the plan to revise the FCL and PLL guidance notes to reflect the new indicators, as well as to improve the implementation of the external economic stress index and the assessment of the impact of reserve drawdown on access levels.

Directors discussed the merits of strengthening incentives for a timely exit from arrangements in the credit tranches that provide members with very high access to Fund resources over a prolonged period. They broadly concurred that the FCL has provided effective precautionary support against external tail risks, and that successor arrangements and access levels have been consistent with the assessment of external risks and potential balance of payments needs. Some Directors also noted the staff's finding that there was no evidence of unjustified prolonged use of the FCL. Directors agreed that exit from precautionary Fund support should be state-contingent. Nonetheless, most Directors considered that the proposal of introducing a time-based commitment fee (TBCF) could strengthen price-based incentives to exit from prolonged use of high-access arrangements on a precautionary basis. A number of Directors, however, were not in favor of introducing a TBCF on the basis that it would run counter to the principle that exit from precautionary Fund support should be state-dependent. A few also expressed concerns that a TBCF could make requesting Fund arrangements for precautionary purposes less attractive to potential users. On balance, the proposal to establish a TBCF was not adopted.

Directors agreed that staff reports for successor FCL and PLL arrangements should continue to provide details on an exit strategy, including a statement on the expectation that access will normally decline when the right conditions (as set forth in BUFF/10/125) are in place, underpinned by a sound and transparent analysis of the risks facing the member country and the authorities’ efforts to increase the country’s resilience, in order to guide market expectations while ensuring that exit continues to be state-contingent.

In accordance with the Board decision on streamlining policy reviews, the experience with the use of the FCL and the PLL will be reviewed in five years or more, or on an as-needed basis, while many Directors expressed a preference for the timing of the next review to be less open-ended and take place within five years.

INTERNATIONAL MONETARY FUND

November 7, 2017

ADEQUACY OF THE GLOBAL FINANCIAL SAFETY NET—REVIEW OF THE FLEXIBLE CREDIT LINE AND PRECAUTIONARY AND LIQUIDITY LINE, AND PROPOSALS FOR TOOLKIT REFORM—REVISED PROPOSALS

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INTRODUCTION

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2. **This work is part of the Fund's broader work stream to strengthen the GFSN**. As such, it complements the new non-financing Policy Coordination Instrument and operational principles and framework for future Fund engagement with Regional Financing Arrangements.[2]

3. **The paper is organized as follows.** Section II lays out the revised set of reform proposals. Section III sets forth issues for discussion, and proposes decisions to (i) complete the review of the Flexible Credit Line (FCL) and the PLL; and (ii) introduce a TBCF. The paper also includes an Annex that describes a planned revision to the presentation of the Fund's Forward Commitment Capacity (FCC) to provide a breakdown between precautionary and other Fund commitments.

REVISED PROPOSALS

A. Short-term Liquidity Swap (SLS)

4. **It was evident from the last Board discussion that there is insufficient support to establish the SLS at the current juncture.** Most Directors supported the proposal to create the SLS for potential short-term, frequent, and moderate balance of payments needs. There was a general consensus that this type of facility could be a valuable addition to the GFSN, and broad agreement on its key design features. However, Board support fell short of the 85 percent majority of the total voting power required to establish the SLS. The failure to address a key gap in the GFSN for such a liquidity facility is regrettable, particularly given the protracted heightened global uncertainty and ongoing geopolitical risks. Nevertheless, the SLS proposal could still act as a blueprint for a new liquidity facility, should there be renewed appetite from the membership in the future.

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[1] "Adequacy of the Global Financial Safety Net—Review of the Flexible Credit Line and Precautionary and Liquidity Line, and Proposals for Toolkit Reform," IMF Policy Paper, December 2017, and the Acting Chair's Summing Up from Executive Board Meeting 17/56, June 30, 2017.

[2] "Adequacy of the Global Financial Safety Net–Proposal for a New Policy Coordination Instrument", "Collaboration Between Regional Financing Arrangements and the IMF", and "Collaboration Between Regional Financing Arrangements and the IMF–Background Paper".

B. Precautionary and Liquidity Line (PLL)

5. In the absence of a new SLS facility, the paper proposes to retain the PLL. Directors generally supported the elimination of the PLL, recognizing its low usage and tiering vis-a-vis the FCL. However, the primary Board concern was instrument proliferation in the context of a reform package that envisaged the creation of a new instrument. Given that establishing the SLS is not currently envisaged, and that some Directors were concerned that the elimination of the PLL might open a new gap in the toolkit, staff does not see a compelling case for elimination at this time.

6. In light of the proposed retention of the PLL, staff suggests that the recommended enhancements to the qualification framework for the FCL be extended to the PLL. In discussing the June paper, the Executive Board endorsed an enhanced qualification framework for the FCL that includes new core indicators with specified thresholds for the assessment of economic fundamentals and policies, as well as the policy track record.[3] The objective of this new framework is to improve predictability and transparency of the qualification process, while maintaining the existing qualification standard. Given the parallel qualification criteria for the PLL and the FCL, staff proposes to extend the core set of indicators with thresholds to the PLL qualification (Box 1). This will not change the overall strength of the PLL qualification standard, which would continue to be based on strong performance in most of the five qualification areas (i.e., three of five areas) assessed on the basis of the nine qualification criteria, as guided by the relevant indicators, which now include the proposed core indicators with thresholds. The mapping of the nine qualification criteria into the five qualification areas for the PLL would remain unchanged from the 2014 review of the FCL and the PLL (Table 1), and there would continue to be no precise "scoring" of the nine qualification criteria.[4] As with the FCL, the bottom-line assessment on each criterion will remain a judgment, guided by the relevant indicator.

7. The guidance notes for both the FCL and the PLL would be revised accordingly. They would include the proposed core set of indicators, as well as the other operational considerations—strengthening the implementation of the external economic stress index (ESI) and the assessment of the impact on access levels of additional reserve drawdown—discussed in the June paper.

[3] Box 3 in "Adequacy of the Global Financial Safety Net—Review of the Flexible Credit Line and Precautionary and Liquidity Line, and Proposals for Toolkit Reform," IMF Policy Paper, December 2017.

[4] "Review of the Flexible Credit Line, the Precautionary and Liquidity Line, and the Rapid Financing Instrument – Specific Proposals".

Box 1. Qualification Criteria and Proposed Core Indicators

This box discusses the core indicators and thresholds proposed to underpin the overall assessment of the nine qualification criteria under the five broad qualification areas for the PLL. The proposed indicators and thresholds are the same as for the FCL. As with the FCL, the bottom-line assessments on each criterion will be informed by other sources of information deemed relevant, some but not all of which are listed here. [1]The rest of the box is identical to Box 3 in the June paper.

1. A sustainable external position. Requires the member's external position to have been assessed, in the most recent Board document (Article IV or ESR), as "broadly consistent", "moderately stronger (weaker)", "stronger", or "substantially stronger" than implied by fundamentals and desirable policies.[2] This assessment implies that members with "weaker" or "substantially weaker external positions" would not meet the criterion. The asymmetry in the assessment follows the reasoning that "weaker" or "substantially weaker" external positions (e.g., high current account deficit or net foreign liabilities, overvalued exchange rate, etc.) constitute early warning indicators for impending BOP crises.

2. A capital account position dominated by private flows. Requires public flows to account for less than half of a member's direct, portfolio, and other asset and liability flows, on average in the past three years.[3]

3. A track record of steady sovereign access to capital markets at favorable terms. Requires public sector issuance or guaranteeing of external bonds or disbursements of public and publicly-guaranteed external commercial loans in international markets during at least three of the last five years for which data are available, in a cumulative amount over that period equivalent to at least 50 percent of the country's Fund quota at the time of the assessment.[4] The indicator also requires that the member did not, in staff's assessment, lose market access at any point in the last 12 months. Following the Fund's framework for loss of market access, deteriorating funding conditions and adverse changes in issuance patterns (volume, maturity, and frequency of issuance) that cannot be explained by funding needs would be indications that the member has indeed lost market access.[5]

4. When the arrangement is requested on a precautionary basis, a reserve position which—notwithstanding potential BOP pressures that justify Fund assistance—remains relatively comfortable. Requires reserves to have been greater than 100 percent of the ARA metric on average over three (the current and the two previous) years, and not below 80 percent in any of these three years. By including a lower—but not an upper—threshold for reserves, the assessment follows the reasoning that excess reserve holdings, while possibly undesirable from a systemic perspective, do not constitute a vulnerability for the member.[6]

5. Sound public finances, including a sustainable public debt position. Requires the member's public debt to be assessed as sustainable with a high probability. The high probability assessment would explicitly take into account risks to public finances not immediately visible in current public debt projections.

6. Low and stable inflation, in the context of a sound monetary and exchange rate policy framework. Requires the member to have maintained single-digit inflation over the past five years. The bottom-line assessment would consider if the member's performance is seen to reflect favorable external conditions and there are grounds to question the ability of its policy framework to maintain low inflation under normal circumstances. It would also consider persistent deviations from stated inflation targets, as well as sustained deflation, to the extent that it reflects deficiencies in the monetary policy framework.

Box 1. Qualification Criteria and Proposed Core Indicators (concluded)

7. Sound financial system and the absence of solvency problems that may threaten systemic stability. Requires the average capital adequacy ratio for the banking sector to be above regulatory thresholds, and that the most recent Article IV did not highlight significant solvency risks or recapitalization needs. The bottom-line assessment would consider other financial soundness indicators, as well as any relevant stress tests conducted by staff, to provide a forward-looking perspective. It would also reflect potential problems in large and systemic banks that may be masked by system-wide averages.

8. Effective financial sector supervision. Requires that the most recent FSAP or Article IV report did not raise substantial concerns regarding the supervisory framework. The bottom-line assessment would consider any significant changes in conditions since the latest FSAP.

9. Data transparency and integrity. Requires that the member is an SDDS subscriber or has made satisfactory progress toward meeting the SDDS requirements.

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[1] While judgment is important for all nine criteria, it is particularly important for criteria 6, 7, and 8.

[2] The assessment of a member's external position as per the mandatory external sector assessment in surveillance takes into account the following five key areas: current account (CA), real exchange rate, foreign exchange intervention and reserves, foreign assets and liabilities, and capital and financial account. The bottom line assessment of a member's external position falls into one the following seven categories, guided by the corresponding indicative ranges for the staff-assessed CA gaps (in percent of GDP) with considerations of all other areas: (i) substantially stronger (CA gaps more than 4 percent); (ii) stronger (CA gaps between 2 and 4 percent); (iii) moderately stronger (CA gaps between 1 and 2 percent); (iv) broadly consistent (CA gaps between -1 and 1 percent); (v) moderately weaker (CA gaps between -2 and -1 percent); (vi) weaker (CA gaps between -4 and -2 percent); and (vii) substantially weaker (CA gaps less than -4 percent).

[3] Public flows are flows to and from the domestic public sector, and are defined as the sum of the absolute values of reserve assets flows, and general government and central bank portfolio and other debt liability flows. In the absence of data for a large sample of countries, other official asset and liability flows of the public sector are assumed to be zero.

[4] This indicator assessment broadly follows the market access criterion for (graduation from) PRGT eligibility. The bottom-line assessment will consider if there is convincing evidence that the sovereign could have tapped international markets on a durable and substantial basis, even though the scale or duration of actual public sector borrowing fell short of the specified thresholds. This would be a case-specific assessment, informed by factors such as the volume and terms of recent actual borrowing in international markets and the sovereign credit rating.

[5] A methodology for making this assessment was articulated in "*The Fund's Lending Framework and Sovereign Debt—Further Considerations*", IMF Policy Paper, April 2015.

[6] See Annex IV in the June paper for an empirical justification of the 80 percent threshold. The overall assessment could consider other reserve metrics if the ARA metric is deemed inadequate for judging the member's reserve position. This assessment should generally be reflected in recent Article IV reports.

Table 1. Mapping Between PLL Qualification Areas and Qualification Criteria

PLL Qualification Area	PLL Qualification Criterion
I. External Position and Market Access	1. A sustainable external position 2. A capital account position dominated by private flows 3. A track record of steady sovereign access to international capital markets at favorable terms 4. A reserve position that is relatively comfortable when the arrangement is requested on a precautionary basis
II. Fiscal Policy	5. Sound public finances, including a sustainable public debt position determined by a rigorous and systematic debt sustainability analysis
III. Monetary Policy	6. Low and stable inflation, in the context of a sound monetary and exchange rate policy
IV. Financial Sector Soundness and Supervision	7. Sound financial system and the absence of solvency problems that may threaten systemic stability 8. Effective financial sector supervision
V. Data Adequacy	9. Data transparency and integrity

C. Time-Based Commitment Fee (TBCF)

8. Notwithstanding differing views, many Directors supported introducing a TBCF. Directors broadly concurred that the FCL has provided effective precautionary support against external tail risks, and that successor arrangements and access levels have been consistent with the assessment of external risks and potential balance of payment needs. Nevertheless, most Directors remained concerned about the prolonged use of high access precautionary arrangements and thus saw scope for strengthening price-based incentives. Many of them saw merit in introducing a TBCF, some favored steeping the commitment fee schedule at high access levels, and a few saw scope for a combination of both options. Directors who did not support a TBCF considered that exit from precautionary Fund financial support should be state-dependent.

9. Against this backdrop, a proposed decision, which would establish a TBCF to be applied to commitments in the credit tranches that remain very high for an extended period, is included in the paper for consideration by the Executive Board.[5] The proposal aims to strike a balance between raising the cost of prolonged use of precautionary arrangements and mitigating the

[5] Considering the preference of most Directors, the option of a steepening of the commitment fee schedule is not considered further in this paper.

concern that a member could be penalized unduly at a time when it faces risks that justify continued high access.[*]

10. Key design elements of the TBCF proposal are the same as in the June paper and are listed below. Box 2 provides an illustrative scenario that explains how the policy would be applied in practice.

- **Application of policy.** An arrangement in the credit tranches would become subject to the TBCF when the level of undrawn credit in the credit tranches has remained above the threshold for a defined period ("duration trigger"). The level of undrawn credit, as per Rule I-8, is the amount that could be purchased during the relevant period (12 months or the period left under the arrangement, if shorter).[6]

- **Threshold.** Setting the threshold for the TBCF at ***575 percent of quota*** would help encourage exit from prolonged commitments under arrangements with very high access, which are typically precautionary FCL arrangements, while limiting the risk of the fee applying to high-access non-precautionary arrangements in the credit tranches.

- **Duration trigger.** The fee would become payable when the level of undrawn credit has remained above the threshold for a ***cumulative 4-year period***, so as to align the trigger with the typical length of a severe shock and two 2-year FCL arrangements.[7]

- **Start of the clock.** The count toward the 4-year duration trigger could start with the ***adoption of the TBCF Decision***. This is the "middle" option presented in the June paper and its Supplement. It would imply that, upon adoption of the decision, the clock towards the 4 year-period would start for current arrangements that have undrawn credit above the threshold.[8]

- **Cooling-off period.** A cooling-off of a ***continuous 12-month period*** appears to strike the right balance between promoting durable exit and not penalizing members who could face new risks after an arrangement. Once undrawn credit exceeds the threshold and the clock toward meeting the 4-year duration trigger has started, the clock would be paused when undrawn balances fall to or below the threshold. If undrawn credit remains at or below the threshold for 12 consecutive months, the clock would be reset and the current or successor arrangements would not become subject to a fee unless undrawn credit again exceeds and remains above the threshold for another 4 years. If, however, undrawn credit rises above the threshold again during those 12

[*] This proposal was not endorsed by the Executive Board.

[6] For example, for FCLs that are being treated as precautionary at approval, the level of undrawn credit would be the arrangement size. For phased arrangements like SBAs, the level of undrawn credit would depend on the Board-approved phasing and actual purchases.

[7] A duration trigger of four years would also make the fee less likely to be triggered by drawing arrangements, since a member's purchases would reduce the level of undrawn credit to below the threshold within each relevant period.

[8] Since the fee could accordingly become payable only under future arrangements, there would be no need for a grandfathering provision for current arrangements.

months (i.e., before the cool-off period is over), the clock would continue to count towards the 4-year duration trigger mark from when it was paused.

Box 2. Illustrative Example of Time-Based Commitment Fees

This box presents a hypothetical scenario that illustrates how a time-based commitment fee (TBCF) policy would work in practice, based on the parameters provided above.

In this illustrative scenario, a member with a quota of SDR 5 billion is assumed to have three successive precautionary FCL arrangements leading up to a drawing during the third arrangement. The level of undrawn credit and the cumulative time ("clock") toward meeting the duration trigger are shown in the figure below.

T0: **A 12-month precautionary FCL arrangement for 600 percent of quota is approved.** As the full amount is immediately available for purchase and exceeds the 575 percent of quota threshold, the duration trigger "clock" starts (blue area in the figure below).

T12: **The FCL arrangement expires with no immediate successor arrangement.** Undrawn credit available to the member falls to zero and the "clock" pauses.

T15: **Three months later, a second 24-month precautionary FCL arrangement for 600 percent of quota is approved.** As the period between the two arrangements is shorter than the 12-month cooling-off period and the new level of undrawn credit again exceeds the threshold, the "clock" resumes from the previously accumulated 12 months.

T39: **At the end of the second FCL arrangement, a third precautionary FCL arrangement of 24 months is approved with 700 percent of quota access.**

T51: **A year into the third arrangement, the 4-year duration trigger is met.** The 15 bps fee starts to accrue daily on the portion of undrawn credit above the threshold under the current arrangement (125 percent of quota).

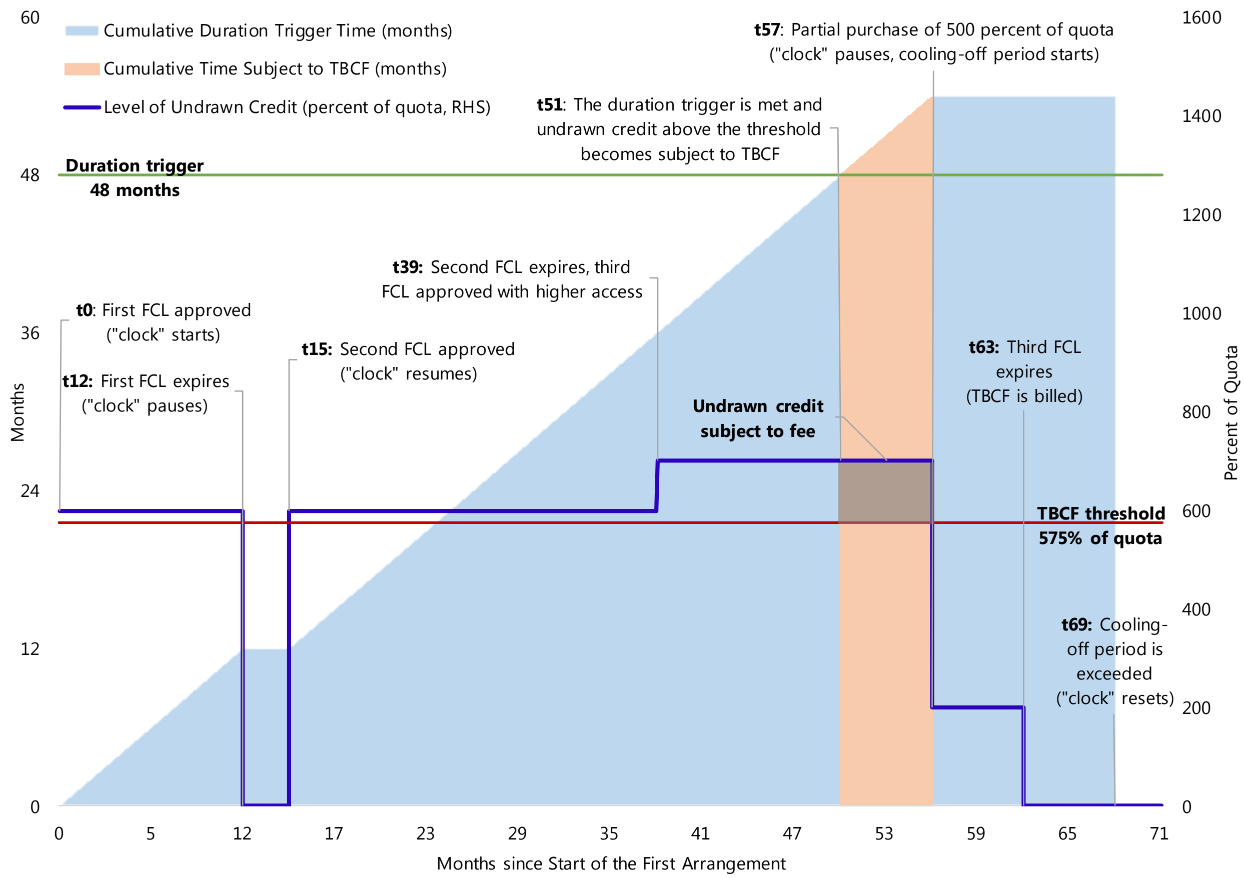
T57: **Six months later, external risks materialize and the member makes a partial purchase of 500 percent of quota to meet a balance of payments need.** The level of undrawn credit falls to 200 percent of quota, the "clock" is paused and the fee stops accruing. The FCL arrangement remains in effect.

T63: **The third FCL arrangement expires with the remaining 200 percent of quota undrawn.** Upon expiry of the arrangement (which would also be the end of the relevant period), the TBCF is billed for the 6-month period between T51 and T57 when undrawn credit remained above the threshold (orange area in the figure). For the assumed quota, the fee amount payable would be about SDR 4.7 million (annual fee rate of 15 bps on undrawn credit of SDR 6.25 billion (125 percent of quota), pro-rated for 6 months).

T69: **The 12-month cooling off period, which started when the "clock" was paused at T57, is exceeded.** The "clock" would start from zero should the member have a subsequent arrangement approved with undrawn credit exceeding the threshold.

Box 2. Illustrative Example of Time-Based Commitment Fees (concluded)

Undrawn Credit and Duration Trigger "Clock" Under Hypothetical Scenario



- **Fee level.** Since the TBCF is not state-dependent and could become payable when members face continued or heightened risk, its level should be modest. The June paper considered a range between 10 bps and 20 bps. On balance, staff considers that a fee in the middle of that range (***15 bps)*** could be appropriate to provide an incentive to reduce the size of prolonged high-access commitments, without unduly adding to exit pressures if risks remained heightened.

- **Billing.** The TBCF would be additional to the regular commitment fees.[9] It would be applied to the portion of undrawn credit that is above the threshold, and only for the period that undrawn credit remains above the threshold after the duration trigger has been met. The fee would be billed and paid ex-post on the day following the end of each relevant 12-month period or the end of the arrangement, if sooner.

[9] The current commitment fees are 15 bps for access up to 115 percent of quota, 30 bps for access in excess of 115 and up to 575 percent of quota, and 60 bps for access in excess of 575 percent of quota.

- **Non-refundability.** Since the TBCF would be charged only for periods when undrawn credit exceeds the threshold, it would not be refundable in the case of drawings. Accordingly, it would be recognized as income by the Fund so long as the duration trigger is met.

- **Scope of the policy.** Given that the purpose of the TBCF is to discourage large-scale prolonged precautionary commitments, it would be appropriate to apply it only to ***arrangements in the credit tranches***. As extended arrangements should generally not be approved on a precautionary basis, staff proposes to exclude them from the policy.

11. If the TBCF were to be established with the proposed parameters, the policy would in practice target large FCL arrangements. Currently, the only arrangement in the credit tranches above the proposed threshold is Mexico's FCL arrangement with access of 700 percent of quota. Should Mexico's access remain above the threshold for 4 years continuously from the date that the TBCF Decision becomes effective (e.g., December 2017), the TBCF of 15 bps would be applied to the portion of Mexico's undrawn access above 575 percent of quota from December 2021, in addition to the regular commitment fee of 60 bps applied on this portion of access.

EXPLANATION OF PROPOSED DECISIONS AND ISSUES FOR DISCUSSION

12. This paper proposes the adoption of a Board decision to complete the FCL and PLL Review. This decision, subject to adoption by a majority of votes cast, would complete the FCL and PLL Review called for in Decision No. 15596-(14/46), adopted May 21, 2014, and confirm that the next review will take place in accordance with the decision on streamlining of policy reviews (Decision No. 15764-(15/39), which states that the next FCL/PLL review will take place in five years or more, or on an as needed basis, or where the aggregate outstanding credit and commitments under the FCL and PLL reach SDR 150 billion as in the Decision currently in effect. It also amends the FCL decision to lower the access threshold (in quota terms), above which an assessment of the impact of an arrangement on Fund liquidity is required for the purpose of consulting the Executive Board on a potential new FCL arrangement in an informal meeting, from 1,000 to 575 percent of quota.[10] It recently came to staff's attention that this threshold was not changed at the review of the access limits policy, following the doubling of Fund quotas.

13. The paper also includes a proposed decision to establish the TBCF. Adoption of Proposed Decision II, which would establish the TBCF on the basis set out above, would require a majority carried by 70 percent of total voting power, and would adopt a new Rule I-8A. The proposed Rule I-

[10] Specifically, the Decision requires an assessment of the impact of a new FCL arrangement on Fund liquidity in cases when staff consults with the Executive Board in an informal meeting and where it is contemplated that access would exceed the quota-based threshold or SDR 10 billion, whichever is lower. Setting the threshold level at 575 percent of quota would align it with the threshold for the highest level of the commitment fees, as had also been the case when the current 1,000 percent of quota threshold was originally established.

8A would "start the clock" on the calculation of the 4-year period from the date of the adoption of the decision.

14. Directors may wish to consider the following issues for discussion:

- Do Directors concur with the proposal to retain the PLL?
- Do Directors agree to extend the use of the core set of indicators with thresholds to the PLL as set forth in Box 1?
- Do Directors support introducing a TBCF? Do Directors agree with the key proposed features?

Proposed Decisions

Decisions I and II are proposed for adoption. Decision I may be adopted by a majority of votes cast. Decision II may be adopted by a 70 percent majority of the total voting power.

Decision I. Completion of Review of Decisions on FCL Arrangements and PLL Arrangements and Amendment to Decision on FCL Arrangements

1. Pursuant to Decision No. 15596-(14/46), adopted May 21, 2014, the Fund has reviewed the decision on Flexible Credit Line Arrangements, Decision No. 14283-(09/29) adopted March 24, 2009, as amended, and the decision on Precautionary and Liquidity Line Arrangements, Decision No. 15017-(11/112), adopted November 21, 2011, as amended.

2. The next review of the decision on Flexible Credit Line Arrangements and the decision on Precautionary and Liquidity Line Arrangements, shall take place in five years or more, or on an as needed basis, or whenever the aggregated outstanding credit and commitments under the FCL and PLL reach SDR 150 billion, in accordance with the decision on streamlining of policy reviews (Decision No. 15764-(15/39), adopted April 23, 2015).

3. Paragraph 6.(a)(iii)(II) of the decision on Flexible Credit Line Arrangements shall be amended to read as follows: "(II) an assessment of the impact of the arrangement on Fund liquidity in cases where it is contemplated that access would exceed 575 percent of quota or SDR 10 billion, whichever is lower."

Decision II. Establishment of a Time-Based Commitment Fee

A new Rule I-8A shall be adopted to read as follows:

"A member with an arrangement in the credit tranches approved or augmented after [Date of Adoption of Decision] (the "arrangement") shall also be subject to the following provisions:

(a) The member shall pay a non-refundable charge of 15/100 of 1 percent per annum on credit tranche amounts in excess of 575 percent of the member's quota that could be purchased by the member during each relevant period from the first point of time during the arrangement when the duration trigger is met, as determined under subparagraph (c) below, until the beginning of the next relevant period or through the end of the arrangement, whichever earlier, or thereafter each subsequent relevant period under the arrangement if the duration trigger continues to be met at the beginning of that relevant period. The charge shall be payable on the day following the end of each relevant period.

(b) Under this Rule I-8A, a relevant period shall be defined in accordance with Rule I-8, and an amount that could be purchased by the member, as being calculated at any time during a relevant period, shall be the amount that could be purchased by the member from that time through the end of the same relevant period.

(c) The duration trigger is met if the amounts that could be purchased by the member during the relevant periods under arrangements in the credit tranches exceed 575 percent of the member's quota for a cumulative duration of 48 months. Such arrangements would be measured in percent of the member's quota in effect on the day on which the charge under subparagraph (a) above is payable. For the purposes of accumulating time towards the total of 48 months, only the period(s) of time during each relevant period after [Date of Adoption of Decision], when credit tranche amounts that could be purchased by the member were in excess of 575 percent of the member's quota, shall be counted. If there was any continuous period of 12 months or longer during which the credit tranche amounts that could be purchased by the member fell to 575 percent of the member's quota or lower, then no time prior to that period shall be counted toward the accumulated 48 months required for the duration trigger to be met."

Annex I. Illustrative Revised Presentation of the Fund's Forward Commitment Capacity (FCC)

This Annex illustrates a revised presentation of total commitments in the calculation of the Fund's Forward Commitment Capacity (FCC) to include a breakdown between arrangements treated as precautionary by the authorities and those expected to be drawn ("non-precautionary").

1. At the June 30 Board meeting, Directors generally supported counting precautionary arrangements at their full value in calculating the FCC ("full scoring").[1] This was seen to provide clear assurance that resources committed under such arrangements will be available to members to whom these commitments were made in all circumstances. Nevertheless, a few Directors saw some scope for flexibility in scoring these commitments against the FCC, given the low probability of drawing under such arrangements.

2. While maintaining full scoring, staff noted that it would seem reasonable to take account of the level of precautionary commitments when assessing the adequacy of the Fund's liquidity.[2] In particular, the same level of the FCC could be considered more or less comfortable depending on the relative size of drawing versus precautionary commitments. In circumstances where precautionary commitments are a relatively large share of the total, the Fund could be willing to tolerate a lower FCC before activating the NAB, and the Managing Director could take such considerations into account in making a proposal on activation. To facilitate such judgments, staff proposes that the FCC calculation in future provide a breakdown of total commitments between arrangements expected to be drawn and those treated as precautionary by the authorities.

3. The Table below illustrates the revised FCC presentation, which would be published weekly on the Fund's website following the conclusion of the FCL and PLL review. The revised table would break down the current line item of undrawn balances under GRA lending commitments into precautionary and non-precautionary arrangements (see rows highlighted in red in Table A.I). As an illustrative example for October 19, 2017, the former would include the three FCL arrangements, the one PLL arrangement and four precautionary Stand-by Arrangements in effect at that time.

[1] See the Acting Chair's Summing Up from Executive Board Meeting 17/56, June 30, 2017.

[2] See paragraph 74 in "Adequacy of the Global Financial Safety Net—Review of the Flexible Credit Line and Precautionary and Liquidity Line, and Proposals for Toolkit Reform," IMF Policy Paper, December 2017.

Table A.I. Illustrative Revised Presentation of the Forward Commitment Capacity

As of October 19, 2017

(in billions of SDRs)

Forward Commitment Capacity (FCC)	
I. Usable resources (a) + (b)	389.3
(a) Fund quota resources	385.7
(b) Fund borrowed resources	3.6
II. Undrawn balances under GRA lending commitments	101.1
Precautionary 1/	82.5
Non-precautionary	18.6
III. Uncommitted usable resources (I - II)	288.2
IV. Repurchases one-year forward	3.8
V. Repayments of borrowed resources one-year forward	2.7
VI. Prudential balance	79.9
VII. Forward commitment capacity (III + IV - V - VI) 2/	209.4
(a) From Quota resources	209.4
(b) From NAB resources	--
(c) From Bilateral Borrowed resources	--

Source: IMF Finance Department.

1/ Undrawn balances under arrangements treated as precautionary by the authorities.

2/ Does not include the Bilateral Borrowing Agreements (activated only if the modified FCC is at or below SDR 100 billion).

December 4, 2017

ADEQUACY OF THE GLOBAL FINANCIAL SAFETY NET—REVIEW OF THE FLEXIBLE CREDIT LINE AND PRECAUTIONARY AND LIQUIDITY LINE, AND PROPOSALS FOR TOOLKIT REFORM—REVISED PROPOSALS—SUPPLEMENTARY INFORMATION

Approved By
Sean Hagan, Martin Mühleisen, and Andrew Tweedie

Prepared by the Finance, Legal, and Strategy, Policy, and Review Departments

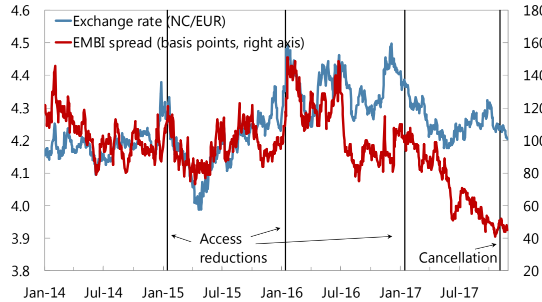
1. This supplement provides additional information to the Staff paper on the *Adequacy of the Global Financial Safety Net—Review of the Flexible Credit Line and Precautionary and Liquidity Line, and Proposals for Toolkit Reform—Revised Proposals,* which was circulated to the Executive Board on November 8, 2017. The information relates to Poland's exit from its Flexible Credit Line (FCL) arrangement and does not alter the thrust of the Staff paper.

2. Poland has exited from its FCL arrangement. The Polish authorities notified the IMF of their decision to cancel, effective November 3, 2017, their arrangement under the FCL. This follows three access reductions since early 2015 and thereby marks the final step in the process of gradually exiting from its FCL arrangements. Poland treated all of its FCL arrangements as precautionary and did not draw on any of these arrangements.

3. Poland's exit from the FCL arrangement was communicated to markets prior to the official cancellation. A few weeks before the cancellation of the FCL arrangement, the Polish Deputy Prime Minister and Finance Minister Morawiecki publicly noted the Polish authorities' intention to exit from the facility, citing the strength of Poland's economy, a reduction in external risks, and the prospects for continued favorable global growth, especially in the euro area. The advance communication of their intention was in line with the Polish authorities' previous practice of communicating to investors and the general public their plans for gradual exit prior to reductions in access. On the day of the cancellation, both the Polish authorities and the IMF (PR No. 17/418) issued press releases to communicate the exit.

4. Market reaction to the cancellation has been muted. Both the exchange rate and EMBI spreads remained broadly stable around the announcement of the exit from the FCL. This is consistent with the findings in the Staff paper "*Adequacy of the Global Financial Safety Net—Review of the Flexible Credit Line and Precautionary and Liquidity Line, and Proposals for Toolkit Reform,*" circulated to the Executive Board on June 2, 2017, which noted that high-frequency data have generally pointed to muted market reaction to access reductions across FCL and PLL arrangements.

Poland: Access Reductions 1/



Source: Bloomberg.

1/ The January 13, 2016, access reduction occurred shortly before an announcement of a potential costly foreign-currency mortgage convertion scheme.