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

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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) (https://www.imf.org/en/News/Articles/2015/09/14/01/49/pr16139) . 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 (http://www.imf.org/en/news/articles/2017/07/26/pr17299-imf-executive-board-approves-proposal-for-a-new-policy-coordination-instrument) and an enhanced framework for cooperation with Regional Financing Arrangements (http://www.imf.org/en/news/articles/2017/07/31/pr17310-imf-executive-board-discusses-collaboration-between-regional-financing-arrangements-imf) .

The discussions were informed by three staff papers: " Adequacy of the Global Financial Safety Net—Considerations for Fund Toolkit Reform (http://www.imf.org/en/Publications/Policy-Papers/Issues/2017/12/19/pp121917-AdequacyOfTheGFSN) " (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 (http://www.imf.org/en/Publications/Policy-Papers/Issues/2017/12/19/pp121917-adequacyofgfsn-proposalsfortoolkitreform) " (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 (http://www.imf.org/en/Publications/Policy-Papers/Issues/2017/12/19/pp121917-adequacyofgfsn-revisedproposals) " (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.

MEDIA RELATIONS

PRESS OFFICER: RAPHAEL ANSPACH

PHONE: +1 202 623-7100 | **EMAIL:** MEDIA@IMF.ORG