BUFF/17/54

July 10, 2017

The Acting Chair's Summing Up
Adequacy of the Global Financial Safety Net—Review of the Flexible Credit Line and Precautionary and Liquidity Line, and Proposals for Toolkit Reform
Executive Board Meeting 17/56
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.