

INTERNATIONAL MONETARY FUND

**The Fund's Financing Role: Reform Proposals on
Liquidity and Emergency Assistance**

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In consultation with other departments

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EXECUTIVE SUMMARY

Motivation: The possible global repercussions from the ongoing turmoil in the Euro Area and recent calls for enhanced emergency assistance in the Middle East and North African region are reminders of the urgent need for a more effective global financial safety net to deal with increased interconnectedness and volatility. Past work by staff identified gaps in the Fund's lending toolkit to respond to liquidity needs of members with relatively strong fundamentals affected during systemic crises (the crisis bystanders), and to address urgent financing needs arising in a broader range of circumstances than natural disasters and post-conflict situations. The companion paper on the [Review of the Flexible Credit Line \(FCL\) and Precautionary Credit Line \(PCL\)](#) also identified gaps in the overall flexibility of the financing toolkit. This paper provides proposals to fill these gaps, while preserving the simplicity and coherence of the lending framework, and balancing members' financing needs against the need for adequate safeguards for the use of Fund resources.

Proposed reforms: Reflecting early feedback by Executive Directors, two reform proposals are made to enhance the flexibility and reach of the General Resources Account (GRA) lending toolkit.

- **Broadening coverage of emergency assistance:** Current GRA emergency assistance tools are proposed to be consolidated under an enhanced and broadened GRA emergency assistance instrument similar to the Rapid Credit Facility under the Poverty Reduction and Growth Trust. Under this proposal, the current emergency assistance special policy covering natural disasters (ENDA) and post-conflict situations (EPCA) would be replaced with a single instrument in the credit tranches, named the *Rapid Financing Instrument* or *RFI*. The RFI would support a full range of urgent balance of payments needs, including those arising from exogenous shocks (e.g., commodity price shocks and natural disasters), post-conflict and other fragile situations, or from other disruptive situations. Financing would be in the form of outright purchases, with an annual access limit of 50 percent of quota and a cumulative access cap of 100 percent of quota. Although upper-credit tranche-quality policies would not be required for approval, the member would need to outline its policy plans and commitments in a letter of intent as well as cooperate with the Fund in an effort to find solutions for its financing difficulties.
- **Enhancing liquidity provision:** Consistent with the findings of the *Review* paper, the PCL is proposed to be made more flexible by (i) allowing its use by members with an *actual* balance of payments (BoP) need at time of approval, and (ii) allowing six-month duration arrangements to meet short-term BoP needs. These changes would enhance the effectiveness of the PCL by allowing members satisfying all other PCL qualification criteria, but with an actual BoP need, to get financing under a PCL arrangement, enabling them to benefit from the positive signaling effect linked with PCL qualification. Establishing a liquidity window by allowing shorter duration arrangements provides a platform to address the needs of crisis bystanders during periods of heightened regional or global stress and contagion. Such a revamped PCL would no longer be strictly precautionary, and could more suitably be named the *Precautionary and Liquidity Line* (PLL). The PLL will be designed flexibly to provide adequate room for maneuver to the Executive Board in dealing with rapidly evolving crises while including stronger procedural safeguards.

Resource Implications: The proposed reforms may increase upfront calls on Fund resources to the extent that they succeed in encouraging more members to seek early Fund financial assistance. However, the timely and effective response to members' financing needs can also be expected to result in confidence effects that offset part of the upfront call on resources. Overall, for a given level of global financing needs, the proposed reforms are expected to have only a limited impact on the need for Fund resources.

I. BACKGROUND¹

1. **The Fund’s ability to respond to the different and evolving financing needs of the membership in an increasingly interconnected global economy calls for a far-reaching and flexible lending toolkit.** The Fund’s workhorse instrument, the Stand-by Arrangement (SBA), has been used to good effect through various economic and financial crises, and is likely to remain the cornerstone of the Fund’s lending framework. However, when the 2008 global crisis struck, it exposed gaps in the toolkit, particularly for large and frontloaded crisis prevention financing. The Fund responded quickly to reform the lending framework by creating the Flexible Credit Line (FCL) and subsequently modifying it while also establishing the Precautionary Credit Line (PCL), significantly enhancing its ability to flexibly provide financing for crisis prevention and resolution with a coherent set of instruments. Once again, now, the increasing contagion concerns from the turmoil in the Euro Area and recent calls for emergency assistance in the Middle East and North African region in the context of BoP needs arising from political and economic transformation are reminders of the urgent need for a broader and more effective global financial safety net.

2. **The proposals discussed in this paper seek to address gaps identified in the GRA lending toolkit on addressing members’ liquidity and emergency financing needs.**

Recent staff work on lessons from past systemic crises, lending to countries in fragile situations, and the findings of the companion paper on the [Review of the FCL and PCL](#) (henceforth called the *Review* paper) recognize the following gaps:^{2,3}

- Staff assesses that there is scope to enhance the Fund’s ability to provide rapid emergency assistance to countries in fragile situations. In the recent Executive Board discussion of the paper [Macroeconomic and Operational Challenges in Countries in Fragile Situations](#) (henceforth called the *Fragile Situations* paper), many Directors saw merit in the proposal to establish an instrument that would provide emergency assistance in the General Resources Account (GRA) with a view towards assisting members in fragile situations, similar to the Rapid Credit Facility (RCF), that is already available to eligible members under the Poverty Reduction and Growth Trust (PRGT), although a number of other Directors were unconvinced of the need for a new instrument.⁴

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² See “[Analytics of Systemic Crises and the Role of Global Financial Safety Nets](#)” and the background paper “[Mapping Cross-Border Financial Linkages—A Supporting Case for Global Financial Safety Nets](#)”.

³ See [Deauville Partnership Finance Ministers’ Meeting Communiqué](#) – Marseille, September 10, 2011.

⁴ See [Public Information Notice \(PIN\) No. 11/95: Macroeconomic and Operational Challenges in Countries in Fragile Situations](#).

- Complex cross-country financial linkages increase systemic risks by facilitating rapid contagion among countries during heightened stress events. The recent global crisis and its continuation in Europe underscore the need to strengthen the global financial safety net by affording greater flexibility in the liquidity instruments at the disposal of the Executive Board to break the chains of contagion and stabilize funding conditions amid highly uncertain and rapidly evolving crisis times. In the recent Executive Board discussion of the [Analytics of Systemic Crises and the Role of Global Financial Safety Nets](#) (henceforth called the *Analytics* paper), Directors noted the increasing difficulty faced even by countries with relatively strong fundamentals and policy track records, i.e., the “crisis bystanders,” to withstand contagion shocks during high stress events. Many supported exploring further enhancements to the global financial safety net to provide timely and adequate liquidity to crisis bystanders and, more generally, to foster greater global cooperation.⁵ They also called for an assessment of existing Fund financing instruments, including their demand during the recent crisis, to inform consideration of any changes to the toolkit.
- Finally, and as also noted in the companion *Review* paper, replacing the current PCL with a more flexible PCL-like instrument would enable the Fund to address broader needs of members amid increased global economic and financial interconnectedness. In particular, allowing access to a PCL-like instrument for members that have an *actual* BoP need at the time of approval, but would in all other regards qualify for the current PCL (which allows only for a *potential* BoP need at approval), and allowing more flexible durations of PCL-like arrangements, would enable the Fund to proactively channel liquidity in response to sudden and possibly contagious shocks thus enhancing the Fund’s ability to deal with a broader set of crises.

3. **Any proposals to enhance the lending toolkit should be guided by the need to preserve a simple and coherent framework, with adequate safeguards and resources.**

Accordingly, the reform proposals set out in the paper follow four key principles: (i) fill potential gaps in instruments by continuing to organize the lending toolkit mainly according to the strength of members’ policies and fundamentals; (ii) preserve simplicity, avoiding proliferation of instruments targeting similar needs; (iii) balance members’ desire for predictable and rapid access to liquidity with the need for adequate safeguards, and to minimize moral hazard; and (iv) ensure that the enhancements to the financing framework are backed by adequate Fund financial resources.

4. **The proposals set out in this paper reflect early feedback from the Board at the recent informal discussions on options to enhance the Fund’s financing role.** At the Board seminar on October 11 on the *Fund’s Financing Role—Options to Enhance the GRA Financing Toolkit*, many Executive Directors expressed preference for a streamlined toolkit, avoiding

⁵ See [Public Information Notice \(PIN\) No. 11/98: Analytics of Systemic Crises and the Role of Global Financial Safety Nets](#). See also the [Final Communiqué from the Meeting of G20 Finance Ministers and Central Bank Governors](#), April 15, 2011, Washington D.C.

proliferation of instruments. There was also broad support for an emergency assistance instrument to address urgent BoP needs, as well as for reforms to allow the approval of PCL arrangements when a BoP need is present and to make the duration of PCL arrangements more flexible. While supporting the need for liquidity provision to crisis bystanders, many Executive Directors preferred to do so within a modified version of the existing toolkit instead of introducing a new instrument or formally activating a mechanism for liquidity injection during systemic crises to avoid the risk of further intensifying the stress event from such activation. Modifications to the FCL decision to allow approval of FCL arrangements with six-month duration also did not receive broad support. In a subsequent informal meeting on October 26, a number of Executive Directors noted that the current highly-uncertain crisis times suggest equipping the Fund's lending toolkit with instruments that are flexible, yet simple to understand and implement, affording adequate room for the Executive Board to deal with rapidly evolving circumstances. The proposed design of the revamped PCL-like instrument will, therefore, aim to provide such room while maintaining adequate safeguards from close and early Board involvement in decision making.

5. **Against this background, this paper sets out two key reform proposals:** (i) consolidate the Fund's emergency financial assistance by replacing the current special policy on emergency assistance, which has separate windows covering post-conflict and natural disaster assistance (EPCA and ENDA) with an enhanced and broadened single RCF-like GRA instrument that would provide financing to address a full range of urgent BoP needs (Section II), and (ii) replace the PCL with a new and more flexible instrument to meet a broader range of BoP needs, including actual needs existing at the outset and short-term liquidity needs of crisis bystanders during periods of heightened stress and contagion (Section III). Resource implications of the proposed reforms are assessed in Section III, and Section IV concludes. The proposed decisions to implement these reforms will be circulated in a supplement to this paper.

II. BROADENING EMERGENCY ASSISTANCE

6. **There is scope to convert the Fund's current GRA instruments for emergency assistance into a broadened, more flexible and effective instrument.**⁶ Currently, the application of ENDA and EPCA is compartmentalized and limited to a narrow set of emergency circumstances—i.e., financing needs arising from natural disasters and post-conflict situations, respectively (Box 1). As a result, and as discussed in the *Fragile Situations* paper, the GRA lacks a well-tailored mechanism to provide emergency assistance to countries in fragile but non-post conflict situations, and more generally to address other urgent BoP needs that particularly middle-income countries may face. Indeed, in such circumstances, non-PRGT eligible members with urgent financing need would normally have

⁶ With the reform of the IMF's concessional lending facilities that became effective on January 7, 2010, the availability of subsidies for new purchases under ENDA and EPCA was terminated, and replaced by the concessional RCF in the PRGT.

to seek support under an SBA, despite potential challenges in their capacity for program implementation, stemming inter alia from their fragility. In light of this, the current GRA special policy covering ENDA and EPCA is proposed to be replaced with a single instrument in the credit tranches called the *Rapid Financing Instrument*, or *RFI*, that would provide financing to address any urgent BoP needs, modeled closely on the RCF.⁷

Box 1: The Fund's Special Policy on Emergency Assistance

Emergency Natural Disaster Assistance (ENDA) has been provided since 1962 to members recovering from a natural disaster in the form of an outright purchase without requiring phasing or performance criteria. To qualify for ENDA financing, the member is required to describe the general policies it plans to pursue. It is also expected to cooperate with the Fund in an effort to find solutions for its BoP difficulties and avoid implementing policies that could compound the problems caused by the disaster. The amount of access is limited to 25 percent of quota, though larger amounts could be made available in exceptional cases. In recent years (2009-11), Pakistan and St. Lucia have obtained emergency assistance under ENDA.

Emergency Post-Conflict Assistance (EPCA) was introduced in 1995 and is available to post-conflict countries meeting specific eligibility criteria. The role of Fund assistance for these countries is to meet urgent BoP needs, help rebuild reserves, and catalyze donor support in a concerted effort to address the aftermath of a conflict in a comprehensive way.

Fund Emergency Assistance to Non-PRGT Eligible Countries
(1962 - present)

Even if the member does not have sufficient

Emergency policy	Number of purchases	Total amount of purchases (in millions of SDRs)	Median access (in percent of quota)
ENDA	16	1650	25
EPCA	8	544	25

institutional capacity to implement an upper credit tranche (UCT)-quality program, it is required to have sufficient capacity and commitment for policy planning and implementation. In order to receive assistance under the EPCA, also in the form of an outright purchase, a country is expected to present a statement of economic policies; a quantified macroeconomic framework; and a statement indicating its intention to move to a UCT-quality program as soon as possible. The key form of conditionality is through prior actions. In 2004, the Board extended the period during which EPCA financial support can be provided with access capped at 25 percent of quota in one year, and a cumulative ceiling of 50 percent of quota. EPCA was last used by Guinea-Bissau and Lebanon in 2008.

In November 2000, the Executive Board converted both ENDA and EPCA emergency assistance into a special policy, so that it would not be subject to the level-based surcharge that was then applicable to outstanding credit tranche purchases.

A. Design Features of the Proposed Rapid Financing Instrument

7. **Purpose and objectives:** The RFI would provide rapid and low-access financing with limited conditionality to address urgent BoP needs arising from a variety of circumstances. These would include, but would not be limited to, urgent BoP financing needs arising from exogenous shocks (e.g., commodity price shocks and natural disasters), fragile or post-

⁷ The features of the low-income country RCF are elaborated in [A New Architecture of Facilities for Low Income Countries](#).

conflict situations, or other disruptive events.⁸ The RFI, with its broader coverage of urgent BoP needs would avoid compartmentalizing emergency assistance based on strictly defined sources of BoP need as has marked previous approaches, and would provide a single, flexible mechanism to support members. As a window in the credit tranches, the RFI would have the same applicable terms of financing (charges, surcharges, and repurchase periods of 3¼ to 5 years) as any other instrument in the credit tranches; it would replace the current emergency assistance special policy that covers ENDA and EPCA. In addition to providing financial resources, the RFI could provide a framework for policy support and technical assistance, playing a catalytic financing role for both official and market sources.

8. **Nature of the BoP need:** The RFI is designed similar to the RCF for PRGT-eligible members. The RFI, which would be available to all Fund members (including PRGT-eligible members), would be designed for situations where (i) the member is experiencing an urgent BoP need that, if not addressed, could result in an immediate and severe economic disruption, and (ii) either (a) the BoP need is expected to be resolved within one year with no major policy adjustments being necessary (e.g., due to the transitory and limited nature of financing and adjustment needs due to, say, a temporary shock), *or* (b) the member lacks the capacity to implement an UCT-quality economic program due to limited policy implementation capacity (e.g., in cases where institutional and policy implementation capacity may be constrained due to fragilities arising from conflicts or political transformations) or due to the urgent nature of the BoP need (e.g., the urgency does not allow sufficient time to reach understandings on a Fund-supported UCT-quality economic program to address the member's longer term needs).

9. **Qualification and Conditionality:** Ex-ante commitment of policy undertakings would be required to qualify for the RFI. As is currently the case under ENDA/EPCA and the RCF, UCT-quality policies would not be required (although such policies would obviously not be precluded).⁹ Also, as Fund support under the RFI would be in the form of outright purchases, there would be no ex post conditionality. A request for an RFI purchase would be approved only if the Board is satisfied that the member will cooperate with the Fund in an effort to find solutions for its BoP difficulties. Approval of an RFI purchase would also require ex ante policy undertakings, as appropriate, outlined in a letter of intent, setting out general policies that the member plans to pursue, and its commitment not to introduce any

⁸ An exogenous shock is defined in the same manner as under the RCF, i.e., an event beyond the control of the authorities, with a significant negative impact on the economy, and could include, inter alia, terms of-trade shocks, natural disasters, shocks to demand for exports, or conflict or crisis in neighboring countries that has adverse BoP effects. "Fragility" has many definitions, and its assessment is necessarily judgmental and complex, and can vary across countries and change over time. See [Appendix 1 of *Macroeconomic and Operational Challenges in Countries in Fragile Situations*](#) for a more detailed discussion of the definition of fragility.

⁹ The Fund has long had GRA policies under which it has made resources greater than the first credit tranche (25 percent of quota) available in the absence of UCT quality policies, including the current ENDA/EPCA and the now-defunct Systemic Transformation Facility and Compensatory Financing Facility.

measures and/or policies that may compound its BoP difficulties. Similar to the RCF, prior actions could also be established, where warranted, for implementation prior to approval of an RFI purchase.

10. **Fund Engagement:** In addition to the general policies required in the letter of intent, as noted above—and in order to facilitate possible future RFI financing (which is conditioned on a track record of adequate macroeconomic policies in certain cases, as described below)—members would be encouraged to include in the letter of intent, where possible, quantitative targets and structural objectives. Alternatively, as under the RCF, the assessment of policy adequacy could also be underpinned by a track-record building Staff Monitored Program (SMP) or, in the rare case where no relevant pre-determined monitorable objectives exist, the track record for repeated RFI financing could be based on the Fund’s assessment that macroeconomic policies have been adequate at least over the most recent six-month period. In addition to offering a medium-term framework for Fund engagement, an SMP would also provide an opportunity to assess the member’s commitment and progress (where applicable) towards building the ability to implement a UCT-standard program, while allowing for more regular reporting to the Board.

11. **Access:** Financial assistance under the RFI would be capped at 50 percent of quota annually and at 100 percent of quota on a cumulative basis.¹⁰ As with all Fund financing, the access level in individual cases would depend on the scale of the BoP need, the assessment of the member’s capacity to repay, the member’s outstanding Fund credit, and its record of using Fund resources in the past. Access under the instrument would count towards the overall limits on access to GRA resources. Thus, approval of an RFI purchase for members with outstanding GRA credit above these limits would be subject to the exceptional access substantive and procedural requirements.

12. **Repeated use:** As under the RCF, and as a means to help ensure that the RFI does not support continued weak policies or create moral hazard, there would be limits on repeat use of the RFI. Specifically, if a member has made an RFI purchase within the three preceding years, any additional RFI purchases—except those requested to meet an urgent BoP need caused primarily by an exogenous shock—could only be approved if the member has established a track record of adequate macroeconomic policies at least over a period of six months immediately prior to the request (as described above in ¶10). Accordingly, the initial staff report for an RFI request, particularly in cases involving fragility, could discuss whether repeat use of the RFI is anticipated, including based on how long it might take to restore capacity to implement a UCT-quality economic program.

¹⁰ Larger BoP needs of an urgent nature could be met under the modified PCL (as discussed in Section III) for countries qualifying for this instrument, and more generally under Stand-By or Extended Arrangements if the country’s economic program were to warrant SBA or Extended Fund Facility support.

13. **Safeguards:** Despite the absence of a requirement for UCT-quality policies, a number of elements in the design of the RFI combine to provide adequate safeguards for the use of the Fund's resources and also help to address moral hazard concerns. These include the scope for using prior actions, the cooperation requirement built into the approval standard, the condition that the member outlines its policy undertakings and commitments in a letter of intent, and the track record requirement in cases where repeat use is not premised on an exogenous shock. Also, similar to the RCF, a member's request for assistance under the RFI will require a commitment to undergo a safeguards assessment and an authorization for Fund staff to have access to the central banks' most recently completed external audit reports and to hold discussions with the external auditors.¹¹

14. **Resource implications:** While the impact of broadening the coverage of emergency assistance on the Fund's finances is difficult to gauge, the additional demand for Fund resources is likely to be limited. This assessment reflects the relatively limited modifications to the existing ENDA/EPCA approval standards and the continuation of access caps.

15. **Voting requirement:** Adoption of the RFI as a window in the credit tranches would require an Executive Board decision adopted by a majority of the votes cast.

III. REPLACING THE PCL WITH THE MORE FLEXIBLE PRECAUTIONARY AND LIQUIDITY LINE

16. **As discussed in the *Review* paper, the PCL could be strengthened further to fill some remaining gaps.** Addressing these gaps would strengthen the toolkit, within a simple and coherent framework, enhancing the extent to which members' needs are flexibly met, with adequate safeguards and without instrument proliferation. Specifically, the following two changes to the PCL are proposed:

- **Allowing actual BoP need at approval:** The PCL was originally envisaged to play mainly an insurance-type role for qualifying countries—and the absence of an actual BoP need at the time of approval was seen as a safeguard given the recognized possibility that PCL qualifiers would have moderate vulnerabilities. Thus, the current PCL policy disqualifies members with sound fundamentals and policies but with an actual BoP need at approval of an arrangement, even if they meet all other qualification criteria for a PCL arrangement. However, the PCL's potential use for crisis resolution was also explicitly acknowledged in its original design by allowing purchases if an actual need were to emerge after approval, as well as augmentation of access and/or rephasing of purchases during the course of the arrangement and upon

¹¹ The timing and modalities of the safeguards assessment for members with assistance under the RFI would be determined on a case-by-case basis. Normally, however, the safeguards assessment would need to have been completed before Executive Board approval of any subsequent arrangement to which the Fund's safeguards policy applies.

completion of a review. Indeed, in rapidly changing global conditions, a potential BoP need that has been identified in a PCL-qualifying country can quickly morph into an actual BoP need without any change in the country's macroeconomic policies and fundamentals.

- **Establishing a liquidity window:** Another enhancement to the PCL could include allowing six-month PCL arrangements as a liquidity window to meet financing needs of a shorter duration, including, but not limited to, those arising from exogenous shocks (see ¶19 for additional consideration of the nature of those shocks). Two potential uses of this shorter duration PCL arrangements are envisaged: (i) during periods of heightened stress and contagion, to enable the Fund to more effectively meet the short-term BoP liquidity needs of its members and break the chains of contagion; and (ii) in normal times, to play a somewhat similar role to the exogenous shock component of the RFI discussed above when used by members with actual BoP needs and with sound policy track record and fundamentals, (but with the associated higher PCL qualification bar allowing for higher access than the RFI, while maintaining safeguards). Limits on access and repeated use will be tailored according to the envisaged dual-purpose use of six-month arrangements to ensure the effectiveness of this window in meeting members' needs while adequately safeguarding Fund resources.

17. **Allowing the PCL to respond to both actual and potential BoP needs would call for a change of name.** A more suitable name for the modified PCL could be *Precautionary and Liquidity Line (PLL)*, indicating its dual crisis prevention and resolution role in addressing the liquidity needs of the qualifying members.

A. Design Features of the Proposed Precautionary and Liquidity Line

18. **Fund policies very close to those that currently apply to the PCL would apply to the proposed PLL.** Specific features are described below.

19. **Qualification:** Qualification criteria and requirements would be unchanged from the current PCL decision, except that members could seek support under the PLL based on a potential *or* actual BoP need. A six-month PLL arrangement too could be based on a potential or actual BoP need, but with this need being of a short-term nature. While what constitutes a short-term BoP need is inherently difficult to define, and would require an element of Board judgment in the approval process, generally it would be considered one in which the member could make credible progress in addressing its vulnerabilities during the duration of the arrangement. Short-term BoP needs may often arise in connection with exogenous shocks, where these are generally intended to include all external stress events beyond the control of the authorities as described under footnote 8, as well as heightened stress in regional or global conditions.

20. **All other qualification criteria under the current PCL decision would remain unchanged.** This helps provide continued safeguards to Fund resources, ensuring that the PLL remains targeted to countries with sound economic fundamentals and institutional policy frameworks.¹² Importantly, the requirement that a PLL arrangement cannot be approved for a member facing sustained inability to access international capital markets will continue to apply, providing an explicit safeguard in terms of the nature of the BoP needs that qualifying members are expected to face. Even so, the existence of an actual BoP need at the time of approval would be factored into the qualification assessment, if it were seen as evidence of substantial underlying vulnerabilities, in which case, the SBA or EFF would be the more appropriate instrument.

21. **Duration and repeated use:** PLL arrangements would allow for one- to two-year duration as is currently the case for the PCL, but could also be approved for a six-month duration to meet short-term BoP needs as described above. Six-month arrangements should not be used in cases with longer term BoP needs (and vulnerabilities requiring a longer period to address), as these should be addressed under one- to two-year PLL arrangements for qualifying members. Specifically, repeated use of the six-month PLL arrangement would only be allowed if either:

- a) A “cool off” period of at least two years have elapsed since the approval of the previous six-month arrangement; or
- b) The member’s short-term BoP need lasts longer than initially expected due to heightened stress in regional or global financial and economic conditions.¹³ * In such a situation, approval of one additional successor six-month PLL arrangement would be possible without the need to observe the two-year period specified above. As with all PLL arrangements, this one-time further support under a six-month arrangement

¹² In particular, the following qualification requirements under the current PCL decision would continue to apply: “In addition to requiring a generally positive assessment of the member’s policies by the Executive Board in the context of the most recent Article IV consultations, a member’s qualification for a PCL arrangement shall be assessed in the following areas (with the member being expected to perform strongly in most of these areas and not to substantially underperform in any of them): (i) external position and market access, (ii) fiscal policy, (iii) monetary policy, (iv) financial sector soundness and supervision, and (v) data adequacy”. Also, the four criteria for not approving the PCL would remain binding ([Decision No. 14715-\(10/83\)](#), 8/30/10, Section 2(b)): A PCL would not be allowed for members facing “(i) sustained inability to access international capital markets, (ii) the need to undertake a large macroeconomic or structural policy adjustment (unless such adjustment has credibly been launched before approval); (iii) a public debt position that is not sustainable in the medium term with a high probability, or (iv) widespread bank insolvencies” ([Decision No. 14715-\(10/83\)](#), 8/30/10, Section 2(c)).

¹³ See [Analytics of Systemic Crises and the Role of Global Financial Safety Nets](#) for a discussion of events of heightened and widespread stress and possible quantitative and qualitative indicators to determine and monitor such events.

would be on a case-by-case basis and subject to an assessment of continued qualification and prior actions, if warranted.

* At the Executive Board meeting on the discussion of this paper, revisions were made to the definition of the circumstances in which repeated use of the six-month PLL arrangement would be allowed outside of the two-year “cool off” period. Under the final decision, repeat use is allowed in this context where the member’s balance of payments need is longer than originally anticipated due to the impact of exogenous shocks, including heightened regional or global stress conditions

- c) Beyond these two circumstances for repeated use of six-month PLL arrangements any additional PLL support, if warranted, would be expected to be under the one- to two-year PLL arrangements, subject to the access limits under the current PCL decision.

22. Allowing repeat use of six-month PLL arrangements provides additional ammunition for the Fund to respond flexibly to regional or global stress events.

Responding effectively to the short-term liquidity needs of a member during periods of heightened stress could help improve overall market confidence, creating positive externalities for other members and helping cut the chain of contagion by ring-fencing crisis bystanders, who could otherwise themselves become vehicles for the shock propagation if their liquidity needs are not quickly and sufficiently contained.¹⁴ Thus, the six-month PLL arrangement could serve as a tool for liquidity provision to address short-term BoP needs of crisis bystanders supplanting the need for a more structured approach as earlier proposed under the Global Stabilization Mechanism, which did not receive broad support from the membership.

23. Conditionality: One-to-two year PLL arrangements would be subject to the same ex ante conditionality (i.e., qualification requirements) and ex post conditionality (i.e., indicative targets, standard continuous performance criteria, six-monthly reviews, and other performance criteria where called for under the Guidelines on Conditionality) as currently apply to one- to two-year PCL arrangements. Six-month PLL arrangements too would be subject to ex ante conditionality, and would also be subject to those elements of ex post conditionality that are applicable taking into account the six-month duration (i.e., the standard continuous performance criteria generally applicable to GRA arrangements).¹⁵ In light of their duration—and consistent with the six-month purchase rights under a one-to-two year PLL arrangement—six-month PLL arrangements would not be subject to the six-monthly reviews, indicative targets, or potential performance criteria, as apply to one-to-two year PLL arrangements. As under the

¹⁴ The companion [Review paper](#) provides evidence of such a phenomenon where the FCL lowered market spreads not only for those countries that requested the arrangements, but also for other emerging market economies perceived to be FCL qualifiers.

¹⁵ The standard continuous performance criteria cover trade and exchange restrictions, bilateral payment arrangements, multiple currency practices and non-accumulation of external debt payments arrears. If a standard performance criterion is not observed at any point during a six-month PLL arrangement, purchases under that arrangement would be blocked until the Board grants a waiver of nonobservance, as is the case under the current PCL.

current PCL, prior actions could be required in arrangements of any duration under the proposed PLL, and the authorities would also be required to submit a concise written communication—with their policy commitments to resolve their BoP difficulties and policies to address remaining vulnerabilities, together with a quantified macroeconomic framework.

24. **Access and phasing** would vary depending on the duration of the arrangement and country-specific needs.

Access

- a) *For normal periods*, access under six-month PLL arrangements would be determined on a case-by-case basis, with no phasing of purchases (i.e., the entire approved amount would be made available upfront), and would be capped at 250 percent of quota. This access level would be half of the 500 percent of quota annual approval limit for current PCL arrangements. As under all Fund arrangements, purchases could in any event not exceed the actual BoP need. After the expiration of the two-year “cooling off” period described in ¶21, a new six-month arrangement of up to 250 percent of quota could be approved.
- b) *In times of heightened stress in regional or global economic and financial conditions* resulting in more protracted BoP need than originally anticipated (as described in ¶21), access under six-month PLL arrangements could exceed the cap of 250 percent of quota that applies in normal periods, but this higher access can in any case not exceed the 500 percent of quota annual approval under the PCL.* This higher access would be available on a case-by-case basis to all six-month arrangements approved or in place during high stress periods, whether a single six-month arrangement or cumulatively in successive six-month arrangements (discussed in ¶21).
- c) * At the Executive Board meeting on the discussion of this paper revisions were made to the definition of the circumstances in which a higher access limit of 500 percent of quota would be allowed. Under the final decision, the higher access limit applies in exceptional circumstances where the member is experiencing or has the potential to experience short-term balance of payments needs that exceed the normal 250 percent of quota limit due to the impact of exogenous shocks, including heightened regional or global stress conditions. As with all access determinations, the applicability of the higher access made available in periods of heightened stress to any particular country would be approved by the Executive Board on a case-by-case basis (see Box 2 for considerations that would underlie such a determination). In determining individual countries’ access levels, key factors for consideration would include the country-specific considerations, as well as the potential for contagion to exacerbate funding strains. Thus, the six-month PLL arrangement could usefully act as a conduit for the Fund to respond to events of widespread stress, providing liquidity to crisis bystanders and helping mitigate contagion.

- d) *For one year or one-to-two years* PLL arrangements, access could be increased up to the PCL instrument's cap of 1,000 percent of quota at any time during the course of the arrangement, subject to the completion of a scheduled or ad hoc review that takes stock of the evolving circumstances and policy requirements of the member, consistent with the current PCL decision.

Box 2: Considerations to Determine a Heightened Stress Event

To inform the Board's determination of access in six-month PLL arrangements, the following factors could be considered to detect heightened stress events. This approach requires analyses and judgment in three main areas:

- **Global/regional economic and financial stress** can be monitored using quantitative stress indicators (e.g., the global systemic crisis indicator developed in the *Analytics* paper), complemented with other multilateral and regional surveillance products such as the WEO, REOs, and GFSR, as well as risk analyses such as the Early Warning Exercise and the Vulnerability Exercises and FSB reports.
- **Contagion risk via trade and financial linkages** could be assessed based on how integrated the member is to the global/regional trade and financial networks. As discussed in the *Linkages* paper, the severity of the 2008/09 global crisis was at least partly attributable to the growth of trade and financial linkages in the last decade and the fact that the shocks originated from the most integrated economies.
- **Contagion risk beyond direct trade and financial linkages** is also critical. Many times a large shock could lead international investors to reappraise risks in similarly-situated, but not directly connected, countries that may be more closely connected to other "core nodes" of the financial and trade networks. Latvia is a case in point. As discussed in the *Analytics* paper, judged by its economic size or financial linkages, Latvia may not be considered a "core node" of the financial network, but its 2008/09 crisis triggered broader creditor panic, affecting many similarly-situated emerging markets notably in Eastern Europe, all more closely connected to core European banking systems.

Access decisions should take into account forward-looking considerations—an issue that is particularly relevant during periods of heightened stress. There are situations where risk indicators for individual countries or a group of countries (e.g., emerging markets) may not reveal stressed market conditions, although a broader assessment of contagion risks taking into account financial and real economy linkages may indicate the potential for a future deterioration in market conditions. Based on the crisis experience in 2008/09, it will be important when proposing access levels in individual country cases to take into account the totality of circumstances, including the potential for contagion to exacerbate funding strains.¹

¹The 2008-09 global crisis is a case in point: it started with stress in financial centers and advanced economies, and for a number of months emerging markets were said to have "decoupled" from advanced economies. The months following the Lehman bankruptcy proved otherwise. In fact, stress in emerging market funding conditions remained elevated even after dollar funding constraints in financial centers abated in early 2009.

Phasing

- a) One-to-two year arrangements approved where the member has an actual BoP need would have purchases phased on a semiannual basis, in line with semiannual reviews, and in contrast to one-to-two year arrangements approved in the absence of a BoP need, where phasing would continue to be done on an annual basis as under the current PCL. The semi-annual phasing of purchases would be commensurate with the

member's projected actual BoP needs, subject to the access limits under the current PCL.

- b) As in the current PCL, access in one-to-two year PLL arrangements Corrected: 11/29/11
rephased or augmented at any time during the course of the arrangement, as discussed above. Rephrasing or augmentations would be subject to the completion of a scheduled or ad hoc review that takes stock of the evolving circumstances of the member, consistent with the current PCL decision.¹⁶

25. **Voting requirement.** A majority of the votes cast would be required to introduce the proposed modifications to the PCL.

26. **Safeguards** under the current PCL and, by extension, the proposed PLL already include the combination of ex ante conditionality (qualification criteria and specific requirements for approval of arrangements), focused ex post conditionality, relatively short duration of purchase rights (no more than six months), capped access, phasing of access such that any amounts above 500 percent of quota are available only after successful implementation of policy commitments in the first year (or subject to review by the Board if needed earlier), as well as semi-annual phasing of access for one to two year arrangements approved for members with actual BoP needs. Further, prior actions could be required, and the member is required to submit a concise written communication containing policy commitments to address remaining vulnerabilities, as well as a quantified macroeconomic framework.

27. **The PLL would also be subject to the Fund's policies on Safeguards Assessments and Post-Program Monitoring as is the PCL at present.**¹⁷ As is currently the case for PCL arrangements, the four substantive criteria and procedural requirement under the exceptional access policy will apply to PLL arrangements involving exceptional access, regardless of the duration of the arrangement. As an added safeguard, it is proposed that PLL arrangements not involving exceptional access be subject to close and early Board consultation requirements similar to those applicable under the exceptional access framework.

¹⁶ While access under one year PCL arrangements may not exceed 500 percent of quota *at the time of approval* of such arrangements, they can be augmented during the course of the arrangement (i.e., subsequent to approval) subject to the applicable PCL access limits (See [The Fund's Mandate - The Future Financing Role: Revised Reform Proposals and Revised Proposed Decisions, Supplement 1](#) and PCL [Decision No. 14715-\(10/83\)](#)).

¹⁷ As is currently the case for PCL arrangements, one-to-two year PLL arrangements would continue to be subject to the standard safeguards assessment policy for Fund arrangements, with a safeguards assessment being required to be completed at least by the time of the first review under the arrangement. Given the absence of a review under six-month PLL arrangements, however, it is proposed that the approach that has been applied for outright purchases under EPCA and the RCF—and as proposed above for the RFI—be applied for such arrangements.

28. **In sum, the proposed replacement of the PCL with the PLL enables the Fund to respond more effectively to the differing needs of its heterogeneous membership while increasing the coherence of the lending toolkit.** Some have questioned whether replacing the PCL with the PLL could create an undesirable “tiering” of the membership. While tiering is intrinsic in any assessment of countries’ fundamentals and policies, failing to recognize such heterogeneity would reduce the Fund’s ability to serve the needs of its members in a well tailored manner, responding to which the FCL and PCL were created. From this perspective, the proposed nonprecautionary aspect of the PLL allows the Fund to respond more effectively to PLL qualifiers who might otherwise delay approaching the Fund for financing if their only alternative is to request an SBA, possibly creating negative externalities if the country is highly interconnected to global/regional financial networks. But for the Fund to continue serving all its members effectively, it is also important to attenuate any possible perceived stigma associated with the SBA. By design, the SBA is a more flexible instrument than the PLL, and this flexibility has been used in full in recent years to help members with very large financing needs (beyond the PLL hard access caps) and/or large adjustment needs (whose absence is a qualification requirement for the PLL). Moreover, significant progress has been made in recent years in increasing the attractiveness of SBAs, including through focused conditionality, elimination of structural performance criteria, and greater flexibility on fiscal and external adjustment as evidenced in the Fund-supported programs during the recent global crisis.¹⁸ Finally, modifying the PCL to allow its approval even when there is an *actual* BoP need would also improve consistency with the FCL and SBA, which both allow dual use for precautionary or actual BoP needs.

B. Resource Implications

29. **For a given level of global financing needs, the proposed reforms are likely to have a relatively limited impact on the overall need for Fund resources.**¹⁹ It is inherently difficult to project future resource demand in the context of reforms of the Fund’s lending instruments. In the case of the proposed PLL reform, its increased flexibility relative to the current lending toolkit may result in some increase in the demand for Fund resources, both in

¹⁸ See “[A Review of Crisis Programs](#)”, September 2009, and its [update](#) in April 2011.

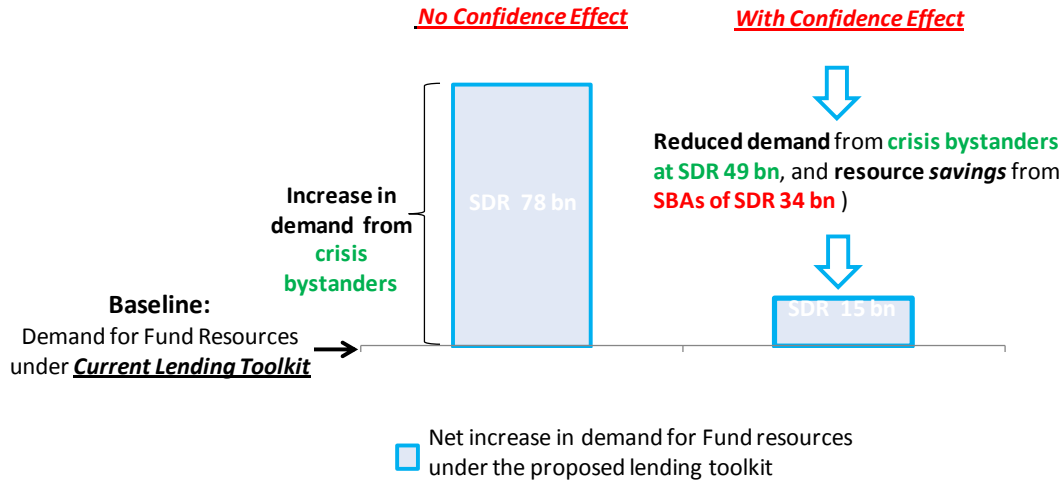
¹⁹ For the tail risk scenario underlying the discussion here, all shock assumptions are the same as the “Unchanged Capital Outflows” scenario in [The Fund’s Mandate—The Future Financing Role—Reform Proposals](#). Specifically, relative to WEO projections (i.e., the baseline) (i) FDI inflows are 20 percent lower, (ii) the external debt rollover rate is 60 percent, (iii) net portfolio inflows are 15 percent lower, (iv) bank deposits by residents are 5 percent lower, and (v) bank deposits by non-residents are 20 percent lower. Members’ financing needs are calculated as the gap between total external financing requirements and financing resources. International reserves could be drawn down to meet financing needs only to the point that they remain sufficient to fully cover short-term debt at residual maturity. When calculating the demand for Fund resources, consistent with the assumptions used for the recent NAB activation, a burden-sharing ratio of 1:2 is assumed for Euro Area countries, 60 percent for the non-Euro Area European members, and 100 percent for the rest of the membership. Finally, access to Fund resources is capped where required by lending policies.

“normal” times and during tail risk events. This additional demand arises from crisis bystanders in both emerging and advanced market countries, who may avail themselves of the proposed PLL arrangement but not request financing assistance from the Fund under the current lending toolkit due to its more limited flexibility.²⁰ However, this is only a partial equilibrium effect, and it is also likely that the more rapid and broader coverage in liquidity provisioning to crisis bystanders during a crisis could help restore market confidence more quickly and mitigate contagion, containing global financing needs and the demand for Fund resources, including under the traditional financing instruments (SBAs and EFFs). Overall, the net effect is likely to be some, albeit relatively limited additional demand for Fund resources in a tail risk scenario, as indicated in the illustrative scenario below (see Figure 1).²¹ Under this illustrative scenario, the timely provision of support to Fund members has a mitigating effect on the size of the shock and the net increase in the demand for Fund resources generated by the reforms would be about SDR 15 billion, compared to SDR 78 billion without the confidence effect (see Figure 1, second bar compared against the first bar).

²⁰ As noted before, stigma in the current toolkit could arise because members who are PCL-qualifiers in all respects except that they have an actual BoP need at the time of approval would need to request an SBA, which they might be more reluctant to do because of perceptions that it does not carry the same positive signaling effect as the PCL.

²¹ The resources implications of the proposed PLL reforms are shown in Figure 1 relative to a baseline of the demand for Fund resources under the current lending toolkit. The upcoming paper on the *Adequacy of Fund Resources* will elaborate on the demand and supply of Fund resources.

Figure 1. Illustrative Net impact on Demand for Fund Resources 1/
(For a given level of global financing need)



1/ The shock assumptions are the same as the "Unchanged Capital Outflows" scenario in SM/10/162, except that in the last scenario, which illustrates how the proposed lending toolkit could rapidly restore market confidence and result in resource savings, all shocks are assumed to be 10 percent smaller than the baseline shocks.

C. Other Issues

Coordination with other institutions

30. **In the event of heightened stress and contagion risks, close coordination in the provision of financing would be most useful.** Coordination has two dimensions: across members exposed to the common source of shock and across lenders, such as other multilateral institutions, regional financing arrangements and central banks. Simultaneous, or closely timed, approval of Fund arrangements (FCL, PLL, SBA) is generally possible under existing Fund policies and, subject to those policies, could be considered (upon request or with the consent of the relevant members) as a means to facilitate coordination across members and send positive signals to markets about the strength of the policy response to a common shock.²² For example, in heightened contagion and stress events requiring coordinated provision of liquidity, central banks' swap lines to selected countries provided in a manner consistent with their domestic mandates could be usefully complemented by the Fund's short-term liquidity provision that could be achieved more broadly and evenhandedly through the proposed reforms. Avenues for co-financing by other multilateral and regional

²² For a discussion of FCL-specific considerations, see [The Technical Note on Synchronized Approval of Flexible Credit Lines for Multiple Countries](#), October 2010.

institutions could also be done similar to the recent Fund-supported programs with European Union members as part of the BoP Facility and European Financial Stabilization Facility.

Future Review

31. As discussed in the *Review* paper, it is proposed that the next review of the decisions on the PLL and on the FCL be completed in three years* or when aggregate outstanding credit and commitments under the two instruments reach SDR 150 billion. The decision on the RFI is proposed to be subject to an expectation of review in five years** consistent with the normal periodicity that applies to reviews of Fund policies.

*At the Executive Board meeting on the discussion of this paper, a revision was introduced to the proposed periodicity for the review of the PLL decision, which is now expected to take place no later than one year after the date of adoption of the decision establishing the PLL. No revisions were introduced to the proposed periodicity for the review of the FCL decision, which is expected to take place no later than three years from the establishment of the PLL, and the periodicity of the proposed joint review of the FCL and PLL decisions, which will take place whenever aggregate outstanding credit and commitments under these two decisions reach SDR 150 billion.

**At the Executive Board meeting on the discussion of this paper, a revision was introduced to the proposed periodicity for the review of the RFI decision, which is now expected to take place one year after the date of adoption of the decision establishing the RFI.

IV. CONCLUSIONS

32. **This paper provides proposals to reform the GRA toolkit to better respond to members' evolving financing needs in an increasingly interconnected global economy.** The proposed reforms—summarized in red in Table 2—preserve the coherence and simplicity of the toolkit, while also balancing members' financing needs against the need for safeguards for use of the Fund's resources and for the adequacy of those resources. The reforms build on the 2009–10 lending toolkit reforms, drawing on the findings of the *Review* paper and Directors' feedback during the recent informal Board seminar and previous discussions, with the aim to ensure that the Fund remains effective in responding to members' financing needs under varying circumstances, including volatile exogenous shocks and contagious global stress events.

- The proposed creation of the RFI would streamline the GRA toolkit by consolidating the tools currently used to address various urgent needs, while also broadening the types of urgent financing needs addressed.

- Replacing the PCL with the more flexible PLL to allow the member to have an actual BoP need at the time of approval would enhance the flexibility of the Fund’s lending toolkit and also align this instrument with the FCL and SBA, both of which cater to actual and potential BoP needs.
- The six-month arrangements allowed under the PLL would enhance this instrument’s ability to address short-term needs by predictably providing targeted liquidity to crisis bystanders during periods of heightened stress in regional or global economic and financial conditions.

Table 1: What would the Proposed New Lending Toolkit Look Like?

Facility	BoP need	Duration	Access	Conditionality
FCL	Actual or potential	12 or 24 months	No cap	Qualification criteria
Precautionary and Liquidity Line	Actual or potential	6 months	250% ; could be augmented to up to 500% under periods of heightened stress*	Qualification criteria Standard PCs expected Prior actions as needed
		12 months – 24 months	500% 1 st year 1000% 2 nd year	Qualification criteria Six monthly reviews ITs and standard PCs expected. Prior actions, SBs, and other PCs as needed
SBA	Actual or potential	6 months – 36 months	No cap	Normally quarterly reviews PCs, SBs, and prior actions
EFF	Medium-term actual or (in exceptional circumstances) potential need	12 months – 48 months	No cap Long repayment period	Normally quarterly reviews PCs, SBs, and prior actions Focus on structural reform
Rapid Financing Instrument	Actual	Outright purchase	Outright purchase 50% quota (100% cumulative)	Low Prior actions possible

* At the Executive Board meeting on the discussion of this paper revisions were made to the definition of the circumstances in which a higher access limit of 500 percent of quota would be allowed. Under the final decision, the higher access limit applies in exceptional circumstances where the member is experiencing or has the potential to experience short-term balance of payments needs that exceed the normal 250 percent of quota limit due to the impact of exogenous shocks, including heightened regional or global stress conditions