INTERNATIONAL MONETARY FUND

The Fund's Income Position for FY 2010—Midyear Review

Prepared by the Finance Department

In consultation with the Legal Department and the Office of Budget and Planning

Approved by Andrew Tweedie

December 7, 2009

Contents Page

Tables

Boxes

Annexes

I. Introduction

1. **This paper updates the outlook for the Fund's income position for FY 2010, taking into account developments in the first half of the financial year**. The FY 2010 income outlook has improved relative to the baseline projections at the beginning of the year,[1] mainly as a result of the combination of higher projected lending income, and lower expenditures, in SDR terms, reflecting the depreciation of the U.S. dollar and a projected underrun in the budget. Net operational income for FY 2010 is projected at about SDR 440 million compared with the previous baseline projection of SDR 290 million in April 2009. However, the actual outcome is subject to considerable uncertainty related to the timing and amounts of disbursements under current and potential new arrangements and the performance of the Investment Account.

2. **The paper provides the basis for the FY 2010 midyear review of the Fund's income.** Although the considerations underlying the FY 2010 margin for the rate of charge of 100 basis points were based on new principles for setting the basic rate of charge under the new income model, the Executive Board decision on the margin for the rate of charge in FY 2010 was adopted under the exceptional circumstances clause of the existing Rule I-6(4) (see Box 1). As highlighted in the April income paper, a decision adopting a new rule for setting the margin for the basic rate of charge has been postponed while steps continue to be taken towards implementing the new income model.[2] Accordingly, the exceptional circumstances clause of Rule I-6(4) continues to apply, and under this clause, a review of the Fund's income at midyear is required.

3. **The paper is structured as follows**: Section II provides an update on the FY 2010 income position, based on the actual outturn for the first half of the financial year and projected developments in the second half of the year. This section also includes a discussion on gold sales and restructuring costs. Sections III and IV discuss the margin for the rate of charge and burden sharing adjustments, respectively.

---

[1] See *Review of the Fund's Income Position for FY 2009 and FY 2010* (4/14/09). Owing to the difficulty in predicting the full extent of demand for Fund credit as a result of the global financial crisis, the April paper included two scenarios for the FY 2010 income outlook: one based on arrangements approved through end-March 2009 (baseline scenario) and a second that incorporated the staff's assessment of possible new arrangements in the pipeline (high lending scenario). This paper reviews developments in FY 2010 relative to the baseline projections, which are closer to the turn of events in the first half of the year.

[2] See *Review of the Fund's Income Position for FY 2009 and FY 2010* (4/14/09), paragraph 14 and Annex I, which elaborated on the new framework for setting the margin for the rate of charge under the new income model, building on principles broadly endorsed by the Board in March 2008 during the discussions on the review of charges and maturities. A key element of the new income model that remains in progress is the amendment of the Articles of Agreement to broaden the Fund's investment mandate.

Box 1. Decisions in Effect Related to the FY 2010 Income Position[1]

The Executive Board has taken the following decisions affecting the Fund's income position for FY 2010:

Rate of Charge
The margin for calculating the rate of charge in FY 2010 was set at 100 basis points. This decision was adopted under the *exceptional circumstances* clause of Rule I-6(4), by which the margin for calculating the rate of charge may be set on a basis other than the estimated income and expense of the Fund and a target amount of net income for the year. A midyear review of the income position shall be held to decide whether (i) "the exceptional circumstances" under which the margin has been determined have changed, and (ii) the margin over the SDR interest rate under Rule T-1 determined under Rule I-6(4)(a) shall be changed in light of the actual income position for the first six months of the financial year.

Poverty Reduction and Growth Trust (PRGT) Administrative Expenses
For financial years 2010 through 2012, no reimbursement shall be made to the General Resources Account from the Reserve Account of the PRGT for the cost of administering the PRGT. The estimated cost of administering the PRGT shall be transferred after the end of each such financial year from the PRGT Reserve Account (through the Special Disbursement Account) to the General Subsidy Account of the PRGT.

Burden Sharing for Deferred Charges
Income losses resulting from unpaid charges are shared equally between debtor and creditor members under the burden sharing mechanism largely pursuant to a decision taken in 2000. Unless amended by the Board, this mechanism will continue for as long as overdue obligations to the Fund persist.

[1] See *Review of the Fund's Income Position for FY 2009 and FY 2010* (4/14/09).

II. Updated FY 2010 Income Position

4. **Net operational income for FY 2010 is projected at about SDR 440 million, compared with SDR 290 million at the beginning of the financial year (see Table 1)**. The improved income position reflects a number of factors, discussed below, on both the income and expenditure outlook:

- **Lending income**. New arrangements and augmentations of existing arrangements since April 2009 have raised projected lending income by some SDR 116 million from the level projected in the baseline at the beginning of the financial year.[3] This increase comprises about SDR 53 million in service charges, about SDR 20 million in

[3] Commitments under new arrangements amounted to some SDR 14 billion, of which scheduled FY 2010 disbursements are some SDR 9 billion. Rephasing of purchases under some existing arrangements has, to some extent, had an offsetting effect on FY 2010 income.

level-based surcharges, and some SDR 43 million from the margin on the rate of charge.[4]

- **Investment returns**. Investment Account (IA) returns in the six months through end-October amounted to some SDR 72 million compared with an initial projection of SDR 83 million for the full year. Overall, the IA returned 1.20 percent (net of fees), exceeding the SDR interest rate by 103 basis points in the first half of the year. The updated projection for FY 2010 assumes, as in the initial projection for FY 2010, that the IA earns 50 basis points over the SDR interest rate during the second half, yielding returns of about SDR 96 million for the full year.[5]

- **Implicit returns on interest-free resources**. The recent sale of half the Fund's post-Second Amendment gold holdings resulted in higher receipts of gold proceeds than initially projected for FY 2010. Consequently, despite a lower projected average SDR interest rate for FY 2010 of 0.30 percent, [6] compared with the initial projection of 0.90 percent, proceeds retained in the General Resources Account (GRA) from the gold sales lead to a small increase of about SDR 2 million in implicit returns on interest-free resources over initial projections.[7] See further discussion on gold sales below.

- **Reimbursements**. As part of the discussions on financing concessional lending for low-income countries (LICs) earlier this year, the Executive Board adopted a decision to delay resumption of annual reimbursements to the GRA, from the Reserve Account of the PRGT, for the cost of administering the PRGT (see Box 1). This reduced income by SDR 51 million from the initial projection.

- **Expenditures for FY 2010 are projected to be lower than budget by some SDR 70 million**. Two factors give rise to this outlook. First, preliminary estimates for the FY 2010 budget outturn indicate a projected under spend of around five percent, or roughly US$50 million (SDR 31 million), which principally reflects a lag in

[4] In the first half of FY 2010, the Fund made drawings under bilateral loan and note purchase agreements to finance lending activity (about SDR 3 billion). Since the interest costs on the borrowed resources are the same as those on use of quota resources, i.e., the SDR interest rate, projections are not affected by the use of borrowed resources.

[5] Consistent with past practice, the projected added value of 50 basis points is based on historical performance and is intended to provide an indication of the additional returns from the IA over the medium term. Actual performance of the IA from year to year will vary with market conditions. Further discussion on the performance of the IA will be provided in the semi-annual review of the IA (to be issued shortly).

[6] The SDR interest rate projection is based on market forward rates for the underlying three-month financial instruments in the SDR interest rate basket.

[7] To the extent gold proceeds are retained in the GRA, the Fund's interest-free resources increase since these currency holdings reduce members' reserve tranche positions and thus the Fund's remuneration expense.

bringing staffing levels towards the ceilings in the budget. Second, administrative expenditures, in SDR terms, are expected to be lower by some SDR 39 million, owing to the depreciation of the U.S. dollar vis-à-vis the SDR; the updated US$/SDR exchange rate for FY 2010 is now 1.60, compared with 1.50 at the beginning of the year.

Table 1. Projected Income Position—FY 2010
(In millions of SDRs)

Net operational income projected in April 2009	**290**
Income variances	**80**
Changes due to:	
New lending activity	116
Investment Account returns	13
Income from interest-free resources	2
Reimbursement of the PRGT administrative expenses	-51
Expenditure variances	**70**
Changes due to:	
Projected budget outturn	31
US$/SDR exchange rate	39
Updated net operational income	**440**

5. **Table 2 provides updated projections for FY 2010 alongside the actual outturn for the first half of the financial year**.[8] The projections do not include any provision for potential purchases under (i) arrangements not yet approved since the timing and amounts involved for these are uncertain or (ii) existing Flexible Credit Lines (FCLs) which are presumed to be precautionary.[9] Repurchases of outstanding Fund credit, and disbursements under Stand-By Arrangements already approved, are assumed to take place as scheduled (see Annex 3).

[8] The projected FY 2010 income and expenses are also presented in Annex 2 in a format similar to the IFRS financial statements presentation.

[9] The projections, however, include income from the commitment fees for the precautionary FCLs at their expiration.

Table 2. Projected Income and Expenditures
(In millions of SDRs)

	Actual to end-Oct 2009	FY 2010 Initial Projections 1/	FY 2010 Updated Projections
A. Operational income	**417**	**931**	**1011**
Lending income	**337**	**779**	**895**
Margin for the rate of charge	153	324	368
Service charges 2/	73	167	221
Surcharges	111	288	306
Investment income	**72**	**83**	**96**
Reserves	72	83	96
Gold endowment pay-out 3/	0	0	0
Interest free resources	**6**	**14**	**16**
SCA-1 and other	6	13	14
Gold book value	0	1	2
Reimbursements	**2**	**55**	**4**
MDRI-I Trust and SDR Department	2	4	4
PRGT	0	51	0
B. Expenses	**352**	**641**	**571**
Net administrative expenditures	338	603	534
Capital budget items expensed	2	11	11
Depreciation	12	26	26
C. Net operational income position (A-B)	**65**	**290**	**440**
Gold profits 4/	2902	719	3251
Restructuring costs	-8	-8	-12
IAS 19 timing adjustment 5/			-94
Retained endowment income 6/	0	9	0
Net income position 7/	**2959**	**1010**	**3585**
Memorandum Items:			
Fund credit (average stock, SDR billions)	30.4	32.4	36.8
SDR interest rate (in percent)	0.34	0.90	0.30
US$/SDR exchange rate	1.56	1.50	1.60

1/ See *Review of the Fund's Income Position for FY 2009 and FY 2010* (4/14/09).
2/ Includes commitment fees, which are refundable (when disbursements take place) so income arises only if planned disbursements are not made.
3/ The proposed amendment of the Articles of Agreement to expand the Fund's Investment Authority is not yet effective. The assumed effective date of the amendment in the projections is after April 30, 2010 and therefore no income is projected for FY 2010 from this source.
4/ Includes actual gold sales of 212 metric tons in October and November. The remainder of the gold sales are assumed to be evenly phased and conducted over a three-year period beginning in the second half of FY 2010.
5/ IAS 19 is the accounting standard that prescribes the accounting treatment of pensions and employee benefits expenses, and involves actuary valuations. The FY 2010 IAS 19 expense was determined in the actuarial valuation completed in May 2009.
6/ Estimate of gold endowment income to be retained in the IA to preserve the real value of the endowment.
7/ Net income on the basis presented in the Fund's IFRS annual financial statements.

6. **The Fund's net income as presented on the basis of IFRS will also be higher, primarily reflecting the impact of gold sales:**

- **Gold sales**. A central element of the new income model involves the limited sale of a portion of the Fund's gold (the post-Second Amendment gold) and investment of the profits in an endowment to generate income.[10] In the initial outlook, it was assumed that one-sixth of the gold would be sold in FY 2010 at a price of US$850 per ounce. As announced recently, about half (200 metric tons) of the Fund's post-Second Amendment gold was sold in October 2009. These off-market sales at an average market price of US$1,049 per ounce yielded profits of about SDR 2.9 billion.[11] At this stage no changes have been made to the original technical assumptions for the remainder of the gold sales (191 metric tons), which are assumed to be evenly phased over a three-year period beginning in the second half of FY 2010. Moreover, for purposes of the FY 2010 updated projections, it is further assumed that the amendment to the Articles of Agreement to expand the Fund's investment authority, which provides for the direct placement/transfer of profits from the gold sales to the Investment Account, will not enter into force during FY 2010. Accordingly, the FY 2010 projections assume that the gold profits will be included in net income for FY 2010 and they do not include any income from the gold endowment payout.[12]

- **Restructuring costs**. Restructuring costs associated with the staff delay period and pension and employee benefit contributions related to separating staff amounted to some SDR 8 million in the first half of FY 2010. The updated estimate for costs to be incurred in FY 2010 is some SDR 12 million compared with an initial projection of SDR 8 million at the beginning of the year. The updated projection reflects the effects of deferring the departure of a small number of staff to support the Fund's response to the global financial crisis. These deferrals lowered the staff delay costs incurred during FY 2009 and will lead to higher costs in FY 2010 as staff complete their delay periods later than initially expected. In addition to these costs, some SDR 17 million was charged in the first half of FY 2010 against the restructuring provision established in FY 2008 for costs related to SBF payments under the voluntary separation plan. Annex 1 provides further details on the restructuring costs.

---

[10] Under the proposed amendment to the Articles of Agreement currently being considered by Fund members, the profits from the gold sales are to be placed in the Investment Account and invested. The amendment is not yet effective, pending the necessary consents from the membership. In addition, the Executive Board agreed in July 2009 to use resources linked to the gold sales, SDR 0.5–0.6 billion, to finance concessional lending to low-income countries.

[11] A further 12 metric tons were sold off-market in November (see Press Release No. 09/413, 11/16/09 and Press Release No. 09/431, 11/25/09).

[12] However, while the gold profits are retained in the GRA they have an income effect as they reduce remunerated reserve tranche positions (about SDR 5 million included in the updated projections for "SCA-1 and other" interest free resources in Table 2).

- **IAS 19 expense**. The Fund's pension and employee benefits expense is determined under the provisions of IAS 19, under International Financial Reporting Standards (IFRS). A timing difference arises between the actuarially determined expense related to benefits earned by employees for rendering services during the financial year and the amount actually funded under the budget. The actuarially determined IAS 19 expense for FY 2010 is estimated at SDR 219 million, compared with funding of about SDR 125 million, giving rise to a timing difference of SDR 94 million.

III. FY 2010 MIDYEAR REVIEW

7. **The Executive Board adopted a margin for calculating the basic rate of charge for FY 2010 of 100 basis points over the SDR interest rate under the exceptional circumstances clause of Rule I-6(4)**.[13] Under this rule, the Executive Board is to review at midyear any change in the exceptional circumstances and decide whether the margin over the SDR interest rate determined at the beginning of the year shall be changed in light of the actual income position for the first six months of the financial year. Consistent with the Board's previous discussions on the approach to setting the basic rate of charge under the new income model, staff considers that the exceptional circumstances under which the margin may be set on a basis other than the estimated income and expenses for the year still exist. Accordingly, no change in the margin is proposed.

IV. BURDEN SHARING MECHANISM

8. **Burden sharing adjustments have fallen further to record lows.** When the Executive Board reviewed the burden sharing mechanism in April this year,[14] the sharp rise in Fund credit outstanding had already brought a steep decline in projected burden sharing adjustments in the rates of charge and remuneration to just 1 basis point. As such, the earlier strains on this mechanism, which in the low credit environment had required adjustments in the rate of charge and the rate of remuneration of as much as 20 basis points, had dissipated. A further rise in the stock of outstanding credit and increase in remunerated reserve tranche positions, coupled with low interest rates that reduced the income loss (from unpaid charges) to be covered by burden sharing, have reduced the quarterly burden sharing adjustments to the rate of charge and the rate of remuneration to 1 basis point each since the fourth quarter of FY 2009 (see Annex 4).

[13] Rule I-6(4) envisages that the margin for the basic rate of charge will normally be established on the basis of a target amount of net income for the year, with a midyear review as a safeguard for instances where the actual income position is significantly below the initially projected amounts, where the Board would then need to consider whether to increase the margin. Owing to the sharp decline in lending and the need to develop a new and sustainable income model, the rule was changed in April 2006 to allow the Executive Board to set the margin on a different basis in exceptional circumstances.

[14] See *Review of the Fund's Income Position for FY 2009 and FY 2010* (4/14/09).

9. **Although the current level of charges to be burden shared is low, a technical amendment to the burden sharing decision is needed to ensure that the mechanism continues to cover these charges.** The current decision provides that the burden sharing adjusted rate of charge and rate of remuneration shall be rounded to two decimal places. Based on existing GRA arrangements, Fund credit outstanding and remunerated reserve tranche positions are projected to rise, which, under the current decision, would lead to adjustments to the rates of charge and remuneration rounded to zero basis point from the end of the third quarter of FY 2010 and during FY 2011, respectively. This unintended consequence of the rounding procedure arises from the combination of historic low interest rates and the large credit and remuneration bases from which the burden sharing adjustments are determined in relation to the amounts of deferred charges to be covered by burden sharing. If no action were taken, this would result in income shortfalls for the Fund due to future unpaid charges.

10. **Staff proposes that the burden sharing decision be revised to include a minimum adjustment of 1 basis point to the rate of charge and the rate of remuneration**.[15] The proposed change would ensure that income losses due to unpaid charges continue to be covered, and that both debtor and creditor groups participate in the burden sharing mechanism. A minimum adjustment of 1 basis point is likely to imply some “prepayments”. However, as under the current practice, to ensure that neither creditors nor debtors contribute more than ultimately necessary because of the minimum adjustment, any amount generated in excess of unpaid charges that are due in a particular quarter would be carried forward to offset their share of deferred charges in the subsequent quarters. If such cumulative amounts in exceptional circumstances were to exceed the relevant share of debtor members and creditor members in unpaid charges subject to burden sharing in a subsequent quarter, no adjustments to the rate of remuneration or the rate of change would be made in that quarter.

[15] While it is possible to eliminate the rounding convention altogether, the determination of the burden sharing adjustments is inherently linked to the SDR interest rate, and the rates of charge and remuneration upon which the adjustments are applied. Since under current rules these rates are rounded to 2 decimal places, it would not be possible for the burden sharing adjustments to be rounded beyond two decimal places.

Annex 1. Restructuring Costs

In the first half of FY 2010 total cash outlays associated with the restructuring amounted to SDR 25 million (about US$39 million). This was comprised of the following elements:

- Costs of SDR 17 million (about US$27 million) that were charged against the restructuring provision of SDR 68 million made in the FY 2008 financial statements. These expenditures represent costs for which no services were rendered (e.g., the modified SBF payments). Through end-October 2009, costs charged against the restructuring provision totaled SDR 37 million, of which some SDR 20 million was incurred during FY 2009.

- Costs of SDR 8 million (about $12 million) that are related to FY 2010 delay costs under the voluntary separation plan, i.e., costs for services from which the Fund benefits such as salaries during the staff delay period, and the Fund's SRP contributions for separating staff. These costs are recognized as expenditures when they are incurred (and thus are not charged against the restructuring provision). Through end-October 2009, costs associated with the staff delay period and SRP contributions for separating staff amounted to SDR 33 million, of which some SDR 25 million was incurred during FY 2009.

The table below provides a summary of movements in the restructuring provision during FY 2010. In addition to the above costs of SDR 17 million charged against the provision, the provision was decreased by SDR 2 million, primarily reflecting updated estimates as at end-October 2009 of the costs in SDR terms, i.e., the effect of changes in the SDR/U.S. dollar exchange rate.

	(In SDR millions)
Restructuring provision at the beginning of the year	55
Amounts utilized	-17
Updated estimates	-2
Restructuring provision at end-October 2009	36

Annex 2. Projected Income and Expenses—FY 2010
(In millions of SDRs)

	Actual to end-Oct 2009	FY 2010 Initial Projections	FY 2010 Updated Projections
A. Income Sources			
a. Periodic charges, including burden sharing	204	616	478
b. Interest on SDR holdings	4	18	7
c. Surcharges	111	288	306
d. Investment income	72	83	96
e. Service charges 1/	73	167	221
f. Reimbursements	2	55	4
Total income	**466**	**1227**	**1112**
B. Expenses			
Remuneration, including burden sharing	47	297	89
Interest on borrowing and issued notes	2	0	12
Administrative expenses	352	641	571
Total expenses	**401**	**938**	**672**
C. Net operational income position	**65**	**290**	**440**
Gold profits	2902	719	3251
Restructuring costs	-8	-8	-12
IAS 19 timing adjustment 2/			-94
Retained endowment income 3/	0	9	0
Net income position 4/	**2959**	**1010**	**3585**

1/ Includes commitment fees, which are refundable (when disbursements take place) so income arises only if planned disbursements are not made.

2/ IAS 19 is the accounting standard that prescribes the accounting treatment of pensions and employee benefits expenses, and involves actuary valuations. The FY2010 IAS 19 expense was determined in the actuarial valuation completed in May 2009.

3/ Initial estimate of gold endowment income to be retained in the Investment Account to preserve the real value of the endowment.

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

Annex 3. Assumptions Underlying the FY 2010 Projections

	Actual through end-October 2009	FY 2010 Initial Projections	FY 2010 Updated Projections
		(In billions of SDRs)	
Regular Facilities:			
1. Purchases (excl. reserve tranche purchases)	14.7	16.4	27.2
2. Repurchases	0.1	0.0	0.3
3. Average balances subject to charges	30.4	32.4	36.8
4. Average SDR holdings	2.3	2.0	2.3
5. Average remunerated positions	29.9	32.8	30.9
6. Average investment account assets 1/	6.0	6.0	6.0
7. Average borrowings and issued notes 2/	1.2		4.1
		(In percent)	
Return on investments 3/	1.20	1.40	1.60
Average interest rates:			
SDR interest rate and basic rate of remuneration	0.34	0.90	0.30
Basic rate of charge	1.34	1.90	1.30
Margin on the rate of charge	1.00	1.00	1.00

1/ The figures are based on a general assumption that investment income is transferred annually to the GRA.

2/ In the first half of FY 2010, the Fund made drawings under bilateral loan and note purchase agreements to finance lending activity (about SDR 3 billion); the figures in the table are period averages. Since the interest costs on the borrowed resources are the same as those on use of quota resources, i.e., the SDR interest rate, projections are not affected by the use of borrowed resources.

3/ End-October figure is unannualized.

Annex 4. Recent Average Burden Sharing Rates and FY 2010 Quarterly Rates
(In basis points unless otherwise stated)

	FY03	FY04	FY05	FY06	FY07	FY08	FY09	FY10		
								H1	Q3	Q4
									(projected)	
Rate of Remuneration 1/										
Total average adjustment	10	9	12	23	23	14	3	1	1	1
Deferred charges	2	1	2	5	13	14	3	1	1	1
SCA-1	8	8	10	18	10	–	–	–	–	–
Rate of Charge 1/										
Total average adjustment	10	8	11	19	23	16	3	1	–	–
Deferred charges	2	1	2	4	13	16	3	1	–	–
SCA-1	8	7	9	15	10	–	–	–	–	–
Average SDR interest rate (in percent)	2.06	1.58	2.09	2.93	3.96	3.64	1.79	0.34	0.30	0.30
Average basic rate of charge (in percent)	2.54	2.09	3.01	4.00	5.04	4.72	2.79	1.34	1.30	1.30

1/ The average rates have been calculated using the quarterly burden sharing rates and SDR interest rates.