

INTERNATIONAL MONETARY FUND

Borrowing by the Fund—Operational Issues

Prepared by the Finance Department

(In consultation with the Legal and
the Strategy, Policy, and Review Departments)

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June 17, 2009

I. INTRODUCTION

1. **An increase in the Fund’s resources available to assist its members represents an important part of the multilateral response to the global crisis.** To this end, the IMFC agreed in April that there should be an increase in the resources available to the Fund through immediate financing from members of \$250 billion, subsequently incorporated into an expanded and more flexible New Arrangements to Borrow (NAB), increased by up to \$500 billion.¹ Recognizing that IMF is, and shall remain, a quota-based institution, the IMFC also called for the completion of the Fourteenth General Review of Quotas by January 2011. This is consistent with borrowing being a temporary arrangement to supplement Fund resources to address the current crisis.

2. **The Executive Board previously considered the options for supplementing the Fund’s resources in February 2009.** Directors agreed that borrowing from the official sector is the most appropriate approach to providing a temporary supplement to Fund’s resources in the short run. They underscored that all borrowing will need to be closely monitored by the Executive Board, and strongly encouraged the inclusion of provisions to help reduce the Fund’s liquidity risks. They also noted that borrowed resources should be used in a manner that takes into account the need to maintain adequate liquidity buffers, and looked forward to the development the Fund’s policies on the timing, and sequencing, of different sources of borrowing, including under the NAB/GAB.²

¹ See IMFC Communiqué (4/25/09). See also the Statement of the G-20 Leaders’ Summit in London available at: <http://www.londonsummit.gov.uk/resources/en/news/15766232/communique-020409>.

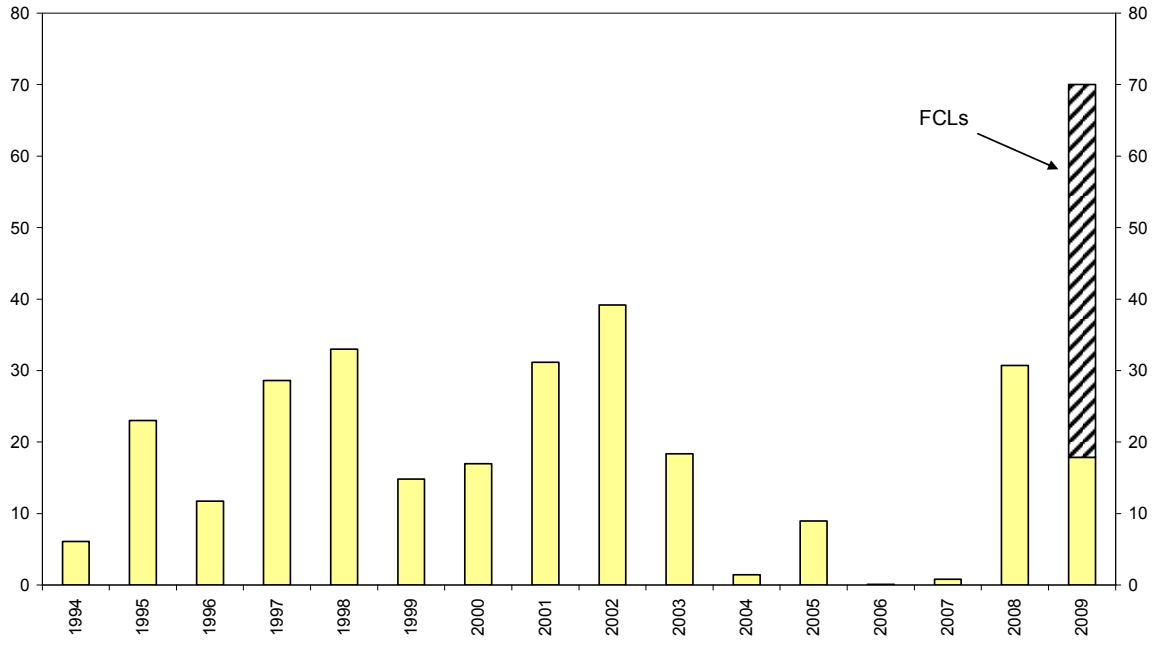
² See *IMF Executive Board Has Preliminary Discussions on Adequacy of and Options for Supplementing Fund Resources* (PIN No. 09/24, 2/26/09).

3. **Good progress has been made toward meeting the above objectives.** A bilateral loan agreement with Japan for up to \$100 billion was approved in February, an SDR 3 billion loan agreement with Norway was approved in early June, and a \$10 billion borrowing agreement with the Government of Canada was issued for Board approval recently. Loan commitments have also been made by European Union members (€75 billion) and Switzerland (\$10 billion), and staff is working with the respective authorities to bring these agreements for Board approval as soon as possible. In April, staff prepared form documents that would allow interested members and their central banks to provide resources to the Fund by purchasing notes. Some members have announced a willingness to purchase notes, including China (up to \$50 billion), and Brazil and Russia (up to \$10 billion each), and other members have also expressed interest. A paper seeking Board authorization to enter into note purchase agreements for up to SDR 100 billion of such notes is being issued separately. In addition, discussions are underway among current and potential new NAB participants on expanding the NAB and making it more flexible.

4. **At the same time, the pace of new commitments of Fund resources has increased sharply.** Since November 2008, the Fund has approved 14 stand-by arrangements, and 3 precautionary arrangements under the newly-established Flexible Credit Line (FCL). Total resources committed under these arrangements have amounted to SDR 100 billion (Figure 1). As a result, the Fund's one-year forward commitment capacity (FCC), which measures the Fund's ability to make new loan commitments from quota resources in the next 12 months, has declined from a pre-crisis peak of almost SDR 128 billion to about SDR 32 billion in early June (Figure 2). Drawings under these arrangements to date have been about SDR 21 billion, as over half of the new commitments reflect precautionary FCL arrangements. Nonetheless, the steep decline in the FCC highlights the importance of finalizing the bilateral financing agreements with members as quickly as possible so that the Fund is in a position to meet potential demands on its resources. It also underlines the importance of early agreement on the modalities governing the use of borrowed resources.

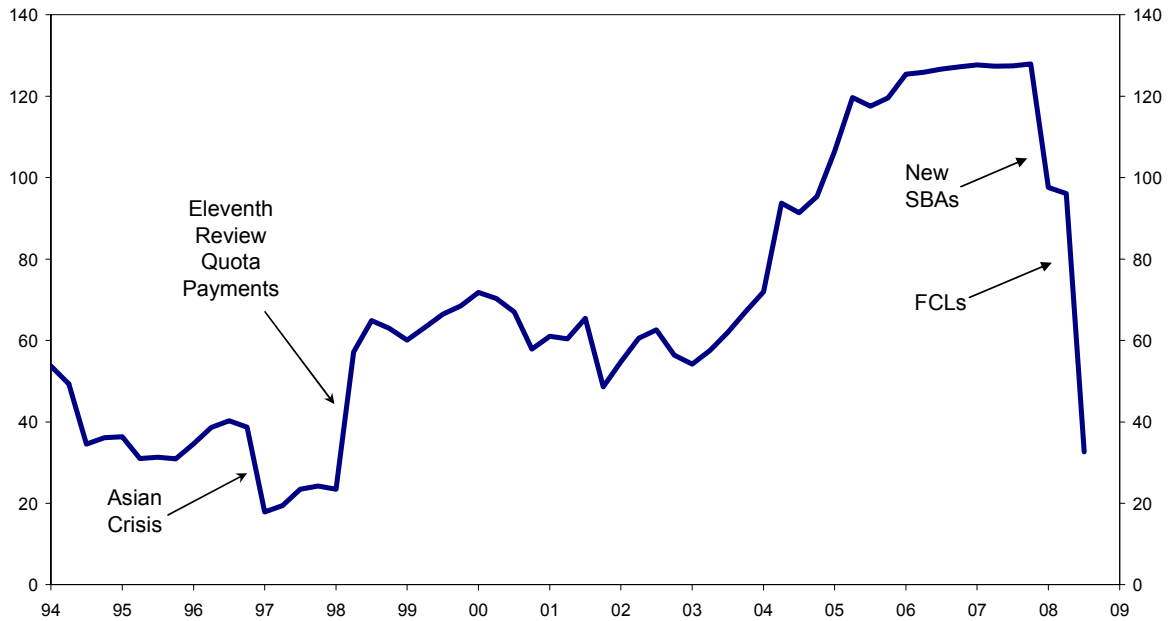
5. **This paper sets out staff proposals on various operational issues related to borrowing during the current crisis.** While a number of borrowing arrangements have yet to be finalized, the paper seeks to provide sufficient guidance to allow the Fund to be in a position to begin drawing on available credit lines—including any note purchase agreements—in the near term. These policies will need to be refined in light of experience and also as the scale and precise form of further borrowing, including the proposed

Figure 1. New Commitments, Calendar Years 1994—2009 1/
(In SDR billions)



1/ Data as of May 31, 2009. Gross amount of new commitments not netted for undrawn balances under expired/cancelled arrangements. Includes disbursements under outright purchases, including emergency assistance.

Figure 2. Forward Commitment Capacity, 1994—009 1/
(In SDR billions)



Source: Finance Department.

1/ Data as of May 31, 2009. FCC calculated on the basis of the current definition including quota resources but not bilateral borrowing.

expansion and enlargement of the NAB, become clearer. Once the new NAB becomes effective it is currently envisaged that remaining bilateral agreements could be terminated and the amounts outstanding folded into the NAB.

6. **The rest of this paper is organized as follows.** Section II discusses the implications of borrowing for the Fund's liquidity management, including, inter alia, the size of the prudential balance; the limit on immediate encashability; and the mix of quota and borrowed resources to be used in financing purchases. Section III discusses possible revisions to the Fund's Borrowing Guidelines, and Section IV suggests issues for discussion.

II. MANAGING THE FUND'S LIQUIDITY— GENERAL CONSIDERATIONS

7. **The potential scale of Fund borrowing needed to address the current crisis is large in relation to Fund quotas and by historical standards.** The proposed immediate increase in available resources of \$250 billion represents about 74 percent of total Fund quotas. If these resources were fully drawn, total borrowing plus unused credit lines under the NAB/GAB would amount to about 90 percent of quotas. This compares with a peak level of borrowing of close to 30 percent of quota in the late 1970s, when borrowing financed over 60 percent of Fund credit.

8. **The extent to which the Fund will need to call on these credit lines is difficult to judge.** It will depend heavily on global economic and financial market developments, which remain highly uncertain, as well as on developments in the external positions of individual members. If the recent improvement in market sentiment is sustained, and access to market financing is restored relatively rapidly, the Fund's need to draw on the committed lending may be relatively limited. On the other hand, if the global downturn is more protracted, and the downside risks identified in the latest WEO were to materialize, members' additional calls on Fund resources and its need to utilize available credit lines could be large.

9. **While the extent of actual borrowing is uncertain, the Fund needs to manage its resources in a way that would allow it to draw on the full amount available should that prove necessary.** This implies a need for judgments on three inter-related issues:

- a) The quota resource buffer needed to protect the liquidity of members' positions in the Fund and the encashability of creditor members' claims on the Fund;
- b) The extent to which creditor members' claims should be immediately encashable; and
- c) The mix of quota and borrowed resources used in the Fund's lending operations.

10. **The remainder of this section discusses each of these issues.** The proposed approach recognizes that the global economic situation is still evolving, demand for Fund financing (including possible drawdowns under precautionary arrangements) is uncertain, and the final size and details of bilateral arrangements are not yet fully defined. Accordingly,

flexibility will be needed and staff proposes that the approach outlined in this paper be reviewed regularly, beginning with the next semi-annual liquidity review prior to the Annual Meetings.

A. The Appropriate Size of the Prudential Balance

11. The Fund aims to maintain adequate liquidity to underpin its financing mechanism and give confidence in its capacity to meet commitments to both borrowers and creditors. The following considerations have been taken into account in the Fund's policies on the minimum prudential balance:

- The unconditional right (whether or not it is exercised) of members to draw on their reserve positions in the Fund on demand in the event of balance of payments need is critical for creditors to consider their positions in the Fund as international reserve assets, and to be able to show them as such in their balance sheets. Members' reserve positions consist of (i) reserve tranche positions (RTPs), which a member acquires through reserve assets paid by the member in connection with quota payments and when the Fund uses the member's currency in its operations; (ii) the amount of any outstanding borrowing under the NAB/GAB, and (iii) any other indebtedness of the General Resources Account that is readily available to the member.³
- Adequate liquidity is also required to protect the Fund against a possible erosion of its resource base available to support lending operations that would occur if some members were no longer able to participate in the Financial Transactions Plan (FTP). With FTP participation now at a record level—51 members representing over 82 percent of total quotas—the possibility that some participating members may experience balance of payments difficulties in the future has likely increased. Similarly, not all NAB participants may be able to participate in an activation of the borrowing arrangements at any given point of time.
- More generally, the Fund seeks to maintain a minimum level of available resources to underpin its credibility and be prepared for unanticipated financial contingencies.

12. The Fund currently maintains a minimum prudential balance of 20 percent of the quotas of FTP participants plus any amounts activated under the NAB/GAB. This approach was agreed in 2002 when the FCC was adopted as the main measure of the Fund's liquidity position.⁴ At the time, Directors stressed that the prudential balance represents an indicative level of uncommitted usable resources that the Fund would not normally use to

³ See *Balance of Payments and International Investment Position Manual*, Sixth Edition, paragraph 6.85.

⁴ See *IMF Announces New Measure of Its Capacity for New Lending* (PIN No. 02/55, 12/16/02).

make financial commitments. However, they noted that this does not constitute a rigid minimum and that Fund resources could, on a strictly temporary basis, fall below this level.

13. **With the mobilization of borrowed resources outside the NAB/GAB framework, a judgment is needed on the prudential balance to hold against such borrowing.** In this regard, the following considerations appear relevant:

- To the extent that creditors' claims on the Fund, either through loans or notes, are encashable on demand in case of balance of payments need, the liquidity risks for the Fund are the same as with reserve tranche positions and claims under the NAB/GAB.
- These risks will be higher to the extent that some potential claims by individual members are large, and that the claims are concentrated on a smaller group of members, rather than being diversified across a broader range. Although, commitments so far have been made by 24 members, only 1 of these is fully in place, compared with the much broader membership of the NAB (26) and the FTP (51).
- To help address these risks, a limit is proposed on the amount of claims that would be immediately encashable under any individual loan or note purchase agreement (see Section II.B below). Such a limit would provide additional breathing space to mobilize the full amount needed, should the need arise, and thus reduce the liquidity risks associated with borrowing or note placement agreements that are large in relation to quotas. The Fund is still obligated to repay the full amount of outstanding claims as soon as practicable within 12 months, and thus a limit on immediate encashability would partially mitigate but not eliminate the liquidity risks associated with large individual borrowing agreements.
- Another mitigating factor against the higher risk associated with large scale borrowing is a provision, included in the bilateral agreements approved to date and proposed in those under discussions, allowing the Fund to draw on other bilateral agreements in the event that a creditor requests repayment because of balance of payments need, and where the agreement with that creditor includes a reciprocity clause that would allow its use to repay those other borrowing agreements. Once a critical mass of agreements with this provision are in place, the Fund would be able to call on significant borrowed as well as quota resources to meet a request for encashment. However, borrowed resources are not a full substitute for quota resources, given that there are typically limits on short-term drawdowns, and also some agreements may include overall limits on cumulative drawdowns, such that any drawings to meet an encashment request would permanently reduce the resources available to finance future lending.

On balance, staff believes it would be reasonable to apply the same 20 percent prudential balance ratio to amounts available under bilateral loan and note purchase agreements as apply currently to quotas of FTP members and drawdowns under the NAB/GAB.

B. Limit on Immediate Encashment

14. **In discussions with potential creditors, many have emphasized the importance of being able to count their claims on the Fund as part of their international reserves.** This would parallel the treatment of members' contributions to the Fund's financing in terms of increases in their RTPs and also their claims under the NAB/GAB. Under the current definition of international reserves, a key requirement for such treatment is that members' claims be immediately encashable in case of balance of payments need. As discussed above, the Fund currently manages the associated liquidity risks primarily by maintaining an adequate prudential balance. However, additional mitigating measures will be needed given the prospective scale of borrowing.

15. **With the possible shift to large-scale borrowing, some individual credit lines will represent a much larger degree of potential exposure than exists at present in terms of members' RTPs and potential claims under the NAB/GAB.** This is the case already with the Japan agreement, which represents \$100 billion or the equivalent of 485 percent of Japan's quota and 36 percent of total quotas of FTP members. This was considered too large an exposure for the Fund to carry without holding a very large liquidity buffer that would defeat the purpose of borrowing. Accordingly, claims under the Japan agreement are encashable within 12 months rather than immediately, allowing time for the Fund to arrange a transfer of the claims to other members or additional borrowing to help repay the claim in the unlikely event that this provision was called upon.⁵ The agreement with Norway includes the same provision, though of course the amount involved is much smaller. In terms of statistical treatment, the practical implication for the creditor is that such claims are counted as part of foreign assets rather than international reserves, which may be more important for some members than for others.

16. **Going forward, it would be desirable to agree on a limit on immediate encashability.** It is envisaged that this limit would apply both to bilateral loan agreements and to the limit on Series A notes under note purchase agreements. In both cases, the potential liquidity risks for the Fund are broadly similar. Given the importance of the treatment of claims as part of reserves for many members, there is a case for setting a high enough limit that can accommodate most potential individual agreements to the extent that the resulting liquidity risks are considered manageable. Staff proposes an initial limit of SDR 15 billion under each agreement with the Fund, which would represent roughly 7 percent of total quotas, a broadly similar proportion to the limit on immediate encashability

⁵ See *Borrowing Agreement with the Government of Japan* (2/10/09).

applied to the last large individual borrowing agreement (with the Saudi Arabian Monetary Agency in 1981). It would also represent about half of the largest potential exposure to individual FTP participants and 2.3 times the largest potential exposure under the current NAB. From an operational perspective, SDR 15 billion is close to double the largest amount the Fund has previously disbursed in a single financial operation.

17. **The limit on immediate encashability would represent only one element of the approach designed to protect the Fund against the liquidity risks associated with large scale borrowing.** Other elements include the proposed requirement that the Board authorize the conclusion of note purchase agreements only with qualifying members with strong external positions, and the related requirement in the two bilateral agreements to date (and also to be proposed for other loan agreements and for note purchase agreements) that, if the notes or bilateral loans are transferred, encashability rights would only transfer if the purchasing member also has a strong external position at the time. It should also be noted that, as the proposed limit only applies on a per agreement or “primary market” basis, it would not in itself protect the Fund against the increased exposures that could result from “secondary market” transfers to a single member. The alternative of applying the limit on a per member basis could have other undesirable consequences as it may diminish the willingness of other members to accept such loan claims or notes and therefore the scope for transfers of loan claims or notes between members. This could raise the likelihood that creditor members would need to request encashment, which would increase the Fund’s liquidity risks.

18. **The limit on immediate encashability could potentially be adjusted over time.** For example, as more bilateral arrangements are put in place with reciprocity provisions allowing their use to repay other bilateral claims, consideration could be given to increasing the limit in light of the broader diversification of liquidity risks and potential sources available to help meet those risks. Similarly, in the case of the enlarged and expanded NAB, staff is exploring a provision for allowing the Fund to make calls on other NAB participants in the event that a participant requests early repayment, which would allow the full amount of potential claims under the NAB to continue to be counted as part of members’ international reserves.

C. Mix of Quota and Borrowed Resources in Financing Purchases

19. **An immediate judgment is needed also on the mix of quota and borrowed resources to be used in financing purchases.** This would guide the formulation of the quarterly FTP during the crisis. Similar approaches were adopted in previous episodes where borrowed resources were used on a regular basis to supplement quota resources, though on those occasions, an additional consideration was the need to ensure equal treatment of members given that credit financed from borrowed and quota-based resources had different rates of charge and repurchase periods (Box 1). In those circumstances, the specific rules on the mix of resources applied to individual purchases, whereas on this occasion, it is

envisaged that the rule would be applied to achieve the desired mix over the period of a quarterly FTP (see below). It is also envisaged that the target for such a mix would be kept under review and adjusted in light of developments. This could be done in the context of the semi-annual reviews of Fund liquidity, or more frequently if necessary in the context of the FTP documents themselves.

Box 1. The Composition of the Financing of Purchases in Previous Periods in which Borrowing was used on a Regular Basis

Specific rules on the mix of resources used in individual purchase transactions were adopted during previous periods in which the use of borrowed resources were used on a regular basis to support the Fund's lending operations. These were needed to ensure equal treatment of members, on account of credit financed from borrowed and quota based resources having different rates of charge and repurchase periods.

Beginning with the Supplementary Financing Facility in 1979, the Fund sought to use a mix of quota based and borrowed resources for meeting members' general, as opposed to specific (for example, oil-related), balance of payments financing needs. The rules for apportioning use of Fund quota and borrowed resources were applied to specific purchase transactions, depending on the type of arrangement/facility and level of access, as follows:

- Under Stand-by arrangements, the ratio of borrowed resources to ordinary quota-based resources was set at 1:2 (i.e., one part borrowed to two parts ordinary) to finance purchases in the first credit tranche and 1.2:1 in the upper credit tranches. Credit in excess of 100 percent of quota, was financed entirely with SFF borrowed resources.
- Under extended arrangements, purchases were financed in equal proportions of quota and borrowed resources until the outstanding use of the upper credit tranches and the EFF equaled 140 percent of quota; thereafter, EFF purchases were financed entirely with borrowed resources.
- These rules continued to apply under the Fund's Enlarged Access Policy established in 1981.

The proportion of borrowed resources used to finance enlarged access policy purchases in the upper credit tranches was nearly doubled to 2:1 in December 1986 to conserve quota resources and make more effective use of the 1984 short-term borrowing agreement with the Saudi Arabian Monetary Agency (SAMA). In June 1988, the ratio for use in EFF purchases was adjusted in favor of ordinary resources to reduce the effective rate of charge and lengthen the maturity of repurchases for borrowers (rate of charge one percentage point lower and maturity of repurchases two years longer for EFF purchases financed by ordinary resources) in the context of the amended EFF at the time.

20. Assessments of the adequacy of quota resources need to be forward looking, given that the Fund has little scope to replenish quota resources in the short-term. In the current context, this means the Fund should ensure it has adequate quota resources to meet

the 20 percent prudential balance based on both actual and potential future drawdowns under bilateral agreements. This reflects the fact that replenishment of quota resources through the next general review will take time to become effective. Even with the agreed new timetable of completing the 14th general review by January 2011, it is unlikely that the new quotas would be effective before, say, late 2012 given the normal periods for ratification, consent and payment for quota increases by the membership. Thus, beyond repurchases, which are expected to be small in the short term, and the quota increases associated with the recent quota and voice reform, the Fund will only have existing quota resources available to meet the needed liquidity buffer. (Currently available loan resources are not appropriate to count towards the liquidity buffer given as discussed above, the small number of members with whom agreements have been completed, and the short-term limits on drawings included in these agreements.)

21. The implications of this analysis are summarized in Table 1:

- If the Fund needed to draw fully on the targeted loan and note purchase agreements of \$250 billion, the required liquidity buffer would be SDR 69 billion, of which SDR 36 billion would be required to cover FTP participants' quotas (as at present) and SDR 33 billion would be required to cover new borrowing (first panel). To preserve sufficient quota resources to meet this target, it would be necessary to employ a mix of borrowed and quota resources in new lending going forward of about 2:1 (first panel, 68 percent borrowed and 32 percent from quota resources).
- If allowance was also made for possible additional loan drawdowns available under the existing NAB (or alternatively if immediate borrowing under bilateral arrangements was somewhat higher than \$250 billion), the implied ratio would be closer to 3:1 (second panel, 72 percent borrowed and 28 percent from quota resources).
- The third panel illustrates the possible implications of actual borrowing consistent with an expanded \$550 billion NAB. If the full liquidity buffer against such borrowing were held in quota resources, this would imply a need going forward to rely predominantly on borrowed resources to finance new lending (a ratio of 8:1).
- However, it is not currently envisaged that borrowing on the latter scale will be needed, and it may also be possible in the context of a reformed NAB to contemplate the additional prudential buffer required to support borrowing being held in unused borrowing capacity rather than quota resources (this would not change total lending capacity but it would allow more quota resources to be used in lending relative to borrowed resources).

Table 1. Remaining Lending Capacity under Borrowing Scenarios (as at May 31, 2009)

	I. Bilateral Borrowing of \$250 bln			II. \$250 bln plus Current NAB			III. NAB Expanded to \$550 bln		
	SDR billions	US dollar billions 1/	Share (Percent)	SDR billions	US dollar billions 1/	Share (Percent)	SDR billions	US dollar billions 1/	Share (Percent)
A. Available Resources	314	471	100	348	522	100	514	771	100
Usable quota resources 2/	147	221	47	147	221	42	147	221	29
Borrowing	167	250	53	201	301	58	367	550	71
B. Prudential balance	69	104	100	70	104	100	103	154	100
For quota resources 3/	36	54	52	29	44	42	29	44	29
For borrowing	33	50	48	40	60	58	73	110	71
C. Remaining lending capacity (A-B)	245	367		278	418		411	617	
D. Source of resources used in lending (assuming full prudential balance held in quota-based resources)									
Quota 4/	78	117	32	78	117	28	44	67	11
Borrowing	167	250	68	201	301	72	367	550	89

Source: Staff calculations.

1/ An exchange rate of US\$/SDR of 1.5 is assumed, close to the current level.

2/ Includes holdings of currencies of members included in the FTP and SDR holdings of the GRA.

3/ Calculated as 20 percent of quota of members included in the FTP, of SDR 178.7 billion.

4/ The prudential balance is deducted from usable quota resources to give quota resources available for lending.

22. **In light of the above, staff believes it would be prudent initially to target a mix of borrowed and quota resources of 2:1.** This would allow for the possibility that full use of the \$250 billion supplementary borrowing may be needed as part of the Fund's response to the global crisis. This mix would be kept under close review in response to developments, including the demand for Fund financing and changes in the potential volume of supplementary borrowing. It could also be revisited once the ad hoc increases under the quota and voice reform become effective.⁶ Staff has considered the possibility of applying a lower ratio of borrowed to quota resources initially (say, a ratio of 1:1). However, as illustrated in Table 2, this approach would run the risk that it could subsequently be necessary to raise the ratio sharply if demand for Fund credit remains strong. Such an approach could be problematic as excessive reliance on bilateral borrowing could limit the Fund's ability to respond to members' needs, including possible requests for large purchases such as could apply under the FCL.

D. Financial Transactions Plan: Operational Considerations

23. **The agreed mix of quotas and borrowed resources would guide the preparation of the FTP presented each quarter for Board approval.** The FTP would include both a plan for transfers of quota resources as at present and provision for possible drawings on available credit lines. In preparing and implementing the plan, staff would seek to achieve the desired mix of use of quota versus borrowed resources over time. As is the case at present

⁶ When implemented, the ad hoc quota increases for 54 members under Resolution No. 62-3 will increase total quotas of current FTP participants by about SDR 19.8 billion,

Table 2. The Mix Between Own and Borrowed Resources: Illustrations with Different Ratios of Borrowed to Quota Resources
(SDR billions)

	Usable Quota Resources 1/ A	Prudential Balance 2/ B	UQR Available for Lending 3/ C=(A-B)	Undrawn Potential Borrowing 4/ D	Borrowing : Quota Remaining 5/ E=D/C
Initial situation (May 31, 2009):					
Total potential borrowing assumed at SDR 167 billion (US\$250 billion)	147	69	78	167	2.1
<u>Assuming Further Disbursements Using a Borrowing:Quota Ratio of 2:1</u>					
<i>After further disbursements of SDR 50 billion:</i>					
Total potential borrowing remains at SDR 167 billion (US\$250 billion)	131	69	62	133	2.2
Total potential borrowing increases to SDR 201 billion (US\$301 billion) 6/	131	76	55	167	3.1
<i>After further disbursements of SDR 100 billion:</i>					
Total potential borrowing remains at SDR 167 billion (US\$250 billion)	114	69	45	100	2.2
Total potential borrowing increases to SDR 201 billion (US\$301 billion) 6/	114	76	38	134	3.5
<u>Assuming Further Disbursements Using a Borrowing:Quota Ratio of 1:1</u>					
<i>After further disbursements of SDR 50 billion:</i>					
Total potential borrowing remains at SDR 167 billion (US\$250 billion)	122	69	53	142	2.7
Total potential borrowing increases to SDR 201 billion (US\$301 billion) 6/	122	76	46	176	3.8
<i>After further disbursements of SDR 100 billion:</i>					
Total potential borrowing remains at SDR 167 billion (US\$250 billion)	97	69	28	117	4.1
Total potential borrowing increases to SDR 201 billion (US\$301 billion) 6/	97	76	21	151	7.0

Source: Staff calculations.

1/ GRA holdings of currencies of FTP members and SDRs.

2/ Prudential balance is held in GRA and is set as 20 percent of the sum of the quota of FTP members and total potential borrowing.

3/ Usable quota resources net of the prudential balance, i.e., quota resources available to finance lending.

4/ At the outset of borrowing, the full amount of initially assumed potential borrowing is undrawn.

5/ The ratio that would allow full disbursement of the remaining borrowed resources.

6/ US\$250 billion plus the current NAB of SDR 34 billion.

with the transfer side of the FTP, it is unlikely to be possible to use precisely the agreed mix of quota and borrowed resources for all individual purchases due to operational constraints. Where departures occur, staff would seek to rebalance the mix on subsequent transactions within the quarter, or where necessary in the succeeding quarter.

24. **As a general principle, staff would aim to arrange drawings under available credit lines in such a way as to maintain equitable burden sharing among all lenders to the Fund.** In implementing individual transfers, the Fund would aim to draw down available credit lines under both loan and note agreements on a proportionate basis, so as to maintain a consistent ratio of cumulative drawdowns to total commitments across all creditors with “active” agreements during the period. Departures from strict proportionality are likely to be needed on individual purchases, for example when the total amounts involved are relatively small, or as a result of other operational constraints. Any departures from proportionality that result in an unbalanced use across credit lines would—to the extent possible—be offset in the financing of subsequent purchases, including in subsequent quarterly plan periods, if needed.

25. **Given that borrowing agreements are expected to come into effect in a phased manner, recourse would initially be limited to those agreements that are already in effect.** As other agreements come into effect, however, it is expected that they would be utilized to a larger extent than agreements on which drawings had already been made. Accordingly, while there is likely to be unbalanced use across individual credit agreements during the transition period, drawdowns will be managed to achieve, once all borrowing agreements are in effect, broadly balanced use across all credit lines, in relation to the size of commitments.

26. **The possibility of large purchases under precautionary FCL and other high access precautionary arrangements poses particular challenges for liquidity management, including the use of borrowed resources.** The Fund has already approved precautionary FCL arrangements with 3 members totaling SDR 52 billion that can be drawn at any time on short notice, and additional demand from other members could be forthcoming. In these circumstances, the average size of the FTP will need to be much larger than has been typical in the past, involving a significant precautionary element. Particularly in the transition to a broad-based set of borrowing agreements, there may also be binding constraints on potential recourse to borrowed resources in the short term, resulting from the weekly drawdown limits. Creditor flexibility in the application of the weekly limits to the extent possible would help facilitate the Fund’s liquidity management in these circumstances. Also, as at present, the transfer plan and staff estimates of potential use of available credit lines may need to be adjusted at short notice.

E. Borrowing and the Forward Commitment Capacity

27. **The main measure of the Fund’s liquidity, the Forward Commitment Capacity (FCC), needs to be adapted to reflect the availability of bilateral credit lines.** The FCC is

a forward-looking measure of the available resources for new commitments during the coming 12-month period. It comprises the Fund's usable quota resources plus projected repurchases over the subsequent twelve months, net of resources already committed under existing arrangements and the prudential balance. The FCC is derived from publicly available financial data and incorporates a transparent judgment on the prudential minimum of uncommitted usable resources. Although the FCC was designed to incorporate effects of NAB/GAB borrowing, it does not currently allow for the effects of bilateral arrangements outside of the NAB/GAB.

28. **In order to capture the Fund's capacity to lend from borrowed as well as quota resources, it is proposed to include undrawn balances under bilateral loan and note purchase agreements in the FCC as soon as they are in place (i.e., activated).** This would increase in the reported FCC from SDR 33 billion at present to about SDR 84 billion as a result of including the Japan loan agreement. Inclusion of the full undrawn amount of available loan or note purchase agreements is warranted as these amounts are fully available to finance lending over the next 12 months, subject to any weekly and monthly limits. This contrasts with the NAB/GAB, where only activated amounts are included in the FCC; potential drawings that have not been activated are not included as these require the approval of participants. Mirroring the treatment of the quotas of FTP participants, the prudential balance would be increased to include 20 percent of all bilateral agreements that are fully in place (Table 3). It will also be necessary in future to adjust repurchases falling due in the next 12 months for those associated with borrowing agreements that are no longer active or that feature cumulative limits on total drawings, as such repayments would not restore the Fund's ability to draw under the agreements.

F. Policies Governing Repayment of Fund Borrowing

29. **Consideration will need to be given in future to the policies governing repayment of borrowed resources.** Given the exceptional nature of the current circumstances in which large-scale borrowing is needed to supplement the Fund's quota resources, it would seem reasonable to consider early repayment of that borrowing once the Fund's liquidity position has strengthened again, because of repurchases and/or the quota increases resulting from the next quota review. However, it is premature to consider the precise modalities of early repayments, particularly given the general expectation as discussed above that bilateral agreements will be folded into an expanded NAB.

Table 3. Proposed Definition of the Forward Commitment Capacity

IMF's Financial Resources and Liquidity Position, May 31, 2009 1/ (In billions of SDRs unless otherwise indicated; end-of-period)		
	FCC Quota- Based Resources Only	Proposed Definition of FCC Quota-Based and Borrowed Resources
I. Total Resources	224.5	289.1
Members' currencies	209.5	209.5
SDR holdings	2.3	2.3
Gold holdings	5.9	5.9
Other assets	6.8	6.8
Available under GAB/NAB activation	-	-
Other borrowing arrangements*	-	64.6
II. Less: Non-Usable Resources	77.3	77.3
<i>Of which: Credit outstanding</i>	27.4	27.4
III. Equals: Usable Resources	147.2	211.8
IV. Less: Undrawn balances under GRA arrangements	79.2	79.2
V. Equals: Uncommitted usable resources	68.0	132.6
VI. Plus: Repurchases one-year forward	0.4	0.4
VII. Less: Repayments of borrowing due one-year forward*	-	0.0
VIII. Less: Prudential balance	35.7	48.7
IX. Equals: One-year forward commitment capacity (FCC)	32.7	84.3
Memorandum items:		
Potential GAB/NAB borrowing	34.0	34.0
Quotas of members that finance IMF transactions	178.7	178.7
Liquid liabilities	35.2	35.2
Encashable immediately 2/*	-	35.2
Encashable within 12 months 3/*	-	0.0
US\$ per SDR	1.54805	1.54805

Note: Details may not add due to rounding.

1/ Preliminary data.

2/ Reserve tranche positions, immediately encashable bilateral borrowing, and Series A notes.

3/ Bilateral borrowing and Series B notes, which are encashable as soon as practicable within 12 months.

* Indicates new items.

30. One immediate issue that arises with new borrowing is the allocation of currencies used for receipts in the FTP. Under existing guidelines, the currencies that are to be used for receipts are allocated in such a way as to promote over time balanced positions in the Fund in relation to quotas.⁷ A member's "position in the Fund" is defined as its reserve tranche position plus any outstanding loans to the Fund by the member or an institution of the

⁷ *Operational Budget—Review of Guidelines for the Allocation of Currencies* (Decision No 11837 – 98/121, 11/30/98). See Selected Decisions Thirty Second Issue, pages 400–401.

member under credit arrangements that are judged by the Fund to provide it, on a continuing basis, with the ability to finance uses of its resources by members on terms comparable to those applicable to the Fund's use of its currency holdings for this purpose.

31. **In line with the treatment of previous bilateral loan agreements, it is not proposed that bilateral loan and note purchase agreements be taken into account for this purpose.** These agreements are intended to provide temporary financial support to the Fund and have no provision for extension beyond a defined availability period. Accordingly, it is not proposed to take account of outstanding indebtedness under these agreements in calculating creditors' positions in the Fund for the purpose of the allocation of currencies. The policies on allocation of currencies used for receipts will need to be reviewed in the context of discussions on the enlarged and expanded NAB.

III. GUIDELINES FOR BORROWING BY THE FUND

32. **The existing borrowing guidelines are shown in Box 2.** These Guidelines were first adopted in 1982 in view of the extensive potential borrowing at the time. They are intended to assure members that the financing of the Fund would be managed in a prudent and systematic manner. The Guidelines focus on ensuring continuous monitoring of the Fund's liquidity and financial position by the Executive Board; the establishment of limits on borrowing (excluding borrowing under the GAB); and a clear statement that any limits so established are not to be considered as targets for borrowing by the Fund. When the Guidelines were last reviewed in 1991, they were retained despite the lack of an immediate need for further borrowing.

33. **Staff consider that the Guidelines continue to provide a broadly appropriate framework for the management of Fund borrowing.** The need for close monitoring of the Fund's liquidity and financial position remains fully relevant. By the same token, as required under the Articles and consistent with the premise that borrowing only provides a backstop to the Fund's quota-based financing mechanism, it should be limited to circumstances in which borrowing is needed to supplement the Fund's resources, and should not become a target.

34. **However, a question arises as to whether it is useful to establish a new limit on borrowing in current circumstances.** The original rationale for a limit was to provide comfort to the major creditors at the time regarding the overall amount of potential borrowing.⁸ In current circumstances, the parameters of potential borrowing have already been endorsed by the G-20 Leaders and the IMFC. The announced intention to substantially increase the financial resources available to the Fund has already helped restore market confidence and it would be desirable to avoid sending any policy signals that could

⁸ See p. 892 in *Silent Revolution: The International Monetary Fund 1979-1989*, by James M. Boughton, Washington: IMF, 2001.

undermine that confidence-boosting effect. Any limit would also need to take account of the likelihood that the Fund could enter into bilateral loan or note purchase agreements exceeding the immediate financing target of \$250 billion as a transitional step towards agreement on an expanded and enlarged NAB. On balance, staff proposes not to establish a new limit on borrowing at this stage, while leaving open the possibility that such a limit could be reintroduced again in future.

35. A revised decision on the borrowing guidelines incorporating the key proposals in this paper will be issued as a supplement to this paper prior to the Board's discussion.⁹

⁹ Pending the adoption of revised guidelines, the requirement that the Fund establish a limit on borrowing would need to be suspended to allow approval of any new bilateral loan or note purchase agreements, as was done already for the agreements with Japan and Norway.

Box 2. Guidelines for Borrowing by the Fund

Quota subscriptions are and should remain the basic source of the Fund's financing. However, on a temporary basis, borrowing by the Fund can provide an important supplement to its resources.

The confidence of present and potential creditors in the Fund will depend not only on the prudence and soundness of its financial policies but also on the effective performance of its various responsibilities, including, in particular, its success in promoting adjustment.

Against this background the Executive Board approves the following guidelines on borrowing by the Fund.

1. Fund borrowing shall remain subject to a process of continuous monitoring by the Executive Board in the light of the above considerations. For this purpose, the Executive Board will regularly review the Fund's liquidity and financial position, taking into account all relevant factors of a quantitative and qualitative nature.
2. In advance of any further borrowing undertaken by the Fund, except in the case of borrowing under the General Arrangements to Borrow, the Executive Board shall establish in the context of circumstances prevailing at that time, limits expressed in terms of the total of Fund quotas above which the total of outstanding borrowing plus unused credit lines would not be permitted to rise.
3. Any limits that may be adopted as a result of a review pursuant to paragraph 2 above are not to be understood, at any time, as targets for borrowing by the Fund.

*Decision No. 9862-(91/156)
November 15, 1991*

Source: *Selected Decisions and Selected Documents of the IMF, Thirty-Second Issue, pp. 504–5.*

IV. ISSUES FOR DISCUSSION

36. Directors may wish to comment on the following issues:

- Do they agree that the Fund should continue to maintain a liquidity buffer of 20 percent to protect the liquidity of members' reserve positions in the Fund and against an erosion of the Fund's resources base, and that this ratio should also apply to new bilateral borrowing through loans or note purchase agreements?
- Do they agree that it would be prudent to establish an initial limit on immediate encashability under bilateral loans and Series A notes of SDR 15 billion, and that this limit should be kept under review?
- Do they agree that an initial ratio of borrowed to quota resources of 2:1 should be used to guide the financing of future new lending, and that this ratio should be kept

under close review and adjusted as appropriate in the context of the six-monthly reviews of Fund liquidity or more frequently if needed?

- Do they agree that the Fund should seek to maintain an equitable burden sharing among lenders to the Fund by seeking, over time, broadly balanced cumulative drawings relative to amounts committed across the range of borrowing sources?
- Do they agree that the definition of the FCC should be revised to include unutilized borrowing capacity available over the next 12 months under agreements that are currently active?
- Do they agree that amounts outstanding under bilateral loan and note purchase agreements should not be included in members' positions in the Fund for the purpose of the allocation of currencies received from repurchases, pending finalization of the expanded and enlarged NAB?
- Do Directors agree that it would not be appropriate to establish a new limit on borrowing by the Fund in current circumstances?