IMF POLICY PAPER

UPDATE ON THE MOBILIZATION OF LOAN RESOURCES FOR PRGT LENDING, PROPOSED AMENDMENT TO THE PRGT INSTRUMENT, AND FLOOR FOR THE SIX-MONTH DERIVED SDR INTEREST RATE

IMF staff regularly produces papers proposing new IMF policies, exploring options for reform, or reviewing existing IMF policies and operations. The following documents have been released and are included in this package:

- The Staff Report, prepared by IMF staff and completed on September 13, 2016 for the Executive Board’s consideration on September 20, 2016.

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International Monetary Fund
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UPDATE ON THE MOBILIZATION OF LOAN RESOURCES FOR PRGT LENDING, PROPOSED AMENDMENT TO THE PRGT INSTRUMENT, AND FLOOR FOR THE SIX-MONTH DERIVED SDR INTEREST RATE

EXECUTIVE SUMMARY

- A Board-endorsed effort to raise SDR 11 billion in new Poverty Reduction and Growth Trust (PRGT) loan resources needed to sustain the Fund’s concessional lending operations is well underway. Staff is now engaging with 16 interested loan providers bilaterally with a view to having firm pledges in line with the target by the 2016 Annual Meetings and a critical mass of new loan agreements in place by end-2016. To date, committed new loan resources amount to half of the SDR 11 billion fundraising target.

- To facilitate members’ contributions of the needed loan resources, staff proposes to amend the rules under the PRGT Instrument on sequencing of drawings under the various loan accounts of the PRGT (“drawing mechanism”). The current drawing mechanism prioritizes drawings under borrowing agreements to the Special Loan Accounts (SLA) over borrowing agreements to the General Loan Account (GLA) and, within each loan account, it provides for prioritization of drawings under borrowing agreements from previous rounds of PRGT fundraising over those from more recent fund-raising rounds. However, under this mechanism, SLA borrowing agreements, including from the current fund-raising round, could be drawn before GLA borrowing agreements from past fund-raising rounds are exhausted, thereby potentially hampering future contributions from providers to the GLA.

- Under the proposed amendment to the drawing mechanism the Trustee would aim to first draw loan resources from an earlier fund-raising round, including from the GLA, before drawing on new loan resources to the SLA, while taking into consideration the overall commitments of loan resources to the Loan Accounts of the PRGT with a view to ensuring the availability of adequate loan resources for all facilities. This amendment to the PRGT Instrument, which may be adopted by the Executive Board with a majority of the votes cast, requires for its effectiveness the consent of current PRGT lenders.

- Finally, in response to inquiries received from lenders, this paper sets out staff’s understanding on the implications for PRGT borrowing agreements if the formula for the six-month derived SDR interest rate were to result in a negative rate for such agreements, and seeks Board endorsement before informing PRGT lenders.
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INTRODUCTION

1. A new loan mobilization round is underway to sustain the Fund’s concessional lending operations over the medium-term. As reported during the annual update of the Fund’s concessional assistance to low-income countries (LICs), the demand for concessional loans from the PRGT has increased sharply and would, absent further steps, shortly outpace available loan resources.¹ Uncommitted PRGT loan resources amounting to SDR 4.23 billion (or SDR 2.83 billion net of the encashment buffer) at June 30, 2016 are sufficient to cover anticipated demand through around mid-2017. As reported in the first section of this paper, good progress has been made in the Board-endorsed effort to raise SDR 11 billion in new loan resources. This marks the first mobilization round since the PRGT instrument was modified to accord priority to drawings under the SLAs.²

2. An amendment to the PRGT drawing mechanism is proposed to help facilitate the new loan mobilization effort. Under the PRGT financing framework, Trust lenders may choose to earmark their loan commitments to specific Trust lending facilities (under the SLA) or make them generally available (under the GLA). In this framework, facility specific loan agreements are drawn first before loan agreements to the GLA, which can fund drawings for disbursements under any facility of the PRGT. While this framework has helped preserve flexibility in the allocation of resources from the GLA, it can imply that the Fund starts drawing under loan agreements to a SLA under a new resource mobilization round before making drawings under a loan agreement to the GLA from the previous resource mobilization round. To strike an appropriate balance between making the GLA the “second line of defense” and providing PRGT lenders with greater clarity about the drawdown prospects of loan agreements to the GLA, this paper proposes to amend the PRGT Instrument.

3. This paper also sets out staff’s understandings on the implications of a negative six-month derived SDR interest rate on outstanding claims under certain PRGT Borrowing Agreements. In the view of staff, there is no basis under the current PRGT Instrument and the existing borrowing agreements to charge lenders a negative rate. Consequently, a zero percent interest rate floor is deemed to apply in the event that the formula for this interest rate resulted in a negative rate. Staff is seeking Board endorsement of this understanding prior to informing Fund lenders.

¹ See Update on the Financing of the Fund’s Concessional Assistance and Debt Relief to Low Income Countries (04/01/2016).
LOAN MOBILIZATION 2015/16

4. **The current fund-raising exercise aims to be more broad based and inclusive.** A regionally diverse set of 28 potential lenders was identified, including 14 new lenders (Figure 1). The proposed new lenders are emerging and advanced economies that are, first, members of the current financial transactions plan and, second, are among the largest 15 providers of financial resources to the GRA, based on at least one of the following criteria: i) quotas after the 14th Review; ii) NAB commitments prior to the implementation of the 14th Review of Quotas; and iii) 2012 GRA borrowing agreements.

![Figure 1. Existing and Potential Lenders to the PRGT (Grouped according to the proposed range of contributions) 1/](image)

5. **Mobilization efforts are relatively advanced and progressing well.** In November 2015, the above existing and potential new lenders were approached to participate in the fund-raising exercise. Responses have been received from 24 countries, of which 16 have either confirmed their intention to participate or signaled a positive expression of interest in principle. No current loan provider has declined to participate, although a response is pending from one member. Expressions of interest have also been received from three new lenders, and responses are pending from two potential new lenders where deliberations are ongoing. Staff has also been advised that amendments to eliminate domestic restrictions preventing the participation of a prospective new loan provider could become effective in 2017.

6. **Committed new loan resources currently amount to half of the SDR 11 billion target.** Staff is actively engaging the 16 prospective loan providers bilaterally on the terms and conditions of the new PRGT borrowing agreements, of which 12 have committed loan amounts totaling SDR 5.5 billion. Discussions to confirm loan amounts with the remaining four lenders are continuing and, based on the contributions proposed by staff, could boost total PRGT loans for the current fundraising round to an estimated SDR 10.4–12.0 billion. Staff is seeking to have firm pledges in line
with the target by the 2016 Annual Meetings and to have a critical mass of new loan agreements in place by end-2016, although member specific approvals processes vary and could in some cases push agreement finalization into 2017. This timeline provides a narrow window to amend the PRGT Instrument as it relates to the priority accorded to loans from previous fund-raising rounds.

**AMENDMENT TO THE PRGT INSTRUMENT**

7. **The last fund-raising round for PRGT loan resources took place over 2009-14, when loan agreements were secured totaling SDR 9.8 billion from 14 member countries** (Table 1). As of June 30, 2016, uncommitted PRGT loan resources amounted to SDR 4.23 billion, of which the bulk (SDR 3.92 billion) were in the GLA, with SDR 0.31 billion left in the Extended Credit Facility (ECF) loan account. The resources of the Rapid Credit Facility (RCF) and Stand By Credit Facility (SCF) loan accounts have been fully committed. With uncommitted PRGT loan resources estimated to be sufficient to cover anticipated demand through mid-2017, new PRGT loan agreements currently under negotiations could well enter into effect before existing loan agreements to the GLA are completely exhausted.

8. **To facilitate ongoing loan mobilization efforts, while preserving operational efficiency, staff proposes to amend the drawing mechanism under the PRGT Instrument.** Under the PRGT, resources from a specific loan agreement may only be drawn to fund the corresponding specific PRGT facility (e.g., the SCF loan account may only be drawn to fund SCF loan disbursements) while GLA resources may be used to finance all PRGT facilities. As such, the current drawing mechanism under the PRGT Instrument prioritizes drawings of resources from facility-specific loan agreements over those earmarked to the GLA so as to preserve GLA resources and to allow the Fund more flexibility in the allocation of loan resources. The mechanism also prioritizes drawings under borrowing agreements from previous rounds of PRGT fundraising over those of more recent fund-raising rounds but only within the same loan account. As a result, drawings under a loan agreement to the GLA to finance a specific PRGT facility may not occur until resources in the special loan account for that facility, including resources raised from a more recent mobilization round, have been exhausted. The current mechanism may therefore discourage potential lenders with loan agreements to the GLA that have not yet been drawn from continuing to pledge new loan resources. Therefore, staff considers it important to amend the drawing mechanism across different fund-raising rounds as new PRGT loan agreements are now being negotiated.

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3 This prioritization only entered into effect in January 2010, after the drawing mechanism under the PRGT Instrument was amended to reflect the 2009 comprehensive reform of the Fund’s lending facilities and financing framework for low-income countries resulting in the creation of three concessional lending windows.
9. The proposed amendment to the PRGT Instrument would provide for greater flexibility in the sequencing of drawings across and within loan resources from different fund-raising rounds, while providing safeguards to ensure the availability of adequate loan resources for all PRGT facilities. Under the proposed amendment the following changes would be adopted:

(i) Before calling on new commitments that are made under new borrowing agreements or augmented under the existing borrowing agreements, which are entered into or amended, respectively, after May 31, 2014, the Trustee will aim to first draw on loan resources available under borrowing agreements entered into before that date for each
specific facility, from both the relevant SLA and the GLA.\(^4\) This is a change from the current regime, which prioritizes drawings from past fund-raising rounds only within the same loan account. This change would thus help to prevent current borrowing agreements for the benefit of the GLA from being pushed back in the queue as new facility specific borrowing agreements are put in place under a new fund-raising round. Within the same fund-raising round of loan resources, facility-specific loan agreements will continue to be drawn before GLA resources.

(ii) The Trustee will, however, preserve some flexibility in making drawings from GLA borrowing agreements from past fund-raising rounds, as there could be circumstances where, considering overall commitments to the various loan accounts of the PRGT, it would be imprudent to draw on such older GLA commitments as this could deplete loan resources for specific facilities of the PRGT.\(^5\) The proposed amendment therefore gives the Trustee the flexibility to make drawings under new SLA commitments, instead of old GLA commitments, if, and to the extent that it is necessary to maintain the adequacy of overall commitments of loan resources for all facilities of the PRGT. The judgement whether to draw on old GLA commitments or new SLA commitments would be exercised by the Managing Director, who is expected to delegate this to FIN staff, and the Executive Board would be informed on the implementation of the new drawdown mechanism through the regular up-dates on concessional financing.

**ZERO PERCENT FLOOR ON SIX-MONTH DERIVED SDR INTEREST RATE ON BORROWED RESOURCES FOR THE PRGT**

10. **The six-months derived SDR interest rate formula, which is used in currency borrowing agreements for the PRGT, could result in a negative rate.** Outstanding claims under loan and note purchase agreements to the PRGT are either remunerated at the official SDR rate in the case of agreements that, as a rule, provide for drawings in SDR, or at the six-month derived SDR rate, in the case of agreements that, as a rule, provide for drawings in currency (currency agreements). The six-month derived SDR interest rate is currently based on: (1) the U.S. treasury bill rate, (2) the

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\(^4\) For the avoidance of doubt, augmentations of existing borrowing agreements are treated as entering into a new borrowing agreement with respect to the amount that has been augmented (i.e., the drawing priority of the undrawn amount of the borrowing agreement prior to the augmentation will remain unchanged).

\(^5\) For example, there could be situation where commitments for a special loan account (e.g., for the RCF Loan Account) are very low, whereas other loan accounts (e.g., ECF Loan Account) might have significant resources under new borrowing agreements from the most recent borrowing round. In such circumstances, drawing from old GLA commitments instead of new borrowing agreements to the ECF Loan Account to fund an ECF disbursement could jeopardize the availability of needed resources for a future RCF disbursement.

(continued)
Japanese treasury bill rate, (3) the Euribor, and (4) the Libor (all at six months maturity).\(^6\) The percentage weight of each interest rate instrument in the calculation of the six-month derived SDR interest rate is based on the corresponding weight of each relevant currency in the valuation of the SDR. While the Executive Board adopted a floor of 0.05 percent or five basis points for the official SDR interest rate on October 24, 2014,\(^7\) there is no explicit floor on the six-month derived SDR interest rate. During the current mobilization round, staff has received questions from lenders using currency agreements on what would happen if the interest formula resulted in a negative rate during the low-interest rate environment.

11. **In the view of staff, the current PRGT borrowing agreements and the PRGT Instrument provide no basis for charging PRGT lenders a negative rate and a zero percent interest rate floor would automatically be applied in the event the six-month derived SDR rate turned negative.** While the interest rate formula for the six-month derived SDR rate could result in a negative rate, neither the PRGT borrowing agreements nor the PRGT Instrument contemplate that charges as a result of a negative interest rate be paid by creditors. In particular, the PRGT Instrument does not include any mechanism for interest payments by PRGT lenders. Furthermore, neither the PRGT Instrument nor the individual agreements require a minimum interest payment by the PRGT. Rather, the PRGT Instrument permits a zero percent interest rate on PRGT loans and has no requirement that remuneration be paid on PRGT borrowing. In light of the foregoing, staff is of the view that a zero percent interest rate floor should be applied to outstanding claims under PRGT loan and note purchase agreements in the event that the six-month derived SDR interest rate formula resulted in a negative rate. The Executive Board is asked to endorse this understanding in the proposed decision to this paper. Upon such endorsement, staff would inform all PRGT creditors using currency agreements of this approach, and new PRGT currency agreements would include a clause clarifying the zero percent floor in case the six-month derived SDR interest rate formula produces a negative rate.

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\(^6\) Effective October 1, 2016, the six-month Chinese Treasury bill rate will be added to the six-month derived SDR interest rate and the Euribor will be replaced with the six-month Euro-denominated euro government bond yield for bonds rated AA and above, as published by the European Central Bank.

Proposed Decisions

Accordingly, the following decisions, which may be adopted by a majority of the votes cast, are proposed for adoption by the Executive Board.

1. The Instrument to establish the Poverty Reduction and Growth Trust (PRGT Instrument) that is annexed to Decision No. 8759-(87/176) ESAF, as amended, Section III, Paragraph 4(a) of the Instrument shall be revised to read as follows:

Section III

Paragraph 4. Drawings under Borrowing Agreements

(a) The Trustee may draw under borrowing agreements to the General Loan Account for purposes of loan disbursements under any of the facilities of the Trust, provided that it shall draw first (i) under borrowing agreements to the ECF Loan Account for purposes of ECF and ESF loan disbursements, (ii) under borrowing agreements to the SCF Loan Account for purposes of SCF loan disbursements, and (iii) under borrowing agreements to the RCF Loan Account for purposes of RCF loan disbursements, and provided further that before calling on commitments made under new borrowing agreements entered into, or augmented under existing borrowing agreements amended, after May 31, 2014, for disbursements under a facility of the Trust, the Trustee shall aim to first draw resources available for that facility under borrowing agreements entered into before that date, including from the General Loan Account if, and to the extent that, commitments of loan resources for all facilities are considered adequate by the Managing Director.

Drawings on the commitments of individual creditors over time shall be made so as to
maintain broad proportionality of these drawings relative to commitments to each Loan Account, provided that commitments under borrowing agreements entered into or augmented after May 31, 2014, shall only be taken into account after borrowing agreements entered into before that date have been fully drawn. Drawings under paragraph 4(b) below will not be taken into account for purposes of the proportionality requirement set forth in this paragraph 4(a).

2. The amendment of the PRGT Instrument set forth in paragraph 1 of this decision shall become effective when all current lenders to the loan accounts of the PRGT have consented to these amendments.

3. The Executive Board endorses staff’s understanding set out in this paper regarding the implications of a negative six month derived SDR interest rate on outstanding claims under PRGT borrowing agreements subject to this rate.