

**Annual Report on Lending, Surveillance, and
Technical Assistance Policies of
The International Monetary Fund**



A Report to Congress
in accordance with
Section 9006 of the Consolidated Appropriations Act, 2016

United States Department of the Treasury
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Introduction

This report provides an assessment of changes in lending, surveillance, and technical assistance policies of the International Monetary Fund (IMF), as well as an overview of new and ongoing exceptional access loans provided by the IMF, since December 2015. This report is required by section 9006 of the *Consolidated Appropriations Act, 2016*.¹

Over the past year, the IMF Executive Board (the Board) approved several changes to IMF lending policies to safeguard IMF resources and adjust to the increase in quota resources. These included: reform of the exceptional access lending framework and removal of the systemic exemption; reduction of access limits and surcharges in line with the 14th General Review of Quotas; rollback of the New Arrangements to Borrow (NAB); maintenance of the Fund's access to bilateral borrowing agreements; and modification of interest rates for concessional borrowing from the IMF. The Board also approved changes to strengthen the IMF's Post Program Monitoring (PPM) surveillance framework. There were no policy changes to the IMF's technical assistance this year. However, the IMF will be considering reviewing its technical assistance funding and policy this upcoming year.

I. Lending Policy Changes

The IMF Executive Board approved the following changes to lending policies over the last year: (A) reform of the exceptional access lending framework and removal of systemic exemption; (B) reduction of access limits and surcharges in line with the 14th General Review of Quotas; (C) rollback of the NAB; (D) maintenance of the IMF's access to bilateral borrowing; and (E) modification of interest rates for concessional borrowing from the IMF.

(A) Exceptional Access Lending Framework

With active U.S. support, the Board reformed its lending framework in January 2016 to tighten standards on debt sustainability in an effort to improve economic outcomes and enhance safeguards for IMF resources. Specifically, the Board voted to repeal the "systemic exemption" to the debt sustainability criterion of its exceptional access framework. The exemption, created in 2010, had allowed the IMF to provide exceptional access — that is, financing amounts that exceeded normal IMF lending limits — to countries whose medium-term debt trajectory was "sustainable but not with high probability" if the negative spillovers from the country would have had a systemic impact on the global financial system.

¹ Specifically, the section 9006 requires Treasury to provide:

1. A description of any changes in the policies of the International Monetary Fund (the Fund) with respect to lending, surveillance, or technical assistance;
2. An analysis of whether those changes, if any, increase or decrease the risk to United States financial commitments to the Fund;
3. An analysis of any new or ongoing exceptional access loans of the Fund in place during the year preceding the submission of the report; and
4. A description of any changes to the exceptional access policies of the Fund.

(B) Access Limits, Surcharges, and Commitment Fees

In February 2016, the Board concluded a review of and adopted changes to access limits, surcharge policies, and other quota-related policies. This review took place in response to the effectiveness of the quota increases under the 14th General Review of Quotas, which on average doubled members' quotas.

A number of IMF policies have thresholds set as a percentage of members' quotas. These include limits on members' normal access to IMF resources in the General Resources Account, thresholds for surcharges on high levels of outstanding IMF credit, and commitment fees.² With quotas doubling on average under the 14th General Review and absent additional policy revisions, quota-based limits and thresholds would have also doubled in nominal SDR terms.³ This would have eroded critical elements of the IMF's risk management framework as it would have doubled, on average, access to IMF resources in the GRA without triggering safeguards under the exceptional access framework. Further, SDR amounts on which surcharges do not apply would have also doubled, reducing incentive for timely repayments. At the same time, the Board saw the need to maintain access relative to economic developments and metrics since the last review of access, in 2009, which called for some increase in limits and thresholds in SDR terms.

In light of these circumstances, the Board approved the following policy changes:

Access Limits: The Board lowered normal access limits for borrowing under the Stand-by Arrangement (SBA) and Extended Fund Facility (EFF) — the main non-concessional lending facilities of the IMF — to 145 percent of quota on borrowing in a 12-month period and 435 percent of quota cumulatively, net of scheduled repurchase obligations. The previous thresholds, approved in 2009, were 200 and 600 percent of quota, respectively. The adjustment was calibrated so that no member's access to GRA resources declined in nominal terms.

The Board also reduced access under other facilities, both non-concessional and concessional, as shown in the table below. The Flexible Credit Line, a short-term facility reserved for countries with very strong fundamentals and policies and a good track record of policy implementation, has no preset access limit.

² The General Resources Account is the principal account of the IMF, consisting of a pool of currencies and reserve assets, representing the paid subscriptions of member countries' quotas.

³ The SDR is a basket of currencies used as a unit of account by the IMF. SDR 1 = USD \$1.38 (November 3, 2016).

Annual and Cumulative Normal Access Limits by Facility
as a percent of quota

<i>Non-Concessional</i>	Current Limits		Previous Limits	
	Annual	Cumulative	Annual	Cumulative
SBA/EFF	145	435	200	600
RFI	37.5	75	75	150
PLL	200	500	500	1000
<i>Concessional</i>				
SCF/ECF	75	225	150	450
RCF				
Normal	18.75	75	37.5	150
Shocks	37.5	75	75	150

Note: Access limits for the concessional loan facilities and the Rapid Financing Instrument (RFI) were raised by 50 percent in July 2015 with the understanding that they would be halved once the 2010 quota reforms were effective.

Surcharges: The IMF uses both level- and time-based surcharges to mitigate risks by generating income to boost precautionary balances, and to produce incentives for countries to avoid prolonged and large use of IMF resources. In February 2016, the IMF adjusted the level-based threshold for surcharges (which is expressed as a percentage of a country's IMF quota) to take account of the 2016 IMF quota reform, and adjusted the time-based surcharges to take account of the longer timeframe of EFFs, which had become more common.

The IMF introduced level-based surcharges in 2000 to discourage excessively high access while being cautious to avoid discouraging countries with need from seeking assistance. In February 2016, the Board approved a reduction in the threshold at which surcharges begin to apply for level-based surcharges from 300 percent to 187.5 percent of quota. The surcharge was maintained at 200 basis points.

The IMF introduced time-based surcharges in 1997 to provide an incentive for early repayment. When credit outstanding exceeded the threshold for level-based surcharges for more than 36 months, a time-based surcharge of 100 basis points was added. In February 2016, the Board decided to differentiate between SBAs and EFFs. SBAs are Fund programs typically lasting 12 to 24 months in duration and cannot extend beyond 36 months. In contrast, EFFs are intended for countries with more prolonged difficulties, including underlying structural problems, and generally last 36 months with a possible extension to 48 months. The repayment period for an EFF is also longer, 4 ½ to 10 years compared to 3 ¼ to 5 years for the SBA. The IMF Board kept the time-based threshold at 36 months for the SBA but increased it to 51 months for the EFF, recognizing that it takes longer on average for a country with an EFF to regain access to markets, namely 39 months, compared to 15 months for a country with an SBA.

The reforms to access limits and surcharges are critical to protect the IMF's balance sheet and safeguard the United States' financial commitments. An up-to-date, credible framework for surcharges will help protect the IMF from incurring losses and protect the United States' financial commitments to the IMF.

Commitment fees: The Board also lowered commitment fee thresholds to reflect the doubling of quotas on average. Commitment fees are intended to compensate the IMF if financial commitments are not drawn and to provide an incentive against unnecessarily high precautionary access, and are refunded pro rata if the amounts are drawn. Under the new thresholds, a 15-basis point fee will be charged on committed amounts of up to 115 percent (from 200 percent) of quota over a twelve-month period; 30 basis points will be charged on committed amounts between 115 percent and 575 percent (from 1,000 percent) of quota; and 60 basis points will be charged on amounts exceeding 575 percent of quota.

(D) New Arrangements to Borrow

While quota subscriptions of member countries are the IMF's primary source of financing, the IMF can supplement its quota resources through borrowing if it believes that quota resources might fall short of members' needs. The NAB stands as the IMF's main backstop for quota resources. Through the NAB, a number of member countries and institutions stand ready to lend additional resources to the IMF.

In the context of the decision in December 2010 to double the IMF's quota resources under the 14th General Review of Quotas, IMF member countries decided that there should be a corresponding rollback of the NAB to shift the composition of the IMF's lending resources from NAB to quotas. After the quota increase came into effect in February 2016, the IMF Board of Governors voted to roll back the NAB from SDR 370 billion (about \$518 billion) to SDR 182 billion (about \$255 billion).

Also in February 2016, the IMF deactivated the NAB such that NAB resources will not be used for any newly approved IMF lending. The changes to the NAB increase the proportion of the United States' financial commitment in the IMF's quota resources relative to NAB, while keeping the overall U.S. financial commitment constant.

(E) Bilateral Arrangements

In August 2016, the Board approved maintaining access to new bilateral borrowing under a revised framework. Bilateral loans serve as the IMF's third line of defense after quota and NAB resources have been tapped. Under the revised framework, activation of the IMF's bilateral borrowing agreements requires approval from creditors representing 85 percent of the total credit committed under the 2016 Bilateral Borrowing Agreements. The agreements will now all have the same end date of December 2019, which the IMF can extend for one year in consultation with creditors. The United States does not extend bilateral loans to the IMF. However, the IMF continues to be able to activate the bilateral borrowing agreements only if the NAB is activated first (and NAB activation requires U.S. support), and if there are no available resources under the NAB. Additionally, each country program comes to the Board for approval, giving the United States an opportunity to vote on (but not veto) the use of resources.

(F) Concessional Lending

In October 2016, the Board approved a modification of the mechanism governing the setting of

interest rates for Poverty Reduction and Growth Trust facilities (PRGT).⁴ Interest rates will be set to zero on all IMF concessional loans under the PRGT for as long as and whenever global market rates are below an established threshold. Zero rates will apply for through end-December 2018, and probably for at least another two years based on projections of global interest rates.

The IMF established the PRGT in 2010 to better tailor financial support to the needs of low-income countries. The PRGT relies on a combination of grant and market-based loan resources, provided by donors and internal IMF resources. PRGT lending is financed by bilateral loan agreements with donor countries at market interest rates, and donor-provided subsidy resources compensate the difference between market rates received by lenders and the concessional interest rates paid by low-income country borrowers.

There are three concessional lending windows under the PRGT: the Standby Credit Facility (SCF) to address short-term and precautionary needs; the Extended Credit Facility (ECF) to provide flexible medium-term support; and the Rapid Credit Facility (RCF) to provide emergency support. In July 2015, the Board set the interest rate on RCF assistance permanently at zero.

Under the previous interest rate mechanism, interest rates on outstanding loan balances under the SCF and ECF were differentiated, based on the average SDR interest rate in the preceding 12 months. The Board had also set the rate charged on SCF loans at 25 basis points above that for the ECF. However, this mechanism was never put into practice and during interest rate reviews conducted every two years, the IMF Executive Board waived the mechanism in favor of zero interest rates on all facilities. The revised mechanism will still set interest rates for two-year periods based on the SDR rate in the previous 12 months. However, it will now permanently unify interest rates (at zero) across all PRGT facilities when global interest rates are very low.

PRGT Interest Rate Mechanism						
SDR interest rate	Prior framework			2016 revision		
	SCF	ECF	RCF	SCF	ECF	RCF
SDR rate 0.75 and under	0.25	0.00	0.00	0.00	0.00	0.00
SDR rate between 0.75 and 2	0.25	0.00	0.00	0.25	0.00	0.00
SDR rate between 2 and 5, inclusive	0.50	0.25	0.00	0.50	0.25	0.00
SDR rate over 5	0.75	0.50	0.00	0.75	0.50	0.00

Note: The IMF set RCF interest rates permanently at zero in 2015

The United States is a strong proponent of the IMF's concessional lending facilities and played a leadership role in the mobilization of internal IMF resources for the PRGT, including use of profits from previous gold sales. However, the United States does not make financial contributions to the PRGT. This IMF policy change has no impact on the U.S. financial commitments to the IMF.

⁴ The Poverty Reduction Growth Trust provides concessional assistance to low-income members.

(G) SDR Interest Rate

Upon the conclusion of the SDR basket review in November 2015, the IMF Executive Board decided to expand the SDR basket of currencies to include the Chinese renminbi (RMB), based on existing criteria for determining the composition of the SDR basket. This decision took effect on October 1, 2016. It led to a small increase in the SDR interest rate, which is based on the currency weightings in the SDR basket, the interest rate on the financial instruments of each component currency in the basket, and the exchange rate of each currency against the SDR. As a result, there also has been a small increase in the rate the IMF pays to creditors (including the United States) for the use of their resources for non-concessional IMF loans.

II. Surveillance Policy Changes

Post Program Monitoring

In July 2016, the Board approved changes to strengthen the IMF's Post Program Monitoring (PPM) framework. PPM promotes ongoing macroeconomic sustainability after the expiration of a country's IMF-supported program and provides an early warning of policies that could jeopardize the IMF's GRA or PRGT resources. Prior to the July reforms, PPM engagement consisted of semi-annual reviews of countries that had completed programs but retained significant liabilities to the IMF (over 100 percent of quota), and were not engaged in a subsequent IMF arrangement or staff-monitored program.

These PPM reviews covered a wide range of issues, but lacked in-depth examinations of risks to a member country's capacity to repay. Further, the quota-based threshold for determining PPM coverage did not reflect the current features of IMF arrangements and quotas — thus posing the risk that the threshold would capture countries posing limited risks. Under these reforms, the Fund is able to direct more surveillance resources and place heightened emphasis on countries that can potentially pose greater risks to IMF resources.

To address these weaknesses, the July reforms established a composite PPM threshold based on two indicators:

1. The absolute size of credit outstanding — a member country is now subject to PPM if outstanding GRA credit exceeds SDR 1.5 billion (\$2.1 billion) or PRGT credit exceeds SDR 380 million (\$526 million)⁵; and
2. A quota-based indicator as a backstop, related to the scale of individual country risk — a member will be subject to PPM if outstanding GRA or PRGT credit exceeds 200 percent of quota.⁶ Two hundred percent of quota is close to the point at which level-based surcharges apply for GRA exposures.

⁵ SDR 380 million corresponds to 10 percent of the end-2015 level of the PRGT reserve balance.

⁶ Countries with blended GRA and PRGT exposure would be subject to PPM if the country meets either of the absolute size criteria, or if their combined GRA plus PRGT exposure exceeds 200 percent of quota.

This reform contributes to a robust PPM system by improving the quality of analysis and targeting countries where significant IMF resources are outstanding. A strong PPM system provides an additional safeguard for U.S. financial commitments, as it monitors the IMF members' policies and economic conditions, with a focus on assessing the country's capacity to repay obligations to the IMF.

The PPM report will be based on a standalone staff visit scheduled between annual Article IV consultations, consistent with the expectation of two IMF engagements in any 12-month period for members subject to PPM.

III. Technical Assistance Policy Changes

At the urging of the OUSED, internal IMF discussions are currently underway to allocate more funding within the IMF's budget towards providing technical assistance to improve Anti-Money Laundering/Countering the Finance of Terrorism (AML/CFT) regulation. However, there have been no formal changes in the IMF's technical assistance policies since December 2015.

We expect an upcoming IMF Board discussion and engagement on the 2017-2018 Capacity Development Review, which encompasses the IMF's technical assistance policies.

IV. Exceptional Access Programs

Under normal access limits, total program financing is limited to no more than 435 percent of quota, and disbursements in any one year may not exceed 145 percent of quota. Financing amounts that exceed normal IMF lending limits are referred to as "exceptional access" programs. See Section I for recent reforms to the IMF's exceptional access lending framework. In the event that a new exceptional access program comes to the IMF Executive Board, Treasury will submit a report to Congress in accordance with section 9004 of the Consolidated Appropriations Act, 2016.

Ukraine is currently the only country with an exceptional access program. While Greece's IMF program expired in January 2016, and is thus included in this report, but the IMF has not made any financial disbursements to Greece since 2014, and Greece's outstanding obligations to the Fund are now below the exceptional access threshold.

(A) Greece

In March 2012, the Board approved a 4-year Extended Fund Facility arrangement for Greece in the amount of SDR 23.8 billion or approximately \$32.9 billion. At the time of program approval, the EFF arrangement amounted to 2,159 percent of Greece's quota.

While the EFF program expired in January 2016, no IMF disbursements under the program had been made since 2014. The last IMF disbursement to Greece followed the Board's completion of the fifth review under the EFF in May 2014, which allowed Greece to receive a disbursement of SDR 3.0 billion (or around \$4.2 billion). This brought total disbursements under Greece's EFF program to SDR 10.2 billion (around \$14.2 billion).

Greece missed payments of about \$2.2 billion in June 2015, which would have prevented Greece from drawing on any IMF resources until the arrears were cleared. However, Greece cleared these arrears to the IMF within three weeks and has since continued to make its IMF payments in full on time. As of end-October 2016, Greece's total exposure to the IMF declined to SDR 10.3 billion (around \$14.3 billion), or roughly 426 percent of Greece's quota, below the exceptional access threshold.

Currently, Greece is under its third European adjustment program, under which the IMF is providing technical advice and analysis, but not financial support. While Europe must continue to provide the bulk of the financial assistance to Greece, the IMF's technical role is critical to the development and implementation of a policy framework that supports economic growth and allows Greece to repay its creditors — including the IMF — and eventually regain access to international capital markets. Beyond technical support, the IMF has made clear that it will not commit additional financing to Greece until it sees a stronger reform effort on the part of Greece as well as meaningful debt relief from Europe premised on a credible fiscal path. Treasury remains closely engaged with the Greek authorities, European institutions and the IMF on Greece's path toward economic recovery.

(B) Ukraine

In March 2015, the IMF Executive Board approved a 4-year EFF arrangement for Ukraine in the amount of SDR 12.35 billion or approximately \$17.1 billion (614 percent of Ukraine's quota). At the time of program approval, the conflict in Eastern Ukraine had taken a significant toll on the industrial base and exports, undermining confidence and putting pressures on the financial system. The program aims to support Ukrainian efforts to stabilize economic conditions, strengthen fiscal sustainability, restore banking system health, reform the energy sector, and strengthen the business investment climate including by tackling corruption. As part of Ukraine's IMF-supported economic program, the government successfully concluded debt restructuring negotiations with private creditors in 2015, including a significant haircut, to put public debt on a sustainable path and enable normalization of Ukraine's relations with its creditors. The IMF Executive Board approved completion of the second review of Ukraine's program in September 2016, which allowed Ukraine to access an additional SDR 716 million, or about \$1 billion.

Ukraine has made significant progress with the support of the IMF program, despite an ongoing conflict in the east with Russian-backed separatists. Notably, Ukraine has: narrowed its general government budget deficit to under the 4 percent of GDP target in its IMF program; dramatically reduced losses from Naftogaz, the state gas company, aided by increases in gas and heating tariffs to cost-recovery levels; made its exchange rate more flexible and stable, following an up-front depreciation, while building up its foreign exchange reserves; improved confidence in the banking system by suspending licenses for weaker banks and requiring more capital for larger banks that need it; and appointed a head anticorruption prosecutor and adopted a new system for public officials to declare their assets and income.

Ukraine will need to continue to implement key aspects of its reform program to avoid slipping back into an economic crisis. The next IMF program review will require that Ukraine adopt a 2017 budget in line with the targets in its IMF program, publish senior official asset declarations and undertake a quarterly energy tariff adjustment. Looking further ahead, Ukraine will need to undertake politically challenging reforms to the pension system and further steps to strengthen the banking sector.

Conclusion

The IMF has taken significant steps over the past year that together aim to safeguard IMF resources and modernize program access and pricing. The IMF made a number of these adjustments, such as changes to surcharges, access and pricing, and the rollback of the NAB, as complements to the implementation of IMF quota reform. Other changes, such as enhancements to the IMF's exceptional access policy and strengthening of post program monitoring, are aimed at promoting sound policies among member countries and thereby safeguarding IMF resources. The IMF's modification of the interest rate structure for concessional lending, which will result in a zero interest rate for at least the next two years, is intended to provide support to low-income countries.