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The IMF's provision of insurance against balance of payments needs and how to improve it

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The IMF's provision of insurance against balance of payments needs and how to improve it

Abstract

This memo summarizes the design and use of the IMF's precautionary facilities since their introduction and discusses lessons and potential reform options.

While playing an important role in the IMF's lending toolkit, prolonged use at high access levels of these facilities has implications for the Fund's lending capacity and risk taking. Due to these issues, the memo concludes that the next review of the IMF's precautionary facilities should:
i) revisit the case for strengthening the price-based incentives guiding how the facilities are used;
ii) consider the value of stronger commitment from authorities to specific exit strategies;
iii) improve transparency in the determination of access levels and consider introducing a cap for all precautionary facilities;
iv) discuss the need to clarify the insurance nature of the facilities; and
v) consider options to improve the complementarity of existing facilities.

Introduction and context

Since the global financial crisis, the precautionary lending facilities of the International Monetary Fund (IMF) have played an important role as part of the Fund's crisis prevention and crisis mitigation toolkit. These facilities can serve as an "insurance"-like line of credit, protecting against potential balance of payments needs and providing rapid financial assistance should risks materialize (see further information in Box 1). Nevertheless, this provision of insurance has been rather limited in scope (few countries), while tying up a significant part of the IMF's lending resources for prolonged periods of time. The purpose of this paper is to discuss possible adjustments to the IMF's precautionary facilities that could allow for more widespread and effective use of these facilities without compromising the IMF's ability to continually meet members' requests for financing in cases of urgent balance of payments needs.

After 10 years of limited uptake, the COVID-19 crisis has brought the precautionary toolkit of the Fund back into the limelight. Since the beginning of the pandemic, two new Flexible Credit Lines (FCLs) were approved, for Chile and Peru, which doubled the number of existing FCL arrangements. In addition, two of the precautionary facility arrangements were recently drawn upon to address actual balance of payments needs. In April 2020, Morocco decided to draw the full amount under its Precautionary and Liquidity Line (PLL). In December 2020, Colombia drew on parts of its FCL, which in September had been augmented to accommodate the worsened outlook. These were the first-ever drawings on the FCL and PLL respectively.

The role of the IMF's precautionary lending

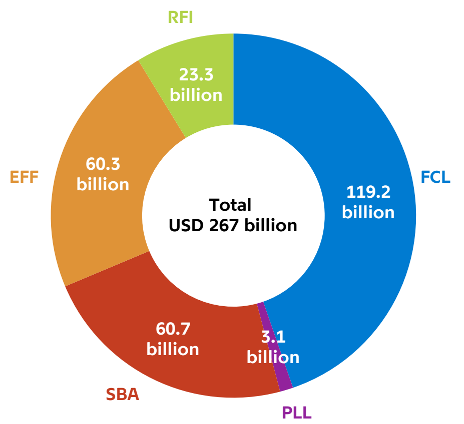
Box 1

The FCL, PLL and SLL are IMF lending facilities aimed at addressing actual or potential balance of payments needs. Contrary to traditional Fund arrangements, these three facilities are only available to IMF members meeting a high qualification bar based on an assessment of their economic fundamentals, institutional policy frameworks, and track-record of and expected future commitment to pursuing strong policies. This high qualification bar unlocks the two particular features of these facilities in relation to traditional Fund lending arrangements, namely i) that the full amount approved can be drawn at any time during the duration of a country's arrangement, and ii) that they have no (FCL, SLL) or very limited (PLL) ex-post conditionality. Up until the COVID-19 pandemic, these facilities had solely been used for precautionary purposes i.e. to protect otherwise strong economies against potential adverse developments. The protection is twofold. First, the facilities can help support market confidence in times of turmoil. Second, if risks were to materialize, the IMF facility in place would be expected to cover the additional financings needs caused by the shock to the economy, thus acting as an insurance policy. In 2020, there have nevertheless been two cases where drawings have been made (Morocco and Colombia). In addition, in the case of Colombia, the drawing on its FCL in December 2020 was made in conjunction with an augmentation of access, constituting the first case where these facilities have been (partly) used to cover an actual balance of payments need and not only for insurance purposes.

The Fund's precautionary lending toolkit consists of the FCL, the PLL and the Short-term Liquidity Line (SLL)[1]. While the FCL was introduced in 2009 in the wake of the global financial crisis (GFC) and the PLL in 2011[2], the SLL[3] is a recent (but long in the making) addition to the toolkit, introduced in April 2020. The common denominator for the facilities is that they are available only to Fund members with strong economic fundamentals, policy frameworks, and a proven and expected future track record of strong policies. So far no country has applied for the SLL. Committed resources from the Fund's precautionary facilities constitute a significant part of the Fund's total lending engagement. As of December 31, 2020, they amounted to USD 122 billion or 46 per cent of total commitments to the IMF's non-concessional lending arrangements[4], cf. Chart 1.

Committed IMF resources by facility

Chart 1



Note: As of December 31, 2020. Exchange rates as of January 4, 2021. Includes lending arrangements under the IMF's General Resource Account. Also includes credit outstanding for countries without active arrangements.
Source: International Monetary Fund.

The Fund's precautionary facilities are reviewed on a regular basis[5] with the latest review concluded in 2017. The review found that "*the FCL had been effective in providing precautionary support against external tail risks and that access levels in successor arrangements were associated with the assessment of external risks and potential balance of payments*

1 Among the other instruments in the IMF's toolkit, the Stand-by Arrangement (SBA) can also be used on a precautionary basis. In this memo, the term precautionary facilities only refers to the FCL, PLL and SLL due to the inherent similarities in their design and intended purposes, as well as being only available to member countries with strong or very strong fundamentals and economic policies.

2 The PLL replaced the Precautionary Credit Line (PCL).

3 Originally named the Short-term Liquidity Swap (SLS) when discussed in 2017. To avoid confusion, the term SLL will be used to cover both versions of the facility throughout the economic memo.

4 Arrangements under the IMF's General Resource Account (GRA).

5 Every 5 years or as needed, as well as when the aggregate outstanding credit and commitments under the FCL and PLL reach SDR 150 billion (USD 217 billion).

needs". The 2017 review also included the first proposal to establish the SLL and a proposal to eliminate the PLL. This was done in order to maintain a streamlined, coherent toolkit, given the low use of the PLL, its overlap with precautionary Stand-by Arrangements (SBAs[6]), and a perceived tiering vis-à-vis the FCL. In the end, the introduction of the SLL was not supported by the necessary majority of the IMF Executive Board[7] at that time. As a result, it was decided to retain the PLL to avoid creating a gap in the Fund's toolkit. The 2017 review also discussed possible reforms of the commitment fee policy which determines the price of having a precautionary facility. The goal of such reforms was to avoid prolonged and unnecessarily large use of the Fund's precautionary facilities and thereby promote a more balanced use of IMF resources. While some chairs on the Executive Board saw merit in strengthened price-based incentives, others argued that the exit of a facility should continue to be state-contingent, i.e. depend on the development of risks. In the end, no changes were made to the commitment fee structure.

The next review is expected to be concluded by 2022, and the main elements will likely address some of the legacy issues of the 2017 review. A stock-taking of the SLL and a discussion of possible reform options are also to be expected, especially if the facility continues to have no or limited uptake. In addition, the fact that the precautionary facilities are now also being used to address actual – and not just potential – balance of payments (BoP) needs warrants attention in the next review in the context of the intended purpose and design of the facilities.

6 The IMF's SBA is available to all member countries and is intended to assist countries in dealing with short-term (actual or potential) balance of payments needs.

7 The IMF Executive Board, composed of 24 Directors elected by the member countries, is responsible for conducting the day-to-day business of the IMF.

Design and use of the Fund's precautionary facilities[8]

Fund members with very strong economic fundamentals and policy track records can request an FCL arrangement when faced with potential or actual balance of payments pressures. This flexible line of credit can be used at any time during the duration of the arrangement to address BoP needs or be treated as a precautionary instrument. The PLL plays a similar role for countries with sound economic fundamentals and polices that due to some remaining vulnerabilities do not live up to the high qualification criteria of the FCL. While there is no pre-defined limit on access under the FCL[9], total access under the 1-to-2-year PLL is restricted cumulatively to 500 per cent of a member's quota[10] in the IMF and subject to an annual access limit of 250 per cent of the quota.[11] The PLL is also subject to focused ex-post conditionality[12] to ensure that the identified vulnerabilities are addressed, which the FCL is not.

Prolonged use of the Fund's precautionary facilities for a limited number of countries

Since its introduction in 2009, the FCL has seen prolonged uptake at very high access levels compared to other IMF lending facilities, but from a very limited number of countries, cf. Charts 1-2. The duration of an FCL is set at 1 or 2 years, although a country can apply for an immediate successor FCL.

To date, only five countries have applied for the FCL. Three of these (Mexico, Colombia, and Poland) were continuously renewed since first being taken up in 2009, although Poland did fully exit from its FCL in 2017. In May 2020, FCLs for Chile and Peru were

8 See the Annex for a full comparison of the facilities.

9 FCL access was limited to 1,000 per cent of quotas until 2010.

10 IMF quotas broadly reflect an individual member's relative position in the global economy. Quotas serve multiple functions in the governance and financing structure of the IMF, including to determine a member's access to Fund lending resources.

11 The PLL is subject to increased scrutiny under the Fund's Exceptional Access Criterion if access is to exceed 145 (annually) and 435 (cumulatively) per cent of quotas.

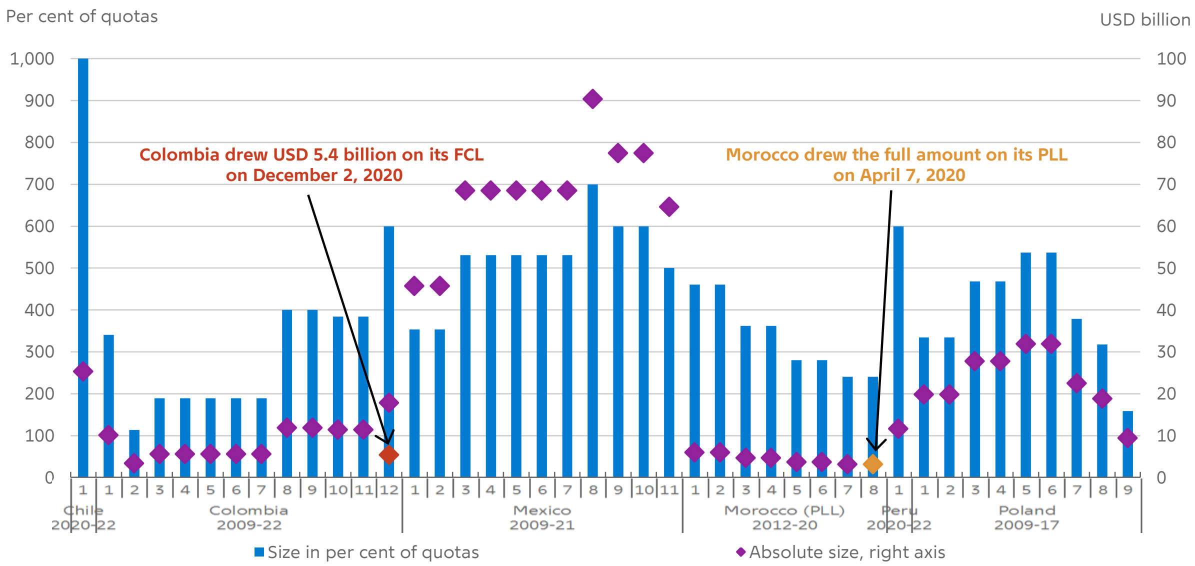
12 Conditionality is the term used to describe the conditions under which a country is granted access to IMF lending. Typically, these conditions include commitments from country authorities to undertake macroeconomic adjustment and implement structural reforms deemed necessary to overcome a country's BoP needs.

approved, both of which were in the upper range of past FCLs in terms of share of quotas, but smaller in absolute size than Mexico's FCL.

"insurance" against potential further BoP needs as before making a drawing and has de facto "refilled" its access under FCL.

Size (in per cent of quotas and USD) and duration (in years) of FCL and PLL arrangements

Chart 2



Note: As of December 31, 2020. For current FCL arrangements, duration count ends in 2020 although the arrangements are expected to continue for at least 1-2 years.
Source: International Monetary Fund and own calculations.

On April 7, 2020, Morocco drew the full amount of USD 3.1 billion under its PLL to deal with the repercussions of the COVID-19 pandemic, thereby effectively ending its PLL arrangement. On December 2, 2020, Colombia drew USD 5.4 billion on its FCL to deal with actual BoP needs. This was the first-ever draw on an FCL. Before this, Colombia had requested an augmentation of access under its FCL to USD 17.8 billion (from USD 11.3 billion) which was approved by the Executive Board in September 2020. In both the Moroccan and Colombian cases, IMF staff assessed the drawings to be fully justified by the actual BoP needs faced by the countries. The Colombian augmentation and subsequent drawing on the FCL were nevertheless unusual. After the drawing, the remaining access is close to the pre-augmentation access level, which is expected to be treated as precautionary. In this way Colombia maintains approximately the same level of

When considering prolonged use of the FCL and PLL, one central issue to consider from a borrower's perspective is the value of maintaining access relative to the costs of doing so. The precautionary facilities provide insurance against actual or potential BoP difficulties and can serve as a backstop in case of external shocks. In addition, the precautionary use of the facilities can help improve investor confidence and potentially bring down a user's total financing costs. IMF studies in 2011 and 2014 (as part of FCL reviews) showed that initial FCL uptake was associated with a relative drop in country-specific Emerging Markets Bond Index (EMBI) spreads[13], a proxy for international foreign exchange denominated funding costs, as well as a decline in exchange rate volatility. Some non-IMF studies have found the effects to be somewhat more muted and

[13] EMBI spreads measure the premium paid on an emerging market bond over a comparable U.S. government bond across a number of sovereign instruments.

difficult to separate from other developments. Essers and Ide (2017) use a counterfactual approach to assessing the longer-term effects of the FCL on EMBI spreads and gross capital inflows, and find some limited beneficial effects. Fernández-Arias and Levy-Yeyati (2012) find that while central bank swaps with the Federal Reserve exerted a benign (and moderately persistent) influence on EMBI spreads, the effect of the FCL was more muted and much less persistent.

While attractive pricing could be one reason for prolonged access, there may also be distinct challenges to reducing access and eventual exit. Once a large precautionary facility is in place, the country might face some potential adverse market reactions if choosing to lower its access level and exit the arrangement. This does not seem to be a generalized concern, however. In the 2017 review, IMF staff analyses showed that reductions in access did not appear to be associated with adverse market reactions. At the time of announcement, no negative impact was observed in yields, spreads, or yield volatility – a result supported by regression analysis of the EMBI spread. In this respect, clear and transparent communication seems to be an important part of any exit strategy. Poland's final exit from the FCL in 2017 was highlighted as a successful case where authorities had made thorough outreach to market participants explaining the reasons for exiting the FCL.

A new short-term liquidity line

On April 15, 2020, the Executive Board supported the creation of the SLL for a period of 7 years, with an expectation that, by end-2025, the Executive Board will decide whether to extend the facility beyond the 7-year period. The SLL was created to serve a special role in the Fund's toolkit, i.e. to assist members facing potential moderate short-term BoP difficulties resulting from volatility in international capital markets. While the SLL has the same qualification criteria as the FCL, access is restricted to 145 per cent of quotas and approved only on a 12-month basis. Specific only to the SLL, any funds drawn can be used on a revolving basis (i.e. paid back and reborrowed within the timeframe of the arrangement). Other main features include a "no exit" expectation (as long as countries manage to requalify), a special fee structure, an approval process where the Fund extends an "offer" instead of members formally applying for an arrangement, and the option for sole central bank signatory[14].

While the SLL and the FCL are designed to address different types of BoP needs, they could, according to IMF staff, play a complementary role in the Fund's toolkit. For members looking to access a precautionary Fund arrangement, IMF staff envisages that the SLL would provide support against moderate, short-term liquidity shocks, while the FCL could be the Exceptional Access counterpart for use as a temporary backstop against extreme shocks/tail events. At the time of the Board approval, staff estimated that potential commitments under the SLL could amount to about USD 58 billion[15]. As mentioned, no country has so far opted for the SLL.

Implications for the IMF's lending capacity and risk-taking

Large precautionary arrangements are challenging, especially when use is repeated/prolonged, as they tie up a significant share of the Fund's finite resources. This thus contravenes the notion of Fund resources being "revolving" in nature, i.e. available to all members according to need. A rapid scale-up in demand for FCLs could also be challenging for the resource adequacy of the IMF. The Fund's Forward Commitment Capacity (FCC), a measure of the resources readily available for new financial commitments, stood at USD 222 billion end-December 2020, and is solely based on the IMF's quota resources. As a merely illustrative scenario, assuming that all staff's envisaged users of the SLL

[14] For all other Fund financing arrangements, the government and central bank need to co-sign the memorandum of understanding on the arrangement.

[15] Assuming SLLs for all qualifying members that do not have active swap agreements with the Federal Reserve.

instead were to apply for an FCL, potential new commitments would amount to USD 200-400 billion[16]. To meet this potential demand, an activation of the IMF's borrowed resources[17] would be necessary, since available quota resources are currently insufficient to meet such resource demands. In this hypothetical scenario, total precautionary arrangements could tie up over half of the Fund's USD 1 trillion total lending capacity.

Precautionary arrangements also force the Fund to maintain access to a high degree of liquidity to meet the potential large calls under the facilities. In practice, the cost of this falls on members deemed strong enough to participate in the IMF's financial transactions[18], who could potentially forgo investment returns by a need to hold a high degree of more liquid (e.g. dollar or euro) assets in their reserves.

A further challenge related to repeated programs is how to handle an applicant with gradually but mildly deteriorating policy performance and fundamentals over time. This includes the risk of adverse market reactions related to external communication on eligibility.

Geographic concentration of precautionary arrangements should also be taken into account in the Fund's risk management. Counting also existing SBAs, over 60 per cent of the Fund's committed resources are currently concentrated in Latin America. Due to economic interconnectedness and, i.a., reliance on commodity prices, Latin American countries are to some extent vulnerable to many of the same shocks, making simultaneous drawings on the FCLs more likely. In addition, many Latin American countries have been severely hit by the COVID-19 pandemic. The Fund is also exposed to potential reputational risks from tying a large share of its resources to a specific region and possibly being unable to provide a similar share of members from other regions with the same financing options, should they ask for them.

16 Assuming access levels in the range of 500-1,000 per cent of quotas.

17 The IMF's borrowed resources consist of a multilateral lending arrangement, the New Arrangements to Borrow (NAB), and temporary bilateral borrowing agreements with member countries (BBAs). See further information in Mortensen (2021).

18 These countries are specified in the IMF's Financial Transactions Plan.

Lessons learned and reform options

A number of chairs on the IMF Executive Board have cautioned in subsequent reviews against repeat use of large precautionary arrangements, as this, i.a., ties up a large share of the Fund's resources. In doing so they have, e.g., called for clearer exit strategies when using the precautionary facilities, more transparency in the determination of access levels, and the introduction of higher commitment fees. Developments in 2020 have underscored the importance of reconsidering these issues in the planned 2022 review.

Another issue to consider is how to address the generally limited uptake of the precautionary facilities given their important role in boosting confidence, protecting against BoP needs, and reducing country incentives to build excessive foreign exchange reserves. In this respect, the perceived stigma of approaching the Fund for financial assistance is a recurring theme. There might be scope for the Fund to more actively analyze and communicate the effects of the facilities as well as the Fund's lending role in general.

Strengthened price-based incentives

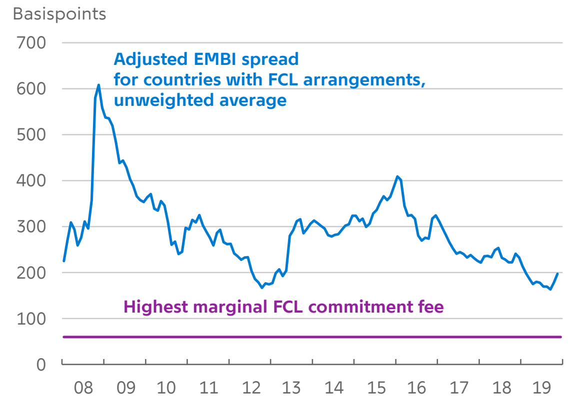
The direct financial cost of using a precautionary facility is the actual price which is made up of a commitment fee[19], service charge[20], and lending rate. For precautionary use, the commitment fee is the relevant cost to consider.

19 The commitment fee is the annual price a country pays for accessing IMF funds on a precautionary basis and is intended to cover the cost of establishing and monitoring arrangements, for setting aside resources, and to discourage unnecessarily high precautionary access. The fee is paid on the full amount that can be drawn during a 12-month period but is refunded when the country makes an actual drawing on the arrangement during the relevant period.

20 The service charge is the price of each drawing. It is meant to generate income to the Fund to cover administrative costs and discourage unnecessary purchases. A service charge of 50 basis points is applied on each amount drawn.

The direct alternatives to the Fund's precautionary facilities are self-insurance by building reserves and contingent credit from other multinational and regional institutions. The 2017 review found that the costs of the Fund's precautionary facilities were generally low compared to other contingent credit. In addition, the costs of precautionary facilities were substantially lower than the estimated costs of accumulating reserves. Using EMBI spreads as a broad proxy for external funding costs, the FCL stands out as a cheap alternative to insure against potential BoP needs, cf. Chart 3. This indicates an apparent price incentive for using the FCL.[21]

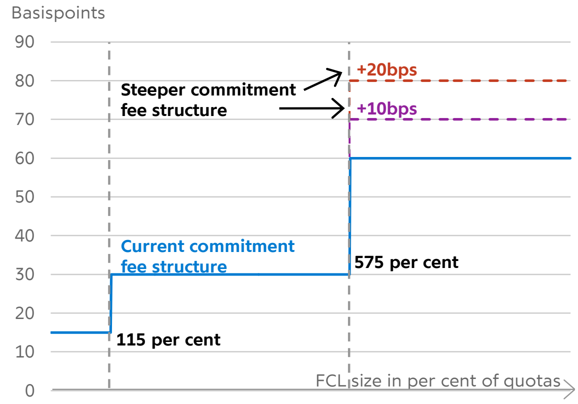
FCLs are priced significantly below external bond market funding costs Chart 3



Note: EMBI spreads measure the premium paid on an emerging market bond over a comparable U.S. government bond across a number of sovereign instruments. The EMBI spread is adjusted by adding the spread between 5 year Treasury bonds and the average of 2-year treasury bonds and 3-month treasury bills to account for the lower maturity of reserve portfolios. A similar measure was used by the IMF in its 2017 review to compare commitment fees with the cost of accumulating reserves.
Source: Macrobond and own calculations.

As part of the 2017 review, two proposals were considered in order to strengthen the price-based incentives against prolonged and large use of precautionary facilities: i) a steeper commitment fee curve, and ii) introducing a time-based commitment fee. The current commitment fee structure[22] is upward-sloping but could be made steeper, possibly by increasing the fee at exceptionally high levels of access, cf. Chart 4, thereby discouraging excessively large programs more than is currently the case. Such a structure would be transparent and relatively simple to implement. Drawbacks include that the changes would apply to all GRA arrangements, not be state-contingent, and fail to target prolonged use specifically.

A more expensive large-access FCL Chart 4



Note: Currently the commitment fee increases with the level of access available (15bps for committed amounts up to 115 per cent of quotas, 30bps for amounts between 115-575 per cent, and 60bps for amounts exceeding 575 per cent of quotas).
Source: International Monetary Fund and own illustrations.

Introducing a time-based commitment fee[23] would be a way to directly address prolonged use. Here, an additional fee (e.g. 15 bps) would be put on an arrangement once the level of undrawn credit has remained above a specified threshold (e.g. 575 per cent of quotas which also triggers the highest marginal fee in the current commitment fee structure) for a defined time period (the so-called duration trigger, e.g. 4 years), cf. Chart 5. The amount of undrawn credit above the specified threshold would remain subject to the additional fee until the level of undrawn credit falls below the threshold either as a result of a purchase under the arrangement or a reduction of the overall access. The

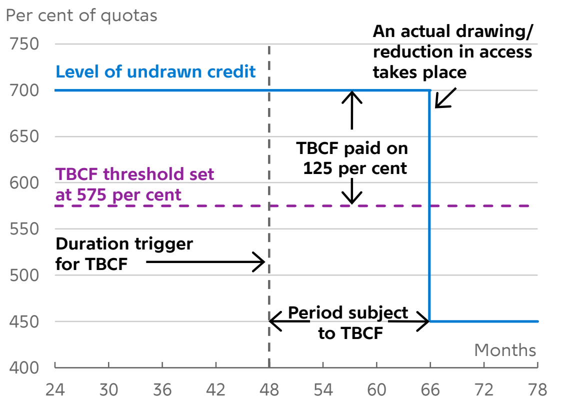
21 A direct comparison can be difficult due to volatility in the costs of market borrowing, and the fact that commitment fee costs related to e.g., the FCL are partially offset by the commitment fee being refundable when drawing on the arrangement. Among the more immeasurable costs is the potential perceived stigma of relying on Fund assistance.

22 Implemented in 2009 when the FCL was established.

23 Since the SLL has no exit expectation, the time-based commitment fee was not intended for the SLL.

time-based commitment fee would not be state-contingent, but would provide an incentive for the country to address outstanding vulnerabilities early on.

Conceptual illustration of a time-based commitment fee (TBCF) Chart 5



Note: In this example, the TBCF threshold is set at 575 per cent of quotas, and the level of undrawn credit is initially 700 per cent. When the duration trigger is met (after 48 months in this example), the amount of undrawn credit exceeding the TBCF threshold (700-575 = 125 per cent of quotas) is subject to an extra fee. When the level of undrawn credit falls below the threshold (in this example after 66 months), the TBCF is no longer accrued.
Source: International Monetary Fund and own illustrations.

During the 2017 review, some chairs on the Executive Board saw merit in both options as a means to address large and prolonged use of the precautionary facilities although no consensus was reached at the conclusion of the review.

Clearer exit strategies

On exit strategies, many chairs in the Executive Board have called for authorities to communicate explicit exit expectations when requesting an FCL. To address this, IMF staff updated its FCL guidance note in 2015 to highlight specific expectations for exit discussions in staff reports dealing with FCLs, including the nature of external risks. Authorities' own language on exit expectations still allows for a high degree of state contingency and can by and large be interpreted as intentions to treat the facility on a precautionary basis with expected exit once external risks subside. Based on experiences so far, there seems to be scope for making clearer commitments to a timely exit. It can be noted that 2-year FCL arrangements include an annual review to assess continued qualification which might be a suitable occasion to reconsider access levels and communicate exit expectations. Another option would be to use the SLL as part of an FCL exit strategy. This was indeed envisioned as a possible feature when the SLL was established (discussed further below).

More transparent determination of access levels

The determination of the appropriate size of FCLs remains an issue that warrants more transparency and structure. Currently, IMF staff use a country-specific External Economic Stress Index (ESI)[24] to identify the potential financing gap in an adverse scenario. This financing gap has generally been equal or very close to the requested size of the precautionary arrangement. Without presenting alternative adverse scenarios, the proposed size seems somewhat arbitrary, especially since country authorities likely play a large role in determining the access level. (Re)introducing a cap on the FCL, of e.g., 1,000 per cent of quotas, could possibly also facilitate a more balanced and empirically founded size of FCLs. While there is a risk that such a cap could lead to a "race to the top" where arrangements converge at the cap, it could be mitigated through higher commitment fees as discussed above and a more transparent determination of access levels.

Reinforcing the precautionary nature of the FCL

Colombia's recent "refilling" of its remaining access under the FCL has raised questions about the intended purpose of the facility and potential flaws in its design. The current FCL framework does allow for "refilling" access and it has always been clear that an FCL could be drawn upon, should the need arise. However, wider non-precautionary use including the practice of increasing access and (more or less) simultaneously drawing on that increase (or immediately drawing on a first approval) carries

[24] The index is calculated based on a set of proxy variables that capture external risks for a given country. In the 2017 review, Executive Directors generally called for a strengthening of the implementation of the ESI with the aim of enhancing the comparability of external risks across countries.

potential risks which should be carefully analyzed in the upcoming review. Risks include, i.a., ambiguous signaling to market participants, both as regards the intended purpose of the instrument and the underlying strength of the country's economy and policies. In addition, wider use of such a practice could provide even stronger incentives for prolonged and large use. It could also lead to a potential lack of evenhandedness in the treatment of FCL users if some are allowed to use this practice while others are not. Here, a more transparent and empirical determination of access levels would be crucial to ensure evenhanded treatment.

Until the Colombian drawing, the FCL had been squarely used to provide insurance against potential BoP needs, i.e. as a primarily precautionary instrument. Whether or not the Colombian case of augmenting and drawing will serve as a precedent for future use of the FCL and thus change its "nature" is yet unclear, but it would be beneficial for the upcoming review to discuss at least two aspects in this regard.

First, the review should consider whether there is a need to change or clarify the requirements for using the FCL in order to underpin its primarily precautionary nature. This could imply considering design changes to clarify that upon approval (or augmentation), the intention is for the program to be treated as precautionary. Additionally or alternatively, stricter qualification criteria, such as a requirement that the country does not have actual BoP needs (at the time of approval or increase in access), could be considered. A softer approach could involve stricter scrutiny of the qualification criteria when the FCL applicant is facing an actual BoP need, including a need to revisit the staff guidance note on this matter. Such design changes would ensure that the insurance element in the FCL is made more explicit. This could in turn facilitate transition to other lending instruments after an actual BoP need has materialized, and a drawing on the FCL arrangement has been made. The benefits of such tightening of access or explicit expected use of the FCL should be weighed against potential drawbacks in the form of lower flexibility and the risk of negative market signaling if a country were to no longer qualify.

Second, the review should discuss whether introducing a steeper commitment fee structure and/or making it time-based (as mentioned above) could help emphasize the primarily precautionary nature of the FCL. In addition, consideration could also be given to making the FCL commitment fee non-refundable (as is the case with the SLL). This may be difficult to implement and would affect all FCL arrangements; however, it could be argued that the FCL in the case of simultaneous drawing/augmentation is to some extent used "in a revolving manner" – which was the main rationale for making the commitment fee under the SLL non-refundable.

Third, a cap on the FCL would limit the size of "refillings" and indirectly the number of times a country can make use of such practice.

Improving the complementarity of the SLL

As mentioned, contrary to IMF staff's expectations, the SLL has so far seen no use despite the huge economic turmoil brought by the pandemic. One reason could be that its access limit is considered inadequate by potential users. Uncertainty about how the market will assess the use of the SLL and the lack of a "first mover" is another possible explanation. In addition, there may be lingering stigma issues linked to the uptake of Fund credit lines in some parts of the membership.

A somewhat higher level of access under the SLL could increase its attractiveness to potential borrowers, and could also, as mentioned above, be a way to facilitate use of the SLL as part of an FCL exit strategy. The latter perspective has been brought up by some chairs on the Executive Board during discussions of FCL arrangements. Potential risks of increasing access under the SLL would have to be considered, taking into account the revolving nature of the instrument, where actual drawings could in principle take place more frequently, and the "no exit" expectation from the SLL. Increasing the SLL access limit to, e.g., 250 per cent of quotas would align it with the current annual access limit under the PLL, and would make it close to the 245 per cent annual access limit under all GRA arrangements (before triggering the IMF's Exceptional Access criteria), though the latter is a temporary increase valid until April 2021.

As for the PLL, a central issue to consider is whether the facility is still needed. In the 2017 review, most chairs on the IMF Executive Board supported eliminating the PLL if the SLL was to be established. This was expected to only leave a small gap in the Fund's toolkit which could to some extent be filled by using precautionary SBAs instead. When the SLL did not gain the necessary majority, it was decided to retain the PLL. Since then, the situation has clearly changed. The SLL has been established and the case for eliminating the PLL should be reevaluated in the 2022 review. The case would be further strengthened if access limits to the SLL were to be increased.

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Annex 1

The IMF's precautionary toolkit

Table 1

	Short-term Liquidity Line	Flexible Credit Line	Precautionary and Liquidity Line
Objective	Provide "swap-like" liquidity support to very strong members for special BoP needs	Allow very strong members to deal with any type of BoP needs	To flexibly meet the liquidity needs of member countries with sound economic fundamentals
BoP need	Potential moderate short-term BoP difficulties reflected in pressure on the capital account and the member's reserves resulting from volatility in international capital markets	Any, potential or actual	
Qualification	Based on an assessment of: Very strong fundamentals and institutional policy frameworks Very strong policies: in the past, currently, and commitment to maintaining them		Similar qualification process to that of the FCL but with a lower bar: countries with sound policies and economic fundamentals but with some remaining vulnerabilities that preclude them from using the FCL (and SLL).
Repurchase period	12 months	31/4-5 years	
Duration	12 months	1 or 2 years	6 months or 1-2 years
Access and phasing	Up to 145 per cent of quotas; revolving access: the full amount can be drawn upfront and used repeatedly when outstanding amounts have been repaid within the 12-month duration.	No access limit The full approved access is available upfront	6-month PLL: 125 per cent of quotas (a higher limit of 250 per cent is possible if the country faces an actual or potential larger BoP need) 1-2-year PLL: maximum access equal to 250 per cent of quotas for the first year and 500 per cent for the entire arrangement. The amount approved for the second year can be brought forward to the first year. PLLs with amounts exceeding 145 per cent annually and 435 cumulatively are subject to the Fund's Exceptional Access Policy

The IMF's precautionary toolkit (continued)

	Short-term Liquidity Line	Flexible Credit Line	Precautionary and Liquidity Line
Charges and fees	A special fee structure would apply: Non-refundable commitment fee (8bps) Service charge (21bps) Normal rate of charge Normal schedule for level-based surcharges.	The usual charges and fees that apply to GRA credit tranches: Normal schedule for commitment fees that are refundable on drawings (15bps up to 115 per cent of quotas, 30bps from 115 to 575 per cent of quotas, and 60bps above 575) Normal service charge (50bps) Normal rate of charge Normal surcharge schedule	
Activation	Board approves the "extension of an offer", and the arrangement enters into effect upon the Fund confirming receipt of the signed written communication from the member, including the acceptance of the "offer" and policy commitments; no prior informal Board meeting required	Upon Board approval of the request for the arrangement; prior informal Board meeting required	
Signatory	Given the more limited anticipated adjustment (if needed), sole central bank signatory of the written communication is possible in certain cases	Both the central bank and the government generally sign the written communication given the broad nature of the BoP needs	
Ex-post conditionality	None		Focused ex-post conditionality aimed at addressing the remaining vulnerabilities identified during the assessment of qualification
Reviews	None	Annual review to assess qualification for 2-year arrangements	1- or 2-year PLLs are monitored through 6-months reviews by the Executive Board to assess to which extent the program remains on track
Successor arrangements	No restrictions, upon Board assessment of continued qualification and existence of special potential BoP need	Exit expected as global risk declines	1-2-year PLL: Exit expected as global risk declines 6-month PLL: Successor PLL allowed after a cooling-off period of 12 months or if the original BoP need is larger than originally envisioned – one additional 6-month PLL arrangement may be approved under these circumstances

Source: International Monetary Fund.

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