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IMF POLICY PAPER

July 2016

STRENGTHENING THE FRAMEWORK FOR POST PROGRAM MONITORING

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 June 6, 2016 for the Executive Board's consideration on July 1, 2016.
- A **Press Release** summarizing the views of the Executive Board as expressed during its July 1, 2016 consideration of the staff report.

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Strengthening the Framework for Post Program Monitoring

On July 1, 2016 the Executive Board of the International Monetary Fund (IMF) discussed the IMF's policy on Post Program Monitoring (PPM), based on a staff report Strengthening the Framework for Post Program Monitoring.

PPM provides a framework for closer engagement with members that have substantial outstanding Fund credit, and are no longer in a program relationship. It involves monitoring of members' circumstances and policies, focusing on their capacity to repay the Fund. PPM is intended to provide an early warning of policies that could jeopardize the resources of the IMF's General Resources Account (GRA) or Poverty Reduction and Growth Trust (PRGT).

Under the current policy, members that are no longer in a program relationship are expected to engage with the Fund on PPM if total credit outstanding exceeds 100 percent of quota. If warranted, IMF management may also initiate or extend PPM for members where total credit is below this threshold, and terminate PPM early even if credit exceeds the threshold. Two PPM discussions are expected each year, one coinciding with the Article IV consultation and the second during a short staff visit.

The share of Fund credit accounted for by members, subject to PPM has increased in recent years. As of end-2015, members accounting for over 40 percent of credit outstanding under the GRA were subject to PPM, whereas under 5 percent of PRGT credit was subject to PPM.

Executive Board Assessment

Executive Directors welcomed the opportunity to discuss proposals to improve the Fund's framework for post-program monitoring (PPM). They considered PPM to be an important element of the Fund's safeguards framework. Through closer engagement with members that have substantial outstanding credit to the Fund but are no longer in a program relationship, PPM enhances the Fund's ability to detect risks to the member's repayment capacity and thus safeguard the Fund's resources. Directors noted that the sizeable expansion of Fund credit in recent years has made it all the more important to ensure that the PPM framework remains robust. At the same time, they recognized the challenge of striking the right balance between different—and sometimes conflicting—objectives, including between strengthening and streamlining efforts, and between flexibility and evenhanded treatment.

Against this backdrop, Directors supported moving toward a more risk-based and focused PPM framework. They agreed that PPM reports should examine in depth the full range of risks to members' capacity to repay, and that the analysis should be tailored to members' specific circumstances. Directors welcomed the range of innovative techniques and indicators used in the analysis and monitoring of risks, while stressing the desirability of maintaining a clear distinction, in terms of both content and modalities, between PPM and other forms of Fund engagement, be it lending or surveillance.

Directors saw merit in establishing absolute-size thresholds to help ensure adequate monitoring of large exposures to the Fund's resources. They found it reasonable to calibrate such thresholds relative to the Fund's loss-absorption capacity, and to use as a proxy the minimum floor of precautionary balances for credit outstanding from the General Resources Account (GRA), and the reserve balance for credit outstanding from the Poverty Reduction and Growth Trust (PRGT). Directors supported, or could support, setting the absolute-size thresholds at SDR 1.5 billion for GRA credit, and at SDR 0.38 billion for PRGT credit. Some Directors considered that a lower threshold for GRA exposures would have provided a better safeguard to Fund resources.

Directors agreed that the quota-based threshold should be retained as a backstop. They supported, or could support, raising the threshold to 200 percent of quota, close to the point at which level-based surcharges apply for GRA exposures. Some Directors would have preferred a lower level, noting that small and medium-sized economies could benefit from enhanced engagement with the Fund, or should be able to opt in voluntarily.

Directors agreed that the policy should be implemented in a flexible and streamlined manner, while ensuring the strongest safeguards to Fund resources. They agreed to reduce the frequency of PPM to once in any 12-month period, based on a mission scheduled between annual Article IV consultations, which would also help differentiate the two reports. That notwithstanding, Directors took note of the requirement that Article IV consultations, inter alia, assess balance of payments stability and risks. While a number of Directors were willing to go along with a presumption that all standalone PPM reports would be considered on a lapse-of-time (LOT) basis, most Directors had reservations and emphasized the importance of the Board exercising its fiduciary duty to oversee risks to the Fund's resources. In this context, a few Directors saw value in applying the absolute-size thresholds as a trigger for formal Board consideration of PPM reports. In light of these considerations, Directors agreed to retain the current risk-based approach to the usage of LOT procedures, whereby it would be possible for the Board to conclude PPM consideration on an LOT basis if no major issues have arisen.

June 6, 2016

STRENGTHENING THE FRAMEWORK FOR POST PROGRAM MONITORING

EXECUTIVE SUMMARY

Post-Program Monitoring (PPM) is an important part of the Fund's safeguards architecture. It provides a framework for closer engagement with members that have substantial outstanding Fund credit but are no longer in a program relationship, and helps identify risks and provide advice on policies that will assist these members in repaying the Fund. The significant expansion in Fund credit since the global financial crisis, much of it through medium-term financing of members with high access levels, puts a premium on this form of monitoring.

The design and implementation of the current policy can be strengthened. PPM reports usually cover a wide range of issues, but sometimes lack an in-depth examination of risks to the member's capacity to repay. Furthermore, the current quota-based threshold for determining an expectation of PPM has not kept pace with the rising size of Fund arrangements, and may capture members posing limited risks, while potentially excluding others whose credit is large relative to the Fund's balance sheets.

Staff therefore proposes moving towards a more risk-based and focused PPM framework. PPM reports should provide comprehensive and detailed analysis of risks to capacity to repay. To better align the PPM threshold with risks to the Fund's balance sheet and that of the PRGT trust, staff proposes adopting a composite PPM threshold based on two indicators, one capturing the absolute size of credit outstanding and the second, a quota-based indicator, proxying the scale of individual country risk.

The rebalancing would help ensure effective monitoring of large exposures and those of PRGT-eligible countries, while maintaining coverage of a significant share of the Fund's balance sheet. The share of the Fund's credit exposure covered by PPM would be largely unchanged by the new thresholds compared with the 2010-15 period. More users of PRGT credit would likely be covered, although there would also likely be some reduction in coverage of small and medium-sized economies.

The policy should also be implemented in a flexible and more streamlined manner. While staff believes the proposed new thresholds will better align coverage with risks to the Fund's balance sheets, it will be important to implement the policy with flexibility to ensure that the key risks are covered. Staff also proposes reducing the frequency for PPM to annual, and introducing a presumption that all PPM discussions will be concluded on a lapse of time basis.

Approved By
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Prepared by staff team from the Strategy, Policy, and Review department in consultation with other departments. The team was led by Gavin Gray, and comprised Zsofia Arvai, Christiane Kneer, Gabor Pula, and Vivian Parlak, under the overall guidance of Alfred Kammer.

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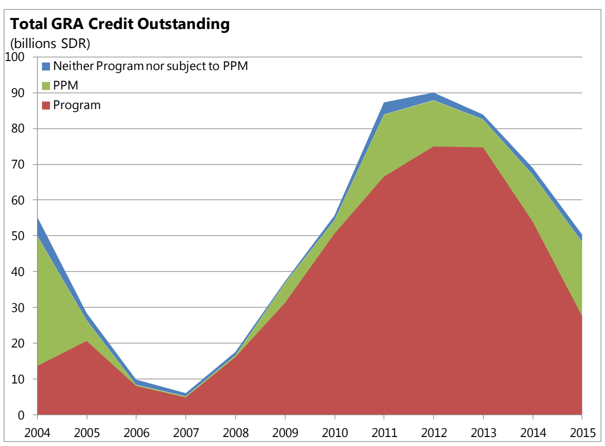
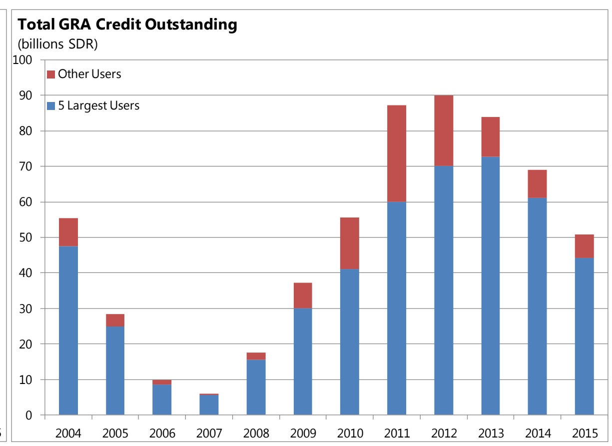
INTRODUCTION

1. **Post-Program Monitoring (PPM) aims to safeguard the Fund's resources through closer monitoring of the circumstances and policies of members with substantial outstanding credit from the Fund.**[1,2] By assessing a member's capacity to repay the Fund, PPM is intended to provide an early warning of policies that could ultimately jeopardize General Resources Account (GRA) or Poverty Reduction and Growth Trust (PRGT) resources. The policy was designed to focus on members that might pose risks to the Fund's balance sheet (including the PRGT)[3] either because of the magnitude of credit outstanding, or the scale of risks facing the member.[4]

2. **PPM has important features that can support the safeguards objective against a backdrop where substantial credit will remain outstanding for years to come.** It involves closer monitoring of the members' macroeconomic and structural policies, focusing on a concept—capacity to repay—that is critical for safeguards. More intensive engagement[5] helps the Fund detect problems, bring them to the attention of the authorities, and encourage them to undertake policy measures to address vulnerabilities. The incidence of arrears has declined since the advent of PPM. Publication of PPM reports can enhance the impact of this work by stimulating measures to strengthen policies, and hence members' capacity to repay the Fund. These features could be beneficial given that Fund credit has expanded sharply since the global financial crisis, it is highly concentrated in a small number of members, and much of it via extended arrangements (with longer repurchase periods); at present members accounting for over 40 percent of credit outstanding under the GRA are subject to PPM.





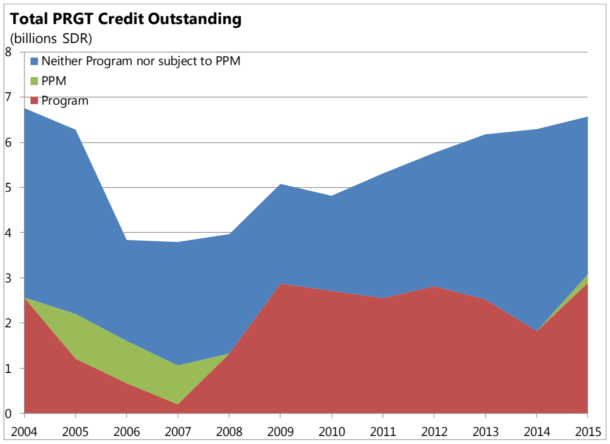
[1] Currently, PPM is governed by Decision No. 13454-(05/26) as amended, and interpreted in the Guidance Note on the Implementation of Post-Program Monitoring.

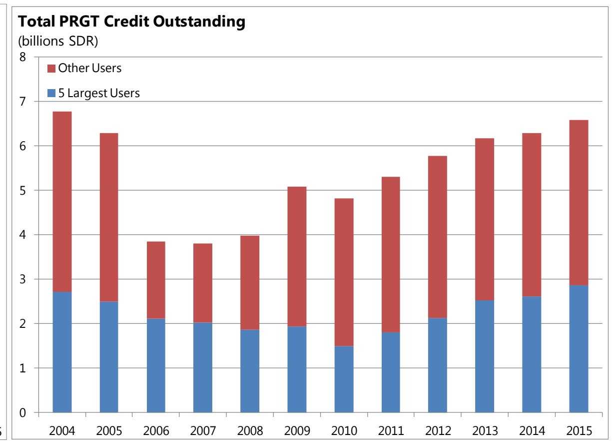
[2] The term "safeguarding Fund resources" applies both to GRA and PRGT resources throughout the paper.

[3] In this paper, references to the Fund's balance sheets encompass both GRA and the PRGT Trust.

[4] "Since resource constraints would preclude a universal application of intensive post-program monitoring, the staff would suggest that the emphasis should be on (a) countries with relatively high outstanding use of Fund resources; and (b) countries where the risks appear highest that the member could encounter difficulties in repaying the Fund" http://www.imf.org/external/np/pdr/roff/2000/eng/fc/#V.

[5] Under current policy, two PPM discussions are expected each year, one coinciding with the Article IV consultation and the second during a short staff visit.





3. **However, the benefits have not been systematically realized.** First, although the overall goal of the policy is clear, there has been variability in the focus of reports: while some are well targeted at the risks and policies that influence capacity to repay, others are less well focused. Second, the current quota-based threshold that triggers an expectation of PPM is out of sync with the rising size of Fund arrangements, and may capture countries posing limited risks to the Fund's balance sheet while potentially excluding others even if credit is large in absolute terms.[6, 7] Third, some of the practical modalities of the policy are cumbersome.

4. **This paper examines the design and implementation of the PPM framework, and suggests steps to strengthen it.[8]** To improve the quality of risk assessments, staff proposes steps to refocus and deepen PPM staff reports. In particular, recent improvements in the Fund's risk analysis should be incorporated into PPM reports, and play a greater role in assessing members' capacity to repay. Also, staff proposes to add a new threshold capturing exposure risk to help ensure that the largest risks to the Fund's balance sheet are covered by PPM, while increasing the quota-based threshold. Moreover, to use resources more effectively, staff suggests setting the standard frequency for PPM as annual, as well as establishing a presumption that all standalone PPM

[6] The overall structure of the Fund's policy on PPM has changed little since the crisis, and is based around an expectation of PPM for members with outstanding credit from the Fund exceeding a threshold expressed in terms of the credit/quota ratio, but no Fund arrangement or staff-monitored program. The threshold was set at 200 percent in 2009 (See GRA Lending Toolkit and Conditionality—Reform Proposals) and revised to 100 percent of quota in the context of the Review of Access Limits and Surcharge Policies as a transitional measure to take into account the impact of the 14th General Review of Quotas.

[7] Management has flexibility to initiate or extend PPM for members where credit is below the threshold, and to terminate PPM early in cases when credit exceeds the threshold.

[8] It builds on staff proposals to update the policy in the context of the 2016-18 budget discussions (see "Selected Proposals Under the FY16-FY18 Medium-Term Budget—Implementation Issues,") The proposals presented in April 2015 recommended increasing the threshold for activating PPM from 200 to 500 percent of old (i.e. pre-14th general review) quota for GRA cases, and to 250 percent of old quota for members with outstanding credit from the PRGT. Most Directors agreed with the principle of aligning PPM more closely with financial risks to the Fund by raising the thresholds. However, a significant minority cautioned that the proposals could weaken countries' incentives to press ahead with essential reforms and undermine the exercise of the Board's fiduciary responsibility, and management therefore withdrew the proposal to reflect further on the issue.

discussions will be completed on a lapse of time (LOT) basis*.

Post Program Monitoring: Proposed Design Changes

Issue	Current Policy	Proposed Change
Threshold (GRA)	100 percent of quota	PPM expected if credit outstanding exceeds either SDR1.5 billion or 200 percent of quota
Threshold (PRGT)	100 percent of quota	PPM expected if credit outstanding exceeds either SDR380 million or 200 percent of quota
Threshold (GRA and PRGT)	100 percent of quota	PPM expected if credit outstanding to GRA exceeds SDR1.5 billion, PRGT credit exceeds SDR380 million, or total Fund credit exceeds 200 percent of quota
Frequency	Normally two PPM discussions per year	Normally one PPM per year, with enhanced scrutiny of risks in the Article IV consultation.
Lapse of time	Possible "if no major issues had arisen"	Presumption of LOT for all standalone PPMs

5. **The remainder of the paper is organized as follows.** The next section discusses steps to refocus and deepen PPM reports to ensure they address the full range of risks to capacity to repay. It is followed by an outline of proposals for Board approval to: (i) introduce a new indicator capturing large exposure risks to the balance sheets of the GRA or PRGT Trust, and (ii) retain the quota-based threshold for triggering an expectation of PPM, but increase its level. The paper concludes with proposals to streamline the implementation of the policy.

ADAPTING CONTENT OF PPM REPORTS TO IMPROVE RISK ASSESSMENT

6. **Currently, many PPM reports, whether combined with an Article IV consultation[9] or stand-alone, do not go beyond the standard risk assessment expected of surveillance cases.** Under current guidelines, PPM discussions are expected to cover the member's policies, the consistency of the proposed macroeconomic framework with the objective of medium-term external viability, and the implications for the member's capacity to repay the Fund. In practice, standalone PPM reports often cover a similar range of issues to Article IV reports and sometimes lack an in-depth examination of risks to the member's capacity to repay the Fund, although there are exceptions (see Box 1). Staff reports for combined Article IV/PPM discussions tend to provide only very brief coverage of issues specific to the member's capacity to repay the Fund.

* The proposal concerning lapse of time completion of PPM discussions was not endorsed by the Executive Board, and was withdrawn by management.

[9] In this paper, the terms Article IV and Article IV consultation are used interchangeably.

7. Focusing PPM reports around the *economics* of capacity to repay would better differentiate PPM from other forms of monitoring and engagement. This would involve developing (i) a realistic baseline and analyzing the path of the indicators that are most relevant to capacity to repay, (ii) assessing in depth how capacity to repay would be affected if risks materialized, and (iii) spelling out the implications for policy choices and trade-offs for the member.[10] Staff's capacity to conduct such analysis depends on access to data pertinent to the key areas affecting capacity to repay. Consistent with these broad goals, the content of PPM reports should be tailored to country circumstances. In many countries, this would involve focusing in the baseline on the near-term path for reserves and the fiscal balance. In other cases—particularly high debt cases—debt sustainability indicators will be critical inputs for the report. In all cases, the assessment should be tailored to the key risks to capacity to repay, and where vulnerabilities are particularly high, PPM could have informal targets, a feature of Staff Monitored Programs.[11]

8. PPM reports should examine the full range of risks to the member's capacity to repay. Members subject to PPM, in particular, can have heightened vulnerabilities as a crisis legacy, which puts a premium on inward spillover analysis. The global financial crisis demonstrated that a wide range of risks can quickly morph into a threat to a country's fiscal or external position: e.g., financial sector vulnerabilities may turn into contingent claims on the sovereign and eventually end up on its balance sheet. Therefore, risk analysis in PPM reports should normally be comprehensive and go beyond the short capacity to repay section currently found in reports.

9. Deepening the analysis in PPM reports would help strengthen the Fund's understanding of risks to its balance sheet. There is scope for staff to innovate in the range of techniques applied to PPM, drawing on work applied in surveillance.[12] Alternative quantified scenarios would be particularly useful in cases where one or a combination of risks could have a material impact on the economic outlook,[13] as they would shed light on the transmission channels and impact of shocks, and potential policy trade-offs.[14]

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[10] This would help differentiate PPM from Article IV staff reports or analytical tools used in the Fund's internal risk management.

[11] As an example, Latvia's PPM included higher-frequency projections for variables influencing whether the authorities would meet the Maastricht criteria for Euro adoption (which was the exit strategy for the program). The authorities met the criteria in 2012, adopted the Euro in early 2014, and were also able to make early repurchases of their entire credit from the Fund.

[12] See Staff background study on risks and spillovers.

[13] See Box 6. "Techniques for Risk and Spillover Analysis" in the 2015 "Guidance Note for Surveillance under Article IV Consultations."

[14] Including a Risk Assessment Matrix (RAM) in standalone PPM reports would help focus attention on risks relevant to the member's capacity to repay the Fund.

Box 1. Examples of Quantitative Risk and Spillover Assessment in PPM Reports

Among PPM reports prepared in 2014-15, the combined Article IV and first PPM report for Moldova (http://www.imf.org/external/pubs/ft/scr/2014/cr14190.pdf) and the third PPM report for Sri Lanka (http://www.imf.org/external/pubs/ft/scr/2015/cr15335.pdf) contain deeper quantitative analyses of risks.

The Moldova report analyzes spillover risks from trade, remittances and financial linkages with trading partners. The effect of shocks to the growth rate of trading partners on Moldova's GDP, exports, the real exchange rate and personal transfers are quantified using impulse response functions of structural VARs. This is complemented by an application of the vulnerability exercise for low- income countries (VELIC)[1] as a tool for identifying emerging risks and vulnerabilities in LICs. The analysis motivates advice to strengthen external and fiscal buffers and greater trade diversification.

The Sri Lanka report analyzes an adverse balance of payment scenario. In line with the risks identified by staff, the scenario models the effect of a decrease in capital inflows of a magnitude witnessed during past crises under minimal policy adjustment. It shows that a shock of this type could significantly reduce international reserves.

[1] Vulnerability Exercise for Low-Income Countries (see https://www.imf.org/external/np/pp/eng/2011/030911.pdf)

RE-ALIGNING PPM THRESHOLDS WITH RISKS TO THE FUND'S BALANCE SHEET

10. **Under the current policy, PPM engagement is expected for members with outstanding credit above 100 percent of quota that have neither a Fund arrangement nor a staff-monitored program.**[15] The current threshold has been set as a transitional arrangement in the context of the recent access limits reform to adjust the PPM policy to the quota increases under the 14th General Review of Quotas, and pending Executive Board consideration of the current PPM reform proposals. The PPM threshold was last increased in 2009,[16] while access to Fund financing has increased, reflecting elevated balance of payments needs since the global financial crisis.[17] This has led to an increase in the potential number of members subject to PPM, even though some of them have low absolute levels of credit outstanding and may pose limited risks to the Fund's balance sheet.[18]

[15] The Fund does not normally initiate PPM if a new program is expected within six months.

[16] In February 2016 the threshold was revised from 200 to 100 percent of quota to take into account the impact of the aggregate doubling of quotas arising from the 14th General Quota Review.

[17] Three main factors are behind the increase in average access to Fund financing: the scale of the global financial crisis, stronger interconnectedness and regional developments (see 2014 Review of Access Limits and Surcharges Policies). Meanwhile, considerable time has elapsed since the previous quota increase—the previous general increase was in 1999, and so access limits (in SDR terms) have been eroded relative to the size of individual economies.

[18] At end-2014, eight members were subject to PPM, two with substantial credit outstanding in terms of quota and absolute terms (SDR 34.8 billion—or 15 percent of total quota resources), i.e., Portugal (SDR 22.9 billion, 2,228 percent of pre-14th review quotas) and Ireland (SDR 11.8 billion, 940 percent of quota)—and another six posing

(continued)

11. Staff sees scope to better align thresholds with risks to the Fund's balance sheet. Credit risk to the Fund's balance sheet can stem from the magnitude of credit outstanding (*exposure risk*) and the level of risk associated with an individual member (*individual country repayment risk*). The Fund needs to set an overall level of risk tolerance in its post-program monitoring, and decide on the relative importance of these two dimensions of risk. While the current policy, based on credit/quota, is weighted towards the second aspect, exposure risk is inherent in the Fund's lending which, in the case of GRA, is cyclical and highly concentrated. Following a period of intensive program engagement in the wake of the global financial crisis, a substantial share of Fund credit is with members that no longer have a program relationship. Therefore, staff proposes rebalancing the policy by taking greater account of exposure risk, and considers that redesigning the thresholds would be desirable to avoid the need for extensive reliance on the flexibility provision of the policy.

12. A redesign of the thresholds should take into account a number of broader principles. An overarching principle, which is a requirement for all Fund policies, is the need to ensure uniformity of treatment (i.e. treating members in similar circumstances similarly). To the extent possible, PPM thresholds should be aligned with other risk management thresholds. To ensure effective engagement with members subject to PPM, thresholds should be transparent and predictable so that country authorities understand why they are subject to PPM.

13. Reflecting these considerations and to help ensure that PPM also covers members posing material risks to the Fund's balance sheets, staff proposes to move to a composite PPM threshold based on *two* indicators. Members would be expected to be subject to PPM if their credit outstanding to the Fund exceeds either of two thresholds:

- *Absolute-size threshold*: to capture risks to the Fund's overall balance sheet from exposures that are large in absolute terms (even if they are not large relative to the member's quota), staff proposes introducing an indicator based on the absolute amount of credit outstanding. It should be calibrated based on a measure of the *Fund*'s overall balance sheet, and the staff sees measures of the Fund's loss-absorption capacity as the most helpful concept in that regard (See Box 2).

- *Quota-based threshold*: this indicator is simple, widely understood and central to the Fund's lending framework, and has been a feature of PPM since the outset. Staff proposes that this indicator be retained, as it represents a proxy for the individual member's capacity to repay—but the level increased. It could help ensure the enhanced monitoring of small- and medium sized economies, which individually might be small if hit by correlated shocks, could collectively pose a sizeable credit risk to the Fund.

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smaller exposures in absolute terms to the Fund's balance sheet (only SDR 1.3 billion at end-2014), i.e., Sri Lanka (SDR 861 million, 208 percent of quota), Moldova (SDR 365 million, 296 percent of quota), Iceland (SDR 237 million, 201 percent of quota), Former Yugoslav Republic of Macedonia (SDR 123 million, 179 percent of quota), Antigua and Barbuda (SDR 51.5 million, 381 percent of quota), and St. Kitts and Nevis (SDR 34 million, 377 percent of quota).

14. A rebalancing of the policy along these lines could have implications for the Fund's engagement with those members—particularly smaller and medium-sized economies—with credit outstanding but below the proposed new thresholds. Some such members have faced enduring vulnerabilities and policy challenges after their Fund supported programs ended, and have benefited from the Fund's continued advice via PPM. If, notwithstanding their size, they pose material risks to the Fund's balance sheet, then management can under the existing policy recommend activation of the PPM (see Modalities section below). Where the risks to the Fund's balance sheet are not pronounced enough to warrant PPM, the Fund can engage, for instance through focused staff visits and Article IVs, to advise them on policies to address residual vulnerabilities—as the Fund does for other members with vulnerabilities but no credit outstanding.

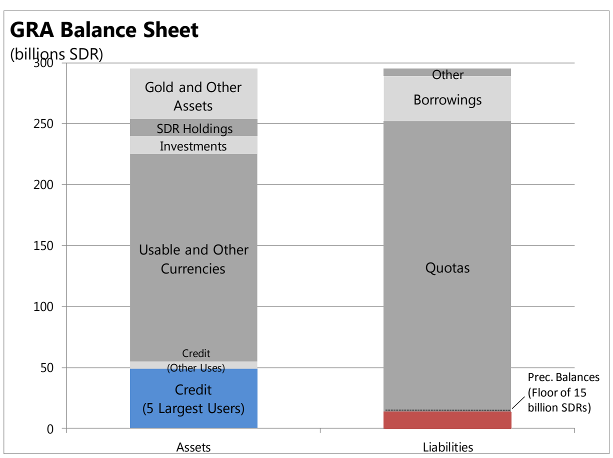
15. Thresholds for monitoring credit outstanding from the GRA and PRGT should be aligned to the risks they pose to each balance sheet. The current policy is based on a uniform threshold for all outstanding credit from the Fund from both GRA and PRGT. In practice, members with credit from the PRGT countries have rarely been subject to the PPM, and therefore risks to the PRGT are rarely directly monitored once a country is outside a program relationship. Different absolute-size thresholds for PRGT and GRA credit outstanding are required to ensure adequate monitoring of risks to the PRGT, and procedures should be developed for members with outstanding credit from both PRGT and GRA (see below).

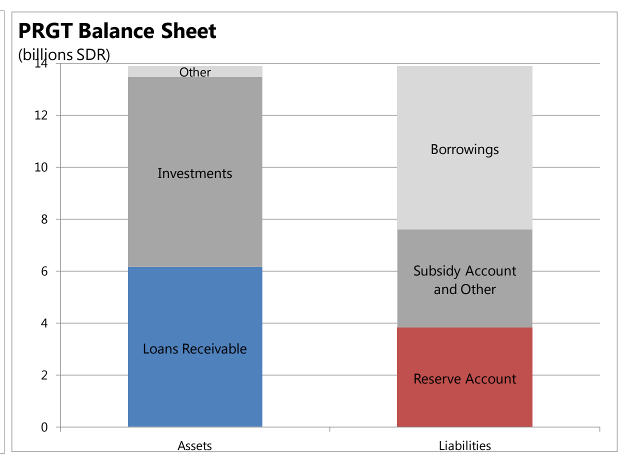
Box 2. Balance Sheet Concepts

To inform thinking on the design of the new absolute-size threshold, staff has examined indicators of risks to the Fund's balance sheet that are sufficiently predictable and transparent to inform the design of a Fund policy. Possible indicators include:

- **Credit relative to loss-absorption capacity.** A threshold calibrated based on the Fund's capacity to absorb losses would have some similarities to large exposure limits in the context of bank regulation, which aim to contain the losses banks face in the event of borrower default. The capital base against which potential losses are measured should consist of capital that can absorb sudden and unexpected losses. The Fund maintains precautionary balances to absorb losses in case a country falls into arrears or other financial risks materialize.[1] Staff thus sees precautionary balances rather than quota resources as the best benchmark to measure the loss absorption capacity of the Fund (See figure below). While precautionary balances vary over time, the minimum floor is currently set at SDR 15 billion, and is a lower bound for the Fund's capacity to absorb losses arising from arrears. Similarly, the PRGT's reserve account (see below) represents resources that would be called upon to meet the PRGT's obligations to its creditors if a borrower were to run arrears.[2] The reserve account is projected to increase over the next two decades in line with investment returns, while the end-2015 balance of SDR 3.8 billion represents a reasonable assumption for a floor on the account's size in coming years.

- **Credit concentration**. Although the Fund should monitor the distribution of its portfolio—to understand large exposures to individual members and concentrations by region or type of countries—this is a less useful indicator of the risk of a member being unable to repay the Fund, given that the amount of Fund credit outstanding varies over time.





[1] IMF Policy Paper "Review of the Adequacy of the Fund's Precautionary Balances"

[2] IMF Policy Paper "Update on the Financing of the Fund's Concessional Assistance and Debt Relief to Low Income Countries"

Credit Outstanding from GRA only

16. For members with credit outstanding from the GRA only, staff proposes using the floor on precautionary balances to inform the calibration of the absolute-size threshold. Precautionary balances are the first line of defense against risks to the Fund's balance sheet from members in arrears to the Fund, and thus represent a concept close to equity. While precautionary balances vary over time, they are expected to exceed the minimum floor on precautionary balances (MFPB), which was set at SDR 15 billion in early 2016. Staff considers individual credits exceeding 10 percent of the MFPB as warranting more intensified monitoring.[19] For operational reasons, however, it is preferable to express the absolute size threshold in fixed nominal amounts, and staff thus proposes that a member would be expected to be subject to PPM if its outstanding GRA credit exceeds SDR 1.5 billion.[20]

17. Staff considers that resetting the quota-based threshold at 200 percent of quota—which is close to the threshold for level-based surcharges—would, in conjunction with the proposed new absolute-sized threshold, help ensure adequate coverage of risks to the Fund's balance sheet arising from individual members' repayment risks. It would provide a backstop by covering cases where credit/quota is high but credit is below the absolute size threshold. This would, in particular, help safeguard the Fund against systemic shocks that might simultaneously affect a number of small and medium-sized economies, with a potentially sizeable aggregate impact on the Fund's balance sheet. A quota-based threshold at this level would be well below the exceptional access stock threshold under the GRA, yet somewhat about the threshold for level-based surcharges—another element of the Fund's risk management architecture, which apply to high levels of access, (i.e. on outstanding credit above 187.5 percent of quota), and were established to provide price incentives to help moderate large use of Fund resources by members, and to protect the Fund against credit risk by accumulating precautionary balances. Thus, setting the quota-based threshold at this level would be consistent with the principles outlined above (¶11) namely being well aligned with the existing risk management framework, transparent and predictable. In practice, in recent years, this threshold would rarely have been necessary, if the absolute size threshold would have also been applied, because many members with Fund credit outstanding would have been captured by the absolute size threshold.

18. The introduction of the composite PPM thresholds is expected to reduce the number of members subject to PPM, while preserving the coverage of credit outstanding at current levels (see text table). The staff proposal, had it been applied in 2010–15, would have reduced the number of members subject to PPM by around a third. It would imply that more than 90 percent of the Fund's credit outstanding would be represented by members either under Fund-supported

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[19] This ratio corresponds to critical values broadly used to determine large exposures of bank portfolios: the Basel core principles define large exposures at 10 percent of banks' eligible capital (see Basel Committee on Banking Supervision on Supervisory framework for measuring and controlling large exposures).

[20] See the Modalities section for a discussion of the proposed review cycle.

programs or subject to PPM, and thus the large risks to the Fund's balance sheet would continue to be covered.

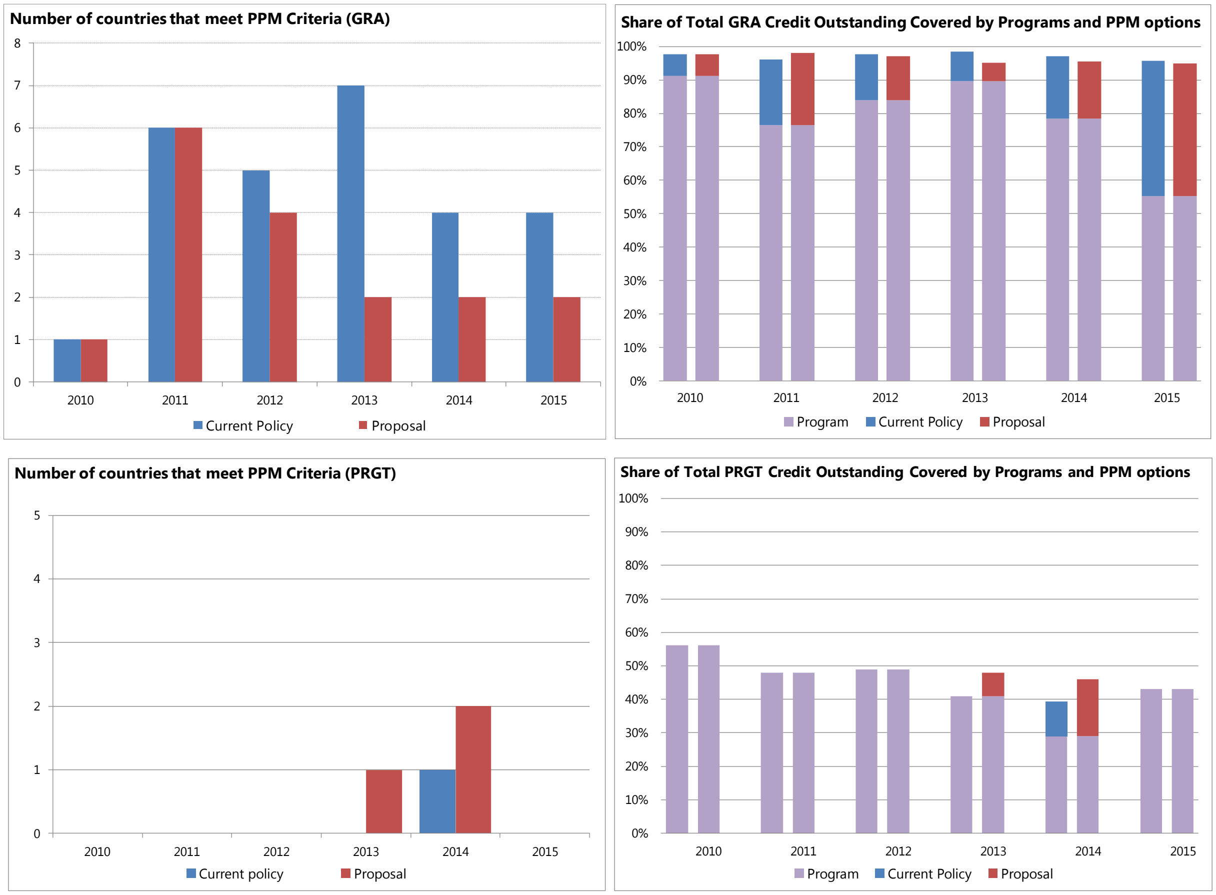
Number of Countries and Outstanding Credit Covered by Alternative PPM Thresholds (2010-15) [1]	Current	Proposed
PPM Composite Threshold		
Quota-based (in percent) [2/]	100	200
Absolute size (in SDR billion)	n/a	1.5
Number of countries under PPM per year	4.0	2.6
Share of total Fund GRA credit covered by PPM (average, in percent)	17.4	16.8

[1] The figures were calculated in terms of old quota relative to a 200 percent of quota threshold.

[2] Credit outstanding in percent of quota.

19. Staff's proposal would lead to some reduction in the number of smaller and medium-sized economies subject to PPM. A number of countries entering PPM over the past three years had credit outstanding that was below both SDR 1.5 billion, and (relative to quota) lower than the proposed new threshold of 200 percent of quota. Management can still recommend PPM for such members, insofar as they pose risks to the Fund's balance sheet, and in other cases Article IVs and staff visits can focus on policies to address residual vulnerabilities and help the authorities repay the Fund.

Figure 1. Number of Countries and Outstanding Credit Covered by Alternative PPM Thresholds, 2010–15[1]



[1] The charts indicate a mechanical calculation by the threshold rule. Consequently the number of countries and outstanding credit covered by PPM under the 200 percent of quota benchmark could deviate from the actual numbers, which were affected by flexibility around the rule and delays in PPMs.

Credit Outstanding from PRGT Resources Only

20. **Members with outstanding credit from the PRGT are rarely captured by the current PPM trigger threshold.** In recent years, no country supported exclusively by the PRGT has been subject to PPM upon program completion. Since 2010, only one country had outstanding PRGT credit above the current threshold of 100 percent of quota after the expiration of a Fund arrangement, and only one member is currently projected to have PRGT credit above the 100 percent threshold in the medium run under existing program arrangements (see Appendix I, Figures 1 and 2). The 100 percent threshold rarely captures PRGT borrowers because their outstanding credit to quota tends to be smaller. The frequency of successor arrangements is another reason that such members tend not to be subject to PPM.

21. Similar to the treatment of GRA credit, staff proposes using a composite threshold indicator to determine whether members with outstanding credit from the PRGT should be subject to PPM. As a trustee, the Fund has a responsibility to safeguard PRGT resources and to reduce the risk that arrears impair the Trust's ability to support LICs. Consistent with the proposal for members with credit from the GRA, staff proposes that PPM would be expected for countries with outstanding credit from the PRGT in excess of SDR 0.38 billion, which corresponds to 10 percent of the end-2015 level of the PRGT reserve balance (see Box 2). This would help ensure that exposures that are large relative to the Trust's loss absorption capacity are monitored.

22. As a backstop, a quota-based trigger criterion should be retained. This additional criterion is desirable to capture countries whose outstanding credit is small relative to the size of the reserve account but large relative to the size of their economies, which could be suggestive of weaker capacity to repay. Some increase in the quota-based threshold seems appropriate in light of the 50 percent increase in the cumulative PRGT access limit approved in July 2015, and staff therefore proposes modifying the quota-based threshold to 200 percent of quota, i.e., the same level as for GRA cases.

23. The introduction of a composite threshold would likely lead to an increase in the number of PRGT countries subject to PPM compared with the current policy. Based on the recent past, the proposed absolute-size threshold of SDR 0.38 billion would have subjected a modest number of countries with the largest exposures to the PRGT; had the proposed new thresholds been applied in the past, the number of countries subject to PPM would have increased to one in 2013 and to two in 2014 (as opposed to one based on the 100 percent of quota threshold). While the absolute-size threshold is likely to be the only relevant trigger for PPM in the immediate future, the quota-based threshold could become relevant if more members take advantage of the new access limits.

Outstanding Credit from the GRA and the PRGT

24. A similar overall approach and principles should be applied to determine thresholds for members that simultaneously have outstanding credit from both GRA and the PRGT. This is a small group of countries at present, with limited obligations towards the Fund. However, it may increase as some PRGT-eligible countries are currently presumed to blend concessional and non-concessional financing (with a presumed contribution of GRA resources twice as large as the contribution of the PRGT), and any PRGT-eligible member may seek blended support.

25. To assess whether absolute-size thresholds are met, staff proposes that credit outstanding from the GRA and PRGT be examined separately relative to the corresponding thresholds. A member would be expected to engage in PPM if either its exposure to the GRA exceeds SDR 1.5 billion, or its exposure to the PRGT exceeds SDR 0.38 billion. The rationale for such an approach is that these represent liabilities to different balance sheets, each with their own loss absorption capacity. Management could take the size of total credit into account in deciding whether to exercise flexibility.

26. By contrast, individual country repayment risk should be assessed based on total outstanding Fund credit. Under the current policy, PPM engagement of countries receiving a mix of funds is assessed based on the sum of its outstanding credit from the GRA and the PRGT as a percentage of quota. This measure should be retained since a country's capacity to repay the Fund depends on its *total* credit outstanding. Staff thus proposes that the GRA threshold—200 percent of quota—be the reference point for comparing total credit (GRA plus PRGT) to determine whether PPM would be expected.

MODALITIES: A FLEXIBLE, MORE STREAMLINED APPROACH

27. Implementing the policy flexibly based on a thorough analysis of risk is essential for its effectiveness. The policy already gives management the flexibility to recommend to the Executive Board that PPM be initiated or extended in cases where the member's outstanding credit from the Fund is at or below 100 percent of quota, or terminated early even if credit exceeds 100 percent of quota. While staff believes that the proposed new thresholds would better align the expectation of PPM with risks to the Fund's balance sheet, management's flexibility should be exercised where warranted, based on a staff proposal, drawing on systematic analysis of the risks to capacity to repay, so as to ensure evenhanded treatment. For instance, Staff might conclude based on thorough analysis that there are cases where PPM could be discontinued even if credit outstanding exceeds the relevant threshold— perhaps because circumstances have improved or the country has demonstrated a long track record of implementing reforms to address risks. But there could also be countries that warrant continued close monitoring because risks remain high even when their Fund credit falls below the applicable PPM threshold—for instance, because of continuing large liabilities to bilateral donors and official creditors.[21] The PPM guidance note will be revised to indicate how the flexibility might be carried out in practice, including the steps that staff would undertake to assess risks.

28. Staff also proposes modifying the frequency of PPM Board consideration from twice to once in any 12 month period, as this would help differentiate PPM from the Article IV consultation. The proposed policy changes would preserve the current expectation of two engagements in any 12 month period for members subject to PPM, and the standalone PPM would be based on a separate staff visit scheduled between annual Article IV consultations, and presented

[21] The managing director may propose PPM even though outstanding credit is below the applicable thresholds if there are developments in the member's capacity to repay the Fund that suggest the need for continued monitoring and in particular where developments call into question the member's progress towards external viability.

in a standalone staff report.[22] For members subject to PPM, the Article IV would also be expected to feature an enhanced assessment of risks.

29. Staff proposes that the Executive Board endorses the proposals for changes in the PPM policy so as to (i) better focus the scope of the PPM on member's capacity to repay the Fund, (ii) replace the 100 percent of quota credit outstanding threshold triggering the expectation of the PPM engagement with the composite thresholds, and (iii) change the frequency of PPMs discussions to normally once every twelve months, as described above.

30. Staff also proposes to establish a presumption of lapse of time consideration by the Executive Board of all standalone PPM reports[*]. The current criteria for LOT procedures for PPM reports are broad, with only a general reference that LOT consideration is possible "if no major issues had arisen." [23] Instituting a presumption of LOT for all PPMs would simplify and clarify procedures and free up Board time. The Managing Director would retain the right to call a Board discussion where warranted by the risks. Moreover, any Executive Director may object to a proposal for LOT consideration of a standalone PPM report.

IMPLEMENTATION ISSUES

31. To ensure effective implementation of these proposals, it is proposed that the new policy would come into effect three months after its adoption by the Executive Board. This would give staff time to develop guidance and explain the new procedures. For all members with credit outstanding to the Fund the revised policy will apply three months after the date of adoption of the proposed decision—unless on the date of adoption of this decision the member's credit outstanding is below 100 percent of quota, in which case the proposed thresholds would not be applied for the purposes of triggering an expectation of PPM.[24] The Managing Director will put forward recommendations to the Board concerning members currently subject to PPM or members expected to engage in PPM on the basis of the new policy, specifying whether management recommends a continuation or initiation of PPM (see Table 1). Staff proposes that the policy be reviewed in conjunction with the next Review of Access Policy, envisaged in 2021, although the review could be brought forward if needed.

[22] Members subject to PPM will likely not fulfil the conditions that would permit an extended Article IV consultation cycle.

[*] The proposal concerning lapse of time completion of PPM discussions was not endorsed by the Executive Board, and was withdrawn by management.

[23] The current approach for proposing LOT consideration of PPMs was established in the Summing Up by the Acting Chairman, Review of Fund Facilities—Proposed Decisions and Implementation Guidelines, and is further articulated in the Guidance Note on Implementation of Post-Program Monitoring.

[24] This provision will grandfather one member, Bangladesh, whose outstanding credit is below 100 percent of quota, but above the applicable absolute-size threshold.

Table 1. Selected Countries Subject to PPM or with Credit Exceeding Proposed new PPM Threshholds, end 2015

	Credit Outstanding (in SDR m)	Credit/Quota (in percent)	Notes
Currently subject to PPM [1]			
Portugal	16,363	794.3	
Ireland	3,773	109.4	
Jordan	1,332	388.2	Program negotiations underway
Cyprus	693	228.1	
Sri Lanka	500	86.3	New Fund arrangement approved
Moldova	336	194.6	
Antigua and Barbuda	38	189.8	
Other countries			
Greece	12,718	523.6	EFF cancelled January 15, 2016
Cote d'Ivoire	778	119.6	New Fund arrangement requested
Bangladesh	653	61.3	PPM not initiated at end of 2012-2015 ECF

[1] Comprises all members for which a decision has been adopted to initiate PPM.

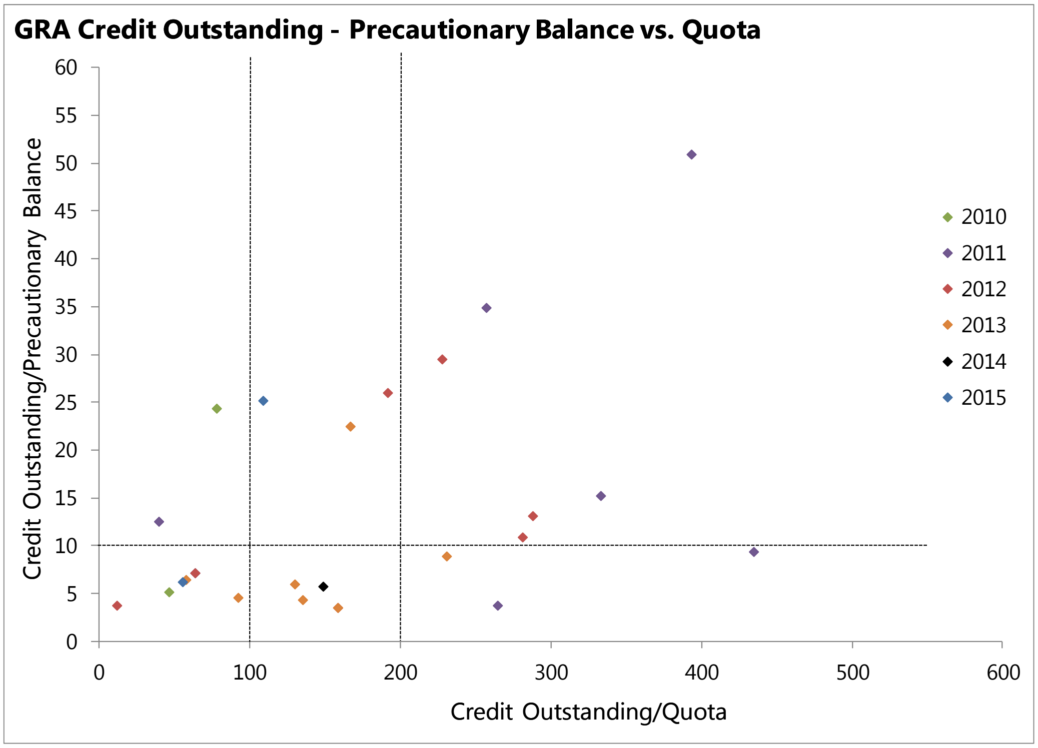
A. Questions for Directors

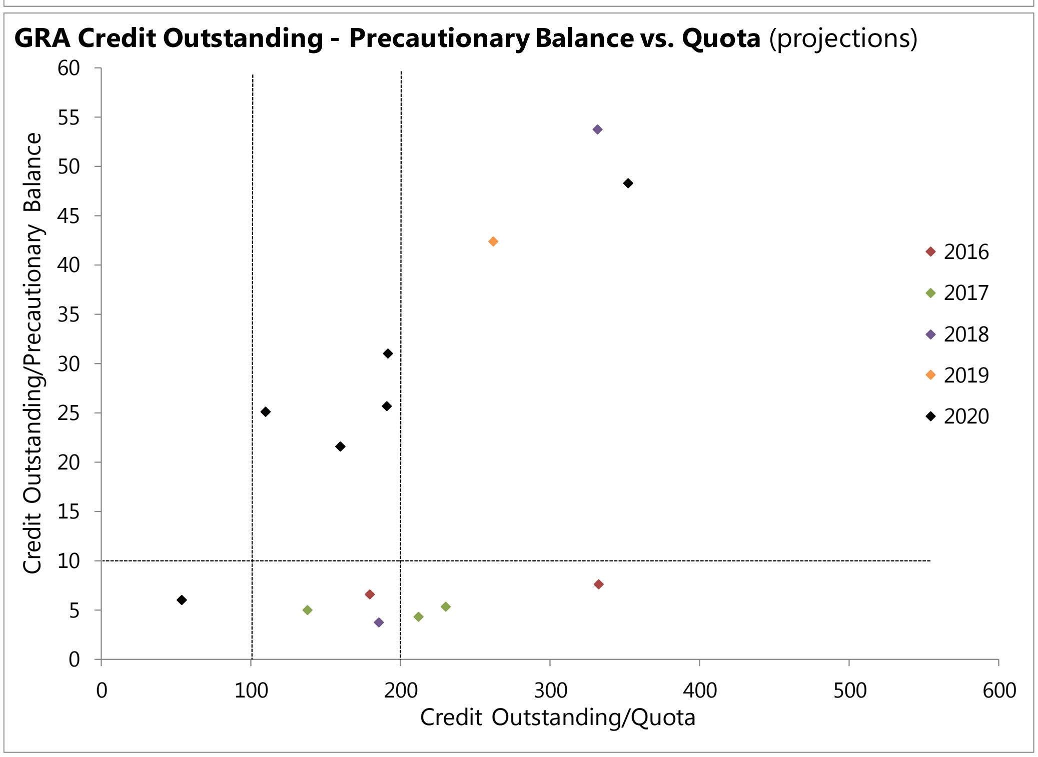
We would welcome Directors' views on the following questions:

- Do Directors agree that PPM discussions should be refocused on risks to members' capacity to repay the Fund, and the risk assessment should be broadened and strengthened?
- Do Directors support staff's proposals to introduce a new balance-sheet related threshold for determining an expectation of PPM, and to retain the quota-based threshold while increasing its level?
- Do Directors agree that the frequency for PPM should be once every twelve months, and that lapse of time consideration should be the presumption for standalone PPMs?

Appendix I. Outstanding Credit

Figure 1: Selected Countries. GRA Credit Outstanding





which level-based surcharges apply for GRA exposures. Some Directors would have preferred a lower level, noting that small and medium-sized economies could benefit from enhanced engagement with the Fund, or should be able to opt in voluntarily.

Directors agreed that the policy should be implemented in a flexible and streamlined manner, while ensuring the strongest safeguards to Fund resources. They agreed to reduce the frequency of PPM to once in any 12-month period, based on a mission scheduled between annual Article IV consultations, which would also help differentiate the two reports. That notwithstanding, Directors took note of the requirement that Article IV consultations, inter alia, assess balance of payments stability and risks. While a number of Directors were willing to go along with a presumption that all standalone PPM reports would be considered on a lapse-of-time (LOT) basis, most Directors had reservations and emphasized the importance of the Board exercising its fiduciary duty to oversee risks to the Fund's resources. In this context, a few Directors saw value in applying the absolute-size thresholds as a trigger for formal Board consideration of PPM reports. In light of these considerations, Directors agreed to retain the current risk-based approach to the usage of LOT procedures, whereby it would be possible for the Board to conclude PPM consideration on an LOT basis if no major issues have arisen.

PROPOSED DECISION*

The following decision, which may be adopted by a majority of the votes cast, is proposed for adoption by the Executive Board:

** The proposal concerning lapse of time completion of PPM discussions in paragraph 4 of the proposed decision was not endorsed by the Executive Board, and was withdrawn by management. The revised decision adopted by the Board does not include paragraph 4.*

1. Decision No. 13454-(05/26), adopted March 14, 2005, as amended, is further amended to read as follows:

"1. If outstanding credit to a member exceeds any of the thresholds specified below:

(a) 200 percent of quota for credit from the Fund's General Resources Account (GRA), or from the Fund as Trustee of the Poverty Reduction and Growth Trust (PRGT), or a combination thereof; or

(b) an amount equivalent to SDR 1.5 billion for credit from the Fund's GRA; or

(c) an amount equivalent to SDR 0.38 billion from the PRGT,

and the member does not have a program supported by a Fund arrangement or is not implementing a staff monitored program with reports issued to the Executive Board, or the member does not have a program supported by a Policy Support Instrument ("PSI"), the member will be expected to engage in Post-Program Monitoring (PPM) with the Fund of its economic developments and policies upon the recommendation of the Managing Director. Where the above criteria are met, the Managing Director shall recommend PPM to the Executive Board, unless, in the view of the Managing Director, the member's circumstances (in particular, the strength of the member's policies, its external position, or the fact that a successor arrangement, PSI or a staff monitored program is expected to be in place within the next six months) are such that the process is unwarranted. PPM will normally cease when the member's outstanding credit falls below all of the applicable thresholds above.

2. The Managing Director may also propose PPM to the Executive Board in cases where outstanding credit as defined above is below the above-specified thresholds if, in the view of the Managing Director, there are developments that suggest the need for closer monitoring of the member's capacity to repay, and particularly, where developments call into question the member's progress toward external viability.

3. For members subject to PPM, there will normally be one standalone PPM paper issued for Executive Board consideration in a twelve-month period. The member will be expected to engage in discussions with staff on its policies, which shall include a quantified macroeconomic framework. The staff will report to the Executive Board on the member's policies, the consistency of the macroeconomic framework with the objective of medium-term viability, and the implications for the member's capacity to repay the Fund. PPM papers should also examine the risks to the member's capacity to repay the Fund.

4. All standalone PPM papers shall normally be issued to the Executive Board for consideration on a lapse-of-time (LOT) basis. The Managing Director may call for a Board discussion of the standalone PPM paper where in the view of the Managing Director such discussion is warranted by risks to the member's capacity to repay. An Executive Director may object to a proposal for LOT consideration up to two business days before the end of the LOT period. If no objection is received to a proposal for LOT consideration during the period in which such objections may be made, the decision concluding the Executive Board consideration of the PPM staff paper will become effective on the date of effectiveness stated in the cover memorandum for the circulation of the PPM paper.

5. The Executive Board's consideration of a PPM paper will be reflected in a press release. The publication of the press release will follow the normal press release procedure, including the requirement of the member's consent. "

2. **Transitional arrangements**: This Decision will enter into effect on September 30, 2016. Notwithstanding the above, if on the date of adoption of this decision, a member's credit outstanding to the Fund's GRA or to the PRGT (or combined credit outstanding to both the Fund's GRA and the PRGT) is below 100 percent of that member's quota, the new thresholds provided for in this Decision will not apply in respect to that member's preexisting outstanding credit for purposes of triggering an expectation of PPM. Such preexisting credit will be taken into account for the purposes of calculating the new thresholds if the member's outstanding credit increases after the date of adoption of this decision.

PROPOSED REVISIONS TO DECISION NO. 13454-(05/26), AS AMENDED*

** The proposal concerning lapse of time completion of PPM discussions in paragraph 4 of the proposed decision was not endorsed by the Executive Board, and was withdrawn by management. The revised decision adopted by the Board does not include paragraph 4.*

1. If outstanding credit to a member exceeds any of the thresholds specified below:

(a) 200 percent of quota for credit from the Fund's General Resources Account (GRA), or from the Fund as Trustee of the Poverty Reduction and Growth ~~Facility~~ Trust (~~PRGF Trust~~PRGT), or a combination thereof~~, exceeds a threshold of 100 percent of quota,~~; or

(b) an amount equivalent to SDR 1.5 billion for credit from the Fund's GRA; or

(c) an amount equivalent to SDR 0.38 billion from the PRGT,

and the member does not have a program supported by a Fund arrangement or is not implementing a staff monitored program with reports issued to the Executive Board, or the member does not have a program supported by a Policy Support Instrument ("PSI"), the member will be expected to engage in Post-Program Monitoring (PPM) with the Fund of its economic developments and policies upon the recommendation of the Managing Director.

Where the above criteria are met, the Managing Director shall recommend PPM to the Executive Board, unless, in the view of the Managing Director, the member's circumstances (in particular, the strength of the member's policies, its external position, or the fact that a successor arrangement, PSI or a staff monitored program is expected to be in place within the next six months) are such that the process is unwarranted. PPM will normally cease when the member's outstanding credit falls below all of the applicable ~~threshold of 200 percent of quota~~ thresholds above.

2. The Managing Director may also propose PPM to the Executive Board in cases where outstanding credit as defined above is below the above-specified ~~threshold~~ thresholds if, in the view of the Managing Director, there are developments that suggest the need ~~of such a process,~~for closer monitoring of the member's capacity to repay, and particularly, where developments call into question the member's progress toward external viability.

3. For members subject to PPM, there will normally be ~~two~~one standalone PPM paper issued for Executive Board ~~discussions~~consideration in a twelve-month period. ~~One such discussion~~

~~will normally coincide with the Article IV consultation.~~ The member will be expected to engage in discussions with staff on its policies, which shall include a quantified macroeconomic framework. The staff will report to the Executive Board on the member's policies, the consistency of the macroeconomic framework with the objective of medium-term viability, and the implications for the member's capacity to repay the Fund. PPM papers should also examine the risks to the member's capacity to repay the Fund.

4. All standalone PPM papers shall normally be issued to the Executive Board for consideration on a lapse-of-time (LOT) basis. The Managing Director may call for a Board discussion of the standalone PPM paper where in the view of the Managing Director such discussion is warranted by risks to the member's capacity to repay. An Executive Director may object to a proposal for LOT consideration up to two business days before the end of the LOT period. If no objection is received to a proposal for LOT consideration during the period in which such objections may be made, the decision concluding the Executive Board consideration of the PPM staff paper will become effective on the date of effectiveness stated in the cover memorandum for the circulation of the PPM paper.

5. The Executive Board's ~~discussion~~consideration of a PPM paper will be reflected in a ~~Public Information Notice (PIN).~~press release. The publication of the ~~PIN~~press release will follow the normal ~~PIN~~press release procedure, including the requirement of the member's consent.