



Independent Evaluation Office  
of the International Monetary Fund

# BACKGROUND PAPER

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## **The IMF Executive Board and the Euro Area Crisis—Accountability, Legitimacy, and Governance**

Miguel de Las Casas

**IEO Background Paper**  
Independent Evaluation Office  
*of the International Monetary Fund*

The IMF Executive Board and the Euro Area Crisis—  
Accountability, Legitimacy, and Governance

Prepared by Miguel de Las Casas

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Abstract

Did the Executive Board adequately fulfill its fundamental duties during the euro crisis? Did management and the senior staff assist the Board sufficiently in executing these duties? Were decisions made according to the internal rules of the IMF? Was good governance exercised? This paper finds that the Board played an anemic role in terms of decision-making and providing guidance for the handling of the euro area crisis, since it lacked the timely and substantive information it needed to play a more active and influential role. This was allowed to occur, in part, by a departure from the objectives, though not the letter, of the IMF internal rules and procedures. The consequence is an erosion of the institution's accountability, legitimacy, and governance.

The views expressed in this Background Paper are those of the author and do not necessarily represent those of the IEO, the IMF or IMF policy. Background Papers report analyses related to the work of the IEO and are published to elicit comments and to further debate.

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**ABBREVIATIONS**

DSA	Debt Sustainability Analysis
EC	European Commission
ECB	European Central Bank
EFF	Extended Fund Facility
EFSD	European Financial Stability Facility
EPE	Ex Post Evaluation
ESM	European Stability Mechanism
EU	European Union
FSAP	Financial Sector Assessment Program
FSSA	Financial System Stability Assessment
MoU	Memorandum of Understanding
PEC	Policy of Early Consultation
PSI	Private Sector Involvement
SBA	Stand-By Arrangement
TA	Technical Assistance
ToR	Terms of Reference
UFR	Use of Fund Resources

## EXECUTIVE SUMMARY

The IMF must be able to respond promptly to its members' needs, most importantly, in fulfilling its function as crisis manager, a role usually played out under conditions of high uncertainty and time pressure. While management and staff are in charge of the technical work and conduct of negotiations, the Executive Board, as the resident governing body representing member countries, is responsible for decisions to approve programs. Therefore, it is paramount that the communication between the Board and management and staff, especially in crisis situations, is open and timely. If this is not the case, the Board is not able to exercise its responsibilities properly and the governance mechanisms of the institution do not work as intended.

The IMF has in place rules and procedures aimed at ensuring that decisions are made properly, in the best interests of the membership and the institution itself. This paper finds that, in handling the euro area crisis, the "letter of the law" was followed, although the approach adopted during the decision-making processes did not satisfy the ultimate objectives of those rules. Thus, the boxes were ticked but best governance was not practiced, as the Board was poorly informed until it was too late in several instances. As a result, the decision-making and supervisory roles of the Executive Board were undermined, most prominently during the process that led to the approval of the Stand-By Arrangement for Greece in May 2010.

These problems had substantial implications for the accountability, governance, and legitimacy of the IMF and its decisions. Lack of timely information made impossible the Board's early involvement as intended under the lending framework. It was therefore unable to provide guidance or exercise control over the work of management, minimizing their accountability to member countries. At the same time, the information asymmetry at the Executive Board, together with the large collective voting power of euro area member countries, left much of the membership with the perception that they were excluded from the decision-making process and that the Fund was trapped in "European exceptionalism." These governance and accountability problems, in turn, generated concerns, both within and outside the institution, regarding the legitimacy of those decisions and the IMF as a whole.

For the current IMF governance structure to work, there must be a fluid and transparent communication between management and the Board. This depends, fundamentally, on both parties' understanding of their respective responsibilities and, in guiding this understanding, internal rules and procedures have to be followed in substance, and not to be regarded merely as bureaucratic inconveniences. A reexamination of those rules may reveal weaknesses and improvements may be required but, in any case, consideration should be given to measures aimed at reinforcing their implementation and strengthening accountability, with the ultimate objective of preserving the representativeness and the effectiveness of the Board.



## I. INTRODUCTION

1. In evaluating the performance of the IMF in the euro area crisis, it is important to consider the role played by the Executive Board. As the organ that represents all member countries in conducting the day-to-day business of the institution, it provides legitimacy to the Fund's decisions.<sup>1</sup> The Board is charged with the responsibility of making the vast majority of decisions, including those related to the formulation of IMF policies and its lending and surveillance operations. At the same time, it is the duty of the Board to direct the work of the management team in carrying out the ordinary business of the Fund. Did the Board adequately fulfill its fundamental duties during the euro crisis? Did management and the senior staff assist the Board sufficiently in executing these duties? Were decisions made according to the internal rules of the IMF? Was good governance exercised? These are the main overarching questions addressed by this paper.

2. Under the existing governance structure of the IMF, there is a tension between the role of the Board as a decision-making body and the need of management and senior staff to undertake the technical work associated with IMF operations. The Board delegates sufficient latitude within the established policies, but it retains final authority. This tension is exacerbated during times of crisis, as program negotiations take place, usually, against a background of high uncertainty and urgency. In particular, when the Fund needs to make precedent-making decisions or assume unusual risks, the Board needs to be even more involved. That is the reason why, for example, the exceptional access policy has strengthened "procedures for decision-making to provide additional safeguards and enhance accountability." In this context, the conditions under which programs were designed for Greece, Ireland, and Portugal were undoubtedly exceptional. All three cases had potentially systemic implications, at the regional and global levels, required extraordinarily high access to IMF resources, and, importantly for the role of the Board, occurred in countries that are members of the euro area. This meant that (i) program negotiations were conducted jointly with the European institutions, (ii) IMF member countries holding more than one-third of the voting power at the Board were also the sole shareholders of those European institutions, and (iii) these countries had already committed, via public statements, to support the programs even before they were brought to the Board for consideration, and approved the parallel European lending, which also ensured that the IMF-supported program was fully financed.

3. Another crucial and related tension, long recognized in IMF activities (Rajan, 2005), is that between rules and discretion. While the Fund needs to have some discretion in deciding when and how much to lend, it is very difficult for the IMF to stand back when a member country is in trouble; indeed, the Articles of Agreement establish the right of any member to draw on Fund

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<sup>1</sup> In June 2011, for example, Christine Lagarde remarked to the Board before assuming office as Managing Director: "I strongly believe in the value of a permanent resident Board. Without a Board representing the membership, there can be no global multilateral organization. I am convinced that the Board's work confers legitimacy to the Fund's action. A strong relationship between the Managing Director and the Board can only be built on trust and respect between us." (IMF, 2011a)

resources with adequate safeguards in order to prevent adoption of policies that are destructive of national and international prosperity. Rules clarify in advance the necessary conditions or safeguards and also help ensure even-handed, or comparable, treatment of members. Therefore, there is a strong case for adhering to established rules to ensure time and country consistency in the Fund's decisions, which helps preserve the best interest of the institution and its membership. The Fund's exceptional access policy and the Board's procedures, two sets of rules germane to the evaluation of the three euro area programs, seek to balance these important considerations.

4. This paper analyzes the manner in which selected key decisions were made and the role played by the Board during the IMF's handling of the crises in these countries. Its focus is on the decision-making process and its implications for legitimacy, accountability, and governance rather than on the appropriateness of the decisions themselves. This report utilizes information gathered from interviews with relevant individuals and from internal documents.

5. The rest of the paper is organized as follows. The second section explains the minimum legal and institutional background necessary to evaluate the involvement of the Board. The third and fourth sections analyze a number of key decisions in chronological order, as the sequence of events helps understand why and how they were made. The fifth section offers some findings and conclusions.

## **II. LEGAL AND INSTITUTIONAL BACKGROUND**

### **A. Main Features of the IMF Executive Board**

6. The Executive Board is the resident decision-making body of the IMF. Under its current configuration, 24 Executive Directors represent the same number of constituencies, covering all 189 member countries. The Managing Director serves as the Chairman of the Executive Board, and the Managing Director or one of the Deputy Managing Directors chair its meetings. Eight members enjoy their own single-country constituencies,<sup>2</sup> while the rest are part of multi-country constituencies (formed prior to biennial elections through the agreement of member countries who associate freely). Roughly, the geographical distribution of constituencies is as follows: one Chinese, one Central Asian, seven Europeans, one Japanese, one from the Middle East and North

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<sup>2</sup> China, France, Germany, Japan, Russia, Saudi Arabia, United Kingdom, and United States. <http://www.imf.org/external/np/sec/memdir/eds.aspx>. Following the entry into force of the Board Reform Amendment on January 26, 2016, and starting with the next regular election to be concluded by October 2016, all 24 Executive Directors are considered to be elected. The first election for an all-elected Board will take place in October 2016. Previously, the member countries holding the five largest quotas were each entitled to appoint an Executive Director, while 19 were elected by the remaining member countries. Three countries (China, Russia, and Saudi Arabia) held sufficient votes to have their own chair.



Africa, one Russian, one Saudi Arabian, one South American, one Southeast Asian, two from sub-Saharan Africa, one from the United States, and five are mixed groupings.<sup>3</sup>

7. According to Article XII, Section 3 of the Articles of Agreement of the IMF, the Executive Board is “responsible for conducting the business of the Fund,” exercising all the powers delegated to it by the Board of Governors.<sup>4</sup> This “business” is defined broadly and includes lending operations and policy decisions. At the same time, the Board has the responsibility to direct the work of management,<sup>5</sup> since Section 4 of the same Article states that the Managing Director “shall conduct, under the direction of the Executive Board, the ordinary business of the Fund.” Thus, the Board has two roles: (i) an executive one, given its decision-making responsibilities, and (ii) a supervisory and advisory one, as it is responsible for directing and monitoring the performance of management.

8. An important characteristic of the Board derives from the dual character of the Executive Director position. Directors are both IMF officials and representatives of the member countries that elect them. This means that they simultaneously defend national interests and those of the Fund as an institution. Directors once elected however cannot be removed from office and continue in their office until their successor is elected biennially.

9. Votes are very rarely taken at the Board. Decisions are normally made by consensus, reflecting the cooperative nature of the Fund and the collegial character of the Board. This operating principle is incorporated in the Rules and Regulations of the IMF, which indicate that “The Chairman shall ordinarily ascertain the sense of the meeting in lieu of a formal vote” (Rule C-10). The “sense of the meeting” is understood as a position supported by Executive Directors having sufficient votes to carry the question if a vote were taken. However, any Director can always call a vote or express their contrary or abstaining position for the record on a particular issue.

10. When a vote is necessary, nearly all decisions, including those on the use of Fund resources, surveillance, and IMF policies, are made by a majority of the votes cast (Article XII, Section 5). Special majorities—either 70 percent or 85 percent of the total voting power—are specified under the Articles of Agreement and required only for decisions outside the “regular business.” Each Director’s voting power is determined by the voting power of the countries in his

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<sup>3</sup> Geographically mixed constituencies include: (i) Some Latin American countries and Spain, (ii) Canada, Ireland, and some Caribbean countries, (iii) some Latin American countries and some Caribbean countries plus Timor-Leste, (iv) some Asian countries and Oceania, and (v) some Middle Eastern countries and Ghana.

<sup>4</sup> The Board of Governors is the highest decision-making body of the IMF, but it has delegated most of its responsibilities to the Executive Board. The Board of Governors meets, normally, once a year and makes decisions by mail without a meeting. Each member country appoints one governor and one alternate governor, who are usually the minister of finance and the central bank governor.

<sup>5</sup> The term management refers, collectively, to the Managing Director and the Deputy Managing Directors.

or her constituency.<sup>6</sup> The vote (or opinion) of Directors representing multi-country constituencies cannot be split, even if members forming a constituency disagree on a particular issue.

## **B. Executive Board Procedures<sup>7</sup>**

11. The Compendium of Executive Board Procedures (the procedures) describes how Board meetings should be organized and held. The Chair of the Board calls the meetings according to the needs of the IMF or at the request of any Executive Director. Likewise, the Chair proposes an agenda of Board meetings, and Directors are entitled to request the inclusion of any item. Directors are to be notified of this agenda at least two days prior to the meeting, except in special circumstances. The procedures point out that a reasonable notice is especially important when a proposal implies a change of Fund practice or policy, or the establishment of exceptions to existing practice or policy. The majority of the Board may decide to postpone the discussion of an item.

12. There are two broad categories of Board meetings: formal and informal. The fundamental difference between the two is that the Board can only make decisions during formal meetings, while informal ones are used for informative and preparatory discussions.<sup>8</sup> Also importantly, the procedures require the preparation of supporting documents, summing ups, and minutes for formal Board meetings, while informal ones are generally free from those requirements (Table 1). The procedures classify Board meetings into the following types:<sup>9</sup>

- Ordinary Meetings: these are formal meetings in which the Board may adopt decisions and reach understandings on the Fund's business.
- Executive Session: these are similar to ordinary meetings but restricted to Executive Directors and management. Attendance of the Secretary, Advisors, or essential staff may be permitted by the Executive Board.

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<sup>6</sup> Each member country of the IMF is assigned a quota, based broadly on its relative position in the world economy. Quotas not only determine a member's voting power (along with basic votes, which are distributed uniformly to all members), but also its maximum financial commitment to the IMF, and its access to IMF financing.

<sup>7</sup> This section refers to the Board procedures applicable during most of the euro area crisis. The Compendium of Executive Board Work Procedures, prepared in October 2001, was updated on May 13, 2010 and reviewed again in October 2015, simplifying and normalizing practices already in use during the euro area crisis (Annex 2).

<sup>8</sup> The 2015 version of the Compendium explicitly acknowledges that informal sessions are meetings in which Executive Directors are not deliberating as a decision-making body of the Fund. Thus, they may present their own views or those of their authorities and no decisions are taken.

<sup>9</sup> Two additional categories "Informal Sessions on World Economic and Market Developments" and "Committees of the Whole" are omitted, as they are not relevant in the context of this evaluation.

- Informal Meetings: these meetings facilitate exchange of views on issues that are not yet at the stage at which a formal decision or understanding is sought, often on *individual* country matters. They may be called without the usual minimal advance notice.
- Informal Country Matters Sessions (restricted attendance): these are held semi-regularly and are intended to keep Executive Directors informed of developments in *several* countries on a strictly confidential basis.
- Seminars: these provide a format for discussion among Executive Directors on issues that may be considered formally by the Board at a later stage.
- Informal seminars: these are conceived for the discussion of subjects at a preparatory stage, both to brief Executive Directors or to gather their preliminary informal views or guidance.
- Executive Board Briefings by the Staff<sup>10</sup>: these are aimed at providing an opportunity for detailed question-and-answer sessions on country and policy issues.

Table 1. Main Characteristics of Executive Board Meetings

	Formal Meetings	Informal Meetings				
	Ordinary & Executive Meetings	Informal Meetings	Informal Country Matters Sessions	Seminars	Informal Seminars	Executive Board Briefings by Staff
Decision	Possible	No	No	No	No	No
Supporting Documents	Yes	Possible	No	Possibly	Possible	No
Summing Up/ Concluding Remarks	Yes	No	No	Yes	No	No
Minutes	Yes	No	No	Yes <sup>1</sup>	No	No
Chaired by	Management	Management <sup>2</sup>	Management <sup>2</sup>	Management	Management/Staff	Management <sup>2</sup>

<sup>1</sup> A disclaimer is included at the first page of the concluding remarks to ensure they are not misinterpreted as decisions of the Executive Board.  
<sup>2</sup> The Compendium is not absolutely clear in this respect.  
Source: Compendium of Executive Board Work Procedures and author's elaboration.

13. On the minimum circulation period, the procedures provide that documents for (formal) Board meetings on the use of Fund resources, including program requests and reviews, be circulated two weeks in advance. In the case of staff reports on Article IV consultations, the minimum circulation period is also two weeks, but for those countries considered to have important regional or systemic impact—a list that in May 2010 included Greece, Ireland, and Portugal—it is three weeks.<sup>11</sup> Waivers of the circulation periods can be granted at the request of the Executive Director representing the country, who should provide the rest of the Board with

<sup>10</sup> On May 13, 2010, the Compendium was revised to include the possibilities of (i) staff briefing a number of Executive Directors, not only the Board as a whole, and (ii) management, not just the staff, conducting the briefing. Thus, they became “Executive Board and Executive Directors’ Briefings by the Staff and Management.”

<sup>11</sup> The differentiation between countries that have a regional or systemic impact and those that do not was eliminated from the Compendium at the time of the May 13, 2010 review.

an explanation for the reasons why they could not be met. Any Director can object but Directors typically extend professional courtesy to each other.

### C. IMF Access Policy

14. The IMF access policy regulates member countries' access to the Fund's resources relative to their quotas. Access varies depending, among other factors, on the needs of the member country and the facility used. When exceptional circumstances require financing above regular access limits (Box 1), the exceptional access framework comes into play with its own set of rules.

#### **Box 1. Access Policy in May 2010: Thresholds and Criteria<sup>1</sup>**

As a rule, access by member countries to the Fund's general resources is subject to (i) an annual limit of 200 percent of quota; and (ii) a cumulative limit of 600 percent of quota, net of scheduled repurchases.<sup>2</sup> However, the Fund may approve access beyond these limits, in exceptional circumstances, if the following four criteria are met:

- i) The member is experiencing or has the potential to experience exceptional balance of payments pressures on the current account or the capital account,<sup>3</sup> resulting in a need for Fund financing that cannot be met within the normal limits.
- ii) A rigorous and systematic analysis indicates that there is a high probability that the member's public debt is sustainable in the medium term. However, in instances where there are significant uncertainties that make it difficult to state categorically that there is a high probability that the debt is sustainable over this period, exceptional access would be justified if there is a high risk of international systemic spillovers.<sup>4</sup> Debt sustainability for these purposes will be evaluated on a forward-looking basis and may take into account, inter alia, the intended restructuring of debt to restore sustainability. This criterion applies only to public (domestic and external) debt. However, the analysis of such public debt sustainability will incorporate any potential contingent liabilities of the government, including those potentially arising from private external indebtedness.
- iii) The member has prospects of gaining or regaining access to private capital markets within the time frame when Fund resources are outstanding.
- iv) The policy program of the member provides a reasonably strong prospect of success, including not only the member's adjustment plans but also its institutional and political capacity to deliver that adjustment.

<sup>1</sup> Decision No. 14064-(08/18), February 22, 2008, as amended by Decision Nos. 14184-(08/93), October 29, 2008, 14284-(09/29), March 24, 2009, BUFF/10/56, May 9, 2010, 14716-(10/83), August 30, 2010, and 15017-(11/112), November 21, 2011.

<sup>2</sup> These limits, raised from 100 percent of quota and 300 percent of quota, respectively, in 2009 (IMF, 2009), were reduced again in February 2016 (IMF, 2016b), to 145 and 435 percent of quota, respectively, in reaction to the entry into effect of the 14th General Review of Quotas.

<sup>3</sup> At the time of the 2009 review, the Board modified this criterion to allow exceptional access for potential and actual balance of payments needs stemming from both capital and current account crises.

<sup>4</sup> The underlined portion, known as the "systemic exemption clause," was introduced at the time of the approval of the Greek program (IMF, 2010b), and later removed in January 2016 (IMF, 2016a). See Annex 1.

15. The main elements of the framework, prior to the approval of the Stand-By Arrangement for Greece in May 2010, were adopted in September 2002 (IMF, 2002).<sup>12</sup> This adjustment of the framework took place in an environment where increasingly integrated financial markets had

<sup>12</sup> The framework has been subject to frequent revisions. Box 1 summarizes the most relevant ones.

given rise to sudden and disruptive capital account crises and the Fund had been faced with members' unprecedented financing needs. Thus, the Board approved arrangements granting levels of access, in terms of percentage of their respective quotas, never seen before; for example, 1,938 for Korea (1997), 1,560 and 1,330 for Turkey (2001, 2002), and 800 for Argentina (2001).

16. At the time of the design of the framework, it was felt that retaining the Fund's ability to lend above regular limits was crucial, but the policies available to do so—the exceptional circumstances clause and the “limits-free” facilities, i.e., the Supplemental Reserve Facility and the Contingent Credit Lines—needed strengthening.<sup>13</sup> Concerns focused, among other issues, on the lack of clarity about the circumstances and scale in which exceptional access was granted and the degree of discretion in making these decisions. As staff explained in 2002, “the degree of discretion and flexibility in the present framework may make the Fund more vulnerable to pressures to provide exceptional access even when prospects for success are quite poor and debt burden of the sovereign is likely to be unsustainable.” Greater involvement of the Board (and the capitals) was intended to counterbalance political pressures, particularly from major shareholders.

17. In response, the Board agreed on a framework with two main components: four criteria that need to be met to justify exceptional access (Box 1), and a set of strengthened decision-making procedures to be followed when exceptional access was considered appropriate. The objectives of the framework are fivefold (IMF, 2004a):

- To define more clearly and narrowly cases when exceptional access may be appropriate, with increasing constraints associated with higher access.
- To provide more clarity on the criteria used to determine when exceptional access is appropriate and when a restructuring of private claims is warranted.
- To provide a better basis for judgments on the appropriate scale of access in capital account crises.
- To put in place internal safeguards to ensure that these judgments are made carefully, risks are appropriately weighed, and the Board involved.
- To preserve the Fund's financial position and safeguard its resources.

18. During the discussions that led to the adoption of the criteria, the possibility of introducing another criterion based on contagion risk or potential systemic effects was explicitly considered, both as a necessary or sufficient condition for exceptional access. However, IMF staff

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<sup>13</sup> The strengthening of the exceptional access policy was not the only measure discussed to improve the Fund's crisis resolution toolkit at the time. A Sovereign Debt Restructuring Mechanism, the introduction of Collective Action Clauses, and a review of the Fund's policy of Lending into Arrears were other possibilities explored in the context of the *Prague Framework for Private Sector Involvement*, endorsed by the International Monetary and Financial Committee in September 2000.

advised against this option and, ultimately, the Board concurred with this view. The main rationale to deny such a criterion was the concern that it would introduce a bias toward higher access for larger members and, therefore, would be incompatible with the principle of uniformity of treatment (IMF, 2002).<sup>14</sup> At the same time, Directors recognized that the Fund should be prepared to provide exceptional access “where the member’s problems have regional or systemic implications, where the other criteria are met.”

19. By strengthening the set of decision-making procedures, the Board sought to provide additional safeguards and to enhance accountability. Directors agreed to (i) raise the burden of proof in program documents, including a thorough discussion on the need and the appropriate level of access, a rigorous debt sustainability assessment (DSA), and an analysis of the derived risks to the Fund; (ii) formalize the requirements for early Board consultations regarding the status of negotiations, program strategy, and case for exceptional access; and (iii) mandate an ex post evaluation (EPE) by staff within a year after the end of the arrangement.

20. Several months later, in February 2003 (IMF, 2003), the Board saw “a more formal process for Executive Board consultation at the early stages of program discussions as helpful for reinforcing careful and systematic decision-making on exceptional access cases” and, in working out the modalities for these consultations, agreed on the policy for early consultation (PEC). The Board also stressed the importance of a consistent and rigorous application of the four criteria for exceptional access, while, at the same time, it recognized the need for management and staff to have sufficient flexibility and discretion in coming to agreement with country authorities in crisis situations without undue delay.

21. The PEC is based on the following six elements<sup>15</sup>:

#1. Once management decides that exceptional access to Fund resources may be appropriate,<sup>16</sup> it will consult with the Board promptly in an informal meeting that will provide the basis for consultation with capitals and help identify issues that would be addressed in a further informal session. Directors are to be provided with a concise note, circulated at least two hours prior to the meeting, that includes, as fully as possible:

- (a) a tentative diagnosis of the problem;
- (b) the outlines of the needed policy measures;

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<sup>14</sup> For more details, see the companion paper on the application of the Fund’s framework for exceptional access in the Greek program (Schadler, 2016).

<sup>15</sup> The requirements of the PEC are closely aligned with those of the Emergency Financing Mechanism, agreed by the Board in 1995, and applied to the Greek, Irish, and Portuguese programs (IMF, 1995b).

<sup>16</sup> This decision is typically formalized by management’s approval of a briefing paper or policy note from staff on the use of Fund resources.

- (c) the basis for a judgment that exceptional access may be necessary and appropriate, with a preliminary evaluation of the four substantive criteria applying in capital account crises, and including a preliminary analysis of external and sovereign debt sustainability; and
  - (d) the likely timetable for discussions.
- #2. Before the (formal) Board's consideration of the staff report, additional consultations will normally be expected, during which staff will aim to keep the Board abreast of program-financing parameters, including:
- (a) assumed rollover rates,
  - (b) economic developments,
  - (c) progress in negotiations,
  - (d) any substantial changes in understandings, and
  - (e) any changes to the initially envisaged timetable for Board consultation.
- #3. The staff will provide the Board with a separate tentative report evaluating the case for exceptional access based on further consideration of the four substantive criteria, including debt sustainability. Where time permits, this report will be provided to the Board in advance of the circulation of program documents. In all cases, this report will be included in the program documents.
- #4. Management will consult with the Board specifically before concluding discussions on a program and before any public statement on a proposed level of access.
- #5. Strict confidentiality will need to be maintained, and public statements by members, staff, and management should take special care not to prejudge the Board's exercise of its responsibility to take the final decision.
- #6. The staff report for an arrangement proposing exceptional access will include:
- (a) a consideration of each of the four substantive criteria for exceptional access in capital account crises (including a rigorous analysis of debt sustainability);
  - (b) a thorough discussion of need and the proposed level of access—including a standard table gauging proposed access levels against a broader set of metrics, and complement quota-based metrics;

- (c) an assessment of the risks to the Fund arising from the exposure and its effect on liquidity;<sup>17</sup> and
- (d) systematic and comprehensive information on the member's capacity to repay the Fund.

22. At the same meeting, Directors highlighted the unusual uncertainty and risk that is often associated with projections of private capital flows and the difficulty this poses for program design. They considered that it was especially important to be explicit and cautious about the assumptions underlying the projections for financing, and a number of Directors requested that additional information be provided to the Board discussing private sector involvement (PSI) in program financing. The Board agreed that discussions on PSI issues would be expected during the consultations with the Board for exceptional access cases.

### **III. THE ROLE OF THE BOARD IN PROGRAM DECISIONS**

#### **A. The Stand-By Arrangement for Greece**

23. On May 9, 2010, the Executive Board approved a Stand-By Arrangement for Greece granting the highest access in the Fund's history: €30 billion representing over 3,200 percent of the country's quota. Was this unprecedented decision consistent with the rules of the Fund? Was good governance practiced?

24. Eight informal meetings of the Board took place in the run-up to the May 9 formal meeting, three of them under the policy for early consultation in exceptional access (PEC) described above (Figure 1).<sup>18</sup> Other meetings, attended only by management and a subset of Directors, also took place. For example, the Managing Director called for meetings of European Directors, together with staff from various departments, on at least two occasions to report on the status of the program negotiations and his trips to Europe.

25. The decision to involve the Fund in an eventual financial assistance package to Greece was taken in Brussels as early as March 25, 2010 by the Heads of State and Government of the euro area. Later, on April 11, euro area member states announced their agreement for the European Commission and the European Central Bank (ECB) to begin working on a joint program, to be designed with and co-financed by the IMF. This announcement also detailed the duration of the program (three years) and the euro area member states' contribution for the first

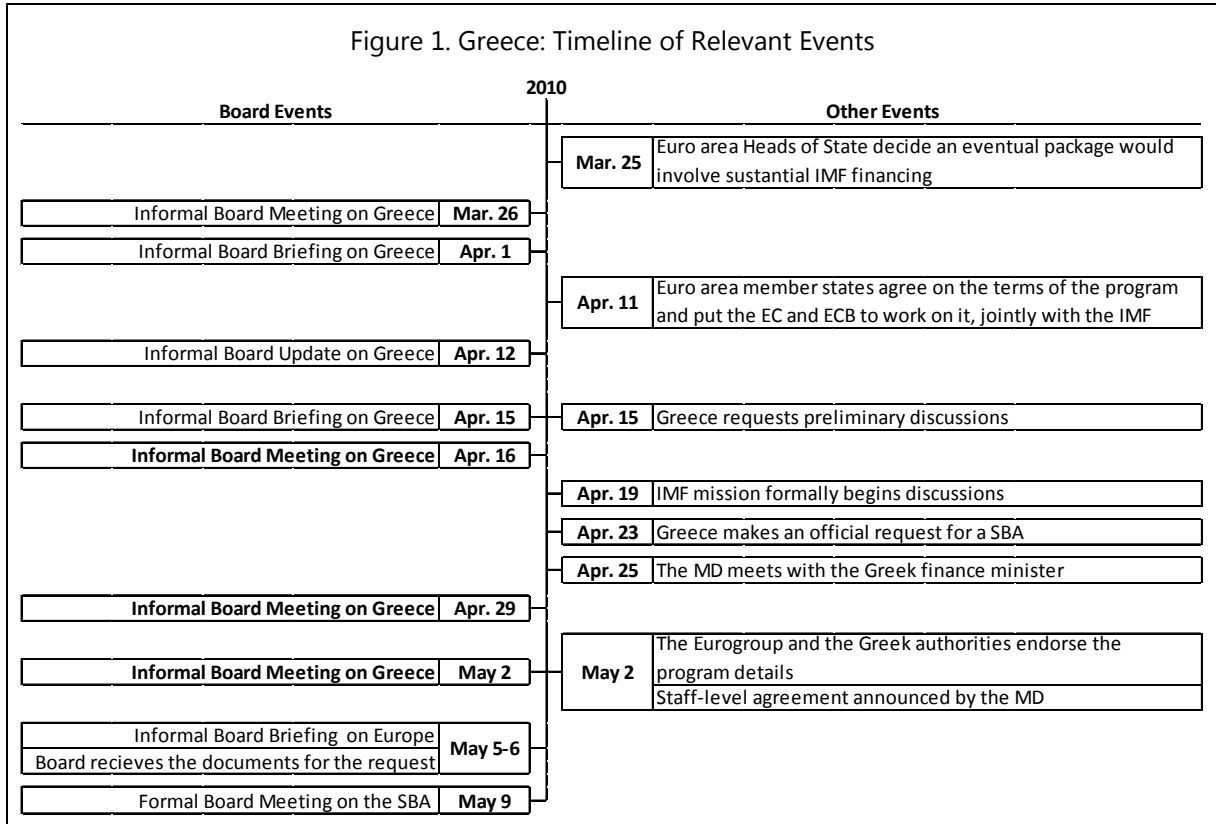
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<sup>17</sup> At a later review, in April 2004 (IMF, 2004b), the Board added the requirement of an in-depth scenario analysis of the financial impact on the Fund and explicit recognition of the cost (to borrowers and creditors) of members incurring arrears to the Fund.

<sup>18</sup> In this paper, "informal meetings" refer only to meetings of the Board as a whole. The term does not include meetings of management with a subset of the Board or meetings of Directors, with or without participation of staff.



year (€30 billion), which later was revised upwards. Also at that early stage, despite having reiterated the absence of negotiations—other than those related to technical assistance (TA)—the Managing Director stated that it was obvious that a potential program would imply exceptional access (perhaps prejudging the Board’s final decision).



26. On April 15, 2010, the Greek authorities requested the initiation of preliminary discussions on a potential program, and an IMF mission began operations in Athens on April 19. Four days later, on April 23, Greece made an official request for an SBA, and on April 25 the Managing Director met with the Greek finance minister. On May 2, the Eurogroup made public the details of the joint program with the IMF, which had already been endorsed by the finance ministers of the euro area and approved by the Greek Council of Ministers. The Managing Director and the EU Commissioner for Economic and Monetary Affairs issued a joint statement strongly supporting the program. The same day, the Managing Director also announced a “staff-level agreement” on a three-year and €30 billion Stand-By Arrangement for Greece (Box 2).

### **Box 2. Staff-Level Agreements**

Staff-level agreements are not binding. They are the manifestation of an understanding reached between the staff of the IMF and the authorities of a member country on a potential program. From the legal point of view these agreements are *ad referendum*. To become Fund arrangements in support of members' programs, they are subject, first, to clearance by management, and, second, to the final approval of the Executive Board.

However, markets and other external agents do not always pay attention to this distinction. From the public relations point of view, it is not always clear "who the Fund is" or "who speaks for the Fund" since, as the last review of the IMF's communication strategy recognized (IMF, 2014a), communication takes place at many levels. Typically, in IMF documents, "the Fund" refers to the Executive Board but, depending on the context, it may have different meanings (e.g., the Board of Governors, the Managing Director, or the institution as a whole). On who speaks for the Fund, the understanding is that each organ of the Fund does so within its own powers. In this regard, staff-level agreements are within the authority of management. The Communication Strategy establishes that public communications regarding these agreements must make very clear on whose behalf a communication is made: "Whenever relevant, where management/staff views are expressed, it should be clearly qualified by language explaining that the Fund's ultimate position would depend on the Executive Board (for example, completion of Article IV consultations and approval of use of Fund resources)."

27. The staff note that the Board received and discussed on April 16 can be judged to satisfy element #1 of the policy for early consultation (PEC). It includes a tentative diagnosis of the problem and the policy measures needed, a preliminary evaluation of the appropriateness of exceptional access, and the anticipated timetable for negotiations. This note was very brief and prepared on the basis of preliminary discussions with the Greek authorities, the EC, and the ECB. It focused mainly on contagion risks and its assessment was that strong implementation of a program would allow Greece to meet all of the exceptional access criteria—a judgment later reconsidered. The note did not provide quantified estimates of the financing gap, expected access to IMF resources, or European financing; these estimates were however already available to management and staff and to the EC and the ECB. Nor was there a discussion of PSI approaches. While not explicitly required by the PEC, this lack of openness undermined the framework's intent to strengthen the decision-making process in exceptional access cases, reduced the information provided to Directors (and their capitals) and limited their ability to provide meaningful feedback. In fact, several Directors, at this stage, expressed concerns over the lack of data provided to the Board and the absence of information on how the IMF was going to be involved in an eventual program, issues already being discussed by the press.

28. Between April 16 and May 2, the Board met informally three times under the PEC. According to the evidence reviewed by the IEO,<sup>19</sup> element #2 of the PEC was formally met. During interviews, however, several Board members were of the view that, while the parameters specified in this element were mentioned, the information provided by management and staff was too general and lacked crucial details (see below). With respect to element #3 of the PEC, it

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<sup>19</sup> As noted in Section II, the Board procedures do not require the preparation of minutes for informal meetings. As a result, there was considerable uncertainty regarding what documents were available and accessible to the IEO. Gaps could only be filled, at least in part, with information gathered from interviews.

appears that the report on the case for exceptional access was made available to the Board together with the program request documents.

29. At the May 2 meeting, management and staff informed Directors that a staff-level agreement had been reached and provided them with the details on the contributions of the IMF and the European partners to the financing package. Prior to that meeting, the level of access to Fund resources required under the program had not been shared with the Board, either in writing or orally, despite repeated questions by several Directors. Neither were specific numbers presented to the European Directors during their meetings with management and staff. Although element #4 of the PEC was complied with, given that the Board met right before the program announcement in Brussels, Directors did not have time to carefully consider, let alone consult with their capitals, the key parameters of the arrangement that were going to be immediately announced.

30. Similarly, element #5 of the PEC was fulfilled, since management and staff did not make any public statement prejudging the Board's final decision. However, the way the process was handled resulted in the IMF Board to be the last decision-making body to be informed about the details of the program, as the Eurogroup and the Greek authorities were already endorsing it, and virtually at the same time they were released to the public.

31. The documents containing the full details of the program and the Greek request were sent to Directors between May 5 and 6 and the Board meeting was scheduled for Sunday, May 9. This left Directors only two days to study, and to consult with their capitals, a very complex program that involved the largest financing package in the history of the Fund.

32. The requirements applicable to staff reports on arrangements involving exceptional access (element #6 of the PEC) were formally met by the May 5 report. However, the background document on the risks to the Fund and its liquidity position did not include an in-depth scenario analysis of the financial impact or explicit recognition of the cost to other members of Greece falling into arrears. In terms of format, the three meetings that took place under the PEC were called as informal restricted meetings. According to Fund's law, no decisions could be taken during any of those meetings, and virtually no procedural requirements applied.

33. In general, the timeliness and content of the informal consultations was judged by many Directors to have been inadequate. They stated to the IEO team that these informal meetings took place too late, post factum, and that the media constituted a better source of information than management and staff. A case in point is the crucial decision to grant exceptional access financing to Greece without private sector involvement (PSI)—standstill or debt restructuring (Wyplosz and Sgherri, 2016). Despite the expectation in the framework that PSI would be discussed during early consultations with the Board, several Directors felt that management and staff had avoided the topic. Although the topic was raised by a few Directors, their questions were, in their view, never substantively answered, which led to the absence of an informed and open discussion and the subsequent perception that they were being presented with a *fait accompli*. For example, when

asked about debt restructuring during one of the meetings, staff replied that debt restructuring had never been on the table and would never be under discussion.

### **The objectives of the exceptional access framework**

34. In sum, as the foregoing discussion suggests, while the letter of the exceptional access framework was complied with, its objectives were not satisfied, particularly, those of the PEC. The lack of timely and relevant information to the Board had three main consequences. First, it created an important information asymmetry at the Board. Some Directors, including those representing European members, might have received more timely information from their capitals on the progress and details of the negotiations, but the rest were not adequately kept informed by management and staff.<sup>20</sup> While this asymmetry occurs in any program discussion, where the Director representing the borrowing country enjoys access to information not available to other Directors, this case was exceptional in that countries holding over 30 percent of the voting power at the Board had potential access to information on program negotiations via their participation in the European institutions.

35. Second, IEO interviews and the sequence of events suggest that the Executive Board's decision-making and advisory roles were undermined, rather than strengthened as intended under the exceptional access policy procedures. Information reached Directors practically at the same time as decisions were publicly announced by management and the IMF's European partners, leaving little room for the Board to provide real input or to influence decisions. On May 9, the Board had the legal prerogative to reject or postpone the approval of the program, since what was presented to them was a staff-level agreement *ad referendum*. But, was this a feasible option? Rejecting a program request is a difficult decision for the Board in any program case, as it implies acting against the advice of management and staff—potentially undermining their authority, and, ultimately, damaging the IMF's credibility—and denying assistance to a member country in difficulties.<sup>21</sup> Indeed, the early Board consultation procedures are intended to avoid this "nuclear option" by keeping Directors informed during program negotiations and allowing for timely consultations with their capitals. In this case, rejection was even more difficult, because of (i) the risk of regional and global contagion, and (ii) the fact that the capitals of member

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<sup>20</sup> According to one interviewee, the frequent interactions of the Managing Director with European Finance Ministers during the negotiations distorted the usual channel of communication of capitals with the IMF, which takes place through the Executive Director. This may have reduced the information asymmetry between European and non-European Directors but may have also aggravated the general lack of information at the Board, thereby removing it further from the decision-making process.

<sup>21</sup> In fact, programs are hardly ever voted down by the Board.

countries holding almost one-third of the voting power at the Board, and providing the non-IMF part of the program financing, had already publicly committed to the agreement.<sup>22</sup>

36. Third, delayed information and involvement deprived the Board of the ability to direct and monitor management and staff, making it difficult to hold them accountable. Thus, management's discretion and decision-making powers were left effectively unchecked.

37. These governance and accountability problems, which the PEC was designed to address, may have eroded the legitimacy and evenhandedness of the IMF. They are not new,<sup>23</sup> but the case of Greece is a particularly clear and striking example. These issues result in part from Directors' dual role as representatives of member countries and as IMF officials. Many Directors noted during interviews a conflict between their own views regarding the viability of the Greek program and those they were instructed to support by their authorities. Some of them even described the Board as a "theatrical exercise" in some instances, and considered it caught in a "governance trap."

38. Why did this happen? It would appear that four factors were at play. First, management was able to maximize its operational and decision-making powers by minimizing the involvement of the Board, and Directors may not have pushed back hard enough, demanding more information. Second, as foreseen by the exceptional access framework, decisions had to be made in a fast-evolving context, subject to a high degree of uncertainty. In the words of one Director interviewed, "the environment of risk and fear created around the negotiations" was such that it looked like "everything was permissible," which led to, at least, the perception of a more favorable treatment of Greece. Third, coordination with the European institutions introduced additional difficulties, as the process did not always operate smoothly. However, the Eurogroup seems to have been kept better informed by the EC and the ECB, than the IMF Executive Board by management and staff (Kincaid, 2016). Fourth, in an environment of extreme market sensitivity, potential leaks were considered a significant risk, especially given the history of recurring information leakage problems at the Board.

39. The process of informing the Board was seemingly approached as a box-ticking exercise, jeopardizing the credibility and legitimacy of the institution. Indeed, the consensus view among Directors interviewed was that the process could and should have been handled differently. They believed that a more timely, open, and transparent involvement of the Board would have prevented (i) the perception, internal and external, that the IMF gave Greece a more favorable

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<sup>22</sup> The consolidation of European voting power in the cases of Greece, Ireland, and Portugal triggered calls for adaptation of the voting rules at the Board. See, for example, the views of Jim Flaherty, Canadian Finance Minister at the time, proposing a double vote and approval; one by euro area members and another one by non-euro area members: <http://www.reuters.com/article/g-idUSL2E8FJ2KJ20120420>. This change would have required an amendment to the Fund's Articles of Agreement.

<sup>23</sup> See, for example, IEO (2008).

treatment, and (ii) the sidelining of the Board that left a part of the membership largely out of the process. Even so, in their view, it would have had little or no impact on the final decisions.

### **B. The Modification of the Exceptional Access Criteria**

40. The approval of the Greek SBA required a modification of the second criterion of the exceptional access framework. Since Fund staff assessed Greece's debt not to be sustainable in the medium term with a high probability (Schadler, 2016) and after IMF management and the European institutions had already agreed and announced that Fund financing above the regular access limits was needed, IMF management decided that a modification of the criterion was the best way forward. The Board was not consulted on this question. In fact, Directors were not informed of staff's doubts regarding the sustainability of the Greek debt under the program, or notified of the proposal to modify the exceptional access criteria, until May 5, when the formal request document was sent to the Board.

41. In making this change, the rationale behind the Board's procedures was overlooked. First, Directors did not have enough time—just two days—for consideration of a decision that modified a crucial element of the lending framework of the IMF. Arguably, this could have been justified by the urgency of the situation at the time but, according to the evidence obtained by the IEO, management had been considering different alternatives for the modification to the exceptional access policy since, at least, end-April. Moreover, staff stated during the formal Board meeting on the Greek SBA request that they had been thinking about how to approach a change in policy for "a couple of weeks." Yet the Board was not consulted or informed during this period.

42. Second, and more importantly, neither management nor staff drew the attention of the Board to the proposed decision itself or to the fact that the exceptional access criteria would effectively be modified by approving the SBA. The policy change was embedded in the report requesting the Greek SBA and, therefore, was to be approved implicitly along with the formal and explicit request for Fund resources.<sup>24</sup> According to internal documents, concerns were raised during a meeting of management and staff that changing the policy might undermine the credibility of the IMF-supported program, especially with financial markets. It was noted by staff that this policy change could be done quietly by embedding the decision in the staff report. This is against the objectives of the Board procedures and normal Fund practice. In fact, according to interviews and the minutes of the meeting, several Directors expressed concerns about the modification being "hidden" in one sentence of the report, and stated they had not realized the

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<sup>24</sup> The report, in assessing the compliance with the exceptional access criteria, reads: "On balance, staff considers debt to be sustainable over the medium term, but the significant uncertainties around this make it difficult to state categorically that this is the case with a high probability. Even so, Fund support at the proposed level is justified given the high risk of international systemic spillover effects. Going forward, such an approach to this aspect of the exceptional access policy would also be available in similar cases where systemic spillover risks are pronounced." (IMF, 2010a, p. 19).

magnitude and implications of this modification until one of them raised the issue during the meeting.

43. Once the issue was put in the spotlight during the Board meeting, several Board members expressed concern over how the modification was being presented and explored different alternatives. They proposed taking a decision applicable exclusively to Greece, but the Legal Counsel explained that the Board has no authority to make individual exceptions and, therefore, a modification of the criteria for Greece would apply to the whole membership. Some Directors also proposed to hold a separate meeting to deliberate such a far-reaching change or, at a minimum, to dedicate an entire paragraph of the report to discussing the modification, which is more in line with the regular practice. In the event, it was decided to go ahead with the language as proposed in the staff report, and to reflect it in the summing up.<sup>25</sup> The published IMF press release made no mention of this change in IMF policy.

44. The process for the inclusion of what became known as the systemic exemption clause went also against the objectives of the exceptional access framework, namely to limit discretion, ensure uniformity of treatment, safeguard Fund resources, and shape expectations of members and markets. Furthermore, the modification clearly was a reversal of the Board's judgment at the time of the introduction of the framework in 2002, when a systemic criterion was rejected (due, again, to concerns about its compatibility with the principle of uniformity of treatment). In coming to the decision to modify the criteria, the same four factors that led to the approach adopted during the approval of the SBA for Greece (see above) may have been at play. Moreover, as management, and the European partners, had already agreed on the design of the Greek program, a pragmatic and quick fix was needed. A senior IMF official interviewed by the IEO considered at the time that the exceptional access criteria were "bureaucratic rules" that should not stand in the way of putting out the fire facing the world and that their modification would not be a serious issue.

45. The way in which the modification of the exceptional access framework was handled raises the same governance, accountability, and evenhandedness issues posed by the departure from the framework itself (see Section A above).

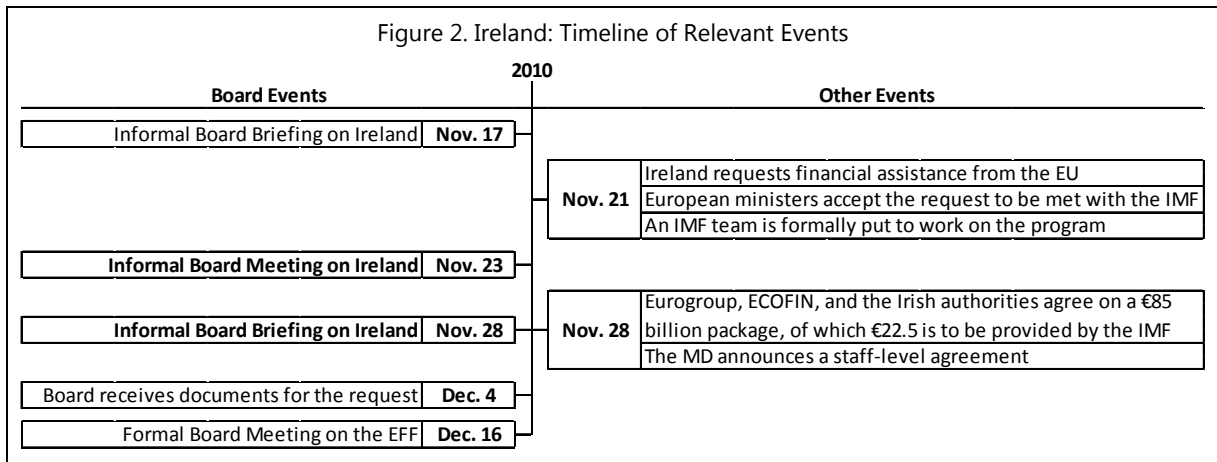
### **C. The Extended Arrangement for Ireland**

46. On December 16, 2010, the Executive Board of the IMF approved a three-year and €22.5 billion arrangement under Extended Fund Facility (EFF) for Ireland, authorizing the second

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<sup>25</sup> The summing up states regarding the debt sustainability issue: "While Directors considered public debt to be sustainable over the medium term, they recognized that there are significant uncertainties that make it difficult to state categorically that there is a high probability that the debt is sustainable over this period as required under the exceptional access policy. Even so, on balance, Directors considered Fund exceptional access as justified given the high risk of international systemic spillovers. Going forward, to ensure the principle of uniformity of treatment, Directors recognized that the Fund would follow this approach regarding this criterion in similar cases with a high risk of systemic spillovers." (IMF, 2010b)

highest level of access in the history of the IMF: 2,322 percent of Ireland’s quota. The Board held three informal meetings on Ireland before the approval of the extended arrangement (Figure 2), two of them under the policy for early consultation (PEC).



47. On November 17, 2010, management and staff communicated to the Board that the next day an IMF mission would begin a “technical engagement” with the Irish authorities on financial sector issues and on “preparation and discussion of program modalities” for a potential program. On November 21, the Irish government formally requested financial assistance from the European Union.<sup>26</sup> On the same date, EU ministers accepted the Irish request, to be met with a joint EU-IMF financial assistance package<sup>27</sup> and the Managing Director instructed an IMF team that was already in Dublin to work on the program, together with the other members of the troika. Also on November 21, a note prepared by staff was sent to the Board in preparation for the Board meeting to be held on November 23. This note presented (i) a preliminary analysis of the problems of the Irish economy, (ii) the recommended policy measures, (iii) a positive assessment of the fulfillment of the criteria for exceptional access, justified by the high risk of international systemic spillovers, and (iv) the anticipated next steps. Thus, it met the requirements contained in element #1 of the PEC. However, as in the case of Greece, this note did not provide estimates of financing requirement, IMF support, and European contribution, all of which was available to management and staff at the time. Moreover, during the November 23 meeting, staff explained that it was still too early to provide estimates on the size of the financing requirements—although it was foreseen that the IMF would cover approximately one third of them—or to discuss in depth PSI approaches. As in the Greek case, while complying with the letter of the exceptional access framework, the approach of management and staff departed from its objectives.

<sup>26</sup> [http://money.cnn.com/2010/11/21/news/international/ireland\\_banks\\_bailout/index.htm](http://money.cnn.com/2010/11/21/news/international/ireland_banks_bailout/index.htm).

<sup>27</sup> [http://ec.europa.eu/economy\\_finance/crisis/2010-11\\_en.htm](http://ec.europa.eu/economy_finance/crisis/2010-11_en.htm).



48. On November 28, the Eurogroup and ECOFIN met and unanimously agreed, with the Irish government, on a financial package of €85 billion, of which €22.5 billion was to be provided by the IMF. An informal Board meeting took place simultaneously, during which Directors were provided with the details of the IMF's financial contribution to the program, in compliance with element #4 of the PEC. The EU Commissioner and the Managing Director announced the agreement immediately after in a joint statement. At the same time, the Managing Director announced separately a staff-level agreement for a three-years arrangement under the EFF and for €22.5 billion.

49. Thus, requirements under element #2 of the PEC were formally satisfied, although Directors felt that key information was not shared with the Board. The Board did not receive a note on the case for exceptional access until the staff report for the program request was circulated, which is consistent with element #3 of the PEC. The Board received the program documents recommending the approval of exceptional access on December 4,<sup>28</sup> with a discussion to be held on December 10.<sup>29</sup> These documents complied with element #6 of the PEC.

50. Overall, the letter of the PEC was complied with during the decision-making process. The rationale and objectives of the exceptional access framework, however, were somewhat set aside. For example, Executive Directors could have been provided with key information in a more timely manner, allowing for more meaningful consultations with their capitals and a more proactive role of the Board at an early stage. The Board was again notified of the IMF's share of the financing under the program as the other members of the troika and the Irish authorities were already giving their agreement and practically at the same time as the public. When the Board was faced with a proposed decision to approve the arrangement, the European authorities and institutions, with the tacit approval of IMF management, had publicly committed to the program for more than two weeks. The nuclear option was the only one left to Directors in case of disagreement. In this respect, the process that led to the approval of the Irish arrangement is subject to analogous criticisms to the process used for Greek SBA, with a similar impact on accountability, legitimacy, and governance.

51. The Irish case also highlights another element of the exceptional access framework: the expectation that the Board would discuss PSI issues during the consultations preceding the approval of an arrangement. During those consultations, despite several questions by Directors, they were not discussed in depth. While during the formal meeting on December 16, some Directors put on the table again the question of alternative approaches to PSI—more specifically asking staff about the possibility of bailing in senior bondholders of Irish banks—the issue had been settled some time earlier. After initial consideration by the Irish authorities and IMF staff, the troika had collectively ruled out this possibility in the last week of November, following a

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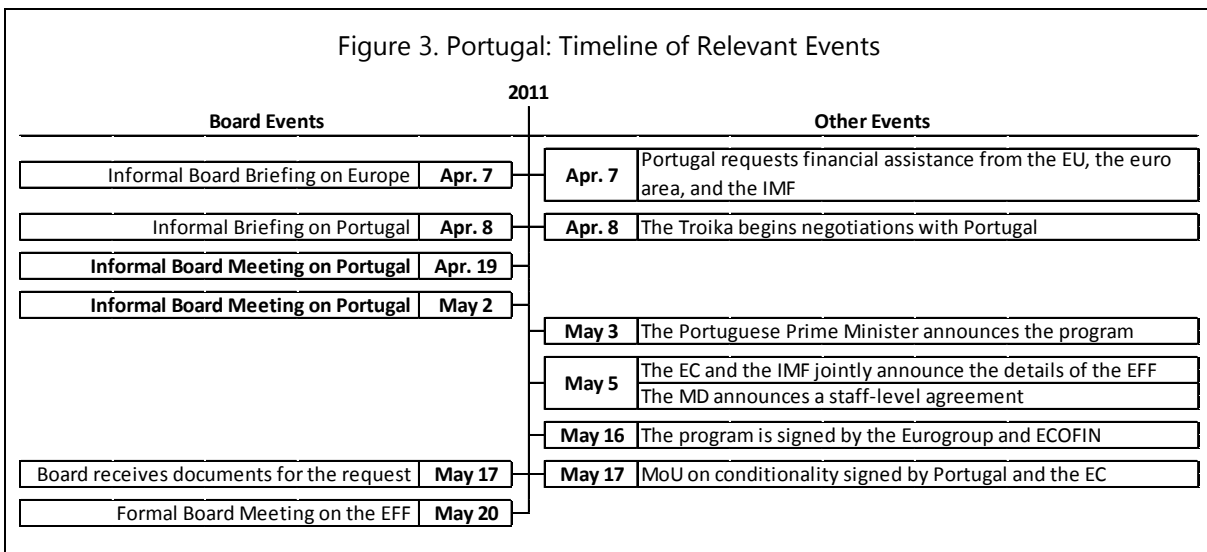
<sup>28</sup> Ireland did not make the formal request until the previous day.

<sup>29</sup> The later decision by the Irish government to table a motion on the program before the Parliament forced the postponement of the Board's discussion until December 16.

teleconference held by the finance ministers of the G7, the president of the European Central Bank, and the Managing Director of the IMF (Donovan, 2016). This issue had not been discussed at informal Board meetings prior to that decision, depriving Directors of an opportunity to provide guidance for negotiations to management and staff and raising again questions of information asymmetry, accountability, and governance more generally.

#### D. The Extended Arrangement for Portugal

52. The Board approved Portugal's three-year arrangement under the Extended Fund Facility involving financing for €26 billion or 2,306 percent of its quota (the third highest access in the Fund's history)—on May 20, 2011 (Eichenbaum and others, 2016). The Board met informally four times, beginning April 7, to discuss issues related to Portugal (Figure 3).<sup>30</sup> Two of these four informal Board meetings took place under the policy for early consultation (PEC).



53. On April 7, the Portuguese authorities requested, formally and simultaneously, financial assistance from the EU, the euro area member states, and the IMF. The Board met informally on the same date to discuss the situation in Europe, including Portugal. On April 8, the Eurogroup and ECOFIN acknowledged the request and invited the EC, the ECB, and the IMF to start program negotiations with Portugal. On the same day, an informal Board meeting was called to inform Directors of the Portuguese request.

54. On April 19, the Board met informally again, for the first time under the PEC, to consider the concise note prepared by staff. This note, circulated to Directors the previous day, met the formal requirements in element #1 of the PEC, including a preliminary evaluation of the criteria for exceptional access in which staff assessed the second criterion to be met given the "high risk

<sup>30</sup> The 2011 IMF Spring Meetings took place between April 15 and 17, and the Managing Director resigned on May 18.

of international systemic contagion.” Yet, as in the other two cases, quantification of the financing requirement, expected IMF access, and European financial support were not provided to the Board in this note even though this information was available to management and staff. Moreover, in response to Directors’ questions at the informal meeting, staff explained that it was still too early to provide such information.

55. There was another informal Board meeting on Portugal on May 2. During that meeting, management and staff shared with the Board a preliminary financing gap estimate of €70 billion, of which one-third was to be covered by the IMF. Therefore, in the Portuguese case, the Board was informed of the (preliminary) level of access before the public announcements and before the program was approved by the European institutions, satisfying elements #4 and #5 of the PEC. Other elements of the PEC were also complied with, since (i) information given to Directors broadly complied with the requirements of element #2, and (ii) the Board received a report on the case for exceptional access with the documents supporting the Portuguese request, which is sufficient under element #3. However, PSI issues were not discussed as expected in the exceptional access framework.

56. The Portuguese Prime Minister announced the program on May 3,<sup>31</sup> but it was only on May 5 that the EC and the IMF jointly released the details of their financial assistance. The Managing Director announced a €26 billion staff-level agreement under the EFF on the same day. Subsequently, on May 16, finance ministers signed the agreement during the meetings of the Eurogroup and ECOFIN. The Memorandum of Understanding that specified the conditionality was signed by the EC and Portugal on May 17. The formal Board meeting was held on May 20. The staff report for the request, specifying the details of the arrangement in full, was sent to Directors two days earlier and was compliant with the requirements of element #6 of the PEC.

57. In general terms, the Board was informed in a more timely manner during the Portuguese negotiations than in the other two cases. However, Directors were still not able to provide guidance during the first stages of the process and could have been provided with information earlier. The Portuguese case is, moreover, the only one in which, at the time of writing, an ex-post evaluation (EPE) has not been discussed by the Board, even though almost two years have elapsed since the expiration of the arrangement in June 2014.

#### **IV. THE ROLE OF THE BOARD IN OTHER SELECTED DECISIONS**

##### **A. “Enhanced Surveillance” for Italy**

58. Italy committed to a series of structural reforms and to a fiscal consolidation strategy during the Euro Summit on October 26, 2011. The leaders’ statement invited the European Commission to assess in detail the proposed measures and to monitor their implementation. The G20, during the November 4 summit in Cannes, supported these measures and welcomed in its

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<sup>31</sup> <http://www.reuters.com/article/us-portugal-bailout-idUSTRE7425UP20110503>.

statement “Italy’s decision to invite the IMF to carry out a public verification on its policy implementation on a quarterly basis” (G20, 2011). The Managing Director, who attended the G20 summit, confirmed immediately afterwards Italy’s request to the Fund and stated that she expected to have a team on the ground before the end of the month. She also explained that the plan was to benefit from the expertise, know-how, and independence of the IMF to verify and certify the implementation of Italy’s commitments, in order to overcome their “lack of credibility.”

59. This monitoring of Italy’s policy implementation, sometimes referred to by the Fund’s spokespersons and the media as “enhanced surveillance,”<sup>32</sup> never occurred. According to IEO interviews, as the new Prime Minister of Italy took office and the measures agreed with the EC were implemented, coupled with the ECB’s purchases of Italian bonds, market pressures eased, and the Italian government and its European partners no longer considered formal IMF involvement as necessary.<sup>33</sup>

60. What was the involvement of the Board in the considerations of this enhanced surveillance engagement? Some members of the Board recalled being informed about the Managing Director’s discussions in Europe, but the issue and the alternative ways in which the Fund could engage with Italy were never presented in written form or discussed informally with the Board, according to evidence available to the IEO. This episode is another example of decisions being taken in Europe with no meaningful involvement of the IMF’s Executive Board. It also contributed to solidify the perception among some Directors that European countries were treated differently.

## **B. The Provision of Technical Assistance to Spain**

61. In 2012, the IMF conducted a Financial Sector Stability Assessment (FSSA) for Spain under the Financial Sector Assessment Program (FSAP), updating the one completed in 2006. On April 25, the preliminary conclusions were made public by the Fund mission. On June 8, the Board formally discussed the Spanish FSSA,<sup>34</sup> and the next day the Eurogroup made public a

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<sup>32</sup> Formally, “enhanced surveillance” is a special instrument in the IMF toolkit used as a signaling device and does not imply IMF endorsement of the member’s economic program. Created in 1985, it has not been used since the early 1990s (IMF, 2007). It is unclear whether references to ‘enhanced surveillance’ in the context of Italy’s monitoring referred to this instrument in particular or generically to an intensified form of surveillance. Had this monitoring been implemented, this differentiation would have been important, as the required involvement of the Board would have been different.

<sup>33</sup> Mario Monti replaced Silvio Berlusconi as Prime Minister on November 16, 2011. The media reported, at the beginning of February 2012, that discussions between Italy and the IMF were being held on the possibility of bringing the format of the planned monitoring closer to the Fund’s regular surveillance, as market pressures eased. (See <http://www.reuters.com/article/italy-imf-idUSL5E8D32KH20120203>).

<sup>34</sup> FSSAs are normally discussed by the Board together with the Article IV report for the country in question. However, in this case, the Board considered the FSSA for Spain on standalone basis (the Article IV report was

statement announcing predisposition to respond favorably to an eventual request for financial assistance by the Spanish authorities. In the same statement, the Eurogroup indicated that the IMF would be involved in the conduct of an initial assessment and designing financial sector conditionality to be attached to the program. It also invited the Fund “to support the implementation and monitoring of the financial assistance with regular reporting.” The Managing Director strongly welcomed this preliminary agreement and signaled the IMF’s readiness to accept the invitation of the Eurogroup. Six weeks later,<sup>35</sup> on July 20, the Eurogroup approved the financial assistance and the Fund made public the “Terms of Reference for Fund Staff Monitoring in the Context of European Financial Assistance for Bank Recapitalization.” This terms of reference, agreed with the Spanish authorities and the EC, clearly specified that (i) the Fund was not responsible for the conditionality or implementation of the financial assistance, and (ii) the Fund’s monitoring was to be conducted as a form of technical assistance.

62. Focusing exclusively on the involvement of the Board, management and staff made a series of decisions that effectively left the Board out of the decision-making process on this Spanish TA. According to information available to the IEO, different alternatives were internally considered and a different course of action could have been chosen. First, the Fund’s monitoring could have been conceived as a form of surveillance under Article IV, which would have implied formal involvement of the Board. However, it was decided to shape it as TA, under Article V, Section 2(b), which can be approved and conducted without the authorization of the Board.<sup>36</sup> Second, the Spanish authorities, not a European institution,<sup>37</sup> made the request for TA. If the request had been made by a nonmember, including an international organization, it would have required Board consent. Third, responsibility for conditionality design and implementation was not assumed, as this would have gone beyond the boundaries of TA, requiring Board approval. Fourth, despite the absence of legal requirements, management could have decided to engage Directors more actively, but, in the event, the Board was not involved except to receive, for information only, the ToR and the staff periodic monitoring reviews.

63. According to Board members interviewed for this evaluation, the Board was never consulted on the possible modalities of IMF engagement with Spain, nor was it formally involved in the implementation of the monitoring. This was a managerial decision, taken in accordance with internal rules and practices, but was it an example of good governance? In the view of some

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presented to the Board on July 25), which was regarded by several Directors at that time as an example of exceptionalism.

<sup>35</sup> In the interim, on June 14, the Article IV mission to Spain ended and a concluding statement was published.

<sup>36</sup> The functions of the Executive Board in the area of capacity development, including technical assistance, are limited to strategic direction and oversight through (i) regular reviews of, and policy guidance for, the Fund’s capacity development policies and activities; and (ii) the budget process. It is management responsibility to approve individual members’ requests, conduct operations, and establish policies in this area (IMF, 2014b).

<sup>37</sup> Financial assistance was provided through the ESM, while the EC was in charge of conditionality and monitoring.

Directors, management effectively excluded the Board and allowed an exceptional treatment to Spain, giving rise to concerns about evenhandedness, legitimacy, and accountability. Directors also noted that a higher degree of transparency and candor in the communication between management and Directors would likely have led to the same outcome but without raising governance-related concerns.

### **C. The Interaction with European Institutions**

64. The Eurogroup created the troika in 2010 as the vehicle for negotiations of joint IMF-EC programs with Greece, and continued on for the Irish and Portuguese crises. The rationale behind this setup, and the important implications that followed, are beyond the scope of this paper (see Kincaid, 2016 for a detailed analysis). However, the troika arrangement was not the only way in which the IMF could have engaged in these programs, both in terms of process and substance. For example, the IMF could have (i) acted more independently, (ii) participated with a larger or smaller financing share, perhaps even within regular access limits, or (iii) assisted in the design and implementation of the program without the provision of financing, as it did in Spain. These and other alternative modalities of engagement could have been explored, but according to the information available to the IEO, the Board was never consulted by staff or management on how to proceed nor were the implications presented to the Board in 2010.

### **D. The IMF's Role in the ESM Treaty**

65. The treaty establishing the European Stability Mechanism (ESM) refers to the IMF in a number of places. Some of these simply refer to the Fund as a model or standard for operations (e.g., consideration of PSI in exceptional cases, or provision of financial assistance when access to regular market financing is impaired), but some other references specify a role for the IMF in the operations of the ESM. In particular, the Treaty stipulates that:

- “The ESM will cooperate very closely with the IMF in providing stability support. The active participation of the IMF will be sought, both at technical and financial level. A euro area member state requesting financial assistance from the ESM is expected to address, whenever possible, a similar request to the IMF.” The framework agreement of the European Financial Stability Facility (EFSF), the predecessor of the ESM, also contained a provision to this effect.
- The assessment of debt sustainability “is expected to be conducted together with the IMF” wherever appropriate and possible.
- MoUs detailing the conditionality attached to the ESM financial assistance will be negotiated by the EC in liaison with the ECB and “wherever possible, together with the IMF,” a provision, again, originally introduced in the framework agreement of the EFSF.

- The EC, in liaison with the ECB and “wherever possible, together with the IMF” will monitor the compliance with ESM’s conditionality.

66. While these provisions are not binding on the IMF, they frame its relationship with European institutions and define coordination expectations. While IMF staff commented on a draft of the Treaty, the issue was never brought before the Board, preventing an open debate on its implications. This is another example of poor governance practices. This lack of an open discussion magnified the perception of European exceptionalism, according to interviewees.

### **E. The Pari-Passu Clause**

67. The financial assistance agreements of Greece, Ireland, and Portugal with the EFSF included a pari-passu clause,<sup>38</sup> by virtue of which any early repayments made by program countries to the IMF would make a proportional amount of the loans under the agreement with the EFSF (and the other lenders) “immediately due and repayable.” This means that the regular individual interaction between the IMF and its members, more concretely the freedom of program countries to repay the Fund at any point during the program, was constrained. This had financial implications for the program country, as fees and interests must be paid for longer periods, and affected the revolving nature of IMF resources, by constraining the availability of financing to other members. It has also been argued—rightly or wrongly—that these clauses affect the preferred creditor status of the IMF.

68. In the event, Ireland decided to make an early repayment to the Fund and the proportional payment was waived by the other creditors on the basis of a note prepared jointly by the ECB, EC, ESM, and the IMF for consideration by euro-area creditors.<sup>39</sup> This note was not circulated to the Executive Board. According to IEO interviews, some Directors felt the Board was sidelined again. During the approval of the programs, the pari-passu clause was not brought to the attention of Directors (although it was included in the addendum on EU conditionality attached to the requests) and its implications were not discussed.

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<sup>38</sup> Greece’s Master Financial Assistance Facility Agreement contains the following clause (a similar one can be found in the other two programs): “If financing granted to the Beneficiary Member State under the IMF Arrangement, any of the facilities provided by the Financial Support Providers, the IMF or the European Union (or any body or institution thereof) or any of the facilities provided by EFSF as described in Preamble (6) is repaid by the Beneficiary Member State in advance in whole or in part on a voluntary or mandatory basis, a proportional amount of the Financial Assistance Amounts of the Financial Assistance provided under this Agreement together with accrued interest and all other amounts due in respect thereof shall become immediately due and repayable in a proportionate amount established by reference to the proportion which the principal sum repaid in advance in respect of the IMF Arrangement or the relevant facility represents to the aggregate principal amount outstanding in respect of the IMF Arrangement or such facility immediately prior to such repayment in advance.” A similar clause was also included in the agreements of Ireland with its bilateral lenders (United Kingdom, Denmark, and Sweden).

<sup>39</sup> <http://www.finance.gov.ie/ga/what-we-do/eu-international/publications/reports-research/early-repayment-imf-credit-letters-lenders>.

## V. MAIN FINDINGS AND CONCLUSIONS

69. The role of the Executive Board, in any substantive sense, was minimal in decision-making and providing guidance for the handling of the euro area crisis. The Board, as the IMF's day-to-day governing body, played largely a nominal role, sanctioning decisions that had already been made by management, in some cases jointly with the other members of the troika, or adopted in other fora like the Eurogroup or the G7. Such anemic involvement of the Executive Board stands in contrast to the expectations under the exceptional access policy that strengthened and clear processes would provide additional safeguards and accountability by reinforcing careful and systematic decision-making by the Board. The unprecedented access levels and unique nature of IMF involvement with the euro-area institutions should have demanded, from a good governance perspective, consultation with the Board and capitals that went beyond the legal minimum.

70. This sidelining of the Board was allowed to occur, in part, by a departure from the original objectives of the IMF internal rules and procedures. The purpose of the Fund's framework for exceptional access was compromised during the process leading to the approval of the Greek, Irish, and, to a lesser extent, the Portuguese arrangements. The Board lacked the timely and substantive information it needed to play a more active and influential role.

71. The manner in which the exceptional access criteria were modified, in order to allow for approval of the Greek SBA, also went against the rationale behind the established Executive Board procedures. First, Directors did not have sufficient time to consider such an important modification. Second, and more importantly, neither management and staff nor the program document presented to the Board alerted Directors about the proposed decision itself or about its implications: a major change in the IMF lending policy. The proposed decision was buried in the report that supported the Greek request and crafted as a pragmatic solution that allowed the launching of a program already agreed upon. At the same time, this decision went against the key objectives of the exceptional access policy and reversed an explicit decision made by the Board at the time it adopted the framework.

72. The Executive Board was not involved in other important decisions. It was never consulted on how best to cooperate with the European institutions in the troika, on the role the IMF was to play in the enhanced surveillance agreed for Italy, or on the technical assistance provided to Spain. The Board did not discuss either the implications of the roles attributed to the Fund in the founding treaty of the ESM, or of the pari-passu clauses included in the master financial agreements between Greece, Ireland, and Portugal and their European lenders. The exclusion of the Board from decisions on these issues, though not a breach of any rules, magnified the perception of secrecy and obscurity associated with the way these programs were managed, with considerable cost to the Fund's reputation.

73. Three immediate consequences resulted from the way the process was handled. First, a deep information asymmetry was introduced in the Board, as European Directors could benefit



from advice by their capitals that was based upon more timely and relevant information through the European institutions, while the rest of the Board (and their capitals) had no direct source of information. Second, the Board was largely removed from the decision-making process and had little chance to provide any inputs or guidance, since it was not meaningfully consulted early in the process as intended under the exceptional access policy. Third, the Board's ability to fulfill its responsibility to supervise management and staff and hold them accountable was undermined.

74. Beyond these immediate consequences, the approach to decision-making adopted had substantial implications for the legitimacy, accountability, and governance of the institution. Regarding legitimacy, a significant part of the membership felt excluded and thought European countries were treated more favorably, as exceptions mounted up. Some of these may have been justified, given the exceptional circumstances, but their rationale was not discussed a priori with Directors. When the program requests were presented to the Board, Directors had the legal capacity to reject or postpone their approval, but this would have been a difficult and virtually unfeasible decision. It would have meant denying assistance to member countries in trouble going against the recommendations of management and staff, in a context of huge uncertainty and possible regional and global contagion. Avoiding this "nuclear option" was precisely the intention of the early and substantive consultations with the Board as envisaged in the exceptional access framework. Such an option was also politically unpalatable, given that the capitals of member countries holding almost one-third of the voting power at the Board had already publicly committed to the agreements. The Board's consultative and oversight functions were also undermined, magnifying management discretion in critically important decisions and minimizing its accountability to the membership. Effectively, the Board was rendered ineffective regarding several major decisions. These governance problems are not new, but they were aggravated by the special circumstances surrounding the participation of the IMF in the euro area crisis.

75. A more open and transparent communication by management and staff with the Board might not have changed the final decisions. The measures adopted had ample political support and the context of extreme uncertainty and urgency at the time did not leave much room for careful consideration of alternatives. However, a more candid debate would have helped preserve the legitimacy of the IMF and avoid the perception of European exceptionalism.

76. The uncertain and risky environment in which the IMF operates, especially when fulfilling its role as crisis manager, requires agility and flexibility. This, in turn, means that management and staff need some room for maneuver and a certain degree of discretion in making decisions and conducting negotiations. Nevertheless, as implicitly recognized in the exceptional access policy and the Board procedures, higher degrees of management and staff leeway, sometimes demanded by exceptional circumstances, must be matched with increased openness and transparency in their relationship with the Board. Otherwise, the Board's roles are undermined and the institution's legitimacy is eroded.

77. While the IMF already has policies and rules designed to prevent these kind of problems, they may need to be reexamined and improved. For example, since informal meetings are an important part of the exceptional access framework, minutes or transcripts of those meetings should be kept in order to allow for later review and evaluation. Other areas that deserve attention are (i) how to prevent information leaks, (i) exploring the possibility and feasibility of adjusting voting rules in certain circumstances, and (iii) how to communicate the Board's views, distinctively from those of management and staff to the public. More generally, consideration should be given to adopting measures aimed at reinforcing the implementation of rules and strengthening accountability, with the ultimate objective of preserving the representativeness and the effectiveness of the Board by keeping it adequately informed. These issues continue to have a significant impact on the legitimacy and reliability of the institution in the eyes of the membership, and underscore the need for a more general debate on how to improve the governance of the IMF.

**ANNEX 1. MODIFICATIONS TO THE EXCEPTIONAL ACCESS CRITERIA IN  
JANUARY 2016 REVIEW (IMF, 2016A)**

“(a) The member is experiencing or has the potential to experience exceptional balance of payments pressures on the current account or the capital account, resulting in a need for Fund financing that cannot be met within the normal limits;

(b) A rigorous and systematic analysis indicates that there is a high probability that the member’s public debt is sustainable in the medium term. Where the member’s debt is assessed to be unsustainable ex ante, exceptional access will only be made available where the financing being provided from sources other than the Fund restores debt sustainability with a high probability. Where the member’s debt is considered sustainable but not with a high probability, exceptional access would be justified if financing provided from sources other than the Fund, although it may not restore sustainability with high probability, improves debt sustainability and sufficiently enhances the safeguards for Fund resources. For purposes of this criterion, financing provided from sources other than the Fund may include, inter alia, financing obtained through any intended debt restructuring. However, in instances where there are significant uncertainties that make it difficult to state categorically that there is a high probability that the debt is sustainable over this period, exceptional access would be justified if there is a high risk of international systemic spillovers. Debt sustainability for these purposes will be evaluated on a forward-looking basis and may take into account, inter alia, the intended restructuring of debt to restore sustainability. This criterion applies only to public (domestic and external) debt. However, the analysis of such public debt sustainability will incorporate any ~~potential~~ relevant contingent liabilities of the government, including those potentially arising from private external indebtedness.

(c) The member has prospects of gaining or regaining access to private capital markets within ~~the~~ a timeframe when Fund resources are outstanding and on a scale that would enable the member to meet its obligations falling due to the Fund.

(d) The policy program of the member ~~country~~ provides a reasonably strong prospect of success, including not only the member’s adjustment plans but also its institutional and political capacity to deliver that adjustment.”

**ANNEX 2. MAIN CHARACTERISTICS OF EXECUTIVE BOARD MEETINGS, OCTOBER 2015**

	<u>Formal Meeting</u>	<u>Informal Session to Brief</u>	<u>Informal Session to Engage</u>
Chaired by	Management	Management/Staff	Management
Supporting documents	Yes	Possible	Yes
Directors' Statement	Yes	Rarely	Rarely
Directors' prepared views	Yes	Possible	Yes
Executive Board decision	Possible	No	No
Summing Up/Chair's Statement	Yes	No	No
Minutes	Yes	No	No

Source: Compendium of Executive Board Work Procedures.

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