



CENTRAL BANK OF SEYCHELLES

Circular on Lending Facility to Commercial Banks: Credit Auction Arrangement

In line with section 29(b) of the Central Bank Act (2004), this circular sets out the Central Bank's guiding principles of the newly introduced lending facility to commercial banks mainly for the purposes of:

- i. addressing systemic and/or cyclical liquidity shortages
- ii. safe-guarding from insolvency events and financial shocks brought about through liquidity shortages.

This initiative is in line with the new policy direction of the Bank which is based on the active management of liquidity within the banking system.

The facility is henceforth referred to as the Credit Auction Arrangement (CAA), an open market operation with the purpose of addressing systemic liquidity shortages in the system, by the Central Bank auctioning funds against eligible collateral for a predetermined period to banks.

The Central Bank reserves the rights to amend any of the provisions in these documents including the borrowing limits and haircuts pertaining to the facility, on the basis of its monetary policy stance and/or to reflect market conditions or the quality of collateral.

Banks will be notified of any changes in advance. The facility is effective as of October 1, 2009 and operational when deemed necessary by the Central Bank.

A. Procedures on Credit Auction Arrangement (CAA)

I. Introduction

To ensure an effective market-based implementation of monetary policy, the Central Bank is developing new instruments to assist banks to adequately and actively manage their liquidity. As part of the new framework, a Credit Auction Arrangement (CAA) facility has been established under which banks may borrow for a pre specified duration from the Central Bank when funding possibilities are unavailable.

The facility is intended to primarily cover deficits that have arisen as a result of systemic or cyclical liquidity shortages by providing collateralised loans at auction derived interest rates¹, using a variable rate tender system.

The facility will therefore provide a monetary stimulus at instances when a shortage of liquidity within the whole financial system could jeopardize banking operations and thus lowers the risk of a negative ripple effect in the economy.

II. Necessary Preconditions and Eligibility

Only banks licensed to conduct domestic banking business in Seychelles shall be the authorised participants at the auction.

Banks must be in a ‘generally sound financial condition’ and are expected to remain so over the terms of the CAA loans. Participation is entirely on a voluntary basis.

III. Scheduling and Term of Facility

Given that the instrument is an open market-type tool used to supply liquidity in the system, it will only be used as and when the need to inject liquidity in the system arises, without any specific schedule.

¹ In the event of a single price auction, the marginal rate will be used.

The term (duration) for a particular auction will be determined on the basis of the liquidity stance of the Central Bank at the time of the intervention. This shall vary from overnight to several weeks or months. Only one maturity option will be offered in an auction.

Banks will be informed through an Auction Announcement of the intention of the Central Bank and details of the auction will be provided.

IV. Eligible Collateral

Advances awarded under this arrangement must be backed with sufficient and eligible collateral(s). Banks will be required to surrender to the Central Bank the required collateral(s) on the day credit is awarded.

Eligible assets that qualify as collaterals for the CAA are listed in Part B of this circular. The Central Bank may at its own discretion, however, accept assets other than those listed therein.

The market value of the collateral(s) needs to be equal to or greater than the amount of credit being sought. In the case of Bills and Bonds, the market value will equal the Net Present Value², less a discount. The discount or haircut is applied to protect the Central Bank from market risks as well as to reflect the credit risk of the issuer of the security.

Collateral must not have a term to maturity which is shorter than the credit auction term.

V. Interest Calculation

The interest rate will be determined by the auction process, using a variable rate tender³ system. Banks will be charged, pending approval by the Central Bank, at the submitted auction bid rate.

In the future, if the Central Bank opts for a single price⁴ auction outcome, then a single rate will be applicable to each and every credit amount awarded to any participant, set at the marginal rate.

²The Net Present Value is the face value of the security discounted at the 91 day T-bill rate.

³That is when the rate of interest is determined by the auction process and the monetary amount available for auction is predetermined.

Allotment priority shall be given to the highest bid rate by ranking the bid rates from the highest to the lowest, in sequence, until the Offering Amount is met. When necessary, bids at the lowest accepted interest rate will be prorated.

VI. Tender Limits

No limits will be set on the aggregate amount a bank can bid for in the facility. Banks should ensure that the amount of any single tendered bid is in compliance with any Maximum and/or Minimum Bid Amount(s), if specified, in the announcement.

In the event any bid does not comply with the stipulated term amount(s), such a bid will not be considered in the auction.

VII. Terms and Conditions

Submitted bids shall be irrevocable, representing firm commitments of the eligible participants, with any bid not meeting the terms and conditions set in the announcement to be excluded from the auction process.

Submission of bids may be by facsimile, email or hand delivered. Only authorised signatories as provided by the banks to Banking Services Division will be accepted as designated guarantors to the credit.

In the event of a submission via email, only requests with the bank's email extensions will be accepted and furthermore, requests must be confirmed via telephone. The Central Bank will only accept hand delivered CAA bids which are officially stamped and have at least one authorised signature at the bottom.

Only bids submitted by the auction window deadline and meeting the information requirements for submission will be accepted.

⁴ A single price auction is where the bids are awarded at one single rate to all successful bidders, determined by the marginal rate at which the available amount is fully allocated.

VIII. Procedures and Instructions

a. Announcement

The Central Bank will issue an announcement, via email or facsimile before an auction is scheduled. This will specify the terms and conditions of the auction and will contain the following:

- A reference number of the Auction, *for example CAA20090509*,
- Date of the Auction, *for example May 9, 2009*,
- Auction Format, *for example Uniform rate or Multiple rate*
- Maturity period (days): *for example nine (9)*
- Offering Amount⁵: *for example R350,000*
- Auction Window Start Time: *for example 09:00 hours*
- Auction Window Closing Time: *for example 10:00 hours*

In addition, when deemed necessary by the Central Bank the following will also be included in the announcement.

- Minimum Bid Amount *for example R50,000*
- Maximum Bid Amount *for example R100,000*

b. Bidding

Participants will be provided with a CAA Bid table, which must be completed for submission of bids. This will require the following information:

- Authorised signatories and official stamp details
- Bid amount(s)
- Bid Rate(s) (expressed as an annual percentage rate to two decimal points)

c. Auction Awards and Notification

Only bids that meet all of the criteria set in section VI. and section VII. of the document will be considered in the allocation process.

⁵ Determined by the Central bank on the basis of liquidity analysis and forecasting.

Notification of approved and rejected bids will be sent to participants instantly following allotment via email and/or fax. In the case of approval, the notification shall state the amount awarded. Banks are expected to comply with collateral requirements set in Section IV. to reach settlement.

The Central Bank will publish the Weighted Average CAA Rate for the maturity period(s) on its website on the auction date. In the event of a uniform auction rate, this rate will instead be published.

The Central Bank reserves the right to accept or reject any or all bids and is not required to provide any reason for doing so.

d. Settlement

Successful banks in the auction will have their accounts credited shortly after verification of the collateral is completed by the Central Bank. In the event that the submitted collateral(s) does not match or is (are) less than the awarded credit as per requirements set out in Section IV., banks will be notified. Until the Central Bank is satisfied, it will result in a delay in the transfer of funds.

e. Repayment

On the stated maturity date, the participating banks will have their demand deposit account at the Central Bank debited with the principal and interest of the loan, as stated in the notification email and/or fax.

Interest payment will be calculated on a per annum basis for the number of days credit was awarded for. No bank will be allowed to prepay an advance awarded in an auction prior to the maturity date unless sanctioned by the Central Bank and in exceptional circumstances.

In the event that the repayment date is on a non-business day including Saturdays and Sundays, the transfer will occur on the following business day.

f. Penalties

It is each bank's obligation and duty to ensure that the required amount for repayment is available on its account on the maturity date. In the event that this condition is not met, the

Central Bank will acquire the bank's collaterals and impose a penalty as decided by the Board.

In the event that the Bank establishes arbitrage undertakings by banks on the facilities in operation, the bank in question will be penalised.

g. Other provision

- (i) The Central Bank is not responsible for, among other things, technical or any other failures that prevent a participant from receiving an announcement, participating in an auction, making any communication with respect to a bid or receiving auction outcome results.
- (ii) The Central Bank is not responsible for any delays, errors or omissions, including any errors in determining the auction results, except for its own delays and/or errors or omissions.
- (iii) The Central Bank reserves the right to amend any of the above provisions to meet the overall objective of its monetary policy stance.

B. Determining Collateral Haircuts & Market Value

I. INTRODUCTION

In line with the Central Bank's recently introduced monetary policy measures, it has become necessary to review eligible assets that may be used as collateral for the Bank's lending facilities.

Assets that qualify as collaterals for the Bank's lending facilities are listed and classified in section II below. The value of the collateral to be used against the lending facility will reflect the market value as well as the associated risks.

In the case of securities⁶, these will first of all be discounted at the market rate prior to applying the haircut. The haircut (or discount) is applied to protect the Bank from market risks as well as to reflect the credit risk of the issuer of the security. For the other collaterals, only the haircut will be applicable.

Section III gives out the steps for the calculation of Net Present Value (NPV) and section IV specifies the haircuts.

II. ELIGIBLE COLLATERAL

Assets are classified into three categories based on the risk profile, with category 1 having the lowest risks and category 3 the highest.

- Category 1
 - 1.1 Deposit Auction Arrangement (DAA)
 - 1.2 Central Bank Bills
 - 1.3 Treasury Bills
 - 1.4 Government Bonds and Stocks (Rupee denominated)
- Category 2
 - 2.1 Securities issued by banks and other financial institutions (Rupee denominated)
 - 2.2 Negotiable instruments approved by the CBS that are repayable within 180 days

⁶ For the purpose of this paper, securities only refer to bills, bonds and stocks issued by government, Central Bank, banks and other financial institutions.

- Category 3
 - 3.1 Government Securities (Foreign currency denominated)
 - 3.2 Securities issued by banks and other financial institutions (foreign currency denominated)
 - 3.3 Negotiable instruments approved by the CBS that are repayable within 365 days
 - 3.4 Balances due from financial institutions abroad (denominated in foreign currency)

Categories 2 and 3 may not be used to back up any overnight to one week lending facility.

III. NET PRESENT VALUE OF SECURITIES

Collaterals other than securities will have a market value which is equal to the face value minus a haircut where applicable. However, for securities, prior to applying the haircut, the Central Bank will discount the face value of the securities at the latest market rate so as to reflect current market development.

Thus, the haircut will apply on the NPV of the security and not the face value. NPV will be inclusive of any processing fee or tax on the securities.

Below, the approach for discounting local government securities is set out. Please note that the same procedures will be used to discount securities issued by the Central Bank, banks and any other financial institutions.

Treasury bills

Market value of T-bills used as collateral will be calculated based on the 91-day T-bill rate.

$$\text{Market Value} = V * [1 - (r * d/365)]$$

Where;

V = Face Value

r = latest T-bill rate

d = Days to Maturity

Government Bonds and Stocks

To discount government bonds, the Bank will use the market rate and the respective series of future cash flows.⁷

NPV (market rate, value1: valueN)

The *market rate* is the rate of discount over the length of one period. A period is defined as the number of coupon payments made in a year. Say the coupon payment is made semi-annually, then the market rate equals the annualised interest rate divided by 2.

The *values* represent the cash flows (income) throughout the remaining lifespan of the bond. These must be equally spaced in time and occur at the end of each period, in the correct sequence.

Put in another way, the Net Present Value of the Bond = Summation of present values of coupons + present value of the par value. The standard formula to calculate the NPV for both single and multiple coupon annual payments is as follows

$$\text{NPV} = \sum_{t=1}^n C_t / (1+r)^t + (P_n) / (1+r)^n \quad \text{for } n > 0$$

Where;

C_t The cash-flow for period t ;

r is the market interest rate (for multiple annual payment r = the rate of interest divided by the number of payments within a year).

n is the number of periods (number of coupon payments) left to maturity

P_n is the par value of the bond

⁷This will be done by using the NPV function from Microsoft Excel.

IV. HAIRCUTS

In view of the risks associated with the eligible assets the following haircuts are applicable.

No haircut will be applied to the DAA deposits⁸ (category 1.1)

Residual Maturities (months)			
0 - 3	4 - 6	7 - 9	10 - 12
0.0%	0.1%	0.3%	0.5%

Categories	Residual Maturities (years)			
	0-1	1 – 5	5 - 10	> 10
1(1.4)	0.5%	1.5%	2.5%	3.5%
2	1.5%	3.0%	4.5%	6.0%
3	2.5%	4.5%	6.5%	8.5%

The Central Bank reserves the right to change the haircuts applied in order to reflect current market conditions.



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Deputy Governor

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⁸ The rationale is that the DAA deposits which are kept at the Central Bank are relatively risk-free, with very short maturities.