RESERVE MANAGEMENT AND INVESTMENT GUIDELINES FOR CENTRAL BANK OF SEYCHELLES

I. RESERVE MANAGEMENT PRINCIPLES

A. Legal Mandate and Eligible Reserve Assets

In accordance with Article 25 of the Central Bank of Seychelles Act on managing official reserves, the Central Bank of Seychelles is responsible for managing all the country's official foreign reserves, with due consideration for the objectives of the monetary policy and external asset position of the country.

The Board of Directors may invest these reserves in any or all of the following assets:

- Foreign currency banknotes and coins held by the Central Bank of Seychelles or on its behalf.
- Foreign currencies held as demand deposits, time deposits, currency forwards, swap lines or reverse repo agreements with foreign central banks, official international financial institutions, or eligible international commercial banks, as determined by the Board of Directors (see Annex I).
- Tradable and liquid debt securities issued by foreign governments, central banks, or official international financial institutions, or eligible international commercial banks (see Annex I) and held by the Central Bank of Seychelles or on its behalf. Only long positions are permitted.
- Investment schemes with external managers (other central banks, international financial institutions, and private sector managers)
- Special Drawing Rights (SDRs) in Seychelles' account with the International Monetary Fund.
- Seychelles' reserve position with the International Monetary Fund.

B. Reserve management objectives, strategy and coordination

Objectives

Reserve management should seek to ensure that:

- adequate foreign exchange reserves are available to make international payments and support the monetary policy;
- liquidity, market, and credit risks are controlled in a prudent manner to achieve the safety and liquidity of the reserves; and
- Subject to safety, liquidity and other risk constraints, reasonable earnings are generated over the medium to long-term on the funds invested.

Earnings generated on the invested reserves shall be treated in accordance with the CBS Act.

Reserve management strategy and coordination

- Reserve management strategy should be consistent with and supportive of the policy environment, in particular the monetary policy.
- Alternative reserve management strategies and their respective implications for reserve adequacy should be subjected to an annual review.
- Strategies should take into account legal considerations to avoid encumbering the reserves and to ensure their safety.
- Reserve management strategies should also take into account external debt and external government assets for purposes of managing the overall external position of the government.
- Official reserves should be invested in convertible currencies (see Annex II for a list of eligible currencies).

C. Transparency and accountability

Public availability of information on foreign exchange reserves

- Summary information on official foreign exchange reserves will be publicly disclosed on a daily basis on CBS website. Conduct of reserve management activities will be included in the annual audit conducted by independent external auditor(s) and detailed in the annual report.
- To support the public trust in the integrity of reserves management appropriate elements of these guidelines will be published.

D. Institutional framework

Internal governance

The internal governance structure of the CBS is guided by and reflects the principles of clear allocation and separation of responsibilities.

- An Investment Committee[1], chaired by the Governor and approved by the Board of Directors, is responsible for monthly review of investment decisions.

[1] The Investment Committee comprises of the Governor, Deputy Governor, HoDs of the MAS and BS; and the Internal Auditor

- Daily implementation of the investment policy (including the oversight of external managers) is vested with the Banking Services Division (BSD), and supervised within the general executive line of the CBS.
- Head of the BSD advises the Investment Committee on strategic allocation of the reserve assets.
- Sound management of internal operations and risks requires appropriately qualified and well-trained staff, following sound business practices.
- Effective monitoring of internal operations and related risks will be supported by reliable information and reporting systems, and an independent audit function, reporting to the Board of Directors.
- Staff involved in reserve management will be subject to a code of conduct and conflict of interest guidelines regarding the management of their personal affairs, to be approved by the Board of Directors.
- Effective recovery and back up procedures shall be put in place to mitigate the risk that reserve management activities might be severely disrupted by the failure of operating systems, human error, or catastrophic events.

E. Risk management framework

- The CBS will establish a framework that identifies and assesses the risks of reserve management operations and that allows the management of risks within the parameters and levels established in these Reserve Management and Investment Guidelines.
- Risk exposures will be monitored daily by the BSD to determine whether exposures have been extended beyond acceptable limits.
- The CBS will also form a general Operational Risk Committee[2] which among other things will oversee risk management in the reserves area. The CBS should be aware of and be able to account for potential financial losses and other consequences of the risk exposures it is prepared to accept.
- To assess the risk and vulnerability of the reserves, the CBS (the Investment Committee) will regularly review Section II (Investment Guidelines) of the Reserve Management and Investment Guidelines in light of prevailing macroeconomic and external circumstances and the potential effects of macroeconomic and financial shocks.

[2] The Operational Risk Committee comprises of two Board members, Deputy Governor, Internal Auditor and Legal Officer [amended December 14, 2009]

II. INVESTMENT GUIDELINES

The following investment guidelines shall govern the reserve management activities and express the risk/return considerations of the Board of Directors of the CBS

A. Currency risk

Currency risk is defined as the risk of adverse movements in foreign currency across exchange rates that reduce or increase the value of international reserves. Currency risk is considered against a basket of currencies (also called the numeraire), reported against such a basket, and shall be reflected in the benchmark.

In terms of methodology, the benchmark currency composition (as reflected by the mid-points in the currency composition benchmark below) is derived on the basis of:

- The currency composition of imports, expressed as the 3-year rolling historical average of the country's imports by trading partner (not invoicing currency);[3]

- The currency composition of external debt, expressed as the currency composition of short-term external debt and external debt maturing within one year[4];

On basis of the above considerations and during the transition period, the currency composition is reviewed every six months by the Board of Directors and is summarized as follows: (See Annex VI)

[3] The relative weights of imports of goods and services (measured in US dollars) based on sales of foreign exchange at the banks since the foreign exchange liberalization in November 2008 are 69% for the US dollar, 20% for the Euro (which includes trade with countries pegging their currencies to the US Dollar or Euro or whose exchange rate is assumed to move in line with the US Dollar or Euro, respectively) 6 percent for the British Pound and 5 percent for other currencies.[Figures are as at August 18, 2009]

[4] During negotiations with external creditors, and in the grace period following outcomes of negotiations, Seychelles will mostly service existing or committed multilateral debt. Around half of this debt is denominated in US Dollars, around 40% in SDR or equivalent, and around 4 per cent in Euro.

Currency Composition Benchmark (excluding SDR holdings)
(In percent)

Currency	Minimum	Mid-point	Maximum
U.S. dollar	82	84	86
Euro	9	11	13
British Pound	3	5	7
Other eligible currencies 1/	0	0	0
Total		100	

1/ Currencies as necessary for trade and payments purposes.

The actual currency composition of the foreign exchange reserves (including all foreign currency assets) shall at any time be in compliance with the above benchmark, except for the transition schedule specified in Annex III. Deviations from the benchmark must be rectified without delay. A summary report of non-compliance shall be reviewed monthly by the Investment Committee that should ensure that the causes of the non-compliance are addressed.

B. Credit risk

Credit risk is defined as the nonperformance or default by borrowers on loans (bonds) or other financial assets, or by a counterparty on a financial contract.

i. International commercial bank risk

- Credit risk related to the placement of deposits with international commercial banks, including correspondent banks, is guided by credit ratings obtained from Standard and Poor's, Moody's Investors Services, or Fitch Ratings. To be eligible for deposits, including holdings on correspondent account, the international bank must be rated AA and equivalent ratings, or better, by any one of these agencies.
- To limit credit risk, no more than 15 percent of reserves should be invested in claims on international commercial banks.
- To diversify exposure to international commercial banks, no more than 2 percent of the foreign exchange reserves, may be placed with any international commercial bank at any time.
- Reflecting uncertainties regarding banks, the maturity of international commercial bank deposits should not exceed 6 months.
- Investment with international commercial banks would best take the form of tradable instruments such as certificates of deposit, as these are more liquid and exposure can be cut in case of downgrades. The maturity of investments in tradable instruments of banks can exceed 6 months.

The foreign exchange reserves may be placed on deposits with eligible international commercial banks with maximum exposures equivalent to the limits indicated in Annex I.

ii. Investments in bills and bonds

- Only long positions are permitted
- Long-term local currency credit ratings from S&P and Moody's Investors Services shall be used to determine the eligible issuers of securities. To be eligible the issuer must be rated AA or better by any one of these agencies. The maturity of non-government bonds should be under 2 years.
- The foreign exchange reserves shall be invested only in bonds listed on the list of eligible bond issuers and within the indicated maximum limits at any point in time, as specified in Annex IV (list of eligible bond issuer).
- The actual instrument composition of the foreign exchange reserves (including all foreign currency assets) shall at all times be in compliance with the previously mentioned benchmark, except for the transition schedule specified in Annex III. Deviations from the benchmark will be rectified on a weekly basis.
- Holdings of each individual instrument (measured at face value) should not exceed 5 percent of the total outstanding stock of that instrument (measured at face value).

Instrument Composition Benchmark

(In percent)

Currency	Minimum	Mid-point	Maximum
Central Banks, BIS and IMF	90	92	94
Bank deposits ,and tradable instruments (incuding cash)	6	8	10
Government securities 1/	0	0	0
Corporate tradable instruments	0	0	0
Total		100	

1/ This can include AAA rated official international financial institutions, or national AAA rated agencies with explicit or near explicit government guarantees (See Annex IV).

iii. Central banks and Bank for International Settlements

The CBS shall consider its exposure limits to central banks, including Bank for International Settlements, and draw up a list of eligible central banks and maximum exposure limits (See Annex V) *iv. Counterparty risk*

The CBS shall carefully consider its investment counterparties (i.e. dealers and brokers). The CBS will draw up a list of eligible counterparties with appropriate maximum exposure limits and in cooperation with external managers (annex VII).

C. Interest rate risk

Interest rate risk involves the effect of increases or decreases in interest rates on assets that are sensitive to fluctuations in interest rates, e.g., money market and bond market instruments.

Interest rate risk increases or reduces the total return on the portfolio and is measured by daily calculation of the effective portfolio duration of the foreign exchange reserves and comparison with the interest rate benchmark specified below. The limits on interest rate risk aim to avoid reporting losses as a result of market valuation changes over a one year reporting period. To simplify calculations, the duration benchmark can be measured and approximated as the weighted average maturity of the portfolio (with the time remaining to the next reset used for the maturity of floating rate instruments).

Interest Rate Risk Benchmark
(Measured by Effective Portfolio Duration or Average Maturity in Months)

Bond Market / Currency	Minimum	Mid-point	Maximum
U.S. dollar	0	1.5	3
Euro	0	1.5	3
British Pound	0	1.5	3
Other eligible markets / currencies	0	1.5	3
Average		1.5	

The maximum maturity of any given instrument is to be less than or equal to 3 years.

The actual effective portfolio duration must be within the minimum and maximum boundaries at any point in time and be reported on a weekly basis, except for the transition schedule specified in Annex III. Other situations would constitute non-compliance, which must be rectified without delay. A summary report of non-compliance shall be reviewed monthly by the Investment Committee that should ensure that the reasons leading to non-compliance are addressed.

D. Liquidity risk

- Liquidity risk refers to the possible difficulties in selling (liquidating) large amounts of assets quickly, possibly in a situation where market conditions are also unfavorable, resulting in adverse price movement. To that end, the liquidity of each financial instrument eligible for investment must be duly considered before an investment is made.

- To reduce liquidity risk of the total reserve portfolio, a minimum of 20 million US dollar equivalent of reserves shall be invested in cash and overnight deposits with other central banks and eligible commercial banks.
- To reduce liquidity risk of investment in debt securities, debt instruments with maturity of up to 6 months shall have an issue amount of at least 250 million US Dollar equivalent, and with maturity exceeding 6 months of at least 500 million US Dollar equivalent.

E. Performance measurement

- Performance shall be measured, attributed and assessed monthly and included in monthly reports to the Investment Committee and quarterly reports submitted for the consideration of the Board of Directors.
- Total return of the reserves shall be calculated, both in the domestic currency for each eligible currency and in the numeraire currency (the midpoint currency benchmark specified above).
- Actual performance shall be measured identified performance benchmarks.
- If these are not yet constructed then the following benchmarks can be used:

Performance Benchmark[5]
(Measured by Effective Portfolio Duration or Average Maturity)

Bond Market / Currency	Performance benchmark indices
U.S. dollar	
Euro	
British Pound	
Other eligible markets / currencies	

To support this performance measurement and develop the reserve management capacity access to Bloomberg terminals will be necessary.

Outsourcing of services

- At this stage it is advisable to use other central banks, including the Bank for International Settlement as fund managers, while building up in house capacity, over

[5] Benchmark will be set based on Average interest rate per maturity of the Top 10/20 Banks on Financial websites. (Bloomberg; CNN, Reuters, etc.) This will be decided once the investment portfolio has been determined by the committee. At the early stage the aim is to invest in 1 week; 2 weeks and 1 month deposit with the BIS.

a 2-3 year period, with the help of advisors and through a training program. Only at a later stage would private external managers be useful to support investment.

- The risks related to such external management should be incorporated in the central bank's risk management system and be consistent with these investment guidelines.
- The appointment of external managers should undergo a careful cost/benefit analysis and counterparty and legal risk assessment. The appointment of a custodian should also be considered as part of such process.
- External managers will be granted mandates based on well documented benchmarks or published benchmarks. Only limited deviations from these benchmarks will be allowed.
- Characteristics of portfolios managed by external managers have to be consistent with these Investment Guidelines, and contribute towards the desired characteristics of the total reserve portfolio.
- Considering the above recommended transition period, the Governor, in consultation with the Board of Directors, may assign an investment mandate to be managed by external fund managers.

F. Gold

The CBS does not plan to invest in gold in a foreseeable future. As with other changes to the Investment Guidelines, any investments in gold must be approved by the Board of Directors.

G. Legal Issues

These investment guidelines shall at any time be compliant with any international or bilateral legal agreements.

H. Derivative Instruments

The plan is to make the relevant legislation compatible with the use of derivative instruments over the next two years / three years, once capacity to manage these instruments has been built.

I. Delegation and responsibility

The CBS Board of Directors approves the investment guidelines, and any modifications hereof.

Approved:

Date ......September 25, 2009......

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Governor

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Deputy Governor

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Board Member

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Board Member

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Board Member

List of Annexes

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Annex I. List of Eligible Banks and Maximum Exposure Limits for These Banks

Abbreviated Name	Moody's LT Foreign Currency Issuer Rating (Aa3 or better)	S&P LT Foreign Currency Issuer Credit Rating (A- or better)	Total Equity (Millions of USD minimum x bln)	Currency area	**Maximum exposure (millions of USD)**	**Ideally exposure under (millions of USD)**

This list will be created once the committee and the Board is satisfied that proper resources have been put in place to open and manage accounts and investment with eligible international commercial banks. In the mean time the CBS will continue to maintain accounts only with eligible Central Banks and BIS as per annex V.

Annex II. Eligible Currencies

Currency		
Euro	Australian Dollar	Swiss Franc
U.S. Dollar	Canadian Dollar	Singapore Dollar
U.K. Pound Sterling	New Zealand Dollar	South African Rand
Japanese Yen		

Annex III. Transitional arrangement for the benchmarks

Currency benchmark

The change in the currency benchmark will be spread over time so as to avoid an undue weight of the exchange rate prevailing at any given moment in time. The change will commence when the Board of Directors decide, based on considerations of equilibrium exchange rates, but ideally earlier than one year after these guidelines were approved.

Transfer a fixed percentage [0.5-1%] of the existing Euro reserves at the time of the decision each week to the other currencies in proportion to their weights in the non-Euro benchmark, until the overall benchmark is achieved; and transfer the net new inflow into reserves each week to all currencies in proportion to their weights in the overall benchmark, until the overall benchmark is achieved. (As at September 01, 2009 the actual currency composition is as follows: 54.5% in US$; 34.6 % in Euro; 3.9% in GBP and in 7% in SDR)

The transfer in terms of currencies is independent of transfers between institutions reflecting safety of reserves and legal considerations. Such transfers should take place regardless of the currency composition.

Interest/credit benchmark

If a gradual approach is adopted in changing the currency composition (see above) investment of the non-dollar assets will take place in line with the instrument and interest benchmarks within a week following the receipts of the currencies. As a result the maturity of the overall portfolio will increase gradually over time.

For the portfolio that remains in dollars, an approach should be adopted that allows on the one hand for the transfer of reserves to other currencies, and on the other hand allows for a gradual increase in the duration of the portfolio that is not transferred. This requires a detailed work plan. It would be advisable to achieve the extension of the duration over a period of 1-2 year.

Annex IV. Eligible Supranational or Government Guaranteed Institutions

Name	Ticker	Guarantor
AAA rated supra nationals		
African Development bank	AFDB	
[Arab Monetary Fund]		
Asian Development Bank	ASIA/ADB	
Bank for International Settlements	BIS	
European Investment Bank	EIB	
Council of Europe Development Bank	COE	
European Bank for Reconstruction and Development	EBRD	
InterAmerican Development bank	IADB	
International Bank for Reconstruction and Development	IBRD	
International Finance Corporation	IFC	
International Finance Facility for Immunization Company	IFFIM	
Nordiska Investeringsbanken	NIB	
Government guaranteed AAA rated Institutions		
Instituto Credito Oficial	ICO	Kingdom of Spain
Oesterreichische Kontrolbank	OKB	Republic of Austria
Autobahn Schnell	ASFING	Republic of Austria
Obnd	OBND	Republic of Austria
Cades	CADES	Republic of France
Sncf	SNCF	Republic of France
Ccce	CCCE	Republic of France
Resfer	RESFER	Republic of France
Kreditanstalt fur Wiederaufbau	KFW	Republic of Germany
Landwirtschaftliche Rentenbank	RENTEN	Republic of Germany
UK Rail	UKRAIL	United Kingdom
Gefco	GEFCO	United Kingdom
Bank of England	BOEN	United Kingdom
LCR Finance	LCRFIN	United Kingdom
AAA rated Institutions with Implicit Government Guarantee		
Eurofima	EUROF	
Federal Farm Credit Banks	FFCB	
Federal Home Loan Banks	FHLB	
Federal Home Loan Mortgage Corporation	FHLMC	
Federal National Mortgage Association	FNMA	
Kommunalbanken	KBN	
Kommuninvest	KOMINS	
Nederland Waterschapsbank	NEDWBK	
Band der Nederlandse Gemeenten	BNG	
Temasek Holdings Pte Ltd	TEMASE	
Tennessee Valley Authority	TVA	

Annex V. List of eligible central banks and BIS

Federal Reserve Bank of New York
Banque De France
Bank of England
Bank for International Settlement

Annex VI. Computation of Currency Composition

Currency Composition Computation					
	Currency share based on trading in the FX mkt				
	Sales	Debt Servicing	CBS Payments [3]	Total	%
	SCR	SCR	SCR	SCR	
US$	209,845,170	24,168,268	780,572,781	1,014,586,220	81
Euro	61,624,191	9,832,610	63,495,530	134,952,331	11
GBP	18,675,659		44,171,302	62,846,961	5
Other currencies[2]	15,655,580		23,339,414	38,994,994	3
	305,800,600	**34,000,878**	**911,579,027**	**1,251,380,505**	**100**

[1] Based on trade data of goods & services

[2] List of other currencies is as follows: SGD; ZAR; AUD; MUR; CHF; AED; IND; JPY; CAD; KES; NOK; HKD; DKK; SEK

[3] CBS payments from January 01 to August 18 2009 (Note: other currencies comprise of Swiss Francs & SDR)

The 3% of the other currencies composition will be added to the US$ composition since all payments in other currencies is covered in US$ and currently CBS do not hold any of the other currencies in the list.

Annex VII: List of eligible counterparties (dealers and brokers)

In view that the CBS is not anticipating in using the service of dealers and brokers but simply invest with the BIS in short term instruments, the list of eligible counterparties will be created in due course.