International Monetary Fund

Seychelles and the IMF

Press Release:
IMF Completes the Sixth Review Under the Extended Fund Facility (EFF) for Seychelles and Approves US$ 2.0 Million Disbursement and One-year Extension
December 17, 2012

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Seychelles: Letter of Intent, Memorandum of Economic and Financial Policies, and Technical Memorandum of Understanding

November 30, 2012

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LETTER OF INTENT (SIXTH REVIEW)

November 30, 2012

Ms. Christine Lagarde
Managing Director
International Monetary Fund

Dear Ms. Lagarde:

The attached Memorandum of Economic and Financial Policies (MEFP) describe Seychelles' performance through June 2012, and sets out our policy and reform priorities for the rest of 2012 and 2013.

We request completion of the sixth review under our Extended Arrangement and the availability for purchase of the ninth tranche of SDR 1.32 million (12.1 percent of quota). Moreover, we also request a one-year extension of the Extended Fund Facility Arrangement to support our economic reform program—for which we see a critical role for the Fund—and along with that, augmentation of access by SDR 6.6 million (60.6 percent of quota).

We have continued to make significant progress in our reforms and our program remains on track. All quantitative performance criteria (PCs) at end-June 2012 were met, in some cases with margins. All structural benchmarks for the end-June test date were also met. Fiscal conditions have remained favorable whilst on the monetary side a tight monetary policy stance by the central bank has enabled us to contain inflation in single digits and ease pressures that were building on the exchange rate.

The extension we are requesting under the EFF Arrangement will help us in preserving the gains that we have achieved in terms of macroeconomic stabilization and our move toward achieving debt sustainability. It will also support our efforts in pursuing structural reforms in key areas including tax administration, promoting private sector-led growth, and reform of public enterprises.

We believe that the economic and financial policies set forth in the MEFP will ensure that the objectives of the program will be met. We stand ready to take any further measures that may prove necessary to meet our objectives. We will consult with the Fund on the adoption of these measures, and in advance of revisions to the policies contained in the MEFP, in accordance with the Fund's policies on such consultations.

The seventh review under the EFF Arrangement will be completed on or after March 31, 2013 and the eighth review under the EFF Arrangement will be completed on or after September 30, 2013. In this context, we request the establishment of the performance criteria for end-December 2012 and end-June 2013. We have made further progress in restructuring our external debt and we now need to complete the restructuring exercise with only one creditor, which we expect to finalize before end-December 2012. We also expect that implementation of two key structural reform measures that we have encountered, namely (i) the introduction of Value Added Tax and (ii) implementation of recommendations the tariff study, will both begin in January 2013.

In line with our commitment to transparency, we request that the IMF publish this letter, the MEFP, the technical memorandum of understanding (TMU), and the staff report. We will simultaneously publish these documents in Seychelles.

Sincerely yours,

/s/	/s/
Pierre Laporte	Caroline Abel
Minister of Finance, Trade and Investment	Governor
Republic of Seychelles	Central Bank of Seychelles

Attachments: MEFP and TMU

Attachment 1: Memorandum of Economic and Financial Policies for 2013

I. INTRODUCTION

This document tracks progress after two and a half years of macroeconomic and financial structural reforms under the three-year program supported by an Extended Arrangement under the Extended Fund Facility (EFF). It updates the MEFP of May 2012 and details our policies for the remainder of 2012 and the start of 2013 to support completion of the sixth review. We are also requesting a one-year extension of the EFF arrangement and augmentation of access under this facility.

The policies and measures laid out in this MEFP are aimed at consolidating the gains made through structural reforms including in the areas of public financial management, taxation reform and financial sector development whilst sustaining the reform momentum in other areas such as public enterprise performance, social sector policy and utility tariff adjustment and rebalancing.

II. MACROECONOMIC PERFORMANCE IN 2012 AND OUTLOOK FOR 2013 AND BEYOND

Macroeconomic outcomes for 2012 have been in line with our projections at the time of the discussions for the fifth review (March 2012). Real GDP has grown by just under 3 percent, inflation is subsiding after peaking at 8.9 percent in June, and the current account deficit is stable at a projected 22 percent of GDP for 2012. Tourism arrivals were 6.9 percent above 2011 levels after 40 weeks, much better than expected given the economic turmoil in the Euro zone. Despite slightly shorter average stays, the sector is estimated to have grown by about 3 percent in real terms.

GDP growth has mirrored global trends in 2012, and is forecasted to continue to do so in 2013, albeit at a slightly higher rate. We are optimistic that in 2013 GDP growth could attain 3.0 percent. Following robust performance in 2012, we expect the manufacturing sector (primarily beverages and tobacco) to continue to grow against the backdrop of further capital investments and continued expansion in domestic consumption. Diversification of the tourism base, including the Asian market where flights to Seychelles through Abu Dhabi will begin in early 2013, should drive growth from new markets, and make up for some of the ground lost in the European market where we also expect a modest rebound following a contraction in 2012. In 2013 we expect to see a full year of benefits from the submarine cable which should lead to technological gains in other sectors of the economy and potentially opening new opportunities for investment.

The rupee has remained stable following interventions from the Central Bank of Seychelles (CBS) in July and August to curb excess volatility. Following the interventions and the tightening of monetary policy, the exchange rate strengthened from 15 SR/USD to 13 SR/USD and has stabilized. With the expected decline in global commodity prices, this could ease some pressure on the exchange rate and the current account in 2013. Based on this we have forecasted a slight reduction in inflation next year with a period average inflation forecast at 5.1 percent or 2.1 percentage points lower than 2012. We are mindful nonetheless of the potential impact of tariff adjustment in the second half of 2013 though the magnitude of this measure should be minimal.

The external balance is expected to remain stable. The current account deficit is expected to stay at 22½ percent of GDP in 2012 and further improve over the medium term, as FDI-related imports moderate following the completion of major projects. Whilst the current account deficit remains large, it continues to be financed by non-debt incurring capital inflows, including net FDI inflows of 18 percent of GDP and sizable project grants in 2012.

We remain committed to attaining our target of 50 percent of debt-to-GDP ratio by 2018. The restructuring of our external debt is nearly complete, with new restructuring agreements reached with two creditors in June and July. There is now only one creditor outstanding. We have already signed one new agreement and will shortly sign the other outstanding agreement. This would further help us in reducing our debt burden and put it on a path toward sustainability. We recognize however, that the need to continue to invest in infrastructure and social services will render our debt reduction endeavors challenging. In order to minimize the risk of not meeting our 2018 target we will seek as much as possible to fund these infrastructure investments through grants.

III. PROGRAM IMPLEMENTATION

We achieved—and in some cases comfortably exceeded—the quantitative targets of the program. All quantitative performance criteria as of end-June 2012 were met (Table 1), and we are on track to achieve end-December targets.

For 2012 we expect to attain a primary surplus of 5.9 percent of GDP, much larger than the program target of 4.5 percent of GDP. It should be noted that the nominal GDP 2012 has been revised upwards considerably from the level in the program (by 4.4 percent) because of the revision of the 2011 deflator. In the first nine months of the year expenditure have been slightly below target (0.2 percent), while revenues have exceeded targets by 2 percent of GDP because of the large stamp duty and other tax receipts arising from the sale of the D'Arros Island between two private parties. Even without the exceptional revenue, the end-June primary surplus target would have been met owing to tight control of expenditures.

The tightened monetary policy stance has resulted in a notable contraction in broad money and an important increase in interest rates. For the period between March and September 2012, broad money contracted by 7 percent whilst interest rates on 91-day T-Bills rose from 5.43 to 16.99 percent. While we comfortably met the end-June reserve money target under the program, the interest rate transmission mechanism remains weak despite increased communication by CBS of its policy stance.

Structural benchmarks were mostly implemented, albeit with minor delays in two cases. The Public Sector Investment Program has been approved by the Cabinet and the Electronic Clearing System was activated ahead of time. The PFM bill was approved by the National Assembly on November 6, 2012. However, the introduction of the Value Added Tax (planned for July 1, 2012) was postponed to January 2013, and the tariff study was delivered only in October 2012 (end-June benchmark). We will start implementing the recommendations of this study in 2013, beginning with the January introduction of a system of tariff indexation to the international price and the March adoption by Cabinet of an action plan to rebalance utility tariffs between residential and commercial consumers over a 7 year period starting in July 2013.

The national airline is now 9 months into its joint venture with Etihad, and initial signs are encouraging. The airline has introduced one new Airbus A330 into the fleet—another expected in 2013—and has increased the load factor of seats. It is expected that the airline will reach profitability sooner-than-expected in the last quarter of 2012 owing to more professional management, more aggressive marketing and higher quality of service. No additional capital injection in 2012 is expected from Government in addition to what took place in the first months of the year (SR 176m). In 2013, we have agreed that we will pay the USD 3.5 million of penalties to ILFC corresponding to the interrupted leases and SR 17 million for indemnities related to personnel severances. However, the second injection of $10 million agreed when Etihad purchased its stake in Air Seychelles has been deferred to at least 2014 given the faster than expected improvement in the airline's financial position.

We are keeping under close review the financial position of SEYPEC which is weakened by losses of approximately USD 1 million a month on its tanker operations. Two tankers have recently been placed on long-term leases and we have started negotiations with the main lender to restructure the existing tankers' loan. If successful this will significantly improve the overall cash flow of SEYPEC. To further improve SEYPEC's financial position the cost of LPG for commercial users was doubled in May 2012 to bring it in line with costs, as a first step toward eliminating the implicit subsidy borne by SEYPEC. We will introduce the same adjustment for household users in two steps, with an initial increase on July 1, 2013 and complete elimination of the subsidy on LPG by early January 2014.

IV. POLICIES FOR THE REMAINDER OF 2012 AND 2013

A. Fiscal Policy

For 2013 we are committed to carry out a fiscal policy consistent with our aim of achieving debt sustainability over the medium term, namely to reduce public debt to 50 percent of GDP by 2018. To that end we have set a primary surplus target for 2013 of 5.6 percent of GDP assuming increased revenues from larger dividend payments and consolidation of SIBA's budget as part of Central Government. We now expect the public debt level as a share of GDP to decrease to 78 percent by the end of 2012 and to 74 percent at the end of 2013.

Government revenue is projected to decrease slightly as a share of GDP in 2013 to 36.9 percent (as against 37.2 percent in 2012 which includes exceptional tax receipts related to the D'Arros sale). Abstracting from the exceptional revenue in 2012, growth in revenue reflects special dividend from SIBA at the beginning of 2013 when SIBA will transfer funds currently held at commercial banks, including those held in foreign exchange deposit accounts (0.6 percent of GDP) and a number of measures to fight poor tax compliance.

In 2013 we will introduce some changes in the tax system to enhance compliance in revenue collections and to render our system more equitable, efficient, and business friendly. We will introduce a simplified, presumptive tax of 1.5 percent of turnover for small businesses with turnover of less than SR1 million, as an option to the current system of 15 percent on taxable income. We have decided to lower the business tax rate from 33 percent to 30 percent as part of a broader plan to reduce it further over the medium term. These measures will allow us to lower rates and broaden the base going forward.

We will also, beginning 2013, introduce a Corporate Social Responsibility tax contribution of 0.5 percent on turnover on all businesses with sales above SR 1 million. Funds raised through this contribution will finance mostly community projects. Finally, we will introduce a 0.5 percent tourism marketing tax on tourism establishments and other selected sectors like banks and insurance which benefit significantly from tourism activities. The funds raised through this tax will go to the Seychelles

Tourism Board, which is currently funded solely by Government for the marketing program of the Seychelles Tourism Board.

Current primary expenditure is expected to increase slightly in 2013 by 0.4 percent of GDP in part on account of wage adjustments in priority sectors and to compensate for increases in the cost of living. To take into account inflationary expectations, including phased elimination of LPG subsidy for households, and increases in tariffs as part of the rebalancing exercise planned in 2013, on July 1, 2013 public sector wages below SR 10,000 per month will be increased by 6 percent, with wages above that threshold rising by 3 percent. In addition, a number of priority sectors will benefit from new schemes of service and some upgrading of position, resulting in a rise of the wage-to-GDP ratio by 0.3 percent. We consider that this increase is justified in order to retain qualified workers, but we are committed to keep the wage bill under very close review. Capital expenditure will be lower in 2013 (9.2 percent of GDP versus 11.3 percent in 2012) because of smaller external grants financed projects, partially offset by the on-lending to PUC of an EIB loan (SR 120 million or 0.8 percent of GDP). Development grants to public enterprises will remain broadly stable, and domestic financing of capital projects will show a small increase.

In recognizing the negative impact of higher inflation in 2012 and potential adverse effects of certain structural measures such as introduction of the VAT, adjustment of utility tariff and partial elimination of subsidies on cooking gas **we will take necessary measures to ensure that the working poor and vulnerable are socially protected**. This will be achieved through: (i) an increase of 6 percent in the minimum wage, and (ii) increases in rates of benefits provided by the Agency for Social Protection and upward revision in the Agency's weights used to determine the level of assistance.

B. Tax and Customs Reform

VAT remains the immediate priority and is on track for implementation in January 2013. Seychelles Revenue Commission (SRC) has intensified its effort to sensitize the public and businesses on this new system, including through the media and technical meetings with relevant stakeholders.

Customs will upgrade to ASYCUDA World in March 2013. The new web-based program will be more user-friendly and is expected to facilitate trade operations. It will also assist in improving the quality and accuracy of trade statistics.

SRC continues with its effort to build capacity and expertise to improve its capability to address the issue of transfer pricing. The OECD provided basic training in August 2012, and a follow up workshop is expected. A few transfer pricing cases have been identified and are undergoing audit, although significant work remains to be done in this area.

The Integrity Action Plan within SRC has been submitted to the Ministry of Finance with a detailed roadmap and key staff has been identified to ensure its implementation.

The Customs Management Act to improve efficiency and governance of SRC's customs department became operational in July 2012. The enabling regulations are expected to be completed by end-2013.

Risk Management has been a point of focus in the customs modernization and tax compliance program. Technical assistance was provided by AFRITAC on risk management and trade facilitation. A risk assessment team has been appointed to provide support to the Risk Management Committee. SRC is developing an audit strategy based on risk identification and management for implementation in 2013.

In line with our continued effort to improve our national tariff nomenclature, **we will be migrating the Harmonized Commodity Description and Coding System from the 2002 version to the 2007** version **in January 2013**.

C. Public Financial Management (PFM)

We are continuing reforms to improve PFM performance. The PFM Act was approved by the National Assembly in November 2012. The main elements of the PFM reform include:

- Adoption of the new Charts of Accounts (COA). The new COA was circulated in August 2012 and the 2013 budget will be based on the new COA. The Ministry of Finance, Trade and Investment (MFTI) is undertaking all the necessary preparations for the introduction of the new COA which includes software modification, capacity building and ensuring stakeholder ownership by the different ministries and departments.

- Starting January 2013, Accounts staff of all Ministries and government departments will be required to report to MFTI. They will all be on MFTI payroll and report directly to the Comptroller General.

- Improvements to the Public Sector Investment Program (PSIP) were submitted to cabinet in November 2012.

- Establishment of the Government Audit Committee, which will act in an advisory capacity to the Minister. The Ministry of Finance is finalizing an audit charter for the Government Audit Committee that will provide guidance to members of the Committee in discharging their respective duties. It sets out the Committee's objectives, authority, composition, roles and responsibilities and provides a channel of communication with the different stakeholders. MFTI aims to seek cabinet approval by December 2012.

- The Public Finance Management bill also provides for the Minister to make regulations and accounting manuals for carrying out the provisions of the bill. MFTI will finalize the Financial Instructions and Accounting Manuals by end of June 2013.

A major reform will be the introduction of Program Performance Based Budgeting (PPBB) starting with two pilot ministries, the Ministry of Education and Ministry of Natural Resources and Industry **in 2014.** Capacity in PPBB will also be developed in many stakeholders including members of Parliament.

Government is working towards adopting the International Public Sector Accounting Standards (IPSAS) classifications. A mission from AFRITAC South visited Seychelles in November 2012 to assist the Government in implementing cash based IPSAS for government accounts. The mission helped identify gaps between the existing practice in Seychelles and the mandatory requirements under the Cash-basis IPSAS, and this will allow us to develop an action plan to meet the IPSAS requirements. The short-term priority is to improve the disclosure statements.

D. Monetary and Exchange Rate Policies

CBS began gradually loosening monetary policy in the fourth quarter of 2012 in view of reduced inflationary risks. However, CBS remains cautious of the potential impacts of external shocks and changes in domestic administrative prices on inflation, and stands ready to adjust its policy if needed.

CBS will continue to enhance its monetary policy framework. The country's inability to influence international prices and its high dependency on imports present important challenges for the Bank to meet its primary objective of price stability. Whilst a tightened monetary policy has helped reduce inflationary pressures originating from the credit channel, the relatively weak correlation between reserve money and headline inflation suggests that excessive tightening might actually hurt the economy whilst not necessarily reducing inflation in a significant way. Whilst reserve money targeting has served us well since it was adopted in 2008 in view of recent challenges in meeting the target CBS will in the coming months assess the desirability and feasibility of adopting an Inflation Targeting Lite (ITL) framework. ITL may prove to be an appropriate framework to allow the CBS to target a measure of core inflation which will exclude movement in prices that is outside the control of CBS. However, in view of our lack of experience with this framework, CBS will request for Technical Assistance from the Fund's Monetary and Capital Markets Department to develop the framework, if it proves feasible.

Government will continue to assist CBS in its liquidity management efforts through the issuance of treasury bills. The recently signed Memorandum of Understanding between CBS and MFTI provides for the funds raised from such issuance to be placed in a blocked account at CBS until maturity and government is bearing the interest cost.

CBS remains committed to a floating exchange rate regime. As it has done since the rupee was floated CBS will intervene in the market only to smooth out excess volatility and ensure orderly market conditions.

CBS will continue to build up international reserves, which will provide Seychelles with an adequate buffer against external shocks. To achieve this objective, CBS will purchase foreign currency for reserves accumulation purposes on the domestic interbank market. CBS' participation will assist in the deepening of the domestic foreign exchange market and also allow for more efficient allocation of foreign exchange within the financial system.

CBS continues to strengthen its reserve management practices. In September 2012, the Board approved the new Investment Policy for International Reserves Management and separate Investment Guidelines. CBS has entered into a three-year reserve portfolio management program with Crown Agent Investment Management (CAIM). The program is comprised of a training plan, which aims to develop and enhance the Bank's staff practical investment skills, in order to manage risks and undertake the necessary supporting functions effectively.

E. Financial Sector Reforms

CBS remains committed to improving competition and transparency in the banking sector. The December 2011 amendments to the Financial Institutions Act 2004 (FIA) provided for the single licensing regime under which both domestic and offshore banking business may be conducted. This has contributed to increased interest from potential investors in the banking sector and also allows the former offshore bank to operate domestically. The FIA amendments also provided for the Central Bank to regulate banks' fees and charges. These regulations are expected to become effective by end 2012. CBS will also further enhance its financial literacy program with the aim of reinforcing competition in the financial sector. This will complement other efforts of Government to strengthen the environment for competition, namely establishment of the commercial list and on-going reform at the Registrar's Office.

The introduction of hire purchase, credit sale and financial leasing activities will provide additional means of accessing finance. These activities are also expected to bring economic benefits to the country through domestic investment, creation of employment opportunities and tax revenue. The Cabinet approved policies for hire purchase and credit sale in May 2012, and will consider policies on financial leasing in December 2012. The Acts covering these activities will be submitted to National Assembly by end-June 2013.

CBS remains committed to strengthening its supervisory framework. As part of its risk-based forward looking approach to supervision, supervised institutions are required to submit their business plans on an annual basis. This requirement came into effect in July 2012. CBS intends to develop a CAELS[1] rating system using the projected financials on which we received the first technical assistance in November 2012. The calendar of onsite inspections is based on results of the examination reports, with the inspections of institutions with more supervisory concerns prioritized on the calendar. CBS also plans to further develop macro-prudential supervision to consider the impact of the macro-economy and developments in the financial market on institutions' exposure to systemic risk.

The Statistical and Supervisory Application (SSA) went live in September 2012. The SSA is aimed at increasing efficiency by further automating the process of offsite supervision through online submission of returns and embedded analytical tools. The SSA eliminates most of the manual process of validating data contained in reports and contains querying, analysis and reporting features which facilitate analysis and the decision making process.

Development and strengthening of the insurance sector's supervisory framework is an ongoing process. In August 2012, Cabinet approved the creation of a Financial Services Commission (FSC) to replace the Seychelles International Business Authority (SIBA) in 2013. The FSC will have oversight over non-bank financial institutions, including the insurance sector. Transfer of supervision of the insurance sector from CBS' portfolio to that of FSC is expected to take place within one year. Preparatory work is already underway.

Seychelles has taken major steps in its endeavor to fight money laundering, financing of terrorism and to improve international tax co-operation. In 2012 we made comprehensive amendments to the Anti-Money Laundering (AML) Act to enhance the independence of our Financial Intelligence Unit (FIU), to establish a time-frame for its administrative freezing of suspected assets and to oblige related parties to supply documents, information and other material for investigative purposes. FIU is in the process of recruiting more staff to increase efficiency, improve its compliance function and to speed up the resolution of cases. We have also made important strides in strengthening our legislative framework that governs offshore activities. Following on recommendations of the last peer review report of the OECD Global Forum on transparency and exchange of information for tax purposes, amendments were made to several laws governing offshore financial sector activities such as trusts, foundations and funds as well as the taxation of these entities. OECD has since classified Seychelles as fully compliant with its international standards of exchange of information. These amendments should also facilitate international co-operation once Seychelles is admitted as a member of the Egmont Group.

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[1] CAELs stands for: Capital Adequacy, Asset Quality, Earnings, Liquidity, Sensitivity to Market Risk.

The launching of the stock exchange, planned for the fourth quarter of 2012, will provide a boost to the financial service sector. A license for operating the stock exchange has been granted. Initially, the stock exchange will handle local listings including shares of both private and public companies. The eventual aim is for the stock exchange to operate a dual listing system.

F. CBS Operations and Governance

The CBS Board approved the Quality Assurance and Improvement Program (QAIP) Policy and Procedures in June 2012. This fulfills the requirements of, and compliance with, the Institute of Internal Auditors (IIA) standards. Subsequently, to ensure that consistencies are maintained in internal as well as external assessment reviews conducted on a periodic basis, the Board also approved the Internal Audit Quality Assessment Framework in July 2012. With the framework now in place, the Internal Audit Division (IAD) started implementation of the QAIP in September 2012. IAD is currently at level 2 on the QAIP evaluation scale and aims to achieve level 3 by July 2013. IAD is currently developing plans to remedy identified areas for improvement and these will be implemented to achieve level 3.

CBS' initiative to further modernize the national payment system is being accelerated. Following successful implementation of the Electronic Cheque Clearing (ECC) project across all banks in August 2012, the project to implement the Seychelles Electronic Funds Transfer (SEFT) system and is now scheduled to go live in the first quarter of 2013. This new electronic system will provide individuals and businesses with an online platform to effect the transfer of funds from the comfort of their own premises. Furthermore, a country-wide Mobile Payment Solution and Service has also been initiated and is expected to go live in the fourth quarter of 2013 which will be followed by the implementation of the local rupee ATM/POS switching system.

Text Table: Matrix of Actions by CBS

Actions	Deadline
Submit Policy Paper, including draft Leasing Bill to Cabinet	December 2012
Implementation of Seychelles Electronic Funds Transfer system	March 2013
Submission of Leasing Bill to National Assembly	June 2013
External Review of the Quality Assurance and Improvement Program	December 2013
Implementation of the country-wide Mobile Payments Solution and Service	December 2013
Implementation of Local Rupee ATM/POS Switch system	September 2014

G. Private Sector Development and Reform of Public Enterprises

Seychelles' ranking in the World Bank's 'Ease of doing businesses' has improved considerably with the country rising by 29 places to 74th in the 2013 ranking. Areas where Seychelles has made significant improvements are: (i) paying of taxes; (ii) resolving insolvency and (iii) dealing with construction permits.

Moreover, a significant number of measures were taken after June and thus are not reflected in the latest raking. These include improvements in business registration through an online company registration and name search facility, as well as an online import permit application. In the coming months we will introduce further measures:

- Improved facility to pay taxes;
- Online land registry and online planning permission application;
- Accelerated land registration at the Attorney General's office,
- Review of the Town and Country Planning Act and the Land Development Bill;
- Publication of environmental guidelines by each Ministries to increase transparency;
- Adoption of a Leasing Bill;
- Establishment of a Mediation and Civil Rules for the Commercial Court; and
- Establishment of a one stop shop for application of all licenses.

Further to the above Government has initiated the process of drafting an Accounting Profession Bill with the assistance of the World Bank. The legislation is aimed at enhancing the quality of financial reporting and strengthening accountancy profession—key contributors to improving competitiveness and governance.

We are undertaking the process of designing and implementing a unified insolvency statute. The insolvency regulatory framework of the Seychelles is covered by numerous laws. In light of this Cabinet has approved that all legislation pertaining to insolvency law in the Seychelles should be revised with a view to modernizing the law. The World Bank will be assisting the Attorney General's Office in drafting the Unified Insolvency legislation. This will be accompanied by introduction of a revised and modern Companies Act.

The Public Enterprise and Monitoring Division in the MFTI will be transformed into a Commission in early 2013. This will enhance its authority and monitoring role over public enterprises. A CEO will be appointed and staff trained to strengthen the monitoring capabilities of the Commission. The new PEM bill provides a three-year timeframe for all public enterprises to transition to International Accounting Standards.

H. Petroleum Issues

As indicated in the previous MEFP of May 2012 we have started preparations for potential oil discoveries with technical assistance from various institutions and governments to put in place the necessary frameworks, including the legal and fiscal frameworks as well as policies for managing of oil revenues. Two recent missions, one from the World Bank and one from the IMF visited Seychelles in November 2012 in this regard. The IMF reviewed Seychelles' current fiscal regime and made a number of recommendations to the Government. The World Bank mission focused on preparations for the new bidding rounds for new concessions that will take place next year. Both missions conducted seminars with key stakeholders in the oil sector.

V. PROGRAM MONITORING

We are seeking IMF Executive Board approval for extension of the EFF arrangement for an additional year and augmentation of access to further support our reform efforts. This will involved two semi-annual reviews corresponding to test dates of end-December 2012 and end-June 2013, which will be based on a set of quantitative performance criteria as shown in Table 1 and structural benchmarks as shown in Table 2. The attached revised Technical Memorandum of Understanding (TMU) defines the quantitative performance criteria, indicative targets, and adjusters under the program.

Seychelles will avoid introducing new exchange restrictions, multiple currency practices, or bilateral payment agreements in contradiction with Article VIII of the IMF's Articles of Agreement and imposing any import restrictions for balance of payments reasons. We stand ready to adopt any additional measures, in consultation with IMF staff, which may become necessary to ensure program success.

Table 1. Quantitative Performance Criteria Under the Extended Arrangement, 2012–13

(Millions of Seychelles rupees; end-of-period)

	2012										2013			
	June				September				December		March	June	September	December
	Performance Criteria	Adjusted	Actual (prog rate)	Actual (market rate)	Indicative Target	Adjusted	Actual (prog rate)	Actual (market rate)	Indicative Target (5th Rev.)	Performance Criteria	Indicative Target	Performance Criteria	Indicative Target	Indicative Target
Performance criteria														
Net international reserves of the CBS, millions of U.S. dollars (floor) [1]	220	218	225	222	217	217	228	228	226	223	227	225	225	229
Reserve money (ceiling)	1,800	...	1,745	...	1,800	...	1,692	...	1,850	1,920	1,950	1,980	2,010	2,040
Primary balance of the consolidated government (cumulative floor) [2]	309	...	420	...	431	...	841	...	610	837	136	412	717	850
Contracting or guaranteeing of new external debt by the public sector (Millions of U.S. dollars; cumulative ceiling) [2]	30	...	0	...	40	...	14	...	40	40	25	40	55	55
Contracting or guaranteeing of new short-term external debt by the public sector (Millions of U.S. dollars; cumulative ceiling) [2]	0.0	...	0.0	...	0.0	...	0.0	...	0.0	0.0	0.0	0.0	0.0	0.0
Accumulation of external payments arrears by the public sector (ceiling) [3]	0.0	...	0.0	...	0.0	...	0.0	...	0.0	0.0	0.0	0.0	0.0	0.0
Accumulation of domestic payment arrears by the government (ceiling)	0.0	...	0.0	...	0.0	...	0.0	...	0.0	0.0	0.0	0.0	0.0	0.0
Memorandum items:														
Net external non-project financing (millions of U.S. dollars; cumulative) [2, 4]	-3.7	...	-5.8	...	-7.5	...	-7.3	...	1.0	-13.1	-2.0	-8.9	-11.1	-10.2
Program accounting exchange rates														
SR/US$ (end-of-quarter)	14.04	...	14.04	14.43	14.04	...	14.04	13.02	14.04	13.02	13.02	13.02	13.02	13.02
US$/Euro (end-of-quarter)	1.33	...	1.33	1.26	1.33	...	1.33	1.29	1.33	1.29	1.29	1.29	1.29	1.29
US$/UK pound (end-of-quarter)	1.60	...	1.60	1.56	1.60	...	1.60	1.62	1.60	1.62	1.62	1.62	1.62	1.62
US$/AUD (end-of-quarter)	1.04	...	1.04	1.52	1.04	...	1.04	1.04	1.04	1.04	1.04	1.04	1.04	1.04
US$/SDR (end-of-quarter)	1.55	...	1.55	1.02	1.55	...	1.55	1.54	1.55	1.54	1.54	1.54	1.54	1.54

Sources: Seychelles authorities and IMF staff estimates and projections.

[1] The NIR floor is adjusted as defined in the TMU.

[2] Cumulative net flows from the beginning of the calendar year; includes external non-project loans and cash grants net of external debt service payments.

[3] The nonaccumulation of new external payment arrears constitutes a continuous performance criterion. Excludes arrears for which a rescheduling agreement is sought.

[4] Includes external non-project loans and cash grants net of external debt service payments.

Table 2. Structural Benchmarks, 2012-13

Measure	Target Date	Macroeconomic Rationale	Status
Introduction of the credit information system (4th Review MEFP, ¶46)	End-March 2012		Met
Creation of the commercial court (4th Review MEFP, ¶47)	End-March 2012		Met
Cabinet approval of new DBS mandates (4th Review MEFP, ¶54)	End-March 2012	To redefine its mandate to finance small and medium enterprises	Met
Commission and complete a study on optimal tariffs for utilities (4th Review MEFP, ¶51)	End-June 2012	To ensure cost recovery and long-term sustainability of utilities.	Met. Final version received October 2012.
Introduce VAT (4th Review MEFP, ¶26)	July 2012	To modernize the tax system and remove tax distortions	Not met. Postponed to January 2013.
Cabinet approval of the Public Sector Investment Program to be used for the 2013 budget planning. (4th Review MEFP, ¶28)	End-September 2012	To improve efficiency of public finance management and planning in capital investments by costing capital projects over the entirety of their implementation phase	Met
Based on the results of optimal tariff study, implement reform of utilities tariffs (4th Review MEFP, ¶51)	End-September 2012	To ensure long-term financial sustainability of utilities	Delayed. Re-phased to reflect receipt of final report in Oct. (see end-March and July 1 benchmarks below)
Implementation of Electronic Clearing House system (5th Review MEFP, ¶38)	End-September 2012	To improve transmission of monetary policy and reduce cost of financial transactions.	Met
Introduce VAT	January 1, 2013	To modernize the tax system and remove tax distortions.	
Cabinet approval of the action plan to rebalance utility tariffs	End-March 2013	To ensure cost recovery and long-term sustainability of utilities.	
Cabinet approval of Financial Instructions and Accounting Manuals in line with new PFM Act and IPSAS standards (MEFP, ¶27)	End-June 2013	To improve efficiency of public finance management.	
Approval of Leasing Bill by National Assembly (MEFP, ¶35)	End-June 2013	To improve access to credit.	Project has started
Implement the first step of the utilities tariffs rebalancing (MEFP, ¶11)	July 1, 2013	To ensure long-term financial sustainability of utilities	

Attachment 2: Technical Memorandum of Understanding

1. This technical memorandum of understanding presents the definitions of variables included in the quantitative performance criteria and indicative targets set out in the memorandum of economic and financial policies (MEFP), the key assumptions, and the reporting requirements of the Government and the Central Bank of Seychelles (CBS) needed to adequately monitor economic and financial developments. The quantitative performance criteria and indicative targets, and the benchmarks for 2012-2013 are listed in Tables 1 and 2 of the MEFP, respectively.

I. QUANTITATIVE PERFORMANCE CRITERIA

A. Net International Reserves of the CBS (Floor)

Definition

2. Net international reserves (NIR) of the CBS are defined for program monitoring purposes as reserve assets of the CBS, minus reserve liabilities of the CBS (including liabilities to the IMF). Reserve assets of the CBS are claims on nonresidents that are readily available (i.e., liquid and marketable assets, free of any pledges or encumberments and excluding project balances and blocked or escrow accounts, and bank reserves in foreign currency maintained for the purpose of meeting the reserve requirements), controlled by the CBS, and held for the purpose of intervening in foreign exchange markets. They include holdings of SDRs, holdings of foreign exchange, demand and short-term deposits at foreign banks abroad, fixed-term deposits abroad that can be liquidated without penalty, and any holdings of investment-grade securities. Reserve liabilities of the CBS comprise liabilities to nonresidents contracted by the CBS, any net off-balance-sheet position of the CBS (futures, forwards, swaps, or options) with either residents or nonresidents, including those to the IMF.

Calculation method

3. For program monitoring purposes, reserves assets and liabilities at each test date must be converted into U.S. dollars using the end of period exchange rates assumed in the program.

Monitoring and reporting

4. At each program test date, the quarterly net international reserves data submitted by the CBS to the IMF will be audited by the CBS' internal audit division in accordance with International Standards on Auditing, to ensure conformity with the program definition and calculation methods. Reports will be submitted to the IMF no later than two months after each test date.

Adjusters

5. The floor on the CBS's NIR will be adjusted upward (downward) by the amount by which the external non-project loans and non-project cash grants exceeds (falls short of) the amounts assumed in the program (MEFP Table 1). The floors will also be adjusted upwards (downwards) by the amount that external debt service payments fall short (exceed) the amounts assumed in the program.

A. Reserve Money (Ceiling)

Definition

6. Reserve money is equivalent to currency issued and deposits held by financial institutions at the central bank (bank reserves), including those denominated in foreign currencies. Evaluation of performance of reserve money with respect to the program ceiling will be done at the program accounting exchange rate.

Monitoring and reporting

7. For each program test date, the quarterly reserve money data submitted by the CBS to the IMF will be audited by the CBS' internal audit division in accordance with International Standards on Auditing, to ensure conformity with the program definition. Reports will be submitted to the IMF no later than two months after each test date.

B. Primary Balance of the Consolidated Government (Cumulative Floor)

8. The consolidated government primary balance from above the line on a commitment basis is defined as total consolidated government and social security fund revenues (excluding privatization and long-term lease income receipts) less all noninterest (primary) expenditures of the government and social security fund.

C. Public External Debt (Ceiling)

9. The ceiling applies to the contracting or guaranteeing of new external liabilities by the public sector (including the central government, the CBS, and all public agencies and parastatals for operations that are not directly linked to commercial activities). The ceiling does not apply to the use of Fund resources, operations related to external debt restructuring; normal import related credits; purchases of treasury securities by nonresidents; or borrowing by parastatals in the conduct of normal commercial operations. The non-zero ceilings on the contracting or guaranteeing of external debt are to allow for normal public project finance and program support from multilateral institutions exclusively. Debt shall be valued in U.S. dollars at program exchange rates. A zero sub-ceiling on short-term external debt applies to the contracting or guaranteeing of short-term external debt by the public sector, with an original maturity of up to and including one year.

10. For the purposes of this performance criterion, the definition of debt is set out in Point 9 of the "Guidelines on Performance Criteria with Respect to External Debt in Fund Arrangements," attached to Executive Board Decision No.6230-(79/140), as amended. Debt is understood to mean a current, non contingent liability, created under a contractual arrangement through the provision of value in the form of assets (including currency) or services, and which requires the obligor to make one or more payments in the form of assets (including currency) or services, at some future points in time; these payments will discharge the principal and/or interest liabilities incurred under the contract. The ceiling on contracting official and officially guaranteed external debt includes all form of debt, including:

a. loans, that is, advances of money to the obligor by the lender made on the basis of an undertaking that the obligor will repay the funds in the future (including deposits, bonds, debentures, commercial loans, and buyers credits) and temporary exchanges of assets that are equivalent to fully collateralized loans under which the obligor is required to repay the funds, and usually pay interest, by repurchasing the collateral from the buyer in the future (such as repurchase agreements and official swap arrangements);

b. suppliers credits, that is, contracts where the supplier permits the obligor to defer payments until sometime after the date on which the goods are delivered or services are provided; and,

c. leases, that is, arrangements under which property is provided which the lessee has the right to use for one or more specified period(s) of time that are usually shorter than the total expected service life of the property, while the leasor retains title to the property. The debt is the present value (at the inception of the lease) of all lease payments expected to be made during the period of the agreement excluding those payments that cover the operation, repair, or maintenance of the property.

d. Arrears, penalties, and judicially awarded damages arising from the failure to make payment under a contractual obligation that constitutes debt are debt. Failure to make payment on an obligation that is not considered debt under this definition (e.g. payment on delivery) will not give rise to debt.

D. External Arrears of the Public Sector

11. The nonaccumulation of arrears to external creditors will be a continuous performance criterion under the program. External payments arrears for program monitoring purposes are defined as the amount of external debt service due and not paid within the contractually agreed period, subject to any applicable grace period, including contractual and late interest. Arrears resulting from the nonpayment of debt service for which a clearance framework has been agreed or a rescheduling agreement is sought are excluded from this definition.

E. Domestic Arrears of Government

12. The nonaccumulation of budget expenditure arrears will be a performance criterion under the program and will be measured on net basis from the beginning of a calendar year. Budget expenditure arrears are defined as the sum of (1) any invoice that has been received by a spending agency from a supplier of goods, services, and capital goods delivered and verified, and for which payment has not been made within the contractually agreed period, or in the absence of a grace period, within 30 days; (2) unpaid wages, pensions, or transfers, pending for longer than 30 days to domestic or foreign residents, irrespective of the currency denomination of the debt; and (3) debt service payment on domestic debt of the government or guaranteed by the government that has not been made within the contractually agreed period.

II. DATA AND INFORMATION

13. The Seychelles authorities (government and CBS) will provide Fund staff with the following data and information according to the schedule provided.

The CBS will report

Weekly (within one week from the end of the period)

- Reserve money.
- Foreign exchange reserves position.
- A summary table on the foreign exchange market transactions.
- The results of the liquidity deposit auctions, primary Treasury bill auctions, and secondary auctions.

Monthly (within four weeks from the end of the month)

- The monetary survey in the standardized report form format.
- The foreign exchange cash flow, actual and updated.
- Financial soundness indicators.
- Stock of government securities in circulation by holder (banks and nonbanks) and by original maturity and the debt service profile report.

The Ministry of Finance will report

Monthly (within two weeks from the end of the month):

- Consolidated government operations on a commitment basis and cash basis in the IMF-supported program format.
- The detailed revenues and expenditures of the central government and social security fund.
- Accounts of the public nonbank financial institutions.
- Import and export data from the customs department.
- Public debt report.
- Statements of Stabilization Fund operations
- Consolidated creditors schedule on domestic expenditure arrears of the government.

Quarterly (within a month from the end of the quarter):

- Financial statements of Air Seychelles

The government and CBS will consult with Fund staff on all economic and financial measures that would have an impact on program implementation, and will provide any additional relevant information as requested by Fund staff.