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

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SEYCHELLES: LETTER OF INTENT

June 16, 2009

Mr. Dominique Strauss-Kahn
Managing Director
International Monetary Fund

Dear Mr. Strauss-Kahn:

1. The attached Updated Memorandum of Economic and Financial Policies for 2009 (MEFP) describes Seychelles' performance in the first quarter of 2009 and policies for the remainder of the year. We request completion of the second review under the Stand-by arrangement and the release of the third tranche of SDR 0.88 million (10 percent of quota).
2. **All the quantitative performance criteria (PCs) at end-March 2009 were met.** One of the two structural benchmarks at end-April was observed. The second was missed due to a delay in the approval of new bank capitalization norms, which was implemented in May. We are making progress towards meeting the structural performance criterion and benchmarks for end-June and end-September. We are also moving ahead with our external debt restructuring strategy and are committed to achieving comparable treatment to the Paris Club agreement with all creditors.
3. **We believe that the economic and financial policies set forth in the MEFP are sufficient to 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. We remain committed to full implementation of the recommendations of the Fund's safeguards assessment of the Central Bank of Seychelles (CBS).
4. **We have begun to elaborate a comprehensive medium-term structural reform strategy,** in collaboration with our international partners, in support of which we intend to request a 3-year arrangement under the Extended Fund Facility in late 2009 coinciding with our 2010 budget.
5. **In line with our commitment to transparency, we request 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/

James Alix Michel
President
Republic of Seychelles

Attachments: MEFP and TMU

ATTACHMENT I

SEYCHELLES: MEMORANDUM OF ECONOMIC AND FINANCIAL POLICIES FOR 2009
(UPDATED FOR THE SECOND PROGRAM REVIEW)

I. INTRODUCTION

1. **This document updates the MEFP of March 13, 2009 for the first program review.** It reviews macroeconomic and financial performance in the first quarter of 2009 and describes our policies and reform measures for the remainder of the year.

II. RECENT DEVELOPMENTS AND PERFORMANCE UNDER THE PROGRAM

2. **The economy has stabilized more rapidly than anticipated so far in 2009.** Supported by tight monetary and fiscal policies, inflation has declined sharply to 2.4 percent in the first four months of 2009 (annualized), aided by sharp declines in food and petroleum prices. The rupee, which stabilized following the float at around SR16-17/US\$, has appreciated significantly in the second quarter. Nominal interest rates have been declining steadily from their highs as inflation has fallen and real interest rates had risen to positive levels early in the year.

3. **The global economic recession is nonetheless pressing on Seychelles, with tourism earnings in particular falling significantly in the first quarter.** Imports fell faster than exports, partly due to the decline in FDI and in private incomes. At the same time, while tourism earnings weakened, exports of tuna have held up well. Gross official reserves rose to US\$85 million (1 month of imports, well above the program target) at end-March on some one-off inflows and the unblocking of foreign asset accounts.

4. **Fiscal policy over performed the program target in the first quarter** on a more rapid repayment by SEYPEC of its financing facility, tightened expenditure controls (notably through the strengthened procedures under the new Procurement Act), the non use of the public financial institutions recapitalization contingency, and higher fishing license fees. Revenues also held up well, exceeding program projections. The primary fiscal balance was SR784 million (8.1 percent of GDP). A qualified financial controller was appointed to the Ministry of Health to strengthen expenditure controls, an auditor was hired to conduct management audits of the largest public enterprises and a public enterprise monitoring unit was established at the Ministry of Finance to support public enterprise reform. The first steps to implement a treasury single account were taken and an upgraded public debt report (for 2008) was produced.

5. **Monetary policy was kept tight and the reserve money target was observed, supported by fiscal over performance.** Positive real interest rates have been instrumental in containing inflationary pressures and limiting the second round effects of the depreciation of the rupee on prices. As an early sign of financial stabilization, interest rates on government

paper declined notably from the peak 30 percent in January 2009 to about 15 percent in May 2009. The CBS has implemented with success the new reserve money management framework, relying on indirect policy instruments, such as the deposit auction facility with commercial banks. To allow for more operational flexibility in commercial banks liquidity management, the required reserves maintenance period has been increased to two weeks, while gradually shifting that on FX deposits to foreign exchange. The 91-day Treasury bill rate has become a benchmark rate.

6. **All quantitative performance criteria for end-March were comfortably met** (Table 1) and one of the structural benchmarks for end-April was observed while part of the second one was missed as bank capitalization norms were approved with a delay (Table 2). Table 3 lists the measures that were implemented (additional to the structural benchmarks) in the first four months of 2009.

7. **The passage of the new central bank act was an important step towards modernizing monetary policy.** In line with best international practices, price stability is now the primary objective of monetary policy. The law also strengthens the independence and accountability of the CBS, introduces new rules for CBS profit calculation and distribution, and puts in place a new capital structure that adjusts dynamically with changing monetary liabilities of the central bank.

8. **On April 16, 2009 Paris Club creditors (with the participation of South Africa) granted an exceptional debt treatment to Seychelles under the Evian approach.** US\$140 million of arrears were regularized and the consolidated debt stock will be reduced by 45 percent in nominal terms in two tranches: the first, after the completion of the second program review (July 2009) and the second after the completion of the first review under a successor arrangement with the IMF (expected around June 2010) and satisfactory implementation of the comparability of treatment clause with respect to the agreements reached with other creditors. The remaining amounts will be rescheduled over 18 years, including 5 years of grace. A “goodwill” payment of US\$1 million will be made by end-June.

9. **We are continuing our good faith efforts with other creditors to agree a restructuring on comparable terms.** We have completed a second road show for commercial creditors and are maintaining a dialogue with creditors to inform the outlines of a restructuring proposal. We have been disseminating data and information relevant to our creditors through a dedicated website, including up to date estimates of our external financing gap and extent of the necessary debt service reduction. However, despite our best efforts, we were unable to stop payments by third parties to two of our external creditors through escrow accounts outside of Government control. We have instructed the third parties to cease making payments into these accounts, consistent with our commitment to inter-creditor equity.

III. UPDATED MACROECONOMIC AND FINANCIAL PROGRAM FOR 2009

10. **Building on the strong performance in the first quarter, our macroeconomic policies for the remainder of 2009 aim to consolidate the gains in macrostabilization, notably on low inflation.** We intend to lock-in most of the fiscal overperformance of the first quarter, while allowing for a measured easing of monetary policy. However, driven by a drop-off in tourism and construction, real GDP is projected to contract by almost 11 percent in 2009, with a modest recovery starting from 2010. On the back of weakening domestic demand and declining FDI, the current account deficit is expected to improve to about 27 percent of GDP in 2009.

11. **Our reform objectives are to consolidate macroeconomic stability, and lay the foundation for economic recovery and sustained growth.** We will continue to remove distortions, modernize economic laws and regulations, and reduce the role of the state in the economy. We will implement a significant reinforcement of monitoring and control over parastatal bodies to address major financial risks to the stability of public finances. We will also implement a fundamental reform of tax policy and administration. We will work to strengthen and modernize the financial system. We will also continue our good faith efforts to restructure our external public debt, building on the agreement with Paris Club creditors.

A. Fiscal Policy

12. **To bank the gains in macro stabilization, the program aims to lock-in most of the over-performance achieved in the first quarter.** The primary fiscal surplus will reach 11.4 percent of GDP. We are taking measures to further strengthen revenue collection, reinforce control of public expenditure, and raise the efficiency and transparency of public finance. At the same time, the contingency for the recapitalization of the public financial institutions has been reduced by two-thirds (2 percent of GDP), reflecting reduced potential need. These savings have been reallocated to meet unforeseen expenditure demands, including to respond to the threat of piracy in Seychelles' territorial waters, to cover financial losses of the public utilities corporation while it is being reformed, and to meet pressing social needs. Overall, the primary surplus, together with declining interest rates, will allow a reduction of domestic financing by the equivalent of 5.6 percent of GDP.

Tax reform

13. **We are preparing to launch a fundamental reform of the tax system with technical support from the IMF.** Our objective is to have a simple, fair, and equitable system, which will promote growth, improve self-compliance, and level the playing field for investors. Our tax reform strategy will have three major components:

- Broadening of the **business tax base** by removing exemptions and sectoral preferences (tourism and fishing); lowering/eliminating thresholds and accelerated capital depreciation schedules. Commensurately, rates will be harmonized at lower levels. This reform will be launched with the 2010 budget.

- Introduction of a **personal income tax** to replace the social security contributions and other taxes on personal earnings to improve transparency, efficiency, and fairness. We expect to introduce the personal income tax by July 2010.
- Introduction of a single rate **VAT** by January 2012, replacing the current multiple rate GST, to improve the efficiency of the indirect tax system and external competitiveness.

The tax incentives under the Tourism Incentive Act, Agriculture and Fisheries Incentive Act, and the Investment Promotion Act will be eliminated by January 1, 2010 with the introduction of the new tax code. New concessions under these acts will have a duration limited to July 2010 at most. We will seek to transition companies with existing concessions agreements into the new tax system. We will also introduce measures to bolster tax administration and have requested technical assistance from the IMF in this regard.

Action	Timing
Administration	
• Introduce a “Valid Tax Invoice” system to provide for an audit trail for the claiming of deductions for business tax as well as input tax credits for the new VAT.	July 2009
• Grant Seychelles Revenue Commission (SRC) autonomy from public administration (DPA) human resource norms	June 2009
• Introduce a Tax Administration Act governing all administrative issues surrounding legislation administered by the SRC.	January 2010
• Eliminate retail shops from the International Trade Zone (ITZ)	July 2010
• Introduction of a Seychelles business number to serve as an account number for all revenue streams within Seychelles.	January 2010
• Introduce legislation to facilitate a single consolidated client account and introduce provisions within such legislation where liabilities and refunds may be netted off.	July 2010
• Integrate the Seychelles Licensing Authority within the SRC in order to achieve synergies for both government and clients	January 2010
• Outsource the Seychelles Pension Fund collection and compliance functions to the SRC to achieve synergies for both Government and clients	January 2010
• Outsource the SRC “point of contact” (cashier) functionalities to a suitable third party with a large geographic footprint in order to further enhance the “one-stop-shop” principle for the public	July 2010
• Develop a Client Management System (CMS) for the SRC so it is in a position to manage the revenue collection effectively and with integrity	July 2009 to January 2012
• Introducing new legislation to strengthen the current Tax Agent Board by providing it with more effective management capabilities as well as limited arbitration functions	January 2010
• Introduce legislation to mandate that all revenue collected by the SRC be posted to the Government’s consolidated revenue account.	September 2009

Business Tax	
• Amend the Business Tax Act in line with the tax reform strategy	December 2009
• Reduce the tax free threshold to international standards	January 2010
• Introduce legislation to facilitate a Uniform Capital Allowance system, annul all accelerated depreciation rules and cap all depreciation allowances at 100 percent of cost	January 2010
• Introduce simple Capital Gains legislation to capture large capital profits currently un-taxed.	July 2010
• Replace the current withholding and DAS provisions in the Business Tax Act with a pay as you go instalment (PAYGI) system.	January 2010
• Introduce a thin capitalisation ratio of 3 to 1 within the Business Tax act for defined types of businesses	January 2010
• Bring the tax rate for tourism, fisheries, agriculture and other concessionary industries in line with the normal tax rate.	January 2010
Personal Income tax (Pay as you go withholding)	
• Introduce new legislation to replace SSF contribution with Pay As You Go withholding (PAYGW) system	July 2010
• Introduce simple Fringe Benefit legislation based on the current interpretation of non-monetary benefits within the Social Security Act.	July 2010
Indirect taxation	
• Introduce GST on licenses provided by the Seychelles Licensing Authority	January 2010
• Introduce GST on all consultancy services	January 2010
• Eliminate the retail mark-up to calculate the GST	January 2010
• Change current GST legislation to include all goods and services unless exempt (create positive list)	January 2010
• Replace current GST legislation and replace it with a full GST (VAT) system including the availability of input tax credits	January 2012
Trade Taxes	
• Introduce the new Customs Management Act including HS codes: “Seychelles Taxation System (Customs Management) Act 2010”	January 2010
• Rationalize all trade tax rates in line with international commitments	January 2010

14. **We will implement expenditure rationalization measures recommended in the World Bank’s Public Expenditure Review (PER)**, initially focusing on the health and education sectors. Based on the findings of the high-level government task force, the functions of the civil service will be streamlined with a view to eliminating duplication and outsourcing ancillary services to the private sector.

15. **We will continue to strengthen the public financial management framework.** Modernizing and strengthening the treasury function will be important to consolidate and optimize the use of government cash balances, and improve oversight by the Ministry of Finance of spending units. For that purpose, we have begun moving to a Treasury Single Account and have already closed most of the ministerial and parastatal entity accounts in commercial banks. We will ensure that the recently created financial analysis branch within the SRC has the staffing and tools to adequately assess all investment proposals.

16. **Rationalizing the size of public sector and greatly increasing the financial control and monitoring of parastatal finances is a key building block of our reform program.** In recognition of the need to improve monitoring and control of the public enterprises, a detailed work plan for the new Public Enterprise Monitoring Division has been approved. The key emphasis of the Division will be to drive improved operational efficiency; significantly strengthened governance; reduction of dependence on public funding and financial risks to the state. The Division will monitor all government owned organizations and will undertake a strategic assessment that will make recommendations on ownership and corporate structure to improve efficiency in the provision of essential services and ensure Government receives maximum returns on its investments and value for money. The Division will achieve these objectives through a combination of improvements in the legal framework, management reviews, external audits, increased and improved reporting obligations, development and introduction of policies and guidelines and strategic assessments of the government's interest in parastatals.

Action	Timing
Budget	
• Adopt a treasury single account	September 2009
Public enterprises and entities	
• Collect monthly reports from public enterprises and analyze on a quarterly basis	July 2009
• Launch a tender for an advisor for the privatization of Nouvobanq and Seychelles Savings Bank	September 2009
• Develop corporate governance guidelines for public entities	August 2009
• Complete external audits of the 2008 accounts of seven major public enterprises (PUC, STC, SEYPEC, SCAA, IDC, Air Seychelles and Nouvobanq) in accordance with international audit standards	September 2009
• Introduce a new Public Enterprise Monitoring and Control Act	September 2009
• Prepare a strategic assessment for each major public enterprise	September 2009
• Ministry of finance to conduct management audits of major public enterprises	2009-10
• Develop reform action plans for major public enterprises following the external and management audits.	2009-10
• Introduce policies to guide management of public entity debt in line with the debt strategy	December 2009
Public debt	
• Prepare a medium-term debt strategy	November 2009
• Prepare an annual borrowing plan to be submitted with the 2010 budget	November 2009
• Begin establishing performance benchmarks for public enterprises	December 2009

B. Public Debt Restructuring Strategy

17. **We are committed to continuing our good faith efforts to achieve a comprehensive public external debt restructuring, consistent with our medium-term payments capacity and the Fund’s lending into arrears policy.** We will ensure information transparency, inter-creditor equity, and dialogue with all creditor groups. As was recognized by Paris Club creditors, immediate and sizable cash flow relief in the short- to medium-term, and a sustained reduction of our debt service burden is necessary. This needs to be supplemented by significant balance of payments support from our international partners. We will also formulate a debt management strategy, complemented by annual borrowing plans. This will incorporate the objective of reducing the cost and risk of public debt, while taking into account monetary and fiscal policy objectives. To this end, we will seek further assistance of the Fund’s Monetary and Capital Markets Department.

C. Monetary, Exchange Rate, and Financial Sector Policies

18. **The primary objective of our monetary policy is to achieve price stability.** With forecasts for continued low inflation, there appears to be room to loosen monetary policy, while ensuring that interest rates remain positive in real terms. Beginning in July we will begin a structural and measured reduction in reserve requirements and the local asset ratio, as conditions permit, to support a recovery in credit to the economy and an unwinding of the effects of longstanding financial repression. Nevertheless, we stand ready to ensure that inflationary pressures do not re-emerge.

19. **Monetary policy is based on reserve money targeting and the CBS will continue to rely on indirect instruments of monetary management.** In addition to the recently introduced weekly deposit auctions, which have become an effective liquidity management tool, we plan to set up a standing credit facility and develop operational procedures for using CBS’s portfolio of treasury bills in open market operations. We have developed and intend to further improve the liquidity forecasting and reserve money programming framework, and strengthen cash flow management through improved policy coordination and information sharing between the Ministry of Finance and the CBS. Going forward, we will continue to expand policy tools, including introducing repo and reverse repo instruments, developing the interbank foreign exchange market, strengthening CBS governance, and work to elucidate the monetary transmission mechanism.

Monetary measures

Action	Timing
• Make operational new lending facilities to commercial banks	June 2009
• Introduce repo and reverse-repo facility	June 2009
• Reduce the local asset ratio further with the aim of phasing it out over the program period as conditions permit, in consultation with IMF staff	2009
• Improve liquidity forecasting and strengthen monetary targeting	September 2009
• Implement a structural and measured reduction in reserve requirements	2009

20. **We will maintain the floating exchange rate regime.** CBS intervention in the foreign exchange rate market will be limited to smoothing excessive volatility and ensuring orderly market conditions, subject to the achievement of our reserve money and external reserves targets. The goal is to strike a balance between the disinflation objective and build-up of international reserves, which are expected to reach 1.3 months of prospective imports by end-2009. We will continue, with IMF technical support, to introduce measures to strengthen nascent foreign exchange institutions and promote efficiency and transparency in the market.

Action	Timing
<ul style="list-style-type: none"> Prepare and submit to the National Assembly a modernized, simplified and transparent foreign exchange act. 	June 2009
<ul style="list-style-type: none"> Establish a Foreign Reserves Management Committee at the CBS 	June 2009
<ul style="list-style-type: none"> Adopt foreign reserves management and investment guidelines 	September 2009
<ul style="list-style-type: none"> Establish stronger controls over day-to-day foreign exchange operations by separating key responsibilities and reporting lines 	September 2009
<ul style="list-style-type: none"> Introduce a net open position limit of 30 percent for class A bureau de change 	September 2009
<ul style="list-style-type: none"> Introduce an augmented real-time gross settlement foreign exchange system 	2010

Financial sector development and stability

21. **We are committed to improving the efficiency and operations of the financial sector.** Modernizing the regulatory framework and strengthening supervisory capacity are key components of our reform agenda, drawing on IMF technical assistance. We are closely monitoring the operations and capitalization of financial institutions, which have proven resilient to large fluctuations in interest and exchange rates. Stress tests undertaken on the basis of the more stringent provisioning requirements to be introduced in June 2009 indicate that the banking sector's net tangible capitalization ratio would remain above minimum standards. Privatization of state-owned financial institutions remains a medium-term objective and we have sought technical support in this endeavor.

Action	Timing
<ul style="list-style-type: none"> Presentation to the National Assembly of a modernized and strengthened Financial Institutions Act with IMF technical support 	June 2009
Further strengthen financial sector supervision through implementation of the action plan developed in consultation with IMF technical experts in December 2007, including:	
<ul style="list-style-type: none"> Issue determination on minimum requirements for appointing external auditors, which will replace existing circular 	June 2009

Action	Timing
<ul style="list-style-type: none"> Update credit concentration regulations and connected lending regulations in parallel with amendments to the Financial Institutions Act 	June 2009
<ul style="list-style-type: none"> Introduce documentation on the acquisition of substantial interests 	June 2009
<ul style="list-style-type: none"> Introduce manual for application to acquire substantial interest in commercial banks 	July 2009
<ul style="list-style-type: none"> Introduce manual on prompt corrective actions 	September 2009
<ul style="list-style-type: none"> Introduce documentation on mergers and acquisitions of assets and liabilities of other financial institutions 	December 2009
<ul style="list-style-type: none"> CBS to publish commercial banking supervision report 	December 2009

Governance and safeguards measures

22. **We are committed to continued rapid implementation of measures to improve CBS governance, financial and accounting systems, and internal audit and control procedures, as identified in the IMF safeguards report.** We are working closely with the IMF to address all of these recommendations over the next two years.

Action	Timing
<ul style="list-style-type: none"> Complete the CBS Procedures manual 	December 2009
<ul style="list-style-type: none"> Adopt a business continuity plan for CBS 	June 2010
<ul style="list-style-type: none"> Establish a new T-Bill allotment committee to ensure that the tendering process exercise is more transparent. 	June 2009
<ul style="list-style-type: none"> Begin transition to IFRS accounting standards at CBS by 2010 financial year 	June 2009
<ul style="list-style-type: none"> Launch a tender to upgrade CBS's IT system, particularly to introduce an integrated accounting framework 	September 2009
<ul style="list-style-type: none"> Set-up a procedure to systematically record all off balance sheet items in the CBS in conjunction with IT system upgrade 	December 2009

D. Statistics

23. **The government will strive to improve the quality, periodicity, and timeliness of macroeconomic statistics and address** deficiencies in key macroeconomic data – especially GDP estimates, and external sector statistics, to improve their usefulness for economic analysis, and policy formulation. The government has requested technical assistance from the IMF Statistics Department (fiscal accounts) and from the World Bank (to strengthen the National Statistic Bureau (NSB)). We will bring Seychelles into line with international best practice, by aiming to implement the IMF's Special Data Dissemination Standard (SDDS). We will set up a central coordination unit at the NSB that acts as a data-bank and a hub for data distribution, and monitors the timeliness of submission of the data by various agencies.

IV. PROGRAM FINANCING

24. **For 2009, the external nonproject financing requirement is expected to be covered by** disbursements from the IMF under the SBA (30 percent of quota; SDR 2.64 million; US\$3.85 million), from the joint World Bank and African Development Bank Development Policy Loan (US\$19 million) and from external debt relief (US\$83 million, including on the US\$15 million that was accumulated as arrears in the first quarter), following US\$3 million cashflow relief secured from the Paris Club creditors, and by additional program financial support, primarily from the European Union.

V. PROGRAM MONITORING

25. **The SBA will henceforth be monitored by semi-annual program reviews.** The quarterly quantitative performance criteria for 2009 (end-June and end-September) have been revised as shown in Table 1, with the end-December targets now proposed as indicative. The structural benchmarks and performance criterion are shown in Table 2. The non zero ceilings on the contracting or guaranteeing of external debt are to allow for budgeted public project finance and program support from multilateral institutions exclusively.

26. **The completion of the third review under the program will be based on meeting the quantitative performance criteria (QPCs) at end-September 2009.** The third review will also focus on further strengthening operations at the CBS, reinforcing public financial management, progress on normalizing relations with external creditors and implementation of the tax policy reform. We intend to request a successor arrangement under the Extended Fund Facility and cancellation of the SBA before end-December 2009. The fourth program review under the SBA would be based on meeting end-March 2010 QPCs and is scheduled to be completed by end-June 2010. Quarterly financing assurance reviews will continue as long as public debt arrears remain outstanding.

27. **The attached 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 payments 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. Seychelles: Quantitative Performance Criteria Under the Stand-By Arrangement, December 2008–December 2009
(Millions of Seychelles rupees; end-of-period)

	2008						2009					
	December			March			June		September		December	
	Country Report No. 09/121	Adjusted	Actual	Country Report No. 09/121	Adjusted	Prel.	Country Report No. 09/121	Rev. prog	Country Report No. 09/121	Rev. prog	Country Report No. 09/121	Rev. prog
Performance criteria												
Net international reserves of the CBS, millions of U.S. dollars (floor) ¹	19.0	26.0	41.2	20.0	26.6	76.2	51.9	69.5	60.5	83.1	77.2	93.7
Reserve money (ceiling)	1,151	...	1,120	1,146	1,146	1,051	1,266	1,266	1,311	1,311	1,351	1,351
Primary balance of the consolidated government (cumulative floor) ^{2, 3, 4}	560	...	336	73	178	784	387	858	642	1,006	946	1,173
The contracting or guaranteeing of new external debt by the public sector (Millions of U.S. dollars; cumulative ceiling) ²	15		10	10	...		10	10	30	34	35	39
The 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
The accumulation of external payments arrears by the public sector (ceiling) ⁵	0.0		0.0	0.0	...		0.0	0.0	0.0	0.0	0.0	0.0
The accumulation of domestic payment arrears by the public sector (ceiling)	0.0		0.0	0.0	...		0.0	0.0	0.0	0.0	0.0	0.0
Memorandum items:												
External non project financing (millions of U.S. dollars; cumulative) ²	-0.4	6.6	6.6	-10.0	-3.4	-3.4	-16.4	-26.0	-4.3	-7.3	-8.2	-8.2
Program financing support ²	1.6	19.9	19.9	0.0	0.0	0.0	0.0	0.0	19.0	19.0	19.0	19.0
Cash payments on foreign debt service ²	2.0	13.3	13.3	10.0	3.7	3.7	17.0	26.7	24.2	28.4	28.4	30.4
External budget grants ²					0.3	0.3	0.6	0.6	0.9	2.1	1.2	2.5
Budget contingency ⁶	100	...	0.0	200	0.0	250	50	300	100
Program accounting exchange rates												
SR/US\$ (end-of-quarter)	14.00	14.00	16.57	16.00	16.00	16.09	16.00	14.65	16.00	14.65	16.00	14.65
US\$/Euro (end-of-quarter)	1.46	1.46	1.39	1.46	1.46	1.33	1.46	1.33	1.46	1.33	1.46	1.33
US\$/UK pound (end-of-quarter)	1.84	1.84	1.44	1.84	1.84	1.48	1.84	1.48	1.84	1.48	1.84	1.48
US\$/SDR (end-of-quarter)	1.56	1.56	1.54	1.56	1.56	1.50	1.56	1.50	1.56	1.50	1.56	1.50
Reserve requirement (percent of deposits)	13	13	13	13	13	13	13	13	13	12	13	12

Sources: Seychelles authorities, and IMF staff estimates and projections.

¹ The floor will be adjusted downwards (upwards) for any shortfall (excess) in external nonproject financial support from that assumed in the program.

² Cumulative flows from the beginning of the calendar year.

³ The floor will be adjusted upwards for any unused amounts of the contingency in the budget for the recapitalization of the banking sector assumed in the program. Amounts of the contingency in excess of programmed amounts need to be funded within the program limits.

⁴ The floor on the primary fiscal surplus will be adjusted upwards (downwards) by any excess (shortfall) of external budget grants from that assumed in the program.

⁵ The non-accumulation of new external payment arrears constitutes a continuous performance criterion. Excludes arrears for which a rescheduling agreement is sought.

Some external arrears were accumulated in December 2008, but cleared before end-December.

⁶ The floor on the primary surplus of the consolidated government will be adjusted upwards by the cumulative amount of the contingency for recapitalizing the state-controlled financial institutions which is not used for that purpose.

Table 2. Seychelles: Structural Benchmarks and Performance Criterion, 2008–09

Measure	Target date	Status
Structural performance criterion		
<ul style="list-style-type: none"> Complete tax audits by Seychelles Revenue Commission of the 20 largest companies 	End-June 2009	Most audits completed and remainder being finalized in June. and target expected to be met
Structural benchmarks		
<ul style="list-style-type: none"> Submit to the National Assembly a revision of the CBS act to strengthen governance and operations (MEFP, ¶30). 	End-April 2009	Approved by Parliament on April 28, 2009
<ul style="list-style-type: none"> Promulgate updated credit classification and provisioning regulations and strengthened commercial bank capitalization norms. (MEFP, ¶32). 	End-April 2009	CBS board adopted credit classification norms and provisioning regulations on April 30. Capitalization norms were adopted on May 29, 2009
<ul style="list-style-type: none"> Adopt a tax policy reform strategy with FAD TA (MEFP, ¶20). 	End-June 2009	Strategy announced June 10, 2009
<ul style="list-style-type: none"> Adopt a modernized and strengthened financial institutions act, with IMF T/A support. (MEFP, ¶32). 	End-June 2009	In progress and expected to be met
<ul style="list-style-type: none"> Introduce a treasury single account (MEFP, ¶19). 	End-September 2009	In progress
<ul style="list-style-type: none"> Adopt foreign reserves management investment guidelines (MEFP, ¶31). 	End-September 2009	In progress
<ul style="list-style-type: none"> Adopt Public Enterprise Monitoring and Control act (MEFP, ¶16) 	End-September 2009	In progress
<ul style="list-style-type: none"> Complete CBS procedures manual (MEFP, ¶22) 	End-December 2009	
<ul style="list-style-type: none"> CBS to publish commercial bank supervision report (MEFP, ¶21) 	End-December 2009	
<ul style="list-style-type: none"> Amend the Business Tax Act in line with the tax reform strategy (MEFP, ¶13) 	End-December 2009	

Table 3. Seychelles: Reform Measures Implemented in January-May 2009

Action	Timing
<i>Fiscal policy</i>	
Introduce GST on casinos	March
Remove the GST on animal feed	March
Appoint a qualified financial controller to the Ministry of Health to strengthen expenditure control	March
Commence work towards implementation of a treasury single account	March
Finalize annual public debt report	March
Gather comprehensive data on parastatal debt and finances	March
Hire additional qualified staff and equip the public enterprise monitoring unit	June
Set up a Financial Analysis Branch at Ministry of Finance to assess investment proposals.	April
<i>Monetary policy</i>	
Introduce remuneration on statutory commercial bank reserves above a certain threshold at an interest rate that reflects the financial cost to commercial banks	March
Increase required reserves maintenance period to two weeks	April
Reduce to 30 per cent of capital the net open positions on foreign exchange, effective end June 2009	April
Establish a platform at the CBS for interbank foreign exchange trading	March
<i>CBS governance and safeguards</i>	
Disclosure in 2008 Annual CBS report of off balance sheet items, including pledged assets and earmarked or blocked funds	March
Submit to Parliament a revised CBS Act, inter alia to strengthen governance and operations.	April
Publish external audit letter and accounts on CBS website	April
<i>Exchange regime</i>	
With technical assistance from the IMF, establish a platform at the CBS for interbank foreign exchange trading/fixing	April
<i>Financial sector reforms</i>	
Further strengthen financial sector supervision through implementation of the action plan developed in consultation with IMF technical experts in December 2007, including:	
◦ Introduction of new liquidity risk management regulations	March
◦ Introduce new bank and <i>bureau de change</i> licensing regulations and update documentation requirements for banks	March
◦ Update credit classification and provisioning regulations	April
◦ Update and strengthen commercial bank capitalization norms	May

ATTACHMENT II**SEYCHELLES: 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 structural performance criterion and benchmarks for 2008–09 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 encumbrances 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 external auditors in accordance with International Standards on Auditing, to ensure conformity with the program definition and calculation methods. Reports should be submitted to the CBS, with a copy 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 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.

B. 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' external auditors in accordance with International Standards on Auditing, to ensure conformity with the program definition. Reports should be submitted to the CBS, with a copy to the IMF, no later than two months after each test date.

C. 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.

Adjusters

9. The floor on the primary surplus of the consolidated government will be adjusted upwards by the cumulative amount of the contingency for recapitalizing the state-controlled financial institutions which is not used for that purpose. Any amounts spent for the recapitalizing of the state-controlled financial institutions in excess of programmed contingency will need to be funded within the program limit on the primary balance.

10. The floor on the primary surplus of the consolidated government will be adjusted upward (downward) by the amount by which external budget grants exceeds (falls short of) the amounts assumed in the program (MEFP Table 1).

D. Public External Debt (Ceiling)

11. 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 subceiling on short-term external debt applies continuously 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.

12. For the purpose of this performance criterion, the term “debt” has the meaning set forth in point No. 9 of the Executive Board’s Guidelines on Performance Criteria with Respect to Foreign Debt (Decision No. 12274-(00/85)). 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:

(i) loans, i.e., 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);

(ii) suppliers credits, i.e., contracts where the supplier permits the obligor to defer payments until some time after the date on which the goods are delivered or services are provided; and,

(iii) leases, i.e., 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 lessor 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.

(iv) Arrears, penalties, and judicially awarded damages arising from the failure to make payment under a contractual obligation that constitutes debt are debt.

E. External Arrears of the Public Sector

13. 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, 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.

F. Budget Expenditure Arrears

14. The nonaccumulation of budget expenditure arrears will be a continuous performance criterion under the program. 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.

II. DATA AND INFORMATION

15. 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 4 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 2 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.
- Monthly accounts of the public nonbank financial institutions.
- Import and export data from the customs department.
- Monthly public debt report.

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.