



## Basis for decision

DATE: 05/11/2018  
DEPARTMENT: General Secretariat/Risk Division  
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## Revision of financial risk and investment policy and supplementary regulations

### Draft Executive Board decision

The Executive Board adopts the following policy and regulations in accordance with the enclosed documents, see Annexes A-D:

- Financial risk and investment policy
- Regulations for the gold and foreign currency reserve
- Regulations for monetary and exchange rate policy transactions
- Regulations for the management of the Riksbank's securities portfolio in Swedish krona

The policy and regulations will enter into force on 1 January 2019. The sections relating to deviation mandates and market risk limits will begin to apply on 1 April 2019.

The policy and regulations replace:

- Investment policy for the gold and foreign currency reserve (2017- 00458)
- Financial risk policy (2017- 00459)
- Credit risk regulations (2017- 00459)
- Liquidity risk regulations (2017- 00459)
- Market risk regulations (2017- 00459)
- Investment regulations (2017- 00459)
- Regulations for monetary and exchange rate policy transactions (2017-00455)
- Regulations for the management of the Riksbank's securities portfolio in Swedish krona (2017- 00456)

### The matter

The Riksbank's instructions state that the Executive Board takes fundamentally important decisions that affect the management of the Riksbank's financial assets and liabilities. The Executive Board thus takes annual decisions on the regulatory framework for the management of the gold and foreign currency reserve.

This year's revision has resulted in a regulatory framework that more clearly reflects which assets need to be held for contingency purposes. To meet the Riksbank's need for foreign currency, the gold holdings shall be held unchanged at 125.7 tonnes. About half of the gold shall be stored in such a way as to allow it to be converted into liquid assets at short notice. Furthermore, management of the foreign currency reserve shall be based on a "policy portfolio", which has a currency distribution equal to 75 per cent US dollars, 20 per cent euros, 3 per cent UK sterling and 1 per cent each of Norwegian and Danish krone. The regulatory framework also establishes the mandates given by the Executive Board to the Markets Department. These mandates are limited to ensure that policy contingency is always good.

In this year's revision, the credit and liquidity risk regulations have been left unchanged, while some sections of the market risk and investment regulations have been amended. The new regulatory framework for market risk determines that the market risk shall be restricted by the imposition of a limit. The proposed amendments to the regulatory framework result in a somewhat tighter overall risk mandate for management of the gold and foreign currency reserve.

The regulatory framework has also been given a new document structure. The two previous policies, the *financial risk policy* and the *investment policy for the gold and foreign currency reserve*, have been combined into a single *financial risk and investment policy*. The credit risk, liquidity and market risk regulations, and the investment regulations have been amalgamated into *regulations for the gold and foreign currency reserve*.

The Executive Board shall also annually adopt *regulations for monetary and foreign exchange policy transactions* and *regulations on management of the Riksbank's securities portfolio in Swedish krona*. Proposals for amendments to these regulations are mainly of an editorial nature.

As a result of regulation amalgamations, amendments are proposed to the Rules of Procedure and Instructions for Sveriges Riksbank in connection with the 2019 review. These amendments mean that the Chief Risk Officer now bears sole responsibility for the drafting of all policy documents concerning the management of financial risks and investment.

## Considerations

Like most central banks, the Riksbank has a gold and foreign currency reserve that enhances the Riksbank's financial independence and allows it to perform its statutory tasks, i.e. to maintain price stability and promote a safe and efficient payment system. The gold and foreign exchange reserves give the Riksbank the capacity to intervene on the foreign exchange market for monetary policy and foreign exchange policy purposes and enable it to provide the financial system with liquidity in foreign currencies in situations where this is deemed necessary. However, it is very important that the banks themselves have adequate liquidity reserves so that they can manage the risks they take in their operations.<sup>1</sup> The gold and foreign exchange reserves also give the Riksbank the

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<sup>1</sup> As the Riksbank has previously noted, Finansinspektionen (FI) should set Liquidity Coverage Ratio (LCR) requirements in Swedish kronor and other significant currencies for the major Swedish banks.

scope to fulfil international commitments, usually in relation to the IMF, but also with regard to other central banks.

## Financial risk and investment policy

In order for the Riksbank to have a fit-for-purpose regulatory framework aimed at ensuring that the Riksbank at any given time shall be able to fulfil its commitments, the regulatory framework governing the management of the gold and foreign currency reserve has been updated. As part of this work, the two previous policies, the *financial risk policy* and the *investment policy for the gold and foreign currency reserve*, have been combined. The new *financial risk and investment policy* establishes the objectives for management and the outer framework for the risk the Riksbank is prepared to take with its financial assets and liabilities. The policy also establishes the principles that shall apply for the Riksbank's investment in the gold and foreign currency reserve and the minimum requirements set for risk management and risk control.

According to the new policy, the *regulations for the gold and foreign currency reserve* shall define a "*policy portfolio*", the asset and currency composition of which shall be based on an evaluated contingency requirement. The policy portfolio and its composition of assets gives rise to a financial risk inherent in the Riksbank's remit. The main financial risk in the gold and foreign currency reserve consists of market risk. The new policy determines that the market risk shall be restricted by the imposition of a *limit*.

In addition to a restriction of the market risk, the policy determines that long-term returns on the gold and foreign currency reserve shall exceed the returns on the policy portfolio. In this way, management of the gold and foreign currency reserve will contribute to safeguarding the Riksbank's financial independence.

The policy allows some limited deviations from the policy portfolio aimed at mitigating market risk or increasing returns from the gold and foreign currency reserve. The permitted deviations are limited to ensure that policy contingency is always good. The deviation mandates are defined in the *regulations for the gold and foreign currency reserve*.

The new financial risk and investment policy also establishes that asset and liability management shall consider sustainability aspects when choosing assets in the foreign currency reserve, provided that the reserve fulfils the requirements imposed by the Riksbank's remit.

## Regulations for the gold and foreign currency reserve

In order to ensure that the Riksbank has a fit-for-purpose regulatory framework, the credit risk, liquidity risk and market risk regulations, as well as the investment regulations, have been updated and amalgamated into one regulation, the *regulations for the gold and foreign currency reserve*. The sections pertaining to the credit and liquidity risk regulations are unchanged, while certain points in the sections pertaining to the market risk and investment regulations have been amended.

The *regulations for the gold and foreign currency reserve* define a "*policy portfolio*". The policy portfolio consists of assets that fulfil the requirements set by the Riksbank's remit and enable the Riksbank to meet its commitments in foreign currency. The policy portfolio

establishes that the Riksbank's gold holdings shall amount to 125.7 tonnes, 62.2 tonnes of which shall be stored at the Bank of England. The policy portfolio's other assets shall have a currency distribution equal to 75 per cent US dollars, 20 per cent euros, 3 per cent UK sterling and 1 per cent each of Norwegian and Danish krone. The distribution of currencies is based on banks' liquidity requirements which are in turn based on their balance sheets and conducted stress tests, and on which currencies are adjudged to be needed to meet international commitments and to be able to implement foreign exchange interventions.

The high percentage of US dollars partly reflects the dollar's role as a global reserve currency. It is also the foreign currency lent most by the Riksbank during the financial crisis of 2008-2009. Banks also have liquidity requirements in euro, UK sterling and Norwegian and Danish krone, which is why the foreign currency reserve shall also contain assets in these currencies. This is because the Riksbank needs to be prepared to cover a certain liquidity requirement in these currencies without fully having to rely on being able to convert dollars or euro to one of these currencies via the FX swap market.

For the Riksbank to be able to maintain high preparedness, tough requirements are also imposed on the assets in the policy portfolio. The value of the assets shall be stable over time and they therefore consist of low-risk government bonds. The government bonds in the policy portfolio shall be issued in the country's own currency. Government bonds in euro shall be issued in Germany as German government bonds are seen as the most secure and liquid euro assets in crisis situations. The assets in the policy portfolio shall have good *liquidity*, which means that they must be able to be converted into liquid funds at very short notice. The assets shall consist of government bonds, and the interest rate risk shall be low without the investments being only concentrated to short-term bonds where liquidity is deemed to be worse. The interest rate risk for the policy portfolio shall therefore amount to 4.0, measured in terms of *modified duration*<sup>2</sup>.

The policy portfolio shall also include the Riksbank's gold reserve. By storing about half of the gold holdings at the Bank of England in London, where most global gold trade takes place, the Riksbank can sell the gold or use it as collateral for loans at very short notice should the need arise. To reduce the security risk, the rest of the gold holdings are stored by the central banks in Canada (Bank of Canada), the United States (Federal Reserve Bank of New York) and Switzerland (Swiss National Bank), as well as at the Riksbank's own depot in Sweden.

A new aspect of the *regulations for the gold and foreign currency reserve* is that market risk is restricted by the imposition of a limit. The market risk in the gold and foreign currency reserve may not significantly exceed the market risk in the policy portfolio. The aggregate risk mandate is thus slightly more restricted than before.

The *regulations for the gold and foreign currency reserve* also establish the deviation mandates given by the Executive Board to the Markets Department so that there is scope to mitigate the market risk or increase returns from the gold and foreign currency reserve. The deviation mandates signify the following:

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<sup>2</sup> *Modified duration* is a measure showing how sensitive the market value of a debt security is to changes in the interest rate level. A *modified duration* of 4.0 means that if the interest rate level changes by, for example, 1 percentage point, the market value will change by approximately 4 per cent.

- 1) The *currency composition* in the foreign currency reserve shall correspond to at least 75 per cent of the policy portfolio's currency distribution, where USD shall make up at least 55 per cent and EUR shall make up at least 15 per cent of the foreign currency reserve. The lowest percentages for the other policy currencies shall be equal to the policy need, i.e. 3 per cent GBP, 1 per cent DKK and 1 per cent NOK. The other maximum 25 per cent may be freely invested in currencies in the policy portfolio and in other eligible currencies.
- 2) The *interest rate risk in the foreign currency reserve* shall be maintained within a modified duration interval of 2.0 - 6.0.
- 3) The *foreign exchange reserves' holdings in EUR* may consist of government bonds issued in euro countries other than Germany.
- 4) The *foreign exchange reserves' holdings may*, in addition to government bonds, consist of bonds issued by state-guaranteed or intergovernmental organisations, and of bonds issued by local or regional authorities.

These deviation mandates are the same as in previous regulations apart from the fact that the deviation mandate concerning currency distribution is now slightly stricter and has been reduced from 30 to 25 per cent. In accordance with the regulatory framework, the Head of the Markets Department shall inform the Executive Board prior to major changes in the utilisation of permitted deviations or if the change is deemed to be of particular interest.

In other sections of the *regulations for the gold and foreign currency reserve*, updates have been performed as a result of the merging of documents and for editorial purposes. This means that no essential changes have been made to other parts of the regulatory framework and the risk regulation in these parts is unchanged compared to previously.

## Regulations for monetary and exchange rate policy transactions

*Regulations for monetary and exchange rate policy transactions* shall specify the direction of monetary policy liquidity management, i.e. how the Riksbank manages the banking system's borrowing and deposit requirements at the Riksbank in order to steer market rates. The regulation determines that the Riksbank shall drain the system of liquidity by issuing Riksbank Certificates given that the liquidity surplus in the banking system persists. Within the *Conditions for RIX and monetary policy transactions*, the Riksbank can also make FX transactions outside the framework for implementing monetary policy (currently only EU payments). These transactions are more closely regulated in the *regulations for monetary and exchange policy transactions*.

In this year's revision, the mandate for active currency positions has been removed from the regulation. FX transactions are now accommodated within the management of the foreign currency reserve, which is regulated in the *regulations for the gold and foreign currency reserve*. Apart from this, only minor editorial amendments have been made and references updated as a result of amendments to the *regulations for the gold and foreign currency reserve*.



## Regulations on the management of the Riksbank's securities portfolio in Swedish krona

Management of securities in Swedish krona shall take place in such a way as to not send signals over and above those decided on by the Executive Board for monetary policy purposes. The regulations on management of the Riksbank's securities portfolio in Swedish krona is formulated in a way that clearly states that the Riksbank will not perform any transactions in Swedish krona other than those motivated by monetary policy and decided on by the Executive Board. Hence, the regulations on permitted asset types, maximum permitted holdings and permitted transactions state that it is the Executive Board that, within the framework for monetary policy decisions, determines these factors. Only minor editorial amendments have been made and references updated in this year's revision of the *regulations on the management of the Riksbank's securities portfolio in Swedish krona*.