

South African Reserve Bank

Gold and Foreign Exchange Reserves Management Investment Policy

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SOUTH AFRICAN RESERVE BANK

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1. Purpose

1.1. The Governors' Executive Committee (GEC) of the South African Reserve Bank (SARB) has the authority to establish, approve or amend policies of the SARB or, where applicable, policies of the SARB Group (i.e. the SARB and its subsidiaries). This policy has been considered and approved by the Reserves Management Committee (Resmanco) as being most appropriate to support the effective and efficient achievement of the SARB's objectives whilst being fair to all stakeholders and in line with sound governance principles.

1.2. In exceptional circumstances, however, the GEC may exercise its prerogative to deviate from the stipulations of this policy when it is believed to be in the best interest of the SARB. Such deviations will be formally approved and dealt with in a controlled, objective, equitable and fair manner, in line with the values and objectives of the SARB.

1.3. The objectives of this policy are to:

1.3.1. outline the investment objectives in the management of the gold and foreign exchange reserves;

1.3.2. articulate the investment risk tolerance and applicable limits;

1.3.3. define the governance framework and delegation guidelines thereof; and

1.3.4. outline the investment universe and set out the necessary exclusions.

2. Policy scope

2.1. This policy sets out the governance framework for the management of the gold and

foreign exchange reserves of the SARB.

- 2.2. The policy is applicable to Resmanco, the Financial Markets Department (FMD) as well as the external fund managers which may be hired to manage a portion of the SARB's gold and foreign exchange reserves.

3. Policy statement

- 3.1. The Gold and Foreign Exchange Reserves Management Investment Policy (Investment Policy) has been approved by the GEC to support the effective and efficient achievement of the SARB's reserves management objectives in line with sound governance principles.
- 3.2. In exceptional circumstances, however, the GEC may exercise its prerogative in deviating from the stipulations of this policy when it believes this is in the best interest of the SARB. Such deviations must be formally documented, approved and implemented in a controlled, objective and transparent manner, in line with the values and objectives of the SARB as well as established reporting obligations.
- 3.3. In accordance with its role as a central bank and the South African Reserve Bank Act 90 of 1989 (SARB Act), the official gold and foreign exchange reserves (reserves) of the Republic of South Africa are held and managed by the SARB.
- 3.4. Reserves play a key role in ensuring that South Africa will be able to service its foreign exchange liabilities, to maintain confidence in its monetary, financial stability and exchange rate policies, and to protect its economic well-being in the event of external shocks.
- 3.5. The Investment Policy provides a framework within which Resmanco sets risk parameters at portfolio level.

4. Investment Policy objectives

4.1. The objectives of this Investment Policy are to:

4.1.1. define the approach and framework governing the management of reserves; and

4.1.2. define the governance structures, roles and responsibilities pertaining to reserves management operations.

5. Scope of the Investment Policy

5.1. The Investment Policy provides a strategic framework that guides the SARB in the reserves management process. It specifies, among other things, the aggregate tolerance parameters of the SARB for the management of the reserves and the eligible asset classes. The strategic asset allocation (SAA) and the investment guidelines (IGs) outline the specific risk parameters and allocations that guide the investment of reserves.

5.2. This Investment Policy is subject to credit risk, market risk and operational risk concepts, which are embedded, and defined in greater detail, in the SARB's Financial Risk Management Policy (FRMP).

5.3. Credit risk

5.3.1. The SARB strives to adopt adequate and prudent credit risk management strategies which aid in preserving the reserves by ensuring that the SARB invests in high-quality credit instruments. This is largely achieved by setting an overall credit risk appetite for the SARB, which translates into a minimum credit rating of A-. The credit risk appetite is further prescribed per sector and issuer or security in the IGs of the individual portfolios.

- 5.3.2. The SARB will minimise the concentration of credit risk by diversifying the investment portfolios such that the impact of potential losses stemming from any one type of security or issuer is minimised. Moreover, the exposure limits pertaining to the risk of issuers, asset classes, industry sectors and certain rating categories are specified in the IGs for each portfolio.
- 5.3.3. Over-the-counter derivatives, securities lending, repurchase agreements and reverse repurchase agreements should provide for early termination of the contract should a specific trigger event occur such as a specific downgrade, merger or acquisition.
- 5.3.4. Counterparty credit risk, where possible, should further be mitigated through minimum collateral requirements as well as International Swaps and Derivatives Association (ISDA) master agreements through the use of exchange-traded derivatives, legally segregated custodians and securities as well as indemnity arrangements.
- 5.3.5. The SARB will limit investments to the types of securities listed in Annexure A of this Investment Policy and will establish pre-qualifying financial institutions, broker-dealers, intermediaries and advisors with which the SARB will conduct business.
- 5.3.6. The creditworthiness of eligible issuers will be monitored through market indicators such as, but not limited to:
- 5.3.6.1. credit ratings;
 - 5.3.6.2. credit rating outlook;
 - 5.3.6.3. market-derived signal credit ratings;

5.3.6.4. financial statement analysis;

5.3.6.5. banking sector outlook review;

5.3.6.6. credit opinions;

5.3.6.7. credit default swaps spreads; and

5.3.6.8. credit risk models.

5.4. Market risk

5.4.1. Market risk in respect of foreign reserves is measured, managed and monitored by calculating risk metrics such as duration, value-at-risk (VaR), conditional value-at-risk (CVaR), relative VaR and tracking error, and reported on using these risk metrics. Other quantitative methods used to assess and analyse market risk can include stress testing and scenario analysis.

5.5. Operational risk

5.5.1. Operational risk is managed through the principles and activities set out in the operational risk management framework to ensure that effective control measures are in place.

6. Investment Policy principles

6.1. Investment objectives

6.1.1. The objectives of reserves management are, in order of priority, as follows:

6.1.1.1. *Capital preservation:* The safety of the principal amount invested is the foremost investment objective. Investments must be undertaken in a manner that seeks to preserve the capital value of the overall portfolio over the investment horizon, subject to the approved risk tolerances.

6.1.1.2. *Liquidity:* Investment management must seek to ensure that adequate reserves are available to meet a defined range of objectives. To maintain sufficient liquidity, reserves must be invested largely in securities with an active secondary market.

6.1.1.3. *Returns:* Subject to the capital preservation and liquidity constraints stated above, the reserves must be invested with the objective of achieving a reasonable return which is consistent with the investment objectives and risk constraints.

6.2. Adequacy, optimality and the tranching of reserves

6.2.1. The SARB aims to maintain an *adequate* level of reserves at all times. The adequate level of reserves is the amount of reserves that a country needs to hold in liquid assets to cover both known and likely trade and debt obligations.

6.2.2. The *optimal* level of reserves includes the provision for unanticipated obligations. The difference between *adequate* and *optimal* reserves can be viewed as a safety buffer. An *optimal* range for the level of reserves must be calculated and reviewed annually using generally accepted models.

6.2.3. The optimal amount of reserves is determined by using various factors that include, among other things, the South African government's short-term external debt, the probability of a sudden stop of capital inflows, imports, exports and gross domestic product growth as well as the cost and return of holding reserves.

- 6.2.4. The SARB does not target any specific level of reserves to guide its investment strategy. Instead, it uses the calculated optimal range as a guideline.
- 6.2.5. The reserves are divided into two tranches, namely the Liquidity Tranche and the Investment Tranche. The size of the Liquidity Tranche is determined by the adequate level of reserves; amounts in excess of this are allocated to the Investment Tranche.
- 6.2.6. The Liquidity Tranche is invested in highly liquid securities to ensure the timely availability and capital preservation of reserves.
- 6.2.7. The Liquidity Tranche is subdivided into four sub-tranches, namely the Special Drawing Rights (SDR) Sub-tranche, the Gold Sub-tranche, the Working Capital Sub-tranche and the Buffer Sub-tranche.
- 6.2.8. The SDR Sub-tranche is focused on the special needs of the SARB in respect of South Africa's membership of the International Monetary Fund (IMF). SDRs can also be exchanged for currencies of the IMF member countries during crisis events and, as such, are viewed as insurance against unforeseen events.
- 6.2.9. The Gold Sub-tranche is a function of South Africa's willingness to hold gold as a special reserve instrument. Given gold's high liquidity, its diversification benefits and its role as a form of currency, it is used as insurance against unlikely but potentially extremely damaging economic events.
- 6.2.10. The Working Capital Sub-tranche provides liquidity for short-term liabilities and cash management needs.
- 6.2.11. The Buffer Sub-tranche caters for unforeseen liquidity needs and serves to replenish the Working Capital Sub-tranche as and when required.

6.2.12. The Investment Tranche aims to enhance the returns on the reserves portfolio and to cover longer-term contingencies consistent with South Africa's overall macroeconomic and financial stability policies. It is invested in higher-yielding securities in order to enhance the return of the portfolio, while still recognising the capital preservation and liquidity objectives.

6.3. Investment strategy

6.3.1. The Gold Sub-tranche is passively managed but can be actively managed when market conditions permit, while the Working Capital Sub-tranche, the Buffer Sub-tranche and the Investment Tranche are actively managed within specified risk and asset allocation tolerance levels.

6.4. Leverage and the use of derivative instruments

6.4.1. Leverage of the reserves portfolio is not permitted. Leverage in this context means the use of borrowed funds to purchase an asset, with the result that the market value of tradable securities in an individual portfolio may exceed the total market value of the portfolio.

6.4.2. Investments can be made in derivative instruments only if explicitly authorised by Resmanco and specified in the IGs. Derivatives must be used to reduce transaction costs or when they are easier to trade than the underlying instrument due to liquidity constraints, and must thereby improve transactional efficiency.

6.4.3. The outright short-selling of eligible financial instruments (Annexure A) is prohibited.

6.5. Currency composition

- 6.5.1. The currency composition of the Liquidity Tranche considers the currency exposure of imports and the debt-service obligations of the South African government's short-term external debt (i.e. over the following 12-month period). The currency composition must be reviewed annually (or whenever deemed necessary) following consultation between the SARB and National Treasury.
 - 6.5.2. The currency composition of the Investment Tranche is determined as part of the SAA decision, subject to the appropriate risk-return optimisation process, which is reviewed from time to time.
 - 6.5.3. The list of eligible investable currencies (Annexure B) is set per portfolio and per tranche, and is detailed in the IGs.
- 6.6. Strategic asset allocation and the role of investment guidelines
- 6.6.1. SAA determines the optimal asset allocation of the SARB's reserves while recognising the risk tolerance and liquidity constraints of the SARB. It sets the tranche sizes, currency composition and appropriate asset classes, and assesses the expected risk and return over the relevant investment horizon. These parameters are specified at tranche level. Hence, each tranche has its own asset mix aimed at achieving the investment objectives of the tranche. SAA is reviewed annually and rebalanced if necessary, with a comprehensive review occurring as necessary.
 - 6.6.2. SAA allows for specific approval of the passive risk tolerance represented by an optimal blend of benchmark portfolios. In addition, it contains the overall risk budget for the active management of the reserves.
 - 6.6.3. Market benchmarks are selected to replicate SAA and form part of the IGs. The tracking error and IGs are determined and allocated on the basis of the risk tolerance for each portfolio. The overall risk budget (i.e. the tolerance level for intended deviation from benchmarks by the portfolio managers) is set at the SAA level and

then allocated to individual portfolios by Resmanco. The risk budget allocated to individual portfolios is not additive at SAA level due to the effect of diversification.

6.6.4. The IGs serve to govern the investment of reserves per portfolio in order to control the risks utilised by portfolio managers and to ensure that risk levels remain within the risk tolerance of the SARB. Benchmarks, IGs and tracking error allocation per portfolio embody the overall risk tolerance assigned for the management of reserves. A risk budget is allocated to each portfolio that is actively managed, in line with that portfolio's contribution to total risk.

6.6.5. Resmanco approves the IGs per investment portfolio, which are then transferred to FMD for appropriate internal and external fund manager distribution.

6.7. Portfolio management

6.7.1. The reserves are segregated according to SAA and managed as individual and independent portfolios. Portfolios are allocated to internal and external fund managers.

6.7.2. The SARB employs internal portfolio managers to manage the reserves, develop and enhance portfolio management skills within the SARB, and gather market intelligence.

6.7.3. Internal fund managers present a review of internal portfolio performance to Resmanco on a quarterly basis or more frequently if requested by Resmanco.

6.7.4. Resmanco approves the appointment and termination of external fund managers.

6.7.5. The SARB hires external fund managers in line with its procurement policy and corporate governance principles. The SARB employs external fund managers on

open-ended contracts with no set expiry period, subject to termination when necessary. The objectives of employing the services of external fund managers are to add value to the reserves portfolios through the diversification of strategies, to transfer skills and build capacity for internal portfolio managers, and, where appropriate, to benchmark the internal portfolio managers. Furthermore, external fund managers are also hired in order for the SARB to invest in asset classes that require a more sophisticated infrastructure than that which is available internally.

6.7.6. External fund managers are contractually obligated to present annual portfolio performance reviews at the SARB Head Office.

6.7.7. Resmanco must conduct an annual review of the external fund management programme, focusing mainly on performance measurement as well as compliance. In addition, Resmanco must conduct a comprehensive quantitative and qualitative review of the external fund management programme every three years.

6.8. Environmental, social and governance factors

6.8.1. In managing the country's gold and foreign exchange reserves, the SARB seeks to incorporate environmental, social and governance (ESG) factors in all investment operations, so as to ensure sustainability. This is achieved by incorporating ESG scores, where available, into the regular security selection and portfolio management processes.

6.8.2. The ESG Charter outlines the actual detail of the incorporation of ESG factors in investment operations. The Charter is attached as Annexure F to this document.

6.9. Performance measurement

6.9.1. The SARB measures the performance of portfolios against their respective benchmarks and submits performance reports as per the periodic requirements to

the appropriate stakeholders.

6.9.2. Portfolio performance is measured in adherence with the Global Investment Performance Standards (GIPS)¹. The key performance metrics employed to measure active return performance are alpha and target alpha, wherein alpha refers to the portfolio's outperformance relative to its benchmark.

6.10. Securities lending

6.10.1. Securities lending involves the temporary exchange of securities, usually for other securities (securities collateral) or cash of an equivalent value (cash collateral), with an obligation to redeliver a quantity of the same securities at a future date. The lender receives a fee from the borrower for lending securities. Where a lender accepts cash as collateral, the cash is reinvested to generate a return. The objective of the SARB's Securities Lending Programme (SLP) is to earn revenue in order to defray the cost of custodial and external fund management fees. The objective of the SARB's SLP is secondary and subject to the SARB's investment objectives, as defined in paragraph 6.1.

7. Investment risk tolerance

7.1. Investment risk tolerance parameters are determined at tranche level because each tranche has its own objectives, expected holding period and associated risks. The objectives are translated into broad overarching tolerances, which are listed below. Detailed parameters are specified in the IGs of each portfolio.

¹ These standards are voluntary and based on the fundamental principles of full disclosure and fair representation of performance results. They were created by the CFA Institute to provide an ethical framework for the calculation and presentation of investment performance history.

- 7.2. The SDR Sub-tranche is an international reserves currency asset, with no set investment horizon.
- 7.3. The Gold Sub-tranche is constituted of physical gold, with no set investment horizon either.
- 7.4. The investment horizon of the Working Capital Sub-tranche is limited to one month.
- 7.5.
- 7.6.
- 7.7. The investment horizon of the Buffer Sub-tranche is limited to one year.
- 7.8. The Investment Tranche has a three-year investment horizon.
- 7.9. The actively managed Buffer Sub-tranche and the Investment Tranche are allocated a total active risk budget of 50 basis points (i.e. an ex ante tracking error of 50 basis points). Furthermore, the active risk budget is monitored by means of relative VaR (i.e. the VaR of the actively managed portfolios in excess of the VaR of the benchmark portfolios) and reported accordingly.
- 7.10. The Buffer Sub-tranche should be invested to maximise returns subject to limiting the probability of negative returns (in base currency terms) to no more than 1% over a one-year investment horizon. Should the probability of negative returns increase to more than 1% over a one-year investment horizon, this would trigger an immediate revision of the SAA to bring the probability back below 1%, giving due cognisance to prevailing market conditions.
- 7.11. Similarly, the Investment Tranche should be invested with the objective of

maximising returns (in base currency terms) subject to limiting the probability of negative returns to no more than 1% over a three-year investment horizon.

8. Reserves management framework

8.1. FMD should, at all times, have a reserves management framework in place that facilitates the integration of all investment management structures, processes and associated activities.

9. Governance of reserves management

9.1. Roles and responsibilities

9.1.1. Governors' Executive Committee

9.1.1.1. The GEC delegates to Resmanco – through the Investment Policy, SAA and the terms of reference document – the authority to define the parameters for the investment of the reserves and to oversee the management of foreign exchange reserves.

9.1.1.2. The GEC approves the SARB's SAA on Resmanco's recommendation.

9.1.1.3. The GEC also approves the size of the SARB's SLP.

9.1.2. Reserves Management Committee

9.1.2.1. Resmanco is responsible for the oversight of FMD with regard to the investment of the reserves, with FMD reporting directly to the relevant Deputy Governor within the

SARB's reporting structure.

9.1.2.2. In the event of an emergency situation, the Chairperson of Resmanco, in consultation with the Governor, may override the prescripts of this Investment Policy and all other related policies and guidelines, subject to reporting any such actions to Resmanco and the GEC as soon as possible after such actions have been taken.

9.1.2.3. Resmanco approves the appointment and removal of custodians for the purpose of providing custody services for the SARB.

9.1.2.4. Resmanco approves any proposals that are put forward for consideration by the GEC.

9.1.2.5. Resmanco approves the SARB's SLP, its agent and the IGs for the SLP, including its risk tolerance parameters, all in accordance with the risk philosophy of the SARB. The SARB reviews its SLP and the agent when required, in line with its corporate governance principles.

9.1.2.6. Resmanco approves the allocation of the risk budget per individual portfolio.

9.1.2.7. Resmanco approves the SARB's custodial service arrangements.

9.1.3. Financial Markets Department

9.1.3.1. FMD is responsible for the management of the reserves in line with the aforementioned objectives.

9.1.3.2. FMD is, at all times, required to have documented and established processes in place to give effect to the principles espoused in the Investment Policy. It is the responsibility of FMD to ensure compliance with this Investment Policy and the

SARB's IGs, to manage the risks associated with the management of reserves, to monitor performance, and to report on the SARB's reserves management activities on a regular basis, as set out in paragraph 8.3.

9.1.3.3. FMD ensures that effective internal controls and an organisational structure exist, such that the reserves are managed in a sound and prudent manner and in accordance with the Investment Policy and IGs.

9.1.3.4. FMD is responsible for the monitoring and reporting of financial and non-financial risks in the reserves management portfolios.

9.1.3.5. FMD, under the guidance of the relevant Deputy Governor within the reporting structure of the SARB, is responsible for the management of the reserves in accordance with the criteria set out in the Investment Policy, the SAA and the IGs, and for the implementation of other prescriptions of the GEC and Resmanco.

9.1.3.6. FMD shall review and propose to Resmanco any possible changes to this Investment Policy whenever deemed necessary.

9.1.3.7. FMD is responsible for the reporting of reserves management activities as stipulated in paragraph 7.3.

9.1.3.8. FMD is responsible for reviewing the SARB's custody service arrangements as and when required, in line with the SARB's corporate governance principles, for approval by Resmanco.

9.1.4. Fund managers

9.1.4.1. External fund managers must provide their Statement on Standards for Attestation Engagements (SSAE) No. 16 or an equivalent report for the purpose of reporting on their design of internal controls and their operational effectiveness.

9.1.5. Risk Management Committee

9.1.5.1. The SARB's Risk Management Committee (RMC) has an oversight role in how risk in relation to reserves management is managed within FMD.

10. Reserves management investment universe

10.1. Details of the permissible instruments for both internal and external portfolio managers are listed in Annexure B.

10.2. Annexure C details the credit risk guidelines used when selecting investments.

11. Custodians

11.1. Resmanco approves the custody model as well as the appointment and removal of the custodian(s) for the purpose of providing a custody service to the SARB.

11.2. Custody services for the SARB's reserves include safekeeping, trade settlements, position reporting, processing corporate actions, collecting and distributing coupons, tax reclaim services, fund administration and, on occasion, providing market news and information.

11.3. The SARB reviews its custody arrangements every three years to provide an opportunity to benchmark the current services received against global custodial service standards and to align business requirements with the service offerings of the custodians.

12. Review of the Investment Policy

- 12.1. The Investment Policy should be reviewed whenever deemed necessary, but at least once every five years.

13. Reporting

- 13.1. FMD must submit monthly and quarterly risk reports to Resmanco. It must also report quarterly to the RMC of the SARB on risk and to the GEC on the performance of the reserves portfolios.
- 13.2. FMD must provide the SARB's Board of Directors with an annual report on the reserves management activities.
- 13.3. Within five working days after every month-end, FMD must release a public notice on the level of the official gold and foreign exchange reserves held at the SARB as at the end of the previous month.

14. Related legislation and documents

- 14.1. This Investment Policy is subject to credit risk, market risk and operational risk concepts, which are embedded, and defined in greater detail, in the SARB's FRMP.

Annexure A: List of eligible instruments

1. The South African Reserve Bank (SARB) is authorised to transact in the following financial instruments, with specific parameters outlined in the investment guidelines (IGs):
 - 1.1. gold: the SARB is authorised to hold a portion of its reserves in gold; the gold must be stored at storage facilities approved by the Governors' Executive Committee (GEC), both within South Africa and abroad;
 - 1.2. government securities: marketable bonds and other obligations issued or unconditionally guaranteed by the sovereign government of a country (including inflation-linked bonds);
 - 1.3. government agencies, states (provinces), multilateral organisation securities (supranational), marketable bonds and other obligations issued or unconditionally guaranteed by an agency of a sovereign government of a country or by multilateral organisations;
 - 1.4. banks' and other financial institutions' short- and long-term securities;
 - 1.5. interest rate and foreign exchange derivatives, as specified in the IGs, which are permitted for efficient portfolio management purposes (i.e. hedging, rebalancing and managing currency as well as duration, yield curve and credit exposures);
 - 1.6. repurchase agreements (repos) and reverse repurchase agreements (reverse repos): the eligible securities comprise securities which the SARB is authorised to obtain;
 - 1.7. foreign exchange: currencies eligible for investment as authorised in the IGs;

- 1.8. corporate, asset-backed and covered securities: any marketable bond, note or other obligation or security (including asset-backed securities) issued or unconditionally guaranteed by a legal entity or trust;
- 1.9. mortgage-backed securities (MBSs): agency MBSs;
- 1.10. money market mutual funds;
- 1.11. equity exchange-traded funds; and
- 1.12. other asset classes as may be expressly authorised by the GEC.

Annexure B: Eligible currencies

Currencies
Australian dollar (AUD)
British pound (GBP)
Canadian dollar (CAD)
Chinese renminbi (CNY)
Chinese yuan renminbi offshore (CNH)
Danish krone (DKK)
Euro (EUR)
Hong Kong dollar (HKD)
Japanese yen (JPY)
New Zealand dollar (NZD)
Norwegian krone (NOK)
Singapore dollar (SGD)
South Korean won (KRW)
Swedish krona (SEK)
Swiss franc (CHF)
United States dollar (USD)

Annexure C: Credit risk guidelines

1. Only ratings issued by the rating agencies Standard & Poor's (S&P), Fitch Ratings and Moody's shall apply, and securities and issuers must be rated by at least two of these rating agencies. In the event that a security is rated by only two of the rating agencies, the lower of the two credit ratings will apply. If the security is rated by all three rating agencies, all three of the ratings must be above 'A-', whilst the lower of the two highest ratings will apply.
2. Securities or issuers of securities rated below 'A-' or 'A-1' are not permitted. Unrated securities of qualifying issuers (i.e. rated 'A-' or 'A-1' and above) will assume the issuer ratings according to the corresponding debt rank level. Counterparties must meet the minimum long-term credit rating by any two of the above-mentioned rating agencies, and the counterparty's credit rating must be at least single 'A-'.
3. Further credit rating stipulations per asset class and issuer are set out in the investment guidelines (IGs) for each portfolio.
4. The Reserves Management Committee (Resmanco) of the South African Reserve Bank (SARB) is responsible for the methodology for the selection and review of counterparties, while the SARB's Financial Markets Department (FMD) is responsible for the implementation of the methodology.

Annexure D: Equity holdings/investments

1. Any investment in banks' equities registered in terms of the Banks Act 94 of 1990, including foreign banks, must be approved by the Minister of Finance.
2. The equities of limited companies (whether listed or unlisted) that are included in the strategic asset allocation (SAA) must be approved by the Governors' Executive Committee (GEC).
3. Any other equity-related financial instrument or product – such as index equities, equity derivatives, exchange-traded funds etc. – shall be approved by the Reserves Management Committee (Resmanco).
4. The investment guidelines (IGs) will capture the limits that apply to these types of investments, and the limits shall be approved by Resmanco.
5. Considerations of including equities in the SAA should take into account potential conflicts of interest, or even perceived conflicts of interest, as well as market and public perceptions of investments made by the South African Reserve Bank (SARB).
6. Any exchange-traded funds must exclude equities with primary listings in South Africa in the composition.

Annexure E: Securities Lending Programme

1. The size of the Securities Lending Programme (SLP) is limited to US\$10 billion.

Annexure F: Environmental, Social and Governance Charter

The South African Reserve Bank (SARB) recognises the critical need to integrate environmental, social and governance (ESG) principles into its investment operations.

The environmental, social and governance Charter (ESG Charter) provides a framework to guide the management of the SARB's investment portfolios.

The ESG Charter is articulated below.

1. Purpose

- 1.1 The purpose of this ESG Charter is to articulate the SARB's commitment and guiding principles for managing its investment portfolios and operations in a manner that fosters a sustainable future for all stakeholders. It establishes a high-level guidance framework to ensure that sustainable and responsible investment considerations are central to the management of the SARB's investment portfolios.
- 1.2 Since the Gold and Foreign Exchange Reserves Management Investment Policy (Investment Policy) focuses on objectives such as capital preservation, liquidity and return requirements, the ESG Charter will enhance and support the Investment Policy as it aims to advance sustainable development, promote responsible investment practices, and align its operations with societal and environmental priorities.
- 1.3 The SARB's short- to medium-term ESG investment strategy focuses primarily on the environmental (E) pillar, while the social (S) and governance (G) pillars are secondary. This is due to the structure of the investable universe for sustainable

instruments. The green bond market² offers a mature and liquid avenue to effectively allocate capital towards sustainable projects, with the social bond market offering significantly lower depth and maturity. In the long term, the SARB plans to expand its focus to the social (S) and governance (G) pillars as data and methodologies for these areas become more standardised.

2. Objectives

- 2.1 The ESG Charter establishes a high-level strategic framework that guides the SARB, its Reserves Management Committee (Resmanco), the Board of Directors (Board) of the Corporation for Public Deposits (CPD), the Board of the Corporation for Deposit Insurance (CODI) as well as the Governors' Executive Committee (GEC) in their respective roles within the investment management process.
- 2.2 The key objectives of the ESG Charter are to:
- 2.2.1 integrate ESG factors into investment decisions: embed sustainable investment principles across all investment practices and ensure ESG considerations in the investment decision-making process;
 - 2.2.2 promote transparency and accountability: establish clear reporting mechanisms to enhance transparency and accountability;
 - 2.2.3 align with international standards: ensure consistency with international standards and best practices in sustainable finance – the ESG Charter is guided by the United Nations Principles for Responsible Investment, the recommendations from the Network for Greening the Financial System regarding sustainable investing as well

² The green bond market has shown considerable growth since the first issuance in 2007, whereas social bonds gained prominence after the COVID-19 pandemic.

as principle 17 of the *King IV™ Report on Corporate Governance for South Africa 2016*;

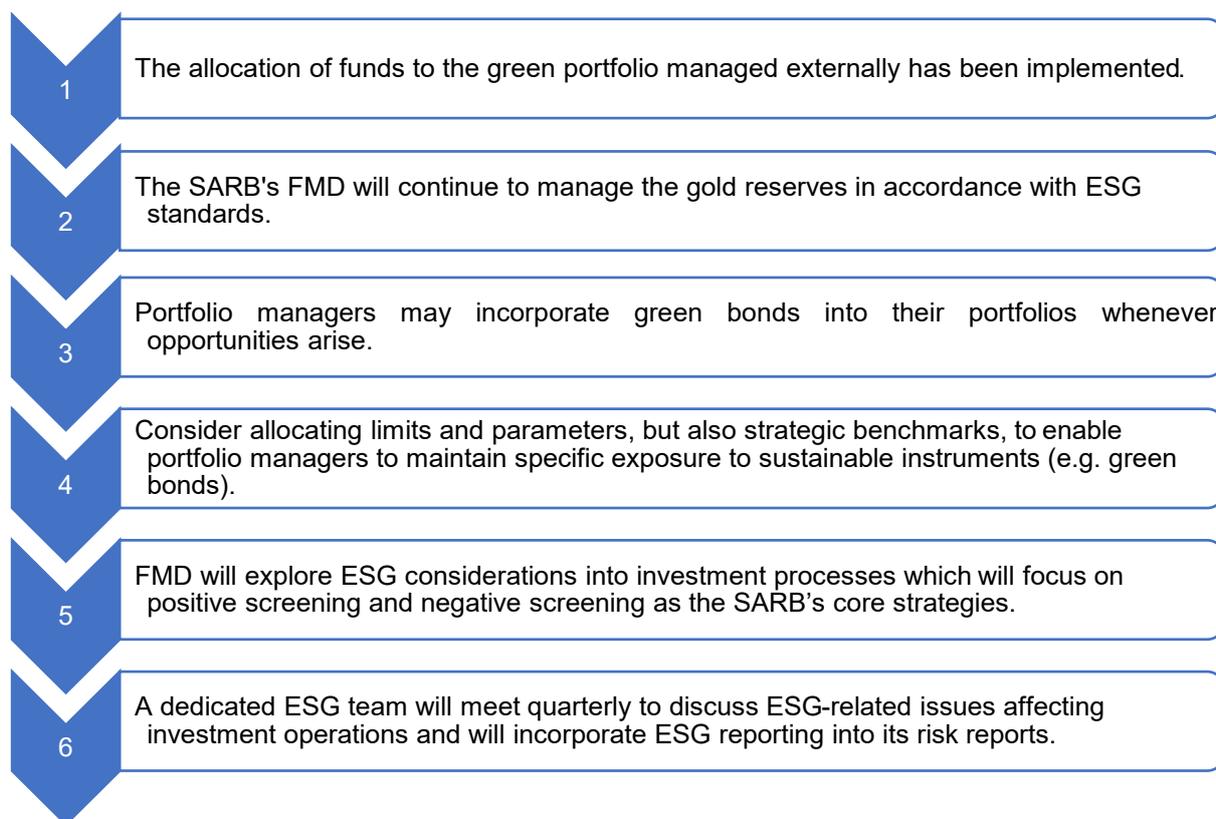
2.2.4 integrate ESG and sustainability considerations into the entire investment management value chain, including market research, collateral management and trade settlements; and

2.2.5 pursue the greening of the financial system by engaging in initiatives which promote the issuance and secondary trading of green instruments.

3. ESG investment strategies

3.1 The GEC approves the ESG Charter together with the Investment Policy, while the relevant committees – such as Resmanco, the CPD Board and the CODI Board – are tasked with overseeing the review and implementation of the ESG Charter. This includes delegating specific roles and responsibilities to the Financial Markets Department (FMD) and establishing ESG strategies that should be employed. Figure 1 below illustrates the strategies that have been identified for FMD.

Figure 1: Summary of proposed approaches and phases to implement the ESG Charter



- 3.2 The SARB has implemented a green bond portfolio managed by an official institution with a credit rating framework in line with the Investment Policy.
- 3.3 Given that gold forms a significant part of the reserves portfolio, the SARB will continue to manage the gold reserves in accordance with the London Bullion Market Association Global Precious Metals Code (Code), which also includes ESG standards. Notably, the SARB is one of only three central banks which attested to the Code. This certification supports ESG principles. In all gold trading, the SARB should adhere to the principles outlined in the Code.
- 3.4 Portfolio managers managing both internal and external portfolios may continue to incorporate green bonds into their portfolios whenever opportunities arise, provided that these bonds align with the approved investment guidelines (IGs) parameters and objectives such as capital preservation, liquidity and return requirements of the respective portfolios. Due to the restricted availability of sustainable instruments in

general and green bonds in particular, it is not prudent to establish holding targets at this stage.

- 3.5 The SARB will explore the establishment of holding limits and parameters within the IGs to enable portfolio managers to maintain specific exposure to sustainable instruments (e.g. green bonds) for portfolios managed internally and externally. Furthermore, the SARB will consider the introduction of an ESG benchmark within the strategic asset allocation (SAA) which will have portfolios (internally and externally) with specific exposure to sustainable instruments (e.g. green bonds).
- 3.6 The SARB will explore ESG considerations into investment processes which will focus on positive screening in the CPD and CODI portfolios as well as negative screening in the gold and foreign exchange reserves portfolios.
- 3.7 The ESG task team will engage with its stakeholders in the Southern African Development Community and the Common Monetary Area development finance institutions in order to promote and support the issuance of high-quality and liquid instruments which fund sustainable projects on the African continent.
- 3.8 A dedicated ESG task team comprising of members from various units within FMD will meet quarterly to discuss ESG-related issues affecting investment operations. This team will submit an ESG report to the relevant committees, such as Resmanco, the SARB ESG Steering Committee (Steerco), the CPD Board and the CODI Board. This report will encompass the following elements:
 - 3.8.1 an analysis of exposure per counterparty in relation to their ESG ratings, providing relevant stakeholders with insights into the SARB's overall exposure; this report will also identify counterparties recommended for investment and those advised against, particularly focusing on those with low or no ESG ratings; each rating provider or agency emphasises different aspects of the E, S and G categories when calculating

their overall scores; additionally, the weighting of specific factors varies by sector or issuer type, as certain factors may hold greater relevance in particular industries;

- 3.8.2 an evaluation of ESG factors that may negatively impact on credit quality, potentially leading to increased credit losses if not addressed;
- 3.8.3 a review of ESG-related factors within market risks such as credit spreads and interest rates on sustainable bonds compared to conventional bonds;
- 3.8.4 an examination of counterparties for ESG-related offenses and any adverse developments, along with reporting on operational risks linked to ESG operations through the operational risk assessments, strategic risk assessments, key risk indicators, risk incidents and audit findings;
- 3.8.5 an assessment of the performance of ESG portfolios against their respective benchmarks; and
- 3.8.6 a review of the actual sustainable investment exposure across all portfolios managed by FMD.

4. Governance

- 4.1 Resmanco will receive delegated responsibilities from the GEC, just as the CPD Management Committee (Manco) will from the CPD Board and the CODI Investment Committee from the CODI Board, on the implementation and oversight of the ESG Charter. This will provide leadership and governance for ESG management within the investment operations of the SARB. This includes establishing a clear strategic framework to effectively integrate ESG principles into all investment activities.

5. Reporting

- 5.1 ESG operations will be reported to the GEC annually in an ESG report on all investment activities, with the primary objective of informing the GEC about the ESG risks associated with the investment operations of FMD. These reports will provide a comprehensive overview of identified risks, the strategies in place to manage them, and any emerging trends or developments in the ESG landscape that may impact on FMD's investments.

6. Reviewing the ESG Charter

- 6.1 The ESG Charter is a living document that remains open to refinement through ongoing input and feedback.
- 6.2 The dedicated ESG task team will review the ESG Charter annually, assessing its relevance and effectiveness while also considering evolving best practice and regulatory requirements. Based on this review, the team will propose any necessary amendments to the GEC to ensure that the ESG Charter remains aligned with the SARB's strategic goals and the ever-changing dynamics of the investment environment.

7. Conclusion

- 7.1 The ESG Charter serves as a vital framework, ensuring that the SARB's investment portfolios are managed with a focus on ethical considerations and long-term societal impact. By prioritising ESG factors, the SARB not only enhances its investment strategies, but also contributes to a more sustainable future, aligning financial success with positive environmental outcomes.

Annexure G: Definitions

Aggregate risk tolerance: The maximum expected loss of the overall gross reserves of the South African Reserve Bank (SARB) should not exceed 1% at a confidence level of 99%. This constraint is used as an overarching criterion in the optimisation of the process in selecting the optimal benchmark portfolios in the strategic asset allocation (SAA).

Asset-backed security (ABS): A financial security collateralised by a pool of assets such as loans, leases, credit card debt, royalties or receivables.

Base currency: The currency in which the portfolio is denominated.

Basis point: A basis point equals one-hundredth of 1% (0.01%).

Benchmark: A notional or reference portfolio comprising investible securities or an investment strategy that reflects the preferred risk position specified in SAA.

Broker-dealer: An organisation that acts as a primary dealer, market maker or broker when trading securities for its own account or on behalf of its customers.

Credit risk: The risk that a financial loss will be incurred if a counterparty to a transaction does not fulfil its financial obligations in a timely manner.

Duration: A measure of the sensitivity of the price of a bond or another debt instrument to a change in interest rates. Duration can be thought of as a measurement of interest rate risk.

Environmental, social and governance (ESG) factors: ...

Excess returns: Portfolio returns in excess of the benchmark returns.

Haircut: The discount applied to the market value of the underlying asset being taken as collateral.

Highly liquid securities: Assets which can readily be converted into cash while maintaining their market value.

Investment guidelines (IGs): The guidelines governing the investment of reserves for each portfolio in order to contain the risk taken by portfolio managers and to remain within the risk tolerance levels.

Investment horizon: The period over which the reserves are expected to be committed for investment, and over which returns and risks should be managed and measured.

Liquidity risk: The possible difficulties in selling (liquidating) large amounts of assets timeously. The risk usually arises in adverse market conditions where prices are deteriorating rapidly, causing market disorder.

Market risk: The risk that value will be lost due to a change in a market variable such as the price of a commodity, interest rates or foreign exchange rates.

Mortgage-backed security (MBS): A type of ABS that is secured by a mortgage or a collection of mortgages. It is issued by a federal government agency company, a government-sponsored enterprise (GSE) or a private financial company.

Operational risk: The risk of loss resulting from inadequate or failed internal processes, people, systems, legal/regulatory and external events.

Passive risk tolerance: The risk that the SARB is willing to take when following an index-tracking (i.e. passive) strategy.

Reporting currency: The currency in which the reserves are reported, namely the United States (US) dollar.

Repurchase agreement (repo): Short-term collateralised borrowing where a counterparty receives cash from the SARB in return for collateral, generally in the form of government bonds, with a commitment by the counterparty to repurchase the government bonds at maturity of the transaction. The cash as well as the interest earned are returned to the counterparty at maturity.

Reverse repurchase agreement (reverse repo): The opposite of a repo; a form of collateralised short-term cash lending where the SARB purchases an eligible security with a predefined commitment to sell it back at an agreed future date.

Risk appetite: The level of risk that the SARB is prepared to accept in pursuit of its objectives.

Risk budget/active risk tolerance: The maximum risk tolerance expressed as a tracking error allocated to an investment portfolio within which active trading can take place.

Securities Lending Programme (SLP): Securities lending involves the temporary exchange of securities, usually for other securities (securities collateral) or cash of an equivalent value (cash collateral), with an obligation to redeliver a quantity of the same

securities at a future date. Most securities lending is structured to give the borrower legal title to the securities for the life of the transaction even though, economically, the terms are more akin to a loan. The borrowing fee is generally agreed in advance, and the lender has contractual rights similar to beneficial ownership of the securities, with rights to receive the equivalent of all interest payments or dividends and to have equivalent securities returned.

Settlement risk: The risk that may arise when the custodian fails to release the stock to the market timeously, the SARB does not match the counterparty or the counterparty/intermediary fails to deliver on a contractual settlement date.

Standard deviation: A measure to quantify the amount of variation or dispersion around the mean for a particular data set (e.g. asset returns). It is calculated as the square root of the variance.

Strategic asset allocation (SAA): A portfolio strategy that involves setting target allocations for various asset classes.

Tracking error: A measure of the risk in an investment portfolio that arises due to the active management decisions made. More specifically, it is a measure of risk that quantifies how closely a portfolio follows the index against which it is benchmarked. It is calculated as the annualised standard deviation of the excess returns over the benchmark.

Value-at-risk (VaR): A measure of market risk and a measure of downside risk exposure expressed in a specific currency. It reflects an estimate of the maximum loss which can occur with a specified confidence level over a selected time horizon. VaR is based on probabilities, so it cannot be relied on with certainty. As it is a measure of volatility, the greater the volatility the higher the probability of loss. The SARB measures VaR over a 10-day horizon with a 99% confidence level.