ABSTRACT

The purpose of this study was to survey the various types of foreign exchange reserves risks faced by the Central Bank of Kenya and the strategies adopted by the Bank to manage these risks.

The research was a case study of the Central Bank of Kenya. A questionnaire to seventeen technical staff working in the reserves management department of the Central Bank of Kenya was used to collect the relevant data. The collected data was analyzed for content using SPSS Software and the results were presented using tables and pie charts.

The study found that the key foreign exchange reserves risks faced by the Central Bank of Kenya were; credit risk, liquidity risk, sovereign/political risk, operational risk and market risk. The risk management strategies adopted by the Bank in managing these risks included but were not limited to; internal control procedures, portfolio construction, tranching of reserves and strategic asset allocation.

The study recommends establishment of a framework that identifies and assesses the risks of reserves management operations that allows the management of risks within acceptable parameters and levels. The framework should seek to identify the possible risks that may impact on portfolio values and to manage these risks through the measurement of exposures, and where necessary, supporting internal control procedures to mitigate effects of these risks. The study also recommends the determination of risk parameters that include the minimum acceptable credit ratings for the counterparties to deal with. The study further recommends the continuous monitoring of risk exposures to determine whether exposures have been extended beyond acceptable limits. Value at Risk (VaR) or other simulation methodologies may be adopted as part of the risk management and monitoring framework.