



Central Bank of Kenya

Kenya Government Benchmark Bond Programme General Guidelines

October 2021



1. Introduction

This document provides general guidelines on the Kenya Government Benchmark Bond Programme (BBP).

2. Definition of Terms

The definition of terms used in this document is presented in the Glossary (Annex I).

3. Legal and Regulatory Provisions

3.1 Public Finance Management Act, 2012 (PFMA)

As the Fiscal Agent of Government, CBK prepares a domestic debt programme and market development (DPMD) strategy and a Borrowing Plan at the start of every financial year aligned to the prevailing Medium Term Debt Strategy (MTDS). A key element of the DPMD strategy is the Benchmark Bond Programme (BBP), and takes into account the following desired objectives:

- a) To meet the domestic borrowing target;
- b) To manage the cost of debt by developing and maintaining a well-priced stable yield curve;
- c) To minimize debt maturity risk by extending bond tenor and targeting a higher ratio of T-Bonds to T-Bills;
- d) To contribute to stable liquidity flows;
- e) To support market development.

The benchmark bond programme focuses on a comprehensive plan for building benchmark bonds and conducting liability management operations with an aim to strengthen secondary market liquidity, maintain a stable and reliable benchmark yield curve and reduce the debt cost.

The benchmark bonds programme in Kenya was mooted in 2007 with the identification and adoption of benchmark tenors of 2, 5, 10, 15, 20 and 25 years along the yield curve. The aim of the programme

was to improve bond market liquidity and achieve a benchmark yield curve by minimizing bond market fragmentation (see Annex III).

4. Enhancing Kenya's Benchmark Bonds Programme

The following main strategies continue to enhance the benchmark bond programme:

i. Sustained Building of Benchmark Bonds

A comprehensive benchmark building programme in place takes into consideration the following

- a) A bond reopening schedule complete with proposed candidate bonds, reopen timing and justification for the choices.
- b) Complementary strategic initiatives to fast track the benchmark building programme.

ii. Liability Management Operations (LMOs)

Liability Management Operations are debt management operations aimed at establishing a targeted bond consolidation and refinancing programme through initiatives such as bond switches and buybacks to reduce refinancing risk.

A comprehensive bond exchange programme includes the following elements:

- a) A bond switching schedule complete with proposed candidate bonds, switch timing, switch sizes and justification for the choices.
- b) Bond buy backs.
- c) Complementary strategic initiatives to fast track the bond switch programme.

The following strategies continue to be implemented to enhance building of benchmark bonds:

- a) National Treasury and CBK coordination - continue close collaboration between National Treasury and CBK to achieve the desired debt programme and market development objectives.

- b) Stakeholder and market engagement - sustain engagements on bond issuance programme and market development agenda through monthly consultation forums and other engagements.
- c) Reopening of benchmark tenors - where bonds are undersubscribed or few bids accepted due to aggressive pricing to continue to build volume on the bonds.
- d) Incentivizing the bonds - package attractive features on the bonds such as maturities mix and timing of issuance.
- e) Green Shoe Option (GSO) – use of GSO to manage pricing behavior at the auction and increase liquidity at the secondary market.

Enhancing the benchmark bond programme is expected to result in the following benefits:

- i. Maintain an appropriate T-bond average time to maturity (ATM) currently at 8.6-years as at June 2021.
- ii. Achieve fewer larger size bonds in the portfolio.
- iii. Increase bond market liquidity and sustain a stable yield curve.
- iv. Increase participation by non-bank players such as pension sector firms, Insurance companies and foreign investors.

5. General Guidelines for the Kenya Benchmark Bonds Programme

The following are the general guidelines for the benchmark bonds programme:

5.1 Legal and regulatory provisions – the applicable laws and regulations relating to the Government securities market in Kenya are presented in Annex II.

5.2 Number of benchmarks – there are six (6) benchmark maturities of 2, 5, 10, 15, 20 and 25 years along the yield curve. The issuance programme continues to focus on building size around these benchmark maturities.

5.3 Size of benchmarks – To improve bond liquidity and reduce market fragmentation, ceiling sizes per benchmark maturity were initially set at KES 30bn for 2, 5 year and KES 40bn for 10, 15, 20 and 25 year tenors respectively (Annex III). The considerations for these volume ceilings at the time included the need to manage refinancing risk on maturity of the bonds while taking into account the size of the overdraft facility limit. The market has evolved since 2007, with the subscription rates for Treasury bonds increasing catalyzing an active secondary market trading environment. Larger benchmark sizes will help to reduce the number of series per benchmark maturity, increase secondary market liquidity, and sustain a stable and reliable benchmark yield curve.

5.4 Selection of benchmarks - All on-the-run issues are regarded as benchmark bonds as they create a new basis of reference for other similar bonds. On-the-run bonds are the most recently issued bonds (for a certain bond maturity) which the market treats as benchmarks because they tend to be actively traded and more liquid issues. Bonds cease to be on-the-run issues when they are replaced by new bonds of the same original maturity.

5.5 Bond standardization – to increase fungibility of benchmarks, bonds issued under the benchmark programme are standardized marketable securities in terms of the following features; tenor or maturity, semi-annual fixed coupon rates and yield basis, benchmark size, frequency of issuance as well as identification of on-the-run and off-the-run issues for purposes of bond reopening.

5.6 Considerations for the benchmark programme

– the choice of instruments in the issuance programme takes into account important considerations such as investor preferences for certain maturities at points in time, prevailing secondary market bond pricing along the yield curve, debt programme objectives, market cycles and seasonality, private-sector events such as corporate bond issuance, IPOs or dividend payments among others.

5.7 Provisions for bond reopening

The following bond reopening provisions are considered:

- a) Existing bond series are eligible for reopening at any time during the life of the bonds, depending on the following reopen maturity bucket criteria;
 - Bonds with remaining time to maturity (RTM) of 2-3.9 years are classified under 2-year benchmark bucket
 - Bonds with RTM of 4-7.9 years are classified under 5-year benchmark bucket
 - Bonds with RTM of 8-12.9 years are classified under 10-year benchmark bucket
 - Bonds with RTM of 13-17.9 years are classified under 15-year benchmark bucket

- Bonds with RTM of 18-22.9 years are classified under 20-year benchmark bucket
 - Bonds with RTM of 23-27.9 years are classified under 25-year benchmark bucket
- b) Reopening of long-term instruments in different maturity buckets is preferred as long as the coupon rates are aligned with market pricing and conditions.
 - c) Reopening of on-the-run benchmark series considers adjustment of bond's duration and its target size to ensure that its coupon rate is within market levels, and enhance its market demand both at the reopening auction and secondary market trading.
 - d) Both benchmark issuance and reopening are complimented with liability management operations (switches and buy backs) to reduce refinancing risks and improve liquidity of the off-the-run bonds.
 - e) Larger bond issuance size is aimed at increasing available tradable volume and promoting price discovery, with a careful balance and understanding of investor preferences to increase auction performance.

6. Enquiries and Additional Information

For enquiries please contact Central Bank of Kenya, Financial Markets Department on 2860000 or send an email to ndo@centralbank.go.ke or visit the CBK website on www.centralbank.go.ke

Financial Markets

August 2021

Annex I : Glossary

Benchmark bond	A government bond that provides a standard against which the performance of other bonds in the market can be measured. There are different ways of determining or selecting benchmark issues based on different country practices, including on-the-run issues for each bond maturity, specific bond maturity with large outstanding size and being traded near par value or bonds that are candidates for successful reopening ¹ .
Bond Switch	A switch also referred to as a “bond exchange” is a liability management operation that is used to alter the profile of a debt portfolio.
Liability Management bond Operations (LMOs)	These are debt management operations aimed at establishing a targeted bond consolidation and refinancing programme through initiatives such as bond switches and buy backs to reduce refinancing risk.
On-the-run bond	An on-the-run issue is the most recently issued bond (for a certain bond maturity), and is usually treated by the market as a benchmark bond because it tends to be the most liquid or actively traded issue around that term-to-maturity. The new bond is considered the on-the-run issue until it is replaced by a new bond of the same original term-to-maturity. A bond ceases to be an on-the-run when it becomes a seasoned issue, often referred to as an off-the-run issue. Most countries do not have official rules on selection of benchmarks. (IMF & WB, 2021, 1999)

¹Bond reopening refers to a re-issuance of a bond that had been issued earlier at the primary market, without changing the bond’s features such as time to maturity, coupon rate and coupon basis and taxation among others. A bond can be reopened several times during its life with the objective of increasing its outstanding volume and enhance its liquidity.

Annex II: Legal and Regulatory Provisions

i. Public Finance Management Act, 2012 (PFMA)

The Public Finance Management Act, 2012 (PFMA) Section 53 (4) states that the authority of the Cabinet Secretary to borrow money includes the authority to borrow money by issuing national government securities.

Section 63 (e) of the PFMA provides that the Public Debt Management Office (PDMO) shall be the Principal in the issuance of government debt securities on behalf of the National Treasury. Section 50 (9) gives the Cabinet Secretary powers to appoint and to enter into agreements with agents for the purpose of raising loans and issuing, managing or redeeming national government securities.

Pursuant to the PFMA Section 53 (8) (c) Government securities are issued by the Central Bank of Kenya as a borrowing agent appointed by the Cabinet Secretary on behalf of the Government.

Section 197 (1) of the Public Management (PFM) Act Regulations criteria for issuance of government securities states as follows;

197. (1) The issuance of government securities to raise debt capital shall be by way of auction or such other method as Cabinet Secretary may determine.

197 (6) Where national government securities are to be issued other than by auction, their terms and conditions shall be subject to the prior approval of the Cabinet Secretary.

ii. Central Bank of Kenya Act (CBKA)

The Central Bank of Kenya Act (CBKA) Section 44 authorizes the Bank to act as fiscal agent of and banker to the Government. The Bank in its capacity as fiscal agent is assigned the function to administer the public debt including issuance of, payment of a return on, and redemption of, bonds and other securities of the government under Section 45 (c).

iii. Agency Agreement between National Treasury & Central Bank of Kenya

In line with the above-mentioned legal provisions, there is in place an agency agreement between the National Treasury (NT) and Central Bank of Kenya (CBK) through Financial Markets Department. The agreement appoints CBK as the fiscal agent of NT for the purpose of implementing the government borrowing programme as well as issuance, management and redemption of government securities on behalf of the National Treasury.

Annex III: Box 1: Benchmark Bonds Programme in Kenya

The benchmark bonds programme in Kenya was mooted in 2007 with the identification and adoption of benchmark tenors of 2, 5, 10, 15, 20 and 25 years along the yield curve. The aim of the programme was to improve bond market liquidity and achieve a benchmark yield curve by minimizing bond market fragmentation. Ceiling sizes per bond maturity were set at KES 30bn for 2, 5 year and KES 40bn for 10, 15, 20 and 25 year tenors respectively. The considerations for the above volume ceilings at the time, included the need to minimize refinancing risk on bond maturity dates. Over the years, the bond portfolio size has increased substantially, growing by 732 per cent to KES 2.2 trillion in August 2021 from KES 272.2bn in June 2007. Total T-bond portfolio including infrastructure bonds stands at KES 3.0 trillion.

The current portfolio was built through a reopening programme undertaken since 2008 as one of the benchmark building strategies. The benchmark portfolio has 48 fixed coupon bonds (FXDs) accounting for 75% (KES 2.3 trillion) of the KES 3.0 trillion stock of bonds. As at August 2021, the average outstanding size on the 48 bonds was KES 47.1bn, with majority (12) in the 5-y maturity bucket accounting for 27.1% (KES 613.2bn) of the benchmark stock. Five (5) bonds have outstanding size range of KES 50-60bn each; with fourteen (14) bonds at over KES 60bn each (Table 1 below). Secondary market liquidity for government bonds has improved significantly over the period 2007 to 2021 with highest annual turnover in 2020 (KES 636.6bn), 2019 (KES 571.6bn) and 2012 (KES 522.89bn) compared to 2007 (KES 84.14bn). As a result of increased liquidity, the yield curve has sustained stability and resilience.

Eleven (11) bonds in the portfolio have up-to 2-years to maturity while 37 bonds are candidates for future reopening.

Size per bond	No. of Bonds by Remaining Maturity Bucket							
	<2-Year	2-Year	5-Year	10-Year	15-Year	20-Year	25-Year	Total
>=KES 20bn	1	0	1	0	1	0	0	3
KES 20-30bn	3	1	1	1	1	1	0	8
KES 30-40bn	6	4	2	1	0	1	0	14
KES 40-50bn	0	1	1	0	1	0	1	4
KES 50-60bn	1	0	3	1	0	0	0	5
KES 60-70bn	0	1	3	1	1	0	0	6
KES 70-80bn	0	0	0	2	1	0	0	3
>KES 80bn	0	0	1	2	1	1	0	5
Total	11	7	12	8	6	3	1	48
Stock (KES bn)	338.6	283.5	613.2	510.4	316	162	41.4	2,265.10
% of B. Stock	14.95	12.51	27.07	22.53	13.95	7.15	1.83	100

Notes

- 11 bonds will mature within 2-years as at August 2021 – These will not be considered for current and future reopening.
- 37 bonds are candidates for current and future reopening.
- Bonds with RTM of 2-3.9 years are classified under 2-year benchmark bucket
- Bonds with RTM of 4-7.9 years are classified under 5-year benchmark bucket
- Bonds with RTM of 8-12.9 years are classified under 10-year benchmark bucket
- Bonds with RTM of 13-17.9 years are classified under 15-year benchmark bucket
- Bonds with RTM of 18-22.9 years are classified under 20-year benchmark bucket
- Bonds with RTM of 23-27.9 years are classified under 25-year benchmark bucket

Annex IV: Box 2: Liability Management Operations (LMOs)

These are debt management operations aimed at establishing a targeted bond consolidation and refinancing programme through initiatives such as bond switches and buybacks to reduce refinancing risk.

A switch also referred to as a “bond exchange” is a liability management operation that is used to alter the profile of a debt portfolio. Switches have been used across the world in Brazil, Hungary, Malaysia, Poland, United Kingdom, Canada and South Africa amongst others. These countries have used switching to smooth bond maturities, manage market liquidity, lengthen the maturity profile and reduce market risk. In some jurisdictions, switching is done regularly on a bi-weekly, monthly or quarterly basis.

The idea of switching Government securities was mooted in February 2020 with the objective of lengthening the maturity profile of existing debt by targeting upcoming maturities of T-bills. At the time, the largest share of the Treasury bills in the domestic debt portfolio was the 364-day bills accounting for 86.5 percent (KES 797.3bn) of the total outstanding stock of T-bills (KES 921.5bn).

The inaugural Government securities switch was successfully conducted on June 1, 2020 and involved the 364-day T-bill Issue No.2236/364 with a stock of KES 25.6 billion, as the source instrument and a 6-year (effective 4.5 years) 10.2 percent coupon amortized Infrastructure Bond (IFB), Issue No. IFB1/2020/6 as the destination bond. Total bids received at the IFB auction amounted to KES 21.2bn against the source T-bill maturity of KES 25.6bn, representing 83% subscription rate. KES 20.2bn was accepted at an average yield of 11.602% compared to the overall market weighed yield of 11.634%.

The success of the inaugural switch was driven by the appeal of the product to the investor pool, close engagement with stakeholders, attractive features in the destination bond and sustained consistent messaging by CBK to the market that helped to strengthen confidence and credibility. CBK continues to review the regular issuance programme to include a switch strategy at appropriate points, to rebalance the portfolio and support market development. Building on the proof of concept and operational success of the inaugural switch, additional improvements have been considered including exploring switch transactions capable of migrating maturing obligations ahead of maturity dates to allow larger benchmark issues and support a more resilient benchmark yield curve.

Annex V: General guidelines for the Kenya Government Securities Switch Transactions

The rationale for Government securities switch is to;

- a) Reorganize the maturity profile of outstanding debt through issuance of longer dated bonds.
- b) Reduce refinancing risk by smoothing the domestic maturity profile, as a cash management tool.
- c) Manage market liquidity through reducing the number of illiquid small issues, and consolidating them into larger more liquid stocks.

The general guidelines for Kenya Government securities switch are as follows:

- i. Switch bonds are issued as destination instruments targeting the holders of specific T-bills and T-bonds (source instruments) due to mature in the near future.
- ii. All holders of the identified source instruments can participate in the switch, but on voluntary and optional basis. Excluding investors who do not hold the T-bills will prevent incentivizing the whole market as this could destabilize the yield curve.
- iii. Investors who wish to participate in the switch auction must reinvest the entire maturity value in the source instrument.
- iv. The switch destination bonds are issued through a multiple price auction with both competitive and non-competitive bidding.
- v. The switch destination bonds can be reopened in future to reduce bond market fragmentation and both existing and new investors invited to participate at the reopen auction.
- vi. Both the source and destination instruments are taxed at the prevailing tax rates as per the Income Tax Act.
- vii. The minimum amount allowed for the destination switch bond is KES 100,000 for Infrastructure bonds (IFBs) and KES 50,000 for benchmark bonds.
- viii. The Central Bank reserves the right to accept bids in full or part thereof or reject them in total without providing any reason.
- ix. Conduct of switch auction.

The switch offer is announced through the CBK website and issued for a specific sale period. Duly completed switch application forms must be submitted to any branch of the Central Bank in the specified tender box or through CBK Internet Banking by 2.00pm on the auction Date and results obtained the next working day by Investors on details of amounts payable for successful bids from Central Bank of Kenya.

References

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2. IMF and World Bank, 2021. Guidance Note for Developing Government Local Currency Bond Markets.
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3. National Treasury, 2020. Medium Term Debt Management Strategy (MTDS).
<https://www.treasury.go.ke/medium-term-debt-management-strategy/>



Central Bank of Kenya

Haile Selassie Avenue P.O. Box 60000 - 00200 Nairobi | Tel: (+254) 20 - 286 0000 / 286 1000 / 286 3000