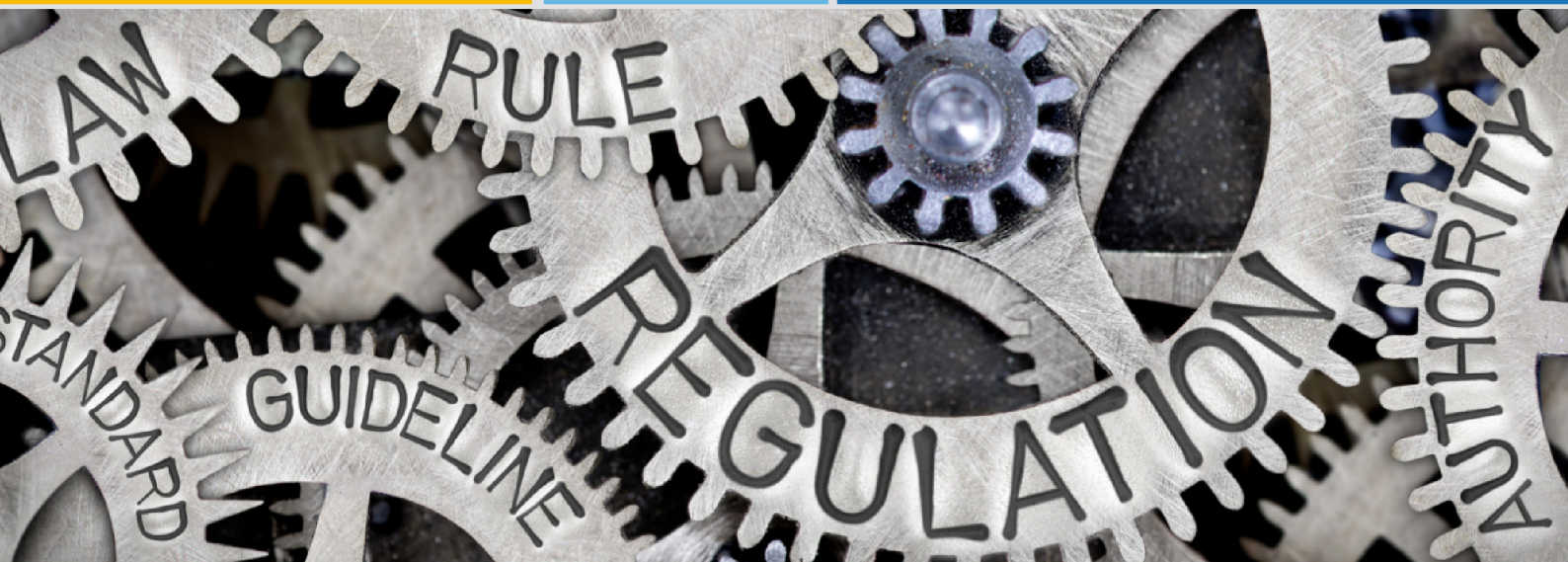




Central Bank of Kenya

Auction Rules and Guidelines for the Issuance of Kenya Government Securities

August 2023



1. Introduction

This document provides general guidelines to inform the public on the issuance of Kenya Government Securities.

2. Definition of Terms

- a. Bid - an offer of a price at an auction.
- b. Multiple price method - an auction in which each successful bidder pays the price/rate at which they bid.
- c. Competitive bid - a participating bid in the auction which is allocated according to the price/rate indicated in the bid.
- d. Non-competitive bid - a bid, which is allocated at the weighted average interest rate determined during the auction.
- e. Cut-off rate - interest rate limit (maximum rate) above which the bids will not be accepted.
- f. Weighted average interest rate - weighted average rate, calculated according to the successful competitive bids of the auction.
- g. Coupon - the fixed interest rate of a Treasury Bond, which the owner of the bond receives at predetermined dates.
- h. Settlement date - the day when the Central Bank receives payment for the government security/securities awarded/allocated at the auction.
- i. Maturity Date - the date when the redemption of government securities must take place.
- j. Value Date - the date when the security starts to accrue interest.

3. Legal and Regulatory Provisions

3.1 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.

3.2 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).

3.3 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 program as well as issuance, management and redemption of government securities on behalf of the National Treasury.

4. Institutional Framework: Principal-Agent Responsibilities

4.1 The Roles & Responsibilities of the National Treasury

As the principal, the overall responsibility for issuance, management and redemption of public debt belongs to the National Treasury. NT will be responsible for:

- a) Formulation of the Medium-Term Debt Strategy (MTDS).

- b) Formulation of the domestic debt borrowing requirement for government securities.
- c) Provide CBK with domestic borrowing requirement to cover new borrowing and redemption obligations.
- d) Design strategies for government securities market development.
- e) Approve government securities auctions carried out by CBK.
- f) Approve cut off rates in close consultation with CBK.
- g) Avail funds for redemptions and coupon payments.
- h) Maintain domestic debt data in the debt database system

- j) Establishing and maintaining register of government securities as stipulated in no. 5 below.
- k) Provision to NT of a detailed analysis of government securities raised and settled in formats agreed upon by the two parties.

4.2 The Roles & Responsibilities of the Central Bank of Kenya

As the agent, CBK is primarily responsible for:

- a) Implementation of the borrowing program approved by NT.
- b) Preparation of a borrowing program upon receipt of the domestic borrowing requirement from NT.
- c) Undertaking auctions of domestic government securities.
- d) Provision of auction results and any other required information to NT in formats agreed between the two parties.
- e) Announcing the auction results on behalf of NT.
- f) Preparation of prospectuses for government securities and facilitate their listing at the Nairobi Securities Exchange (NSE).
- g) Preparation of auction rules and guidelines in liaison with NT.
- h) Implementation of market development strategies for government securities.
- i) Preparation, provision and publishing information as required by NT and the market.

5. Government Securities Depository

Central Bank of Kenya (CBK) has established an electronic register, Central Securities Depository (CSD) which is used to account for ownership of Securities. Once payment takes place, the register of securities is updated at CBK and statements are availed to CSD account holders via CBK DhowCSD.

6. Government Securities Instruments

Central Bank of Kenya issues Kenya Shilling denominated Treasury Bills and Treasury Bonds to raise money for the Government.

6.1 Treasury Bills (T-Bills)

Treasury Bills are short term government securities. CBK currently issues T-Bills with maturities of 91-, 182-, and 364-day. These securities are issued at a discount and redeemable at face value on maturity. The bills are currently issued weekly subject to applicable terms as specified on the CBK website.

Treasury Bills are traded Over the Counter (OTC). The OTC trading guidelines are available on the CBK website.

6.2 Treasury Bonds (T-Bonds)

Treasury Bonds are medium to long term government securities. CBK currently issues T-Bonds with maturities of between 2 and 30 years on a monthly basis subject to applicable terms as specified on the prospectus.

An investor earns a return during the life of the security which is redeemed at face value on maturity. Currently T-Bonds pay interest semi-annually. T-Bonds may be issued at a discount, par or premium depending on the auction outcome.

They are listed at the Nairobi Securities Exchange to facilitate secondary trading.

There are several types of T-Bonds that are available:

- a) **Fixed Coupon Bonds:** At present, most T-bonds auctioned by the Central Bank of Kenya are fixed coupon bonds, which means that the interest rate associated with the bond will not change over the bond's life, therefore semi-annual interest payments from these bonds will remain constant.
- b) **Infrastructure Bonds:** Are fixed coupon bonds whose proceeds are used to fund specified infrastructure projects. These bonds typically see a lot of market interest because returns from them are currently tax exempt.
- c) **Savings Development Bonds:** Are fixed coupon bonds of long dated tenures targeting savers.
- d) **Zero Coupon bonds:** These bonds are issued at a discount. They do not have fixed interest and investor's return is only the discount amount equivalent to the yield quoted.
- e) **Floating Rate bonds:** These bonds pay semiannual interest based on a benchmark rate, for example average rate of 91-days or 182-days Treasury bill plus some margin.

7. Eligibility for Investment in Government Securities and Key Documents

Participation in an auction is open to all categories of investors provided they have an active CSD account at the Central Bank of Kenya. CSD accounts may be opened in the names of individual investors or corporate entities.

Individual investors may open CSD accounts either individually or jointly, while the corporate investors include companies, co-operatives and other societies, insurance companies, banks, non-bank financial

institutions, NGOs and entities established by statutes, which are mainly State Corporations.

Investors may choose to open the CSD accounts directly with the Central Bank of Kenya where no fee is charged or they may open a client account through an authorized custodial institution including commercial banks and investments banks who may charge a maintenance fee.

All requisite documents and reading materials on how to invest are available on the CBK website, Financial Markets counter at the head office, branches and centres.

The Central Bank of Kenya will establish the requirements for opening and managing CSD accounts and may make changes from time to time to these requirements as the situation warrants. When such changes are implemented, Central Bank of Kenya will keep the public informed.

8. Auction Process

8.1 Advertisement

The purpose of an auction announcement is to notify the public of the sale of government securities and provide details of each auction. The announcement, which is published on the CBK website contains the following information:

- a) The issue numbers
- b) Value date
- c) Auction date
- d) Bids closure date and time
- e) Offer amounts
- f) Minimum bid amount
- g) Maximum bid amount where applicable
- h) Payment date and time
- i) Bids submission requirements
- j) Coupon rate where applicable
- k) Coupon payment dates

8.2 Bids Submission

Submitted bids must comply with the following Rules and Guidelines:

- a) Submission of bids by Commercial Banks and Investment Banks for their own investments and client accounts shall be through the CBK DhowCSD Graphical User Interface.
- b) Submission of bids by retail investors shall be through the CBK DhowCSD investor portal available via mobile app or web-based platform or the Treasury Mobile Direct (TMD).

8.3 Auction Decision

- a) The method used to conduct auctions is the multiple price method.
- b) Competitive bids are ranked by the yield bid, from lowest to highest. The weighted average interest rate of competitive bids is computed, and the consideration reports presented to the Auction Management Committee to determine the cut off rate and amount to be accepted.
- c) Allotment of bids is done in the following manner:
 - Competitive bids up to the cut-off rate are allotted at bid rate.
 - Competitive bids above the cut-off rate are rejected.
 - Non-competitive bids are allotted at the weighted average rate at the cut-off rate determined at the auction.
 - All non-competitive bids are accepted in full.
 - Where several bids fall at the cut-off rate, bids may be prorated at the discretion of the Auction Management Committee.

8.4 Results Announcement

After the conclusion of the auction, the auction outcome is published on the CBK website.

It is the responsibility of investors to ensure they obtain their individual auction results from the transactions tab on the CBK DhowCSD investor portal and make payment by the stipulated deadline.

8.5 Settlement

- a) For successful bids by commercial banks, custody accounts including those under statutory management and liquidation, the Central Bank of Kenya will directly debit their settlement accounts at the CBK with the amount due for successful bids.
- b) Investors should instruct their commercial banks to remit payments on their behalf indicating the following account holder's details; **account name, CSD account number, payment key and amount payable.**
- c) Maturing securities held in a CSD Account, amortizations and coupon payments may be rolled over into new securities offered by activating the netting (rollover) flag on the CBK DhowCSD. Payment for successful bids will automatically be processed and any refund amount paid to the investors commercial bank account.
- d) Investors who do not honor payments for their successful bids will be barred from investing in government securities for a period prescribed by the Bank.

8.6 Rediscounting

In the event an investor needs to redeem their securities before they mature and is unable to find a buyer in the secondary market, the Central Bank will buy the securities back as a last resort at 3% above the higher of either the prevailing market yield or the coupon rate.

8.7 Discretion

With the approval of The National Treasury, The Central Bank of Kenya has the right and discretion to:

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- a) Accept or reject, any bids submitted in an auction.
 - a) Accept more or less than the amount specified in the auction announcement.
 - a) Change the terms and conditions of an auction and inform the public.
 - a) Modify the terms and conditions of new securities and the pattern of their offerings at any time.
 - a) Cancel an auction.

9. Amendment Clause

Any part of this document may be amended by CBK through issuance of a notice specifying the amendment thereof.

10. Enquiries and Additional Information

For enquiries, please contact Central Bank of Kenya, Financial Markets Department on 020 286 0000 or any Central Bank of Kenya Branch in Mombasa, Kisumu or Eldoret or Centre in Nyeri, Nakuru, Meru and Kisii or send an email to dhowcsd@centralbank.go.ke or visit the CBK website on www.centralbank.go.ke



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