



Central Bank of Kenya

PROCEDURES FOR OVER-THE-COUNTER (OTC) SECONDARY TRADING OF 364-DAYS TREASURY BILL

1.0 Introduction

As part of the on-going reforms towards development of Government Securities markets, the Central Bank of Kenya introduced 364-days Treasury bill in August 2009. This is aimed at diversification of product range with a view to widen the spectrum of options for investors geared towards deepening money market in Kenya. The ultimate objective of this, among other initiatives is to enhance the liquidity and vibrancy in the secondary markets for debt instruments. Therefore the inaugural 364-Days Treasury bill is a milestone not only in increasing money market products, but will for first time pave way for outright trading/sale of Treasury bills in the secondary market through the OTC platform. The Bank has developed the following trading procedures to govern transactions in this market:

2.0 Trading Processes/Procedures

2.1 Mode of Trading

The 364-days Treasury bill, being a non-listed security will trade Over-the-Counter (OTC). As a first phase, this will only be open to commercial banks, their nominees, custodial and clients Central Depository System (CDS) account holders. OTC transaction process will initially be conducted manually using the current Sale and Purchase Confirmation forms (*the pink & blue forms*) already issued to commercial banks. Same forms are being used for other secondary trading transactions dealt outside the Nairobi Stock Exchange (NSE).

2.2 Transaction Type

To trade this instrument, a new Transaction **Type No. 1-Sale** has been added to the current transaction types for Treasury bills. This requires all transacting parties to price their trades and provide the cash settlement instructions for the sale proceeds that will be executed through Kenya Electronic Payment and Settlement System (KEPSS) and GPAY systems at the Central Bank of Kenya (CBK). Existing secondary market transactions for Treasury bills such as Liens, Repos (both vertical and horizontal), Intraday Liquidity Facility (ILF), Transfers and Rediscounts continue alongside this new operation.

2.3 Trading Process

A commercial bank wishing to sell 364 days Treasury bill will complete a Sale Confirmation (pink) forms and the counterparty wishing to purchase the bill will fill out Purchase Confirmation (blue) forms. The transacting parties should have agreed on a firm/settlement price, issue number, amount and cash settlement mechanism. The Bank will facilitate the verification, matching settlement instructions and settlement of both cash and securities.

2.4 Matching of Trading Forms

The sale and purchase will be jointly forwarded to the Monetary Operations & Debt Management Department (MO&DM) at the CBK Front Office, Banking Hall. The forms MUST bear the following details;

- i. Dealing date - (part 2 of the forms)
- ii. Names of selling & buying dealers (part 3 of the forms)
- iii. Selling and buying parties on both forms (part 4 of the forms)
- iv. Description of the trade; specify under part 5 section (1) the transaction type as No. 1 or Sale, then complete all transaction details as required under part 5 sections (2 through 6) on both forms.
- v. Indicate seller's CDS account and buyer's CDS account under part 6 of the forms i.e. Delivery From: to debit the bills and Delivery To: for credit of purchased bills.
- vi. To allow cash settlement, counterparties MUST complete section 7 on Settlement, clearly indicating agreed price, clearing bank account for seller in CBK to receive sale proceeds and the corresponding buyer's clearing account at CBK for direct debit of cash for the purchased bills and the applicable value date. The instructions on the forms will act as irrevocable order for debit and credit entry in the transacting banks' clearing KEPSS accounts.
- vii. The authorised signatories for both seller and buyer MUST clearly indicate their names and append signatures as per specimens held in the mandate cards under part 10 of the forms.

3.0 Pre-Trade Verification, Settlement & Transfer

Consistent with the current requirements for secondary market transactions dealt through the physical forms, both parties under this operation MUST meet these requirements, in particular embossing corporate seal, confirmation of the transaction via SWIFT Message MT599, among others.

On full compliance with these secondary trading requirements;

- i. The bills identified for sale will be booked by setting aside the amount at face value in the CDS account of the seller. The agreed sale price will be posted in the Banking ledger system simultaneously to enable cash settlement through the of participants' KEPSS clearing accounts.
- ii. The following entries will take place to execute settlement instruction between commercial banks:
 - Dr. Buying Participant KEPSS account
 - Cr. Selling Participant KEPSS account

The instructions conveyed by the buyer (either as a bank or client) through the purchase form will be deemed as irrevocable authority to

- debit its KEPSS clearing account with cost as specified in the form. The buying participant/ bank will be responsible funding level of its account.
- iii. Nominee/Clients and Custodial - Settlement instructions will be two levels of entries to cater for intra-bank nominee/clients trades. This will also facilitate ultimate direct cash credit to the seller's account in the seller's bank as instructed in the account opening mandate card. This instruction will be executed through **G-PAY** system.
- Dr. Participant KEPSS Account for the buying client
 - Cr. NDO Treasury Bills Secondary Trading Suspense Account

 - Dr. NDO Treasury Bills Secondary Trading Suspense Account
 - Cr. Participant KEPSS Account for the selling client (*with full details of seller own account in the bank*).
- iv. Through RTGS interface portal and the GPAY systems (as the case will be), cash settlement will be done through the current dual procedure of "CHECK" and "APPROVE" and upon successful settlement of the cash leg, sold securities previously booked will be transferred in the CDS accounts in the same manner as with other sale transaction as currently executed by:-
- Dr. Seller's CDS account
 - Cr. Buyer's CDS account

4.0 Transactions Timings

The 364 Day OTC transactions timings, being third party transactions will operate under the following timelines:-

- i. Inter-bank CDS accounts sale and purchase trades - As third party KEPSS transactions, settlement will be same day (or T+0) for instructions received by 2.00pm. This will however require all supporting documentation with accurate details in all respects be available. Otherwise they will have to be processed next day on T+1.
- ii. Nominee/Clients and Custodial sale and purchase trades - As is the case for interbank trades, these transactions are also third party. In order for execution of settlement of trades to take place same day at T+0 accurate and fully supported settlement instructions will have to have to be received by 2.00pm of the same day. Otherwise they will be processed next day on T+1.

5.0 Failure to Settle

In case of failure to settle due to insufficient funds in the clearing account of the buyer's participant KEPSS Clearing account by KEPSS closure time for third party transactions, the intended trade will be annulled for that day. In addition, incomplete/incorrectly filled out forms or those lacking requisite support documents will be returned unprocessed to the dealing parties.

6.0 Notification

On conclusion of the trades, the parties shall be notified of the changes in their Banking Ledger clearing accounts through the KEPSS banking statements and

CDS accounts balance statements as a physical statement or on-line CDS online daily statement.

7.0 Responsibilities

- i. The Central Bank of Kenya being responsible for availing the OTC trading platform for the 364-days Treasury bills, shall provide trading infrastructure for delivery of securities, settlement of cash and information and data/information dissemination on daily transactions of the instruments.
- ii. Participating commercial banks will be responsible for ensuring that clearing accounts have sufficient balances to meet cash settlement for the purchase and that the CDS account of seller has sufficient 364 days securities free of any encumbrances for the intended sale. The banks will also be expected to price their trades and only submit to CBK an agreed positions both their own accounts and those of Nominees/Clients and custodial customers that they operate.

8.0 Automation

In the mean time, an automated trading platform that will ensure Delivery versus Payment (DvP) for OTC trades for 364 day Treasury bill is being developed and the investors will be advised when ready.

MONETARY OPERATIONS & DEBT MANAGEMENT DEPARTMENT

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