



CENTRAL BANK OF KENYA

**ISSUANCE
OF GOVERNMENT SECURITIES**

RULES & REGULATIONS

September, 2009

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1.0 INTRODUCTION

The Central Bank of Kenya has developed these rules and regulations¹ to guide and inform all investors on the issuance of Kenya Government Securities.

2.0 AUTHORITY TO ISSUE GOVERNMENT SECURITIES

2.1 Central Bank of Kenya Act Cap 491

The Central Bank of Kenya Act Cap 491 part II section 4A (e) authorizes the Bank to “act as banker and advisor to and fiscal agent of Government”. The Bank through Monetary Operations & Debt Management Department is responsible for the issuance and redemption of public domestic debt management.

2.2 Internal Loans Act Cap 420

The Internal Loans Act Cap 420 section 45 authorizes the Minister for Finance to appoint the Central Bank of Kenya as fiscal agent to borrow in local currency from the domestic market on behalf of the Government. Among other things, the Act also specifies the appropriate borrowing instruments through which the Government procures debt from the public.

3.0 TYPES OF SECURITIES

Central Bank of Kenya issues, on behalf of the government, Treasury Bills, Treasury Bonds, and Government Stock to raise money for the Government.

3.1 Treasury Bills.

The Bank issues 91, 182 and 364-day Treasury bills on behalf of the government. Treasury bills are registered securities, issued at a discount and redeemable at face value on maturity.

3.2 Treasury Bonds.

The Bank issues, on behalf of the government, Treasury bonds with maturities of more than one year with the longest being 20 years. An investor earns a return during the life ¹of the security which is redeemed at face value on maturity date. Treasury bonds are registered instruments that have interest payable semiannually.

¹ The rules and regulations will be linked to other information on the CBK website including the formulae for pricing and determination of the cut off rate.

3.2.1 Types of bonds

The Bank has issued the following types of bonds:

- i. **Fixed Rate Coupon (FXTs).** Entitles investors to a fixed sum of interest, which applies constantly throughout the bond life.
- ii. **Floating Rate Coupon (FRs).** Investors earn a floating sum of interest, which is pegged to a reference rate such as the 91 or 182-day Treasury bills average rate plus a margin. Since Treasury bill rates vary with market forces, different coupons are applied throughout the bond life.
- iii. **Zero Coupon Bonds (ZCs).** Do not have any fixed interest payable periodically. Investors return is only the discount amount equivalent to the yield quoted. Mostly these are short term.
- iv. **Infrastructure bonds (IFBs).** Are infrastructure development instruments whose proceeds are used to fund specific infrastructure/projects defined in the prospectus.

3.3 Specific bid requirements

- 3.3.1 All bids must state the face value of government securities and must equal or exceed the minimum threshold which is Kshs 100,000.00 and Kshs 50,000.00 for Treasury bills and bonds respectively.
- 3.3.2 Bids in larger amounts than the minimum must be in multiples of Kshs 50,000.00.
- 3.3.3 The maximum bid limitation on the non-competitive bids is Kshs 10million per investor in any issue.
- 3.3.4 Competitive bids must show the discount rate bid or price per Ksh100.00 expressed with 3 decimals. There is no maximum amount for competitive bids.

4.0 CENTRAL DEPOSITORY SYSTEM (CDS)

Government securities are held in book entry form without the physical necessity for certificates in a central facility at the Central Bank of Kenya, known as the Central Depository System (CDS) for government securities. The CDS account acts as an investor database with investor details and records of their portfolio holding.

4.1 CDS Accounts Opening

- 4.1.1 Prospective investors wishing to buy or trade in government securities are required to open a CDS account with the Central Bank of Kenya and each investor is required to hold only one CDS account, which is to be used for all investment in Government securities.

- 4.1.2 Investors may choose to open the CDS accounts directly with the Central Bank of Kenya or open a client account through an authorised agent which includes, commercial banks, investments banks, stock brokers and investment advisors. No fee is charged for opening and maintenance of the CDS accounts opened directly or on behalf of a customer at the Central Bank of Kenya.
- 4.1.3 CDS accounts may be opened in the names of individual investors or corporate entities. Individual investors may open CDS accounts either singly 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.
- 4.1.4 The Central Bank of Kenya will establish the requirements for opening and managing CDS accounts and from time to time change these requirements as the situation warrants. When such changes are to be implemented, Central Bank of Kenya will keep the public informed.

4.2 *Categories of investors*

Participation in an auction is open to all categories of investors provided they have a CDS account at the Central Bank of Kenya. The following may participate in an auction:

- 4.2.1 Resident or non-resident individuals and/or corporate bodies who hold an account with a local commercial bank.
- 4.2.2 Resident or non-resident individuals and/or corporate bodies who may not have an account with a local commercial bank but invests as a nominee of a commercial bank or investment bank in Kenya.
- 4.2.3 Resident or non-resident individual and/or corporate bodies that has CDS Account with Central Bank of Kenya.

5.0 AUCTION ANNOUNCEMENT

- 5.1 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 in the print media contains the following information;
- the issue number,
 - date of the issue,
 - total offer amount
 - auction date

- minimum bid amount
- maximum amount for non-competitive bidders
- date of roll over submission
- closure date and time
- payment date
- place where bids may be submitted

6.0 SUBMISSION OF BIDS

6.1 Manual submission of bids

- 6.1.1 Submitted bids must comply with the Central Bank of Kenya approved method. In the case of manual submissions, bids must be submitted using specified application forms. Fully completed and signed forms must be dropped in the Tender boxes, clearly marked “Treasury Bills/Treasury Bonds” that are placed at the banking hall during the sale periods specified in the advertisement for the securities.
- 6.1.2 Only under exceptional circumstances and with prior arrangements, will faxed applications be accepted from investors.
- 6.1.3 Applications which are wrongly filled or incomplete may be rejected.
- 6.1.4 Application forms are available at the National Debt counter in the Central Bank of Kenya banking hall. These forms may also be obtained from the CBK website on www.centralbank.go.ke
- 6.1.5 All competitive bids and non-competitive bids must be received by the Central Bank of Kenya prior to their respective deadlines which are stated in the auction announcement. Late applications will not be accepted.

7.0 AUCTION

7.1 Processing of bids

- 7.1.1 Competitive bids are ranked by the yield bid, from lowest to highest. The weighted average interest rate, the mean, median and standard deviation of competitive bids are computed and the cut-off rate determined through a formula.
- 7.1.2 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 allotted at the cut-off rate
- Non - competitive bids are allotted at the weighted average rate at the cut-off rate
- All non-competitive bids are accepted in full
- The bids falling above cut off rate may be prorated at the discretion of the auction committee

7.2 *Results*

7.2.1 After the conclusion of the auction, the auction results are disseminated through the press, web site and Central Bank of Kenya branches.

7.2.2 It is the responsibility of investors to obtain the results of the bids from any CBK branch on the next working day after the auction.

7.2.3 The information given to the successful investors includes the reference number and offer amount, which is vital at the time of effecting payment for successful bids.

8.0 **PAYMENTS FOR TREASURY BILLS AND BONDS**

The following procedures for payment by successful bidders became effective on August 15, 2006 (See Banking Circular no. 8 of 2005).

8.1 *Commercial Banks*

For commercial banks that succeed in their bids, including those under statutory management and liquidation, the Central Bank of Kenya will **directly debit** their settlement accounts at the CBK with the cost of successful bids. The banks will no longer be required to submit letters of authority for this purpose.

8.2 *Nominee Accounts of Commercial Banks*

For nominee accounts managed and operated by commercial banks, the settlement accounts of the respective commercial banks will also be **directly debited** by Central Bank of Kenya with the cost of successful bids. The Central Bank of Kenya will also not need a letter of authority for this purpose.

8.3 *Customers of Commercial Banks*

In the case of investors where the commercial bank is paying on their behalf, the commercial bank will need to send an MT 102 or 103 SWIFT messages to Kenya Electronic Payment and Settlement System (KEPSS) indicating the

following account holder's details; CDS number, issue number, reference number, amount and value date. The remittance instructions should be relayed to the Central Bank of Kenya using MT202, MT102 and MT103 formats submitted to all commercial banks. The effect of this message will be to directly debit the settlement account of the respective commercial bank and credit the Central Bank of Kenya with an equivalent amount of funds. Any funds, which cannot be applied due to wrongly completed SWIFT messages, will be refunded by the Central Bank of Kenya as soon as it is possible.

8.4 "Specified" Bidders

Licensed insurance companies, licensed stock brokers, authorized fund managers and other specified bidders will continue to pay for their securities using their own cheques or any of the methods mentioned below.

8.5 Other Bidders

All other successful bidders, including individuals, will continue to pay cash, banker's cheque or through commercial banks as is convenient to them. In the event they choose to pay through commercial banks, then the information should be given by the commercial bank in the manner described in section 8.1.

8.6 Payment by maturing securities

Maturing securities held in a CDS account may be used as payment for investments into new securities offered as long as the appropriate instructions are received on time.

9.0 PAYMENT OF HIGH VALUE TRANSACTIONS

9.1 Effective October 1st 2009, the Central Bank of Kenya will stop processing high value payments using Cheques and Electronic Funds Transfers (EFTs) of Kenya Shillings one (1) million and above through the Nairobi Automated Clearing.

9.2 These high value payments will be processed through the Real Time Gross Settlement (RTGS) System known as the Kenya Electronic Payments and Settlement System (KEPSS).

10.0 SETTLEMENT/RECONCILIATION PROCESS

10.1 Securities bought in the auction must be paid in full by the value date.

10.2 If the amount paid is more than the offer payment amount, the Central Bank of Kenya will refund the balance to the investor after the auction, by crediting the commercial bank account provided in the CDS mandate.

- 10.3 When the offer payment amount is more than the amount paid, Central Bank of Kenya will notify the investor of the additional amount.
- 10.4 Investors making payments by banker's cheques or cash can make their payment before 2.00 pm on value date.
- 10.5 Payments by direct debits are effected on value date.
- 10.6 Rollover payments are effected on value date as well as refunds for discount where applicable.
- 10.7 No payment is accepted after the 2.00 pm deadline.
- 10.8 Individual CDS accounts of the successful paid up bidders are then updated.

11.0 DISCRETION

The Central Bank of Kenya has the right and discretion to:

- 11.1 Accept, reject, and refuse to recognize any bids submitted in an auction.
- 11.2 Award more or less than the amount of securities specified in the auction announcement.
- 11.3 Waive any provision for any bidder.
- 11.4 Change the terms and conditions of an auction.
- 11.5 Modify the terms and conditions of new securities and the pattern of their offerings at any time.
- 11.6 Cancel an auction under special circumstances.

12.0 LATE PAYMENTS, PENALTIES & DEFAULTERS

12.1 Late Payments

- 12.1.1 The investor should obtain the details of the amounts payable for the successful bids from the Bank on the next working day after the Auction.
- 12.1.2 Payments for Treasury bills and bonds are due on value date as stipulated in the advertisement or prospectus or on the next working day if the value date falls on a holiday.
- 12.1.3 The Bank, where delay in payment occurred due to unavoidable circumstances, may approve request for late payment.
- 12.1.4 That notwithstanding, the approval shall be for payments by 2.00 p.m. on the working day after the value date.

12.2 Penalties

- 12.2.1 Penalty is charged for approved late payments.
- 12.2.2 No further payments shall be accepted after 2.00pm on Tuesday or on the next working day if Tuesday falls on a holiday.

12.2.3 Investors who do not honor payments for their successful bids in full shall be barred from investing in government securities for a minimum of six months.

12.3 *Defaulters*

12.3.1 Investors who default for the **first time** shall be given a written warning.

12.3.2 Investors who default a **second time** within a period of one year shall be barred from investing in government securities for a minimum period of **six months**.

12.3.3 Subsequent failures to pay within 12-month period shall lead to the investor being barred from investing in government securities for **one year**.

12.3.4 The Bank reserves the right to lift the bar at any time or to vary the suspension period imposed.

13.0 **APPLICABLE TAX RULES**

13.1 *Withholding tax on discount and interest*

Withholding Tax of 15% is charged on the discount and interest on government securities unless an investor is exempted, in which case a tax exemption certificate must be provided or the investor has made arrangements to pay tax directly to the Kenya Revenue Authority e.g. banks and insurance companies. Those subject to tax include Individuals, Companies, as well as non-residents. Tax is added to cost of the securities.

13.2 *Exemption of tax on interest income from Infrastructure bonds*

Paragraphs, 51 and 52 of the first schedule of the Income Tax Act Cap 470 provide for the exemption from tax the interest income arising from Infrastructure Bonds.

51. Interest income accruing from all listed bonds used to raise funds for the infrastructure and social services, provided that the bonds shall have maturity of at least three years.

52. Interest income generated from cash flows passed to the investor in the form of asset-backed securities.

13.3 *Withholding tax on long term bonds*

Withholding tax on interest income accruing from listed bonds was reduced from 15% to 10% with effect from June 12, 2009 provided the bonds:

- Do not relate to infrastructure or asset-backed securities, and
- Are for maturity period of ten (10) years and above.

13.4 Withholding tax on commission payments

Commission payments attract withholding tax at the rate of 5% subject to a minimum of Ksh 24,000.00 per month under section 35(3)(f) and paragraph 5(f) of the Third schedule of the Income Tax Act.

For enquiries please contact Central Bank of Kenya, Monetary Operations & Debt Management Department on 2860000 or any Central Bank of Kenya Branch in Mombasa, Kisumu or Eldoret or send an email to NDO@centralbank.go.ke or visit the CBK website on www.centralbank.go.ke