CENTRAL BANK OF KENYA

Operational Procedures & Guidelines

AUTOMATED SECONDARY TRADING FOR GOVERNMENT OF KENYA TREASURY BONDS

1: DEFINITIONS & ABBREVIATIONS

ATS -------------------------------Automated Trading System used at the NSE. This is the software, hardware, communications and network systems forming the electronic trading system for the automatic matching of orders designated and approved by the exchange for the trading of listed securities at the Exchange.

BCA---------------------------------Business Continuity Arrangement

Stockbroker/Broker-------------A person licensed by the CMA to carry on the business of buying and selling of securities as provided for under the Capital Markets Act.

CMA -------------------------------Capital Markets Authority

CBK -------------------------------Central Bank of Kenya

CDS---------------------------------Central Depository for Securities maintained at CBK

DvP --------------------------------Delivery versus Payment

ISIN---------------------------------International Securities Identification Number

KEPSS-------------------------------Kenya Electronic Payment & Settlement System

MT----------------------------------Message Type

NSE --------------------------------Nairobi Stock Exchange

OTC---------------------------------Over the Counter Trading

RTGS-------------------------------Real Time Gross Settlement

SWIFT-------------------------------Society for Worldwide Interbank Financial Telecommunication

TB-----------------------------------Trading Book

T-------------------------------------The day on which a trade took place on the Stock Exchange

2: INTRODUCTION

i) Background

The Capital Markets Authority (CMA) regulates operations of activities and players in the capital markets and also approves has to approve trading rules and regulations developed by various intermediaries/players in the capital markets in line with the provisions of the Capital Markets Act. CMA Act. The Act and the rules and regulations are the pillars that govern listing and trading of capital markets instruments which include Government of Kenya Treasury bonds. These are the instruments referred to as listed securities and do not include Treasury bills.

For the purpose of these guidelines, a Treasury bond denotes a security or financial instrument with a maturity of at least one (1) year at issuance, used by the Government of Kenya to borrow/raise funds from the domestic market. These guidelines are therefore intended to set out Trading and Settlement Procedures for Treasury bonds automated trading at the Nairobi Stock Exchange (NSE) Fixed Income Securities Board (FISB) segment.

The guidelines, will detail the process flow for the electronic system inter-link, connectivity and data interchange between the Central Bank of Kenya's (CBK's) Central Depository System (CDS) Registry and the NSE Automated Trading System (ATS) platform. The guidelines and procedures outlined endeavour as far as practicably possible to operate within the legal, regulatory and operational framework for fixed income securities which recognizes the role played by the CMA, NSE, Stockbrokers and the Registrar, National Debt, currently domiciled at CBK.

The current statutes, guidelines and rules, namely the *Internal Loans Act**, the Capital Markets Act, the, Central Bank of Kenya Act, the Kenya Electronic Payments and Settlements System (KEPSS) Guidelines and the NSE Trading Rules as well as any other relevant statute(s) or rules that may come up from time to time, will govern the operations of this process.

In consultations with the Capital Markets Authority, these guidelines may be revised from time to time so as to keep them in tandem with ever changing dynamics in the capital and financial markets.

These Guidelines recognize that the Internal Loans Act (Amendment) 2007, which recognises dematerialization of government securities, though enacted, has not been operationalized and all efforts are being undertaken towards this end.

ii) **Purpose & Scope:**

In recognizing the shortcomings of the current secondary trading arrangement for Treasury bonds that is largely manual, the CBK and NSE undertook a joint

initiative to automate this process with the ultimate objective of ensuring the efficiency and safety of the process.

Under the new automated trading arrangement for Treasury bonds, there will be an electronic system inter-link, connecting and allowing data interchange between the Central Bank of Kenya (CBK) Central Depository System (CDS) Registry and the NSE Automated Trading System (ATS) platform. The proposed system will endeavour as far as practicably possible to operate within the current legal, regulatory and operational framework for Treasury bonds whose scope is envisaged as set out here-below:-

a) Central Bank of Kenya (CBK) will remain the Registrar of Government domestic debt (NDO- Registry) and all deliveries of securities will take place there.

b) CBK will also be the settlement place for all sales and transfers of Government securities under a Delivery versus Payments (DvP) arrangement.

c) The SWIFT communication channel will be used as the media for instruction transmission and the Kenya Electronic Payment & Settlement System (KEPSS) will be used as the settlement vehicle for interbank clearing for sell/buy proceeds.

d) Cash settlement for this system will be executed through KEPSS, the transactions cash settlement cycle has been set at T+3. However, parties may choose to settle any time upon matching of trades as long as it is within T+3.

e) Data held in the CDS accounts at CBK for identified trades and as instructed by investors, will be shared with the NSE and appointed stockbrokers and uploaded through a special facility referred to as the Trading Book (TB), into the ATS to facilitate the placement and matching of orders by brokers at the NSE.

f) All Prospective investors both (buyer and seller) wishing to buy or sell Treasury bonds, will as a prerequisite to trading using this system, be required to register their CDS account details and names of stockbroker(s) who will act as their agents, with CBK. A Registration/Deregistration form has been designed to be completed for this purpose as a one-off process so that thereafter the investor's details are availed to their broker(s) at the start of every day. The same form will be used to deregister from the system and all such forms will require to be executed by the CDS account mandated signatories.

g) The system envisages a fair, open, competitive and a transparent market where there will be no pre-agreed trade deals and prices. Matching of buy/sell orders will be expected to take place on the ATS trading platform.

h) The new system is intended to automate the current manual processes with minimal variations and has largely retained the existing procedures, legal, regulatory and operational framework for fixed income securities secondary trading of Government Treasury bonds. Owing to its set up however, the system will, require categorisation of investors into two broad groups, so as to recognize their unique characteristics, These are:-
   o Commercial banks – commercial banks own accounts , and clients accounts operated by commercial banks
   o Non- banks - all other non banks corporate investors and individuals.

i) Buyers and sellers will be required to comply with the Capital Markets (Licensing Requirements) (General) Regulations 2002 on placement of orders

and payment of commissions to brokers. As provided for under these Regulations, all orders should be written. In addition, these Operational Procedures require that, irrevocable payment instructions for the transaction should be provided.

j) Payment of broker's fees and commissions will be handled outside this system.

3: SYSTEM PROCESSES

i. **Selling Commercial Bank**
   a) Bank sends a SWIFT Message MT502 to CBK with details of the security intended for sale and simultaneously instructs/informs its broker in writing of the details of the sale order.
   b) CDS verifies the instructions and book the securities identified for sale, and then loads the details to the Trading Book (TB).
   c) Trading book details to be automatically availed to the NSE's ATS.
   d) Selling broker to place the sale order in ATS on sighting the securities.

ii. **Selling Non Bank Investor**
   a) Selling investor gives broker written sell instructions and fills CBK Sale form.
   b) Selling Broker sends the sale form to CBK for verification (done manually)
   c) Upon verification, CBK books the securities and loads the securities details to the Trading Book. Form is not sent back and life ends.
   d) Trading Book details are automatically availed to the ATS.
   e) Selling broker places the sale order in ATS on sighting the securities.

iii. **Information required on SWIFT MT502 to initiate a sale transaction**
   a) Transaction type – e.g. Sale or Type 1
   b) CDS account number
   c) Seller – Bank sending the SWIFT message
   d) Security to sell – (both ISIN and traditional issue number)
   e) Face value of security to sell
   f) Expiry date of request for sale, if absent default to 30 calendar days.
   g) Broker ID – Broker to whom ATS will avail the security to sell.

iv. **Events in the Trading Book (this will apply for both banks & non banks)**
   a) After correct validation of the SWIFT instruction by the system or the manual form by a CBK officer, the equivalent face value of securities will be booked for trading. This value from the TB will be uploaded to the ATS for trading purposes
   b) The Bank account to credit with the sale proceeds will be as per disposal instructions provided to CBK in the seller's CDS account mandate cards.
   c) Sale intents will be retained in the TB until they match in the ATS or until the expiry of a sale request period or following the expiry of 30 calendar days from the date the request was lodged (whichever comes first).
   d) ATS will upload TB data at the start of day with intraday updates being allowed. Such information shall only be available to authorized brokers as per client instructions.

v. **By Buying Bank**
   a) Investor (bank) gives written instructions to its broker on the securities to buy in line with the Capital Markets (Licensing Requirements) (General)

Regulations 2002 The investor will also provide irrevocable payment instructions for the transaction.

b) Upon execution of the buy order, the broker informs the buying bank (settling bank) of the details of the trade.

c) The Buying bank sends a SWIFT MT502 with details of the CDS account, securities traded and most importantly quoting the ATS Trade ID. The bank that sends the MT502 quoting the ATS Trade ID for an executed BUY order is the settling bank to be debited in KEPSS in the settlement process.

d) The buying bank and buying broker must ensure that the MT502 is sent as soon as the trade is executed and not later than 30 minutes after closure of the trading session for Treasury bonds for the settlement process to begin.

e) In the event that a buying bank unduly delays or fails to submit the MT502 to initiate the settlement process, a penalty to be determined by CBK will be imposed on that bank.

vi. Buying Non Bank Investor

a) Investor instructs its broker on the securities to buy and gives irrevocable written payment instructions as per current listing and trading rules.

b) On execution of buy order, broker to inform its bank (broker's bank is the settling bank) of the details of the trade which, should include the ATS Trade ID.

c) The broker's bank to send a swift MT502 with details of the, CDS account, securities traded and most importantly quoting the ATS trade ID. The bank that sends the MT502 quoting the ATS Trade ID for an executed BUY order is the settling bank (in this case the broker's bank) which will be debited in KEPSS in the settlement process.

d) The buying broker and its bank shall ensure that the MT502 is sent not later than 30 minutes after the closure of the trading session, for the settlement process to begin.

e) In the event that a buying bank unduly delays or fails to submit the MT502 to initiate the settlement process, a penalty to be determined by CBK will be imposed on that bank.

vii. Information required on SWIFT MT502 to confirm a buy transaction for settlement (this will apply for both banks & non banks)

a) CDS account name- Indicate if CDS account is own, client or other.

b) The bank to debit is the sender of the SWIFT message i.e. **buyer's bank for banks and broker's bank for non-banks**. The debit instructions should be specific on the amounts to be debited. If there is any variance between the amount quoted on SWIFT and the amount on actual trade at NSE, the actual trade amount from NSE will be applied.

c) Security bought – both ISIN and traditional issue number.

d) The ATS trade ID for the specific trade to be settled by the sent MT502.

h) Broker ID - Buyer.

viii. Matched Trades (this will apply for both banks & non banks)

The sale order quantity submitted to ATS can only be less than or equal to quantity booked. These orders will be traded in multiples of 50,000 i.e. a booked order of 10M can be submitted as 1M and only 150,000 is matched. The balance of 850,000 remains in the ATS and a broker can continue submitting new orders as demand and supply of the day. A sell order of 10M can be fulfilled by multiple

buy orders and vice versa. Upon trade execution, the following details will be transmitted to the CDS:-
   a) ATS trade ID
   b) Buyer CDS account and broker
   c) Seller CDS account and broker
   d) Security traded – provide for both ISIN and traditional issue number
   e) Net settlement amount - commissions outside of this arrangement
   f) Transaction date & Time
   g) Settlement date & time at T+0
   h) Quantity, Clean Price, Dirty Price and Yield Traded

ix. DVP Engine Settlement Process:
   a) Entries for all matched orders should have settled by 3.00 pm. Settlement of the trades shall be processed as the BUY MT502's are received and shall end 30 minutes before KEPSS initial cut-off, which at present is 3:00pm.
   b) Upon successful debit, the system will raise an MT103 to the seller's disposal account and send a Participant Credit MT205 to the bank if the seller is a bank (as specified in the seller's mandate card).
   c) Transfer booked securities to buyer's CDS account and update CDS balances file.
   d) Notify buyers & sellers bank via MT 515 - advice of the execution of a trade, and also avail CDS positions to the trading parties' via CDS statements.

4: SWIFT MESSAGE TYPES

For purposes of automated secondary trading of bonds at the NSE, CBK will receive, validate and process automated SWIFT Requests/Intents to sell bonds or provide settlement details to buy bonds. Here-below are the various SWIFT Message Types that will be in this system.

i. SWIFT MT 502: Intent/Request to BUY or SELL
   a) For purposes of a SELL: This message type will be used to request CBK to release transaction details from an investor's CDS a/c to the trading book which is mirrored to the ATS system for the purpose of automated trading. The MT502 will be sent by commercial banks to CBK with details of securities intended for sale for verification against the CDS register for seller of securities.
   b) For purposes of a BUY: This message type will be sent by either the buying bank or the bank of the buying broker quoting the **ATS Trade report ID** and details of the purchase to identify the settling bank for the particular BUY of bonds executed by the broker.
   c) For purposes of a CANCELLATION: This MT502 may also be used to request the cancellation of a previously sent MT502 for BUY/SELL for orders that have not been matched at the ATS.

ii. SWIFT MT 509 - Trade Status Message e.g. NACK
   CBK will advise on the status of all MT502's sent by use of this message. On receipt of a new request/intent to SELL/BUY or, a request to cancel a

previously sent intent to SELL/BUY, CBK will validate and process the MT502 and advise the requesting party whether the request has been accepted or rejected by sending an MT509 Trade Status Message.

iii. **SWIFT MT 515 - Client Confirmation of Purchase or Sale**

Once the order has been fully or partially executed in the ATS system at the NSE, and CBK has received the BUY MT502 for settlement of the trade, CBK will confirm the details of a purchase or sale using this message and advise on the amount to debit the buyer's broker's bank and credit the seller's personal account as per CBK CDS account disposal instructions.

5: DELIVERY *versus* PAYMENT (D*v*P) ARRANGEMENT

Settlement in KEPSS will take place simultaneously against movement of securities in the CDS accounts. Only settled deals will trigger delivery of securities thereby attaining DvP for secondary trading of Government Treasury bonds.

5: ELIGIBILITY

For the purposes of these guidelines, this facility will only be available to all investors in Treasury Bonds. The facility will however not be available for the secondary trade of Treasury Bills or for OTC transactions.

Other aspects of operations of the Government securities register such as primary issuance of securities, coupon payment, register closures and redemptions shall continue as specified in the prospectuses, circulars and guidelines issued by CBK. Trading securities will "temporarily" be moved to the CBK-NSE ATS Trading Book which will hold the securities for the trading period *(intraday)* only and revert to the main register upon conclusion of the trade or on expiry of the trading window period *(currently set at 30 days in line with the Capital Markets (Licensing Requirements) (General) Regulations 2002)*. The Register and the Trading Book will maintain records in book entry form in the CDS system. Statements of holdings will continue to be issued to securities holders as is the case currently.

6: INTEREST/COUPON PAYMENT

Coupon interest due for Treasury bonds shall be paid to the investors whose names shall be in the register on closure of register date in the usual manner and at the applicable coupon payment rate/terms for the issue in question. Currently the register for Treasury bonds closes two (2) working days to due date.

7: BUSINESS CONTINUITY ARRANGEMENT (BCA)

The electronic trading of Treasury bonds will involve several independent systems namely CDS, KEPSS, SWIFT, DvP Engine and ATS. An appropriate BCA has been put in place that will cater for the four systems and establish back up arrangements.

All transaction instructions shall be effected through SWIFT with no provision for manual intervention **(at least for commercial bank transactions).** In this phase, there

will be some minimal manual intervention for non banks. As a fall back strategy in case of system failure, CBK and NSE will avail an alternative electronic backup system, determine lead time for system outage on a case by case basis and advise system users appropriately.

8: CONNECTIVITY BETWEEN CBK CDS AND NSE ATS

There is an electronic connectivity between the three key systems i.e. the CBK's CDS and KEPSS that are linked to the ATS at the NSE.

9: OTHER RELATED GUIDELINES

i. **Settlement Timings**
   a) Settlement of matched orders will continuously take place between 9.00am to 1.30pm on every business day at the CBK's KEPSS as they are uploaded by ATS.

ii. **Settlement Cycle**
   Currently, the Settlement cycle for Fixed Income Securities as per the NSE Trading Rules is T+3. Treasury bond settlement will take place in KEPSS that is domiciled at CBK. In order to align this activity with the rest of the bond market, Settlement Cycle for matched trades for treasury bonds will take place within T+3 on a DvP basis. However, parties to the transaction may choose to fast track this process.
   NB: Matching shall take place only when purchasing party's bank has made requisite arrangements to fund the KEPSS clearing account since KEPSS operates on a credit push.

iv. **Cancellation of a sale or buy order**
   Only unmatched sale or buy order can be cancelled

iii. **Cancelled Transactions**
   Cancellation of matched trades will only be allowed in instances of fraud **and will involve manual intervention.** All such cancellations will be done according to NSE trading rules and appropriate punitive actions taken against the defaulting party.

v. **Market Cycle- T+1**
   The market cycle after trades will be T+1, meaning that a buyer of a security can trade it the following day and a seller can utilise the proceeds for purchase of a security the following day.

vi. **Gratis Transfers for Treasury Bonds – Transaction Type 4**
   These types of transactions, though they have to be processed through the NSE, need to be approved by the CMA first. Under the circumstances, Gratis Transfers will continue to be processed manually.

vii. **Liens, Transfers of Treasury Bills and all Rediscount by Non Bank Investors**
   These types of transactions will continue to be processed using physical forms until an appropriate infrastructure is developed for them.

viii. **Governing Law**
   The Laws of Kenya

10: INFORMATION SHARING

It is recognized that investors and other stakeholders will continuously require relevant data, statistics and information on the activities and outcomes of Treasury bond trading. The CBK in conjunction with NSE will provide the necessary information. The information to include Clean Price, Dirty Price, Traded Yield, Trade Volumes, and Applicable Coupon. NSE will disseminate information   that will be

useful in assisting investors' price their orders and develop a market yield curve for Treasury bonds.

11: ENQUIRIES

Any queries relating to transaction processing and operations of the CBK's CDS and KEPSS should be referred to the Director, Monetary Operations & Debt Management Department, Central Bank of Kenya while those related to ATS operations should be referred to The Nairobi Stock Exchange

APPENDIX: ATS REGISTRATION/DE-REGISTRATION

CENTRAL BANK OF KENYA

Registration/De-registration* **of participation in the Automated Trading System (ATS) for Treasury bond trading at the Nairobi Stock Exchange (NSE)**

Declaration: I / We .... holder(s) of Government of Kenya (GoK) securities CDS account number ………………………………… do hereby authorize the Central Bank of Kenya (hereinafter 'the Bank', as the Registrar of GoK securities) to *register/de-register** my approval to have records pertaining to the details of Government Treasury Bond investments in my/ our CDS account(s) released for trading purposes to the NSE as I/ We shall instruct in writing or in any other acceptable form.

Further, I/We do confirm that I / We shall abide by all the rules and guidelines issued by the Bank from time to time governing the operations of the ATS for Treasury bond secondary trading transactions executed through the Nairobi Stock Exchange.

In line with the current trading rules that require trading orders for listed securities to be placed by stockbrokers duly licensed by the Capital Markets Authority (CMA), I / We wish to appoint the under-listed stockbrokerage firm(s) to act on my/our behalf.

1. ....
2. ....
3. ....
4. ....
5. ....

I / We also understand that any or all of the above listed stockbrokers may, pursuant to my/our written instructions to the Bank, be deleted from our list of approved agents. In addition, I/We also appreciate that the Bank will similarly require written instructions to replace any of the above-listed brokerage firms or to add additional firms to the existing list. The Bank shall notify all relevant players of such changes before the newly appointed brokers take up any trade transactions.

I / We solemnly declare that I/ We have fully understood the content of and requirements under this Declaration and that all information provided herein is in every respect true and accordingly shall remain binding on me/us.

1. Signed…………………………….. 2. Signed …………………..Date……….

1. Name……………………………… 2. Name……………………..Date……...

Institution's stamp
Delete as appropriate

CENTRAL BANK OF KENYA
November 27, 2009