



Central Bank of Kenya

Operational Procedures & Guidelines

**AUTOMATED CLEARING AND SETTLEMENT FOR
GOVERNMENT OF KENYA TREASURY BONDS**

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1. DEFINITIONS & ABBREVIATIONS

ATS	Automated Trading System used at the NSE
Banned Account	Account where uncanceled contracts mature to on maturity date
BCP	Business Continuity Plan
Clean price	Price of a Treasury bond without accrued interest
CMA	Capital Markets Authority
CBK	Central Bank of Kenya
CBK Client	A Retail/Corporate investor who opens the CDS account directly at CBK
CSD	Central Securities Depository
CSD Earmark Account	Account that holds Treasury bond designated for trading
DhowCSD	Central Securities Depository system maintained at CBK
Dirty price	Price of a Treasury bond with accrued interest
DvP	Delivery Versus Payment
Earmark Balance	Treasury bond balance designated for trading at NSE in the CSD system
GUI	Graphical User Interface
ISIN	International Securities Identification Number
KEPSS	Kenya Electronic Payment & Settlement System
MT	Message Type
NACK	Negative Acknowledgement (Swift acronym for rejection Message)
NSE	Nairobi Securities Exchange
OTC	Over the Counter Trading
Pledger Account	Borrower/transferor/deliverer security account
RTGS	Real Time Gross Settlement
SWIFT	Society for Worldwide Interbank Financial Telecommunication
T	The day on which a trade took place at the Securities Exchange
Trading Participant	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 and is admitted by the Exchange as a Trading participant

2. INTRODUCTION

i. Background

The Capital Markets Authority (CMA) regulates operations of activities and players in the capital markets and approves trading rules and regulations developed by various intermediaries/players in the capital markets in line with the provisions of the Capital Markets Act. The Act, 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 Government Treasury bills.

For these guidelines, a Government 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 Securities Exchange (NSE) Fixed Income Securities Board (FISB) segment. Previously, Central Securities Depository (CSD) was referred to as Central Depository Securities (CDS).

These 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 Securities Depository (CSD) System 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 CBK, CMA, NSE and Trading Participants.

The current statutes, guidelines and rules, 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.

ii. Purpose & Scope

In recognizing the need to enhance the current secondary trading arrangement for Treasury bonds, the CBK undertook an initiative to further 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) CSD and the NSE Automated Trading System (ATS) platform. The system will operate within the and the following operational framework for Treasury bonds set out here below: -

- a) The SWIFT, GUI and Montran Gateway 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.
- b) 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 NSE trading platform in a transparent manner.

DhowCSD system is intended to increase automation with minimal variations and has largely retained the existing procedures, legal, regulatory, and operational framework for fixed income securities for secondary trading of Government Treasury bonds. Owing to its set up however, the system will, require categorisation of investors into three broad groups, to recognize their unique characteristics, these are: -

1. Commercial Banks - Commercial banks own accounts, and clients' accounts operated by commercial banks under Custodian arrangements.
2. Investment Banks - Investment banks own accounts and clients' accounts. Investment Bank are required to appoint a commercial bank to be settling its Treasury bonds trades in the KEPSS.
3. CBK Clients - all other non-bank entities i.e., corporate investors and retail individuals.

3. GOVERNANCE

The system will also operate within the current legal and regulatory framework as set out here below: -

- a) Central Bank of Kenya (CBK) will remain the Registry of Government domestic debt register, and all transactions 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, exchange trades for Treasury bonds, Free of Payment (FOP) and Pledges.
- c) Cash settlement for this system will be executed through KEPSS. The parties to the transaction may choose to settle the trades on T, T+1, T+2 or T+3. Settlement of a trade will be as per the value date traded in the ATS by the broker as agreed by seller- buyer.
- d) Account details and data held in the CSD at CBK for earmarked instructions and as instructed by investors, will be shared with the NSE and appointed brokers and communicated through swift proprietary message to the ATS to facilitate the placement and matching of orders by brokers at the trading system.
- e) All investors both (buyer and seller) wishing to buy or sell Treasury bonds, will as a prerequisite to trading using the system, be required to register their Portfolio account details against names of stockbroker(s) who will act as their agents, with CBK. Registration and deregistration will be through the Dhow CSD Investor Portal (IP). The CSD system will transmit these details to the ATS platform for trading purposes.
- f) Buyers and sellers will be required to comply with the Capital Markets Regulations 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.
- g) Payment of broker's fees and commissions will be handled outside the CSD system.

4. SYSTEM PROCESSES

i. Selling Commercial Bank

- a) Bank or Custodian earmarks the security in the CSD through GUI or sends a SWIFT Message MT502 sell to CSD with details of the security intended for sale and simultaneously instructs/informs its broker in writing of the details of the sale order.
- b) CSD validates the instructions and earmark the securities identified for sale, and then transmits the details to the seller's broker at the ATS.
- c) Selling broker loads the security details to the Trading book.

ii. Selling Investment Bank

- a) Investment Bank earmarks the security in the CSD through GUI or give instructions to a Commercial bank to send a SWIFT message MT502 sell to CSD for any of its custodial accounts and simultaneously instructs/informs the selling broker in writing of the details of the sale order.
- b) CSD validates the instructions and earmark the securities identified for sale, and then transmits the details to the seller's broker at the ATS.
- c) Selling broker loads the security details to the Trading book.

iii. Selling CBK Client

- a) CBK Client earmarks the security in the CSD through the DhowCSD Investor Portal (IP) or give instructions to a Commercial bank to send a SWIFT message MT502 sell to CSD and simultaneously instructs/informs the broker in writing of the details of the sale order.
- b) CSD validates the instructions and earmark the securities identified for sale, and then then transmits the details to the seller's broker at the ATS.
- c) Selling broker loads the security details to the Trading book.

iv. Information required on SWIFT MT502 Sell to initiate a sale transaction

- a) Transaction type
- b) CSD account number, previously referred to as CDS account number
- c) Seller – Bank sending the SWIFT message
- d) Security to sell – (ISIN and Issue number)
- e) Face value of security to sell
- f) Broker ID – Broker to whom ATS will avail the security to sell.

v. Buying Commercial Bank

- a) The Commercial Bank gives written instructions to its Trading Participant on the securities to buy in line with the Capital Markets laws and Regulations. The investor will also provide irrevocable payment instructions for the transaction.
- b) The written instructions to the buying broker for execution in the ATS to be either system generated instructions (electronic) or Swift Message MT599 or any other approved infrastructure of submitting instructions. Upon execution of the buy order, the broker informs the buying bank (settling bank) of the details of the trade to ensure that the trade settle on value date.
- c) On value date, CSD automatically sends debit instructions to the buying bank settlement account in KEPSS for settlement under DvP mechanism.
- d) In the event the buying bank account has insufficient funds at close of KEPSS the transaction will be cancelled.

vi. Buying Investment Bank

- a) The Investment Bank gives written instructions to its Trading Participant on the securities to buy in line with the Capital Markets laws and Regulations. The investment Bank will also provide irrevocable payment instructions for the transaction.
- b) The Investment Bank written instructions is a confirmation to the Trading Participant that the amount will be settled by the appointed settlement bank account in KEPSS for the trade executed by the broker in the ATS on value date. The appointed settlement bank will also provide written instructions via the Investment Bank to the buying Trading Participant before execution in the ATS either through system generated instructions (electronic) or Swift Message MT599 or any other approved infrastructure of submitting instructions. Upon execution of the buy order, the broker informs the Investment bank of the details of the trade to ensure that the trade settle on value date by the appointed settlement bank.
- c) The appointed settlement bank shall set the settlement limit in the CSD for Investment Banks trades.
- d) Upon execution of the buy order, the broker informs the Investment bank of the details of the trade to ensure that the trade settle on value date.
- e) On the value date the CSD automatically sends debit instructions to the Investment bank appointed Settlement bank account in KEPSS for settlement under DvP mechanism.
- f) In the event the appointed settlement bank account has insufficient funds at close of KEPSS the transaction will be cancelled. CBK/NSE will take appropriate punitive action(s) against the Trading Participant or the appointed settlement bank.

vii. Buying CBK Client

- a) Investor instructs its Trading Participant on the securities to buy and gives irrevocable written payment instructions as per current NSE trading rules.

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- b) On execution of buy order, broker to inform the paying bank of the details of the trade which include CSD reference number, Settlement date, Buyers CSD No. and settlement amount.
 - c) The broker's/buyer bank to send a swift message MT598 with the following details: CSD reference number, Settlement date, Buyers CSD No. and settlement amount.
 - d) The buying broker and its bank shall ensure that the MT598 is sent not later than 3.30 pm, for the settlement process to completed before KEPSS Initial cut off (ICO) time.
 - e) In the event the buying bank unduly delays or fails to submit the MT598 to initiate the settlement process, the trade is cancelled and a penalty to be determined by CBK/NSE will be imposed on that Trading Participant or settling bank (Trading Participant's bank).

viii. Information required on SWIFT MT598 -Debit Authorization message for only CBK Clients

- a) CSD account number
- b) Settlement /value date
- c) Buyer's bank – Bank sending the SWIFT message
- d) The CSD transaction reference number for the specific trade to be settled.
- e) Security to buy – (ISIN or Issue number)
- f) Face value
- g) Settlement amount.

ix. Matched Trades

Trading at the ATS is equivalent or less than the Earmark balance in the CSD Earmark account, currently trading units is in multiples of 50,000. Upon trade execution, the following details will be transmitted to CSD:

- a) ATS trade reference number
- b) Buyer CSD Portfolio account and broker
- c) Seller CSD Portfolio 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 /value date
- h) Quantity, Clean Price, Dirty Price and Yield Traded.

x. DVP Engine Settlement Process

- a) Trades for Value T should be settled by 4.00 pm. Settlement of the trades T+1, T+2 and T+3 for Banks, Custodian and Investment Banks will be automatically submitted to KEPSS at 8.30 am for settlement. Settlement for CBK Clients will await submission of MT598 by the brokers/investor's settlement bank and shall end 30 minutes before KEPSS initial cut-off, which is at present 4.00pm.
- b) Settlement in KEPSS will take place simultaneously against movement of securities in the CSD Portfolio accounts. Only settled deals in KEPSS will trigger delivery of securities thereby attaining DvP for secondary trading of Government Treasury bonds.
- c) Upon successful debit, the KEPSS 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 settlement instructions in the CSD system). At the same time securities transferred to buyer's CSD Portfolio account and Portfolio balances updated accordingly.
- d) Notify buyers & sellers on Swift platform via MT 525 (advice of the execution of a trade) and for CBK Clients a notification message is send to their Investor Portal (IP).

5. 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 used in the system.

i. SWIFT MT 502: Intent/Request to SELL and MT598 (CAM036)

- a) For purposes of a SELL: This message type will be used to request CBK to release transaction details from an investor's CSD 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 CSD register for seller of securities.
- b) For purposes of a BUY: CBK client MT 598/500 (CAM036) will be sent by the bank of the buying broker/ Buyer quoting the CSD transaction reference number and details of the purchase to identify the settling bank for the BUY of bonds executed by the broker.

ii. SWIFT MT 509 - Trade Status Message e.g., NACK

- a) This is a system response on the status of an MT502's earmark (sell) after processing in CSD. On receipt of a new request/intent to SELL, system will validate and process the MT502 and advise the requesting party whether the request has been accepted or rejected message by sending an MT509 Trade Status Message. If accepted, CSD processes the message and create an earmarking balance which is sent to ATS. CSD automatically generates MT548 advising the bank on the earmarking movement in the CSD account.
- b) For the BUY Swift message MT598/500; the CSD will process and validate the message submitted by the paying bank and generate MT598/501 with accepted or rejected status.

iii. SWIFT MT 525 - Client Confirmation of Purchase or Sale

Once CSD receives settlement instruction from NSE for matched trade on value date, Delivery Vs Payment (DvP) is executed between CSD and KEPSS. Once the settlement occurs CSD generates MT525 message to the buyer/seller confirming the purchase and sale movement status.

6. ELIGIBILITY

For the purposes of these guidelines, the CSD supports the trading at NSE ATS platform, Free of Payment (FOP) transfers and Over the Counter (OTC) trading for government securities.

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.

7. INTEREST/COUPON PAYMENT

The coupon interest for Treasury bonds will be paid to investors whose names appear on the register on the date of closure, in accordance with the applicable coupon payment rate and terms for the specific issue. The redemption of Treasury bonds will also be made to investors whose CSD accounts appear on the register on the date of closure. The register for Treasury bonds closes two (2) working days to due date.

Pledge contracts that have not been released before their maturity date will be automatically transferred from the pledger account to the Banned account on the pledge maturity date. Upon maturity or amortization of the security, all security balances in the Banned account will be redeemed or amortized to the pledgee account and associated interest and redemption payments will be paid to the pledgee.

The coupon payment remitted to the pledgee will be based on the taxation scheme of the pledgee and NOT of the pledger. Subsequent coupon payments for the security will be paid to the pledgee.

8. BUSINESS CONTINUITY PLAN (BCP)

The electronic trading of Treasury bonds will involve several independent systems namely CSD, Investor Portal (IP), KEPSS, SWIFT, CSD/ATS Interface and ATS. An appropriate BCP has been put in place that will cater for the six systems and establish back up arrangements.

9. CONNECTIVITY BETWEEN CBK CSD AND NSE ATS

There is an electronic connectivity using swift proprietary messages between the two systems i.e., the CBK's CSD and the ATS at the NSE.

10. OTHER RELATED GUIDELINES

i. Settlement Timings

Settlement of matched orders will continuously take place on near real time basis, for T trades between 8.30am to 4.00pm on every business day at the CBK's KEPSS as they are uploaded by ATS to the CSD. For trades with value date of T+1, T+2 or T+3 will be submitted automatically to KEPSS at 8.30am for Commercial

banks, Custodial accounts, and Investment Banks while trades for CBK Clients will be processed once MT598 is received.

ii. Settlement Cycle

Currently, the Settlement cycle for Fixed Income Securities as per the NSE Trading Rules is T+0, T+1, T+2 or T+3. Treasury bond settlement will take place in KEPSS that is domiciled at CBK RTGS. In order, to align this activity with the rest of the bond market, Settlement Cycle for matched trades for treasury bonds will take place as per the trade value date provided in the settlement file on a DvP basis.

iii. Cancellation of a sale or buy order

Sell order or buy order not matched in the ATS or CSD can be cancelled. For ATS transactions, the selling investor will transfer the securities in the Earmark account to the Main Account.

iv. Cancelled Transactions

Cancellation of matched trades will only be allowed in instances of fraud and will involve manual intervention from CBK or NSE. All such cancellations will be done according to NSE trading rules and appropriate punitive actions taken against the participant(s) involved.

v. Erroneous Transactions

Erroneous trades will be reversed by re-trading to correct accounts.

vi. Free of Payment (FOP) transactions for Treasury Bonds

These types of transactions will be processed as follows:

- a) Where there is no change of beneficiary – Commercial Banks and Investment Banks will process these transactions as provided in the Capital Markets Regulations. The section provides that the securities exchange or the central depository shall, upon receipt of an application made under regulation 57(e), forward the application together with its recommendations to the Authority for approval. These transfers need to be approved by CMA but submitted via NSE. CMA may delegate the approval role to NSE or any other approved Institution by CMA.

Once approved by CMA or mandated Institution, the transfers will be processed in the CSD and a transaction report forwarded to NSE in an agreed format and timeline. Where there is no change of ownership, only the Custodian bank(s) will be involved in processing.

- b) Where there is change of beneficiary - These transfers need to be approved by CMA as provided in the Capital Markets Regulations. Once the approval has been obtained, they can be processed in CSD or through the Investor Portal (IP). All transfers through the IP will be approved by CBK.

vii. Pledge Transactions

- a) A pledge transaction is where the Pledger assigns or transfers Treasury bonds as Collateral to the Pledgee to secure the cash/ facility/obligation. The pledger grants the Pledgee a security interest in all the Pledgers right, title and interest in those Treasury bonds.

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- b) If any event of default occurs, the Pledgee may with respect to the Collateral, with reasonable notice and in its sole and absolute discretion sell, assign, or transfer the Collateral or any part thereof for cash, on credit or for future delivery, and upon such other terms as the Pledgee may deem commercially reasonable.
 - c) Prior to effecting the sale through the exchange, the pledgee will give sufficient notice to the pledger as required by any applicable law or agreement.
 - d) If the pledge matures before cancelling by both parties (Pledger and Pledgee) the system moves security automatically to Pledger Banned account.
 - e) Once the security is in the Banned account the Pledgee can either release to the Pledger or to the Pledgee account.
 - f) If the Pledger is in default, the Pledgee can appropriate the security to its account to sell and recover the default amount and any surplus amount is paid to the Pledger.

11. GOVERNING LAW AND JURISDICTION

- a) These operational procedures and guidelines shall be governed by and construed in accordance with the Laws of the Republic of Kenya.
- b) Any dispute arising from the implementation or application of these operational procedures and guidelines may be referred to the courts in Kenya, which shall have exclusive jurisdiction to resolve all disputes arising herein. However, at first instance, be negotiated in good faith between the parties themselves with a view to amicable settlement of the dispute. The parties may not initiate any further proceedings until either Party has, by written notice to the other, NSE and CBK declared that such negotiations have failed.

12. 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. NSE will provide the necessary information as per their policy. The information may 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.

13. ENQUIRIES

Any queries relating to transaction processing and operations of the CBK's CSD and KEPSS should be referred to the Director, Financial Markets Department, Central Bank of Kenya while those related to ATS operations should be referred to The Nairobi Securities Exchange.

14. AMENDMENTS

CBK working with CMA may review these guidelines and make any changes as necessary and will communicate with market in writing.



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