INVESTING IN GOVERNMENT SECURITIES

INTRODUCTION

Government securities are debt instruments issued by the government to raise funds for various purposes such as infrastructure projects, budget deficits and debt refinancing. These securities are generally considered low-risk investments because of the government's high creditworthiness.

Types of Government Securities

In Kenya, there are two main government securities:

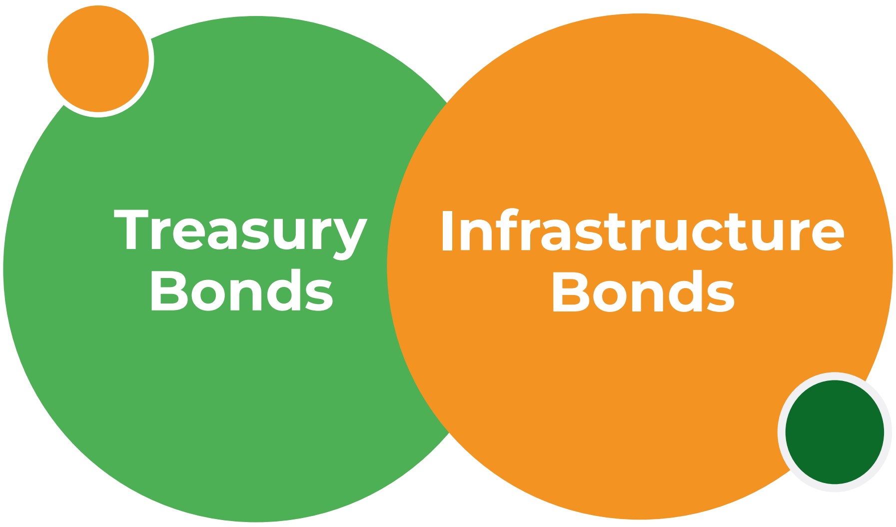
Treasury Bills (T-Bills): These are short-term investment options with maturities of 91, 182 or 364 days, issued weekly. Investors who purchase T-Bills can expect to recover their initial investment within three, six or twelve months respectively.

Treasury Bonds: They are long-term, secure investments offering regular interest payments, usually semi-annually, until maturity. It is a debt security where the bond issuer (the borrower) issues the bond for purchase by the bondholder (the lender).

TYPES OF BONDS

Treasury Bonds: They are issued by the government to raise funds for financing budgetary deficits.

Infrastructure Bonds: These are specifically allocated to finance government designated infrastructure projects. These bonds have a lot of market interest because their returns are tax free.



Bond Fundamentals

Bond Price: The market value of a bond, influenced by factors such as interest rates, time to maturity and creditworthiness.

Bond Yield: The rate of return an investor expects to earn from a bond.
Coupon Rate: The interest rate paid on a bond. It is typically expressed as a percentage of the bond's face value.

Tenor: The length of time until a bond matures.

Bond Issuance and Bidding

Competitive Bids:
Investors specify the interest rate they're willing to accept for a bond.

Non competitive Bids:
Investors accept the auction-determined interest rate.

Period Sale:
The time frame during which investors can submit bids for a specific bond issue.

Evolution of Investing in Government Securities

Traditionally, investors were required to physically submit their bids to the Central Bank of Kenya (CBK) and make payments in cash or through bank drafts. This manual system involved extensive paperwork and was time-consuming.

In today's investing landscape, the DhowCSD platform which was introduced on 31st July 2023, has replaced the traditional manual system, offering a more efficient and accessible way to invest in government securities. Investors can now submit bids electronically and make payments through their bank accounts.

Steps to Investing in T-Bills & T-Bonds.

The world of Fixed Income offers a variety of products with different features and investment options. This allows one to tailor their investments towards specific goals. Let's explore some of the most common Fixed Income products.

1. Open a CDS account

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2. Submit the Completed Application Form.

The application form requires comprehensive details including the desired T-Bond's identification number, term and investment amount. Additionally, it necessitates personal information such as name, contact details, CDS account number, commercial bank account number and the specific origin of the investment funds (domestic or foreign).

On the application form, investors indicate their preferred interest rate. For bond with fixed rates, select the 'Non-Competitive/Average Rate' option. For variable rates, choose either the 'Competitive Rate' to specify your desired rate or the 'Non-Competitive/Average Rate' to accept the market-determined average.

The application concludes with rollover instructions enabling automatic reinvestment of maturing bond proceeds into new government securities. Bond sale periods are outlined in the prospectus, with application deadlines set at 2 pm on the final Tuesday of the sale period.

3. Getting Auction Results.

The Central Bank's Auction Management Committee determines the auction cut-off rate and weighted average rate following a 4 pm meeting on auction days. Auction results are subsequently disseminated via Treasury Mobile Direct, the CBK Twitter handle and the bank's website. Although full allocation is typically provided, the Central Bank retains the discretion to reduce allotment amounts.

Post auction, investors must contact the Central Bank to confirm application status and payment requirements, with payments due by the following Monday (or Tuesday if Monday is a public holiday).

4. Payments.

Investors must remit payment, as determined by the Central Bank, by 2 pm on the following Monday. Payments exceeding KES 1 million necessitate a KEPSS transfer, while smaller amounts can be settled via cash or banker's cheque . Non-compliance with the payment deadline may result in disqualification from future government securities investments.

5. Maturity Value.

Bondholders receive periodic interest payments credited to their designated bank accounts and the principal amount upon maturity. To reinvest maturity proceeds, investors can opt for a rollover into a subsequent bond issue by submitting a rollover application before the sale period closes. The system automatically reinvests the proceeds, minus applicable taxes, into the new bond.

Eligible Investors in Treasury Bonds and Bills.

Government securities are accessible to a broad investor base, including commercial banks, corporate entities, pension funds and individuals. While direct investment through the Central Bank necessitates a Kenyan bank account and a CDS account, individuals can alternatively invest via commercial banks. Foreign investors may participate through local commercial banks, investment banks or stockbrokers.

What is the Difference between Primary and Secondary Bond Markets?

Primary Bond Market: The primary market is where bonds are initially issued by the government to raise capital. Investors purchase these newly issued securities directly from the issuer. This process is often facilitated by the Central Bank of Kenya.

Secondary Bond Market: Once bonds have been issued in the primary market, they can be traded among investors in the secondary market. This market provides liquidity for bondholders who wish to sell their bonds before maturity. The secondary market is where most bond trading occurs and it is facilitated by the Nairobi Securities Exchange (NSE).

What is the Difference between New and Reopened Bonds?

New bond: This is a fresh issuance by the government to raise capital. Investors bid for these bonds and the interest rate is typically market determined rate.

Reopened Bond: This is an additional issuance of an existing bond. The coupon rate for a reopened bond is based on the original issuance. This means investors know the exact return beforehand, unlike in new bond issues.

Main Risk involved in Treasury Bills and Bonds.

Interest Rate Risk: Bond prices and interest rates exhibit an inverse relationship. Rising interest rates typically lead to a decline in bond prices and vice versa. The duration of a bond or time to maturity, amplifies this interest rate risk. Longer-term bonds are generally more sensitive to interest rate fluctuations.

CONCLUSION

The potential for consistent and predictable returns is one of the primary benefits of investing in bonds, particularly government bonds. Bondholders receive regular interest payments throughout the bond's life, providing a stable income stream. This makes bonds a suitable investment for individuals seeking regular cash flow or those building a retirement portfolio.

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