UGANDA GOVERNMENT SECURITIES
OPERATIONAL PROCEDURES AND GUIDELINES

Introduction

Government of Uganda borrows funds from the public in the domestic market. Since 1969, Bank of Uganda (BOU) has been working as the agent of Government in operations relating to domestic borrowing from willing lenders. The public/lenders place funds with government through their Central Securities Depository (CSD) system accounts opened at BOU through commercial banks. The legal basis for Government issuing securities and the public investin in the same is the Treasury Bill Act 1969, and Public Finance and Accountability Act 2003.

The following are the instruments available to the public to invest in.

Treasury bills – these are short term instruments that allow the public to lend money to Government for a period 91 days, 182 days, and 364 days. These securities are issued at a discount and currently they account for less than half of total outstanding securities (government securities that are yet to mature).

Treasury bonds - these are long term investment instruments and allow the public to place funds with Government for periods of 2, 3, 5, 10, 15 or 20 years. Treasury bonds were introduced in 2004 mainly to extend the yield curve and to minimize the cost of sterilization by locking up commercial banks' liquidity for long term. Effective financial 2012/2013, these bonds are largely being used for fiscal financing purposes. The broad term government securities encompasses both Treasury bills and bonds.

Who can invest in Uganda Government securities?

The Uganda Government securities market is open to all investors, individuals and corporates alike. The following are the main categories of the main investors frequently observed in the market.

- Commercial banks
- Insurance companies
- Individual companies
- Government agencies

- Pension funds
- Individuals (of at least 18 years of age)
- Offshore investors (individual persons and corporate entities)--through a local agent i.e., a commercial bank registered and licensed in Uganda

What are the advantages of investing in Uganda Government securities compared to other alternatives?

- They offer a competitive rate of return
- They are credit risk-free instruments
- A good saving mechanism requiring minimal starting amount (UGX100,000 only)
- They are very liquid; can easily be sold in the secondary market at competitive exit prices
- They can be pledged as collateral for borrowing

Investment procedures

There are two ways of how investors can participate in Uganda government securities market, namely, through the primary auctions (per Auction Calendar frequency on the BOU website) and/or through the secondary market which is available any working day.

All investors wishing to participate in the treasury bills/bonds transactions must be registered on the CSD (Central Securities Depository System). An investor registers by filling one ***CSD Account Opening Form*** (available on the BOU website). The form is delivered to a commercial bank that opens up the CSD account on behalf of BOU.

Only BOU CSD-registered participants are eligible to submit bids in auctions or purchase the securities through the secondary market via commercial banks. There are two categories of investors or bids during auctions:

i. Competitive investors – investors whose bids exceed 200 million shillings (only Primary Dealer banks are allowed to submit competitive bids into auctions)

ii. Non-competitive investors – investors whose bids range from Shs. 100,000= to 200 million shillings.

All bids, competitive and non-competitive, must be submitted through a commercial bank. Bids are captured on the Central Securities Depository System (CSD) by Commercial banks for themselves and for their clients. (Secondary market purchase/sale orders are also placed via the investor's commercial bank.)

The auction is carried out at the Bank of Uganda on the auction day (usually Wednesday at 10am); there is no need for presence of any investor to witness the auction.

Settlement – Bank of Uganda applies a T+1 settlement arrangement. All successful bids are settled by directly debiting the commercial bank accounts at the Central Bank for the value of the securities/investments through a particular commercial bank. Securities are automatically created on the CSD after settlement through the RTGS at 12 o'clock on settlement day. Bank of Uganda issues electronic securities and they are stored electronically (there are no physical certificates issued to Treasury bills and bond holders; investors can instead request for their CSD statement free of charge from their commercial bank).

Holidays - On Unscheduled holidays (this is a day which is not a Business Day and the market was not aware of such fact), settlement for auctions and redemptions will be extended to the next business day. In the event that the settlement for auctions and redemptions is extended due to an unscheduled holiday, there will be no extra interest accrued. In the event that the settlement for auctions is extended due to an unscheduled holiday, the coupon payment and redemption dates will remain as specified in the Invitation to Tender (or issue prospectus).

Pre-auction procedures

i. In line with annual Calendar on the website, the public is given a 7-days (14 days for bonds) notice of the BoU's intention to auction Treasury bills/bonds through one or two of the leading newspapers and via the BOU website a s well as a email to the main market participants.

ii. All bids must be submitted through Primary Dealers (and commercial banks for non-competitive bids)

Auction Rules/ bid volumes

i. The minimum bid volume is Shs100, 000

ii. Bids must be in multiples of Shs100, 000

iii. Bank of Uganda has no limit to high volume bids (dominance by single investor)

iv. Bid volumes ranging between Shs100,000 and Shs200,000,000 are classified as non-competitive (these are auction price-takers)

v. Bid volumes of Shs200,100,000 or more are classified as competitive (these are auction price-makers)

vi. A bidder cannot place both competitive and non-competitive bids in a single tenure of a Government security

vii. **ALL Bidders (competitive and non-competitive) are awarded at the auction's accepted highest yield (corresponding to the lowest price per 100).**

Rejection of bids

Bank of Uganda reserves the right to reject any or all bids if it deems it necessary in the interest of maintaining stable rates in the financial market. Bids may also be rejected if:

i. The auction rules stipulated above are breached

ii. A bid is established to be an outlier

iii. A bid is construed to be speculative

Withholding tax and interest rate calculations

Withholding tax (WHT) of 20% (**and 10% for 10-year and longer maturity bonds**) is charged on all interest earned on Treasury bills and bonds on all investors except those that are explicitly exempted by Uganda Revenue Authority and/or other regulatory authorities. Tax is withheld at three tax points: coupon payments dates, at redemption and upon rediscounting of instruments at BOU. There is no WHT when selling or buying in the secondary market. The formula for calculating WHT is as follows.

$$WHT = 20\% * Interest\_Earned \qquad \textbf{(1a)}$$

Interest Rates terminology in primary auctions

(a) Treasury Bills

(i) <u>Annualised Discount Rate</u>

$$Annualised\_Discount\_Rate = (100 - P) * 365 / DTM \qquad \textbf{(a1)}$$

(ii) <u>Money Market Yield</u>

Money Market Yield = (100 – P)/P*365/DTM **(a2)**

(iii)<u>Yield to Maturity or Effective Yield</u>

$$Effective\_Yield = 100 * [(100 / P)^{365 / DTM} - 1] \qquad \textbf{(a3)}$$

where P is any primary market price quoted by the bidder, DTM is 'days to maturity' or tenor (i.e. 91, 182 or 364 days). The price for Treasury bills is usually a discount price (and expressed in shillings per 100) i.e., less or equal to 100, e.g., 99.9999

(b) Treasury Bonds

Relationship between bond price and yield to maturity

Let P be the price of a bond in shillings per 100 of a bond;
C be coupon payment (in shillings) per year (payment begins in period t = 1);
Assume there are n coupon payments in the bond's life;
Let M be the maturity value of the bond.

Then the following formula is used to calculate yield to maturity (YTM) or price:

$$P = \sum_{t=1}^{n} \frac{C}{(1+YTM)^t} + \frac{M}{(1+YTM)^n} \qquad \textbf{(2)}$$

In Uganda, coupon is paid semi-annually. Thus a 2-year 10% per annum coupon bond pays 5%X100 = 5 shillings per 100 per six-month period for a total of 4 coupon payments. In this case, the price –YTM relationship in formula (3) above translates into the following:

$$P = \sum_{t=1}^{4} \frac{5}{(1+\frac{YTM}{2})^t} + \frac{100}{(1+\frac{YTM}{2})^4} \qquad \textbf{(3)}$$

How to compute proceeds from Secondary Market Sale:

Let M denote the maturity value of the affected CSD instrument account holdings

Ps denote the agreed secondary market price

Secondary market proceeds:

$$Secondary\_Market\_\Pr oceeds = \mathrm{M} \times \frac{P_S}{100}$$

(4)

Formula (4) applies to both T-Bills and T-Bond secondary market sales.

For additional information:

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