FRAMEWORK FOR SECONDARY MARKET TRADE OF GOVERNMENT SECURITIES

1.0 Background

In 2021, the Ministry of Finance National Planning and Trade (MoFNPT) reviewed its debt management strategy with the aim of lengthening the debt maturity profile and developing the domestic market. As such, the frequency and volume of T-bonds increased resulting in a rise in the stock of bonds in the debt portfolio. The rising stock of bonds has warranted the need for secondary market trading in government securities in Seychelles, which is currently absent. Following a technical assistance (TA) mission on Secondary Market Development facilitated by the International Monetary Fund (IMF) in July 2022, several recommendations were proposed to the MoFNPT together with the Central Bank of Seychelles (CBS) and Financial Services Authority (FSA) to address short-comings in the government securities market. The TA assessment concluded that the Seychelles' secondary market is underdeveloped with the building blocks for local currency bond market at either the nascent or developing stage. To this end, the TA recommended the implementation of alternative arrangements for secondary market development in consideration of current structural constraints.

2.0 Choice of Arrangement for Trading of Government Securities in the Medium-term

Following the IMF TA recommendations and discussions between MoFNPT and relevant stakeholders, namely CBS, FSA and representatives from commercial banks, the parties have agreed for interested commercial banks to operate a buy-back window with a two-way quote on a risk-taking basis with the securities routed through their own account. Unlike the other variants of buy-back window, the chosen arrangement is closer to a market making model and will provide investors with a two-way market for trading of government securities in support of future market development. Additionally, it will satisfy the high appetite of commercial banks for government securities in an environment of decreasing domestic debt stock. The aim is to start the trading arrangement in 2024.

The chosen arrangement has several requirements as per below:

i) Drafting of Code of Conduct

The MoFNTP in consultation with the CBS will have to draft a code of conduct to outline the obligations of the participants with respect to quoting and reporting requirements, the standards of market practice to protect investors, any applicable fees, supervisory procedures and coordination between participants.

ii) Appointment of Market-makers

Based on the above regulations and balance sheet requirements of banks to play the role of market-maker in government securities, the MoFNTP in consultation with the CBS will appoint select commercial banks as market-makers on a pilot basis. The effectiveness of this pilot arrangement will be reviewed over the medium-term to make necessary enhancements.

iii) Establishment of oversight responsibilities

The MoFNPT in consultation with the CBS will have to establish the supervisory procedures for evaluating the conduct of the commercial banks with respect to the agreed code of conduct and taking necessary disciplinary action when the need arises.

iv) Securities settlement

The CBS, as operator of the securities registry, will have to establish a line of communication with the commercial banks to ensure efficient and secure settlement of securities exchanged through the buy-back window.

v) Trade transparency

To promote trade transparency, the commercial banks will have to publish their daily quotes for exchange of government securities and report the same to the MoFNPT and the CBS. Moreover, information on the buyback window will be published in aggregated form on both MoFNPT and CBS' websites. This will include information about procedures to access the facility and aggregated post trade information.

3.0 Long-term plan

The chosen alternative arrangement is an interim solution and the MoFNPT, in consultation with the CBS and FSA, aims to iron out other issues to facilitate the establishment of a secondary market in the long term.

In the long-term, the relevant stakeholders will discuss and assess the recommendations received for improving the building blocks required for local bond market development in support of secondary market trade. The following recommendations will be considered, but not limited to;

- feasibility of the MOF conducting Exchanges through issuance of new bonds or reopening of bonds to provide an avenue for investors to roll-over T-Bonds close to maturity. This will help to avoid market fragmentation and improve liquidity, subject to a tolerable level of refinancing risk
- feasibility assessment on trade of government securities on the stock exchange or over-the-counter and if the stock exchange is to be used as a vehicle for secondary market trade, revision of the Securities Law to incorporate government securities as a "security" for listing them on the stock exchange, thereby enabling the FSA as the formal regulator of the secondary market
- amend the Securities Law regulating short selling to allow for covered short selling of G-secs for market making purposes

- review the Public Debt Management Act to address some of the limitations in the current act and prescribe regulations for transfer and trade of government securities, as required under the PDMA, based on options of trading venue for secondary market trade
- discuss the organization of Central Securities Depository in support of secondary market trade
- further TA request to implement measures necessary for secondary market development.

The above Framework has been approved by the MoFNPT and CBS.

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