

## Part 4 – Institutional Arrangement in the Botswana Bond Market

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In last week's article, we outlined the benefits of investing in bonds and contrasted them to investing in shares. In this edition we take the discussion further to highlight the contrast between the two (2) asset classes on the way they are traded, cleared and settled. Trading entails the activity of buying and selling of securities. Clearing on the other hand, is the process of enforcing a commitment to sell or buy securities, while settling is whereby securities traded are actually delivered, ownership changes to the buyer in exchange for payment to the seller. Traditionally, shares trade centrally on stock exchanges, although in some markets there are alternative trading platforms such as multilateral trading facilities, and are thereafter cleared and settled through a securities depository. Bonds do not necessarily follow the exact process, and we will explain why.

This week we paint a picture of the institutional arrangement in the Botswana bond market so as to get a sense of the parties involved in the trading, clearing and settlement of bonds in Botswana. This will include highlighting the different bond trading platforms and bond clearing and settlement venues in Botswana.

Broadly speaking, there are two kinds of issuers in Botswana; the Government and the Corporates (including the Parastatals). Government issuance programmes are originated and approved by the Ministry of Finance and Development Planning (MFDP). The auctioning of the government bonds is undertaken by Bank of Botswana (BoB). BoB has in turn appointed Primary Dealers (PDs) who purchase Government bonds on behalf of investors in the primary market during the bond auctions. Further, the primary dealer network is utilized by investors to trade government bonds in the secondary market.

As such, the only way an investor can trade Government bonds is by going through the primary dealers. Since all Government bonds are listed on the BSE, BoB reports the auctions, new issuances, additional issuances and bond trades that have been executed by the primary dealers to the BSE. Usually, the reporting of trades to the BSE is done at the end of each business day hence published the following day (1 day lag).

At present, the primary dealer network comprises of the five (5) BoB licensed commercial banks being BancABC Botswana, Barclays Bank of Botswana, First National Bank Botswana, Stanbic Bank Botswana Limited and Standard Chartered Bank Botswana.

On the other hand, corporates usually prepare their bond programmes and register them with the BSE for approval. Upon approval, the corporate bonds are usually privately placed with institutional investors and listed on the BSE although other methods such as public offerings are available for selling of corporate bonds. Thereafter, investors who want to trade in the corporate bonds have to go through a

BSE licensed broker who can trade the corporate bonds on their behalf on the Exchange.

Currently, brokers employ the floor-based-trading method (this involves brokers seeking bids and offers from other brokers over the phone) when executing orders in bonds, unlike the Over-The-Counter (OTC) trading platform used by primary dealers to trade government bonds. The process of migrating corporate bonds listed on the BSE to the Automated Traded System (ATS) is ongoing. This would enable the brokers to trade bonds through the ATS just as they as they trade shares and Exchange Trades Funds (ETFs) through the ATS. This is the recent global developments in the world markets.

As far as clearing and settlement is concerned, the government bonds are cleared and settled by BoB whilst the corporate bonds are cleared and settled through the Central Securities Depository Botswana (CSDB) system and its Nominated Transfer Secretaries (NTS).

The CSDB clears and settles the corporates bonds that have been dematerialized and are held in the CSD system while the NTS clear and settle corporate bonds that are still held in physical certificate form. Currently, 32 of the 33 corporate bonds listed on the BSE have started the process of dematerialisation so that they can be traded through the ATS for clearing and settlement through the CSD system. Government bonds listed are not yet dematerialised.

Evidently, there are two separate platforms on which bonds are traded in Botswana. Firstly, there is the BoB regulated primary dealership platform on which government bonds are traded. Secondly, there is the BSE regulated broker platform on which corporate bonds are traded. The BSE and the brokers are in turn regulated by the Non-Bank Financial Institutions Regulatory Authority (NBFIRA).

The presence of a dual market poses its own challenges. Apart from the impaired dissemination of trade data, this market fragmentation tends to lead to inefficient price discovery, inefficient price formation and price confirmation, limited liquidity and tends to unintendedly marginalize participation of the retail investors in the bond market at large.

It must be noted that role players continue to cooperate to explore synergies that will transcend above the challenges faced by the domestic bond market. Notwithstanding the past and continued efforts by all the stakeholders in the market, there is consensus that the centralization of the trading, clearing and settlement of bonds could be a panacea to the challenges faced by the domestic bond market.

**This article was written by BSE Product Development Manager, Mr Kopano Bolokwe, as a build up to the 2016 Botswana Bond Market Conference and was published during the week of 16 September 2016.**