



2023

The Bahamas Benchmark Bond Issuance Policy

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Definitions

Benchmark bond	A government bond that serves as a reference or standard for pricing and comparing other bonds in the market. They are considered representative of their market and widely used as a point of reference by investors, issuers, and financial professionals.
Bond Switch	This refers to an exchange of one security for another to change the maturities of bonds in the debt portfolio.
Buybacks	Involve the repurchase of government securities in the secondary market before maturity by way of reverse auction or outright purchase.
Liability Management Operations (LMOs)	Debt management operations aimed at establishing a targeted bond consolidation and refinancing programme through initiatives, such as bond switches and buybacks, to reduce refinancing risk.
On-the-run/off-the-run bonds	The most recently issued bond for a specified maturity that is typically treated by the market as a benchmark bond due to its high liquidity and active trading activities around that term to maturity. The new issue is considered the on-the-run issue until it is replaced by a new bond of the same original term to maturity. A bond ceases to be an on-the-run issue when it becomes seasoned, often referred to as an off-the-run issue.
Reopening	Refers to the tendering of additional amounts of an outstanding issue of government bonds before the maturity of the issue. This technique helps build up the size of individual bond issues over time to improve liquidity in the secondary market.

Benchmark Bond Issuance Policy Guidelines for The Bahamas

1. Introduction

This document outlines the policy guidelines for the Government of The Bahamas' Benchmark Bond Issuance Programme (BBIP), which is a key facet of the annual domestic securities issuance strategy and is aligned with the government's medium-term debt management strategy and annual borrowing plan.

By aggregating bond issuances in a relatively limited number of popular, standardized maturities, the government seeks to:

- promote the development of a deeper and more liquid government securities market, thereby contributing to reduced borrowing costs.
- establish a reliable yield curve that can serve as a reference for the pricing of other financial instruments.
- enhance investor confidence in the government's commitment to maintaining a stable and transparent debt issuance process.
- stimulate the overall development of domestic financial markets, with liquid benchmark securities encouraging a more diversified and sophisticated financial ecosystem (e.g., the creation of derivative products such as interest rate swaps and futures).

2. Legal and Operational Frameworks

The Bahamas has in place the requisite legal, regulatory, and accounting frameworks, coupled with a competent operational market infrastructure to support the adoption of a benchmark issuance policy.

i. The Public Debt Management Act, 2021

- The Minister of Finance is authorized to borrow money by issuing securities (section 16 2(b)).
- The Minister of Finance may authorize portfolio management operations, including rollovers, swaps, and other derivative transactions, buybacks, switches, and prepayment of government debt (section 14(1)).
- The method, procedure, and mechanisms for the issue of government securities include auctions, private placements, syndication, offer for sale by tender, offer for sale at a fixed price, or any other method as may be prescribed (section 25).
- Any money required to be paid by the government for portfolio management operations, including swaps and other derivative transactions, buybacks, and switches, are to be charged to the Consolidated Fund and paid without further appropriation (section 15).

ii. Central Bank of The Bahamas Act, 2020

The Central Bank is authorized to act as a fiscal agent of and banker to the government (section 20(2)).

iii. Inter-Agency Agreement (the “Agreement”) between the Ministry of Finance and the Central Bank (April 2023)

The Agreement outlines the role and responsibilities of the Central Bank as fiscal agent, banker, and registrar/custodian in relation to the management of the public debt. Activities include the Central Bank conducting issuances, buybacks, switches, redemptions of bonds and treasury bills, and publication of outcomes in accordance with guidelines provided by the Ministry of Finance.

3. General Guidelines for Development of the Benchmark Issuance Policy

With approximately 240 Bahamas Registered Stock (BRS) securities, comprising 149 fixed-rate, and 90 floating-rate bonds¹, often issued with non-standardized features and varying original maturities, the bond market in The Bahamas faces significant market fragmentation. The primary aim of the BBIP is to eliminate market fragmentation by adopting bond standardization, concentrated issuance of bonds from benchmark maturities, bond reopening, and the implementation of liability management operations, such as bond buybacks and exchanges.

The BBIP will promote close and continuous collaboration with market participants to ensure it incorporates features desired by the market.

3.1. Standardizing Bond Issuance

The government will strive to implement standardized bond issuance practices that encompass the following key elements:

- All new securities will primarily originate from specified benchmark maturity buckets.
- Adherence to a conventional semi-annual coupon payment framework is a priority.
- A preference for fixed-rate structures will be maintained.
- Utilization of auctions as the primary issuance method.
- Bonds will be issued in standardized benchmark sizes.
- Prescribed issuance frequencies will be followed.
- Issues will be categorized as either "on-the-run" or "off-the-run" for bond reopening.

To the greatest extent possible, the issuance of securities with unique features such as callability, unmarketability, the utilization of amortizing bond structures, varying regulatory treatments, etc., will be minimized.

¹ Profile as at end-June, 2023.

3.2. Number of Benchmarks & Maturity Distribution for Issues

To issue and create benchmark securities, the government, in consultation with the market, has identified six (6) distinct maturities—3, 5, 7, 10, 20, and 30 years. These predetermined maturities will continue to be used for the issuance of all new securities and bond reopening.

3.3. Appropriate Size and Frequency of Benchmark Issues

To reduce market fragmentation, enhance bond liquidity, and effectively manage rollover (refinancing) risk, the government will establish specific issuance targets for various maturity buckets. Currently, the following targets have been set for the identified maturity categories:

- \$85 million for 3- and 5-year tenors
- \$105 million for 7- and 10-year tenors
- \$170 million for 20- and 30-year tenors

Other variables, such as auction size per issue and the frequency of auctions, will be determined primarily through market consultation and other considerations, including: (a) the market's capacity to absorb securities in different maturity ranges, (b) the targeted fundraising as outlined in the Annual Borrowing Program, and (c) the desirability of maintaining a consistent schedule of auctions throughout the year.

3.4. Bond Reopening

Any existing bond series from any maturity bucket can be reopened at any point during the bond's life.

- Any bond reopened with remaining maturities ranging from 2.0 to 3.9 years, will be categorized in the 3-year benchmark maturity bucket.
- Any bond reopened with remaining maturities ranging from 6.0 to 7.9 years, will be categorized in the 7-year benchmark maturity bucket.
- Any bond reopened with remaining maturities ranging from 9.0 to 10.9 years, will be categorized in the 10-year benchmark maturity bucket.
- Any bond reopened with remaining maturities ranging from 19.0 to 20.9 years, will be categorized in the 20-year benchmark maturity bucket.
- Any bond reopened with remaining maturities ranging from 29.0 to 30.9 years, will be categorized in the 30-year benchmark maturity bucket.

A reopened benchmark bond should have a coupon aligned with the prevailing market yield. Should such a bond not be available in the benchmark maturity bucket, a new bond will be issued and reopened to establish it as the benchmark bond.

Bond reopening will be complemented by bond buyback and switch operations to effectively eliminate illiquid off-the-run securities, manage refinancing risk, and promote liquidity in the bond market by increasing the volume of on-the-run bonds.

3.5. Bond Buyback and Conversion

The government will incorporate bond buybacks and switches into its strategy to proactively retire less-liquid and off-the-run government securities that are approaching maturity. Both bond buybacks and switches entail repurchasing securities. However, a buyback involves repurchasing securities using cash, while a conversion entails exchanging old bonds for a newly issued and more liquid one.

Securities bought or exchanged by the government during these exercises will be considered redeemed and will no longer be available in the market. This will reduce government liabilities and future payment obligations. Bond buybacks and conversions will enhance the execution of the benchmark issuance policy by: a) mitigating the refinancing risk associated with benchmark bonds as their outstanding amounts reduce near maturity and b) facilitating increased issuance of recently introduced (on-the-run) securities, thereby building size and fostering market liquidity.

Key considerations for the proposed repurchase of securities through buybacks and switches are as follows:

- Less-liquid and off-the-run securities will be considered for repurchase. The current (on-the-run securities) or targeted benchmark securities will not be subject to buybacks or switches.
- Maturity and coupon structure are to be used as the key variables for selecting off-the-run securities for repurchase. Strategically, off-the-run bonds with significant outstanding volumes and remaining maturities of one year or less will be prioritized for repurchase operations.
- Repurchase of old benchmark bonds may be carried out in multiple tranches of small lots to ensure that the actual bond redemption remains manageable on the redemption day.

4. Enquiries

Any questions/comments may be addressed to:

Central Bank of The Bahamas
Financial Market Infrastructure Unit
FMI@centralbankbahamas.com

The Central Bank, along with the Ministry of Finance, will continue to work with market participants on exploring initiatives for improving the functioning of the domestic bond market, including enhancing market liquidity.
