



**NATIONAL TREASURY**  
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## **FINAL TERMS AND CONDITIONS OF EXCHANGE**

### **1. Introduction**

Firstly, the National Treasury is grateful for the constructive feedback received from the market participants. The majority of the feedback was in the form of telephone calls requesting clarification. In general, there was a consensus that switches will enhance the liquidity of the domestic capital market. The majority of the respondents were more interested in the list of the bonds that would be involved in the switch programme. There were no dissenting opinions and no major changes were proposed on the conditions of exchange.

1.1 A large number of respondents wanted to know the reasons behind the selection of the primary dealers as the only eligible participants to submit offers. The rules in respect of Primary Dealers in Government bonds state that the primary dealers have exclusive dealing rights in government bonds. Also, it is believed that the primary dealers are more capable of taking the risk of duration mismatch. Further, the primary dealers are expected to be involved in marketing and educating the investors about the switch auction programme.

1.2 Some respondents questioned the decision by the National Treasury of conducting auctions in terms of price basis instead of the current standard of using yield basis. The answer to this question is that the price basis will make the calculation of the switch ratio easier. Further, if a yield is bid by the primary dealer, then it is the responsibility of the SARB to convert this yield into a price, and this might lead to an unforeseen error. Using the price basis will ensure that the auction runs smoother, results are generated quicker and the margin for error is dramatically reduced.

1.3 Paragraph 4.11 states that the bids for new destination bonds should be submitted in a clean price to five decimal places. The Bloomberg system currently can only accommodate three decimal places in the price field. This is a standard practice in all markets that are using Bloomberg. The R193-bond tender is also conducted to three decimals. The bids will therefore be up to three decimals, however the calculations for settlement will be done to five decimals.

1.4 Some respondents felt that paragraph 4.8 seems to imply that there may only be one source bond per switch auction. The answer is that there may be more than one source bond in one auction.

1.5 A number of respondents were interested in knowing whether the National Treasury will switch from Fixed to Inflation Linked Bonds. This is a possibility that will be looked at in future.

## **2. Rationale for Switch Auctions**

2.1 Switches will provide the Government with a powerful tool to rapidly restructure the maturity profile of outstanding debt. With the declining deficit (and without a switch programme), further reductions in new issue sizes and frequencies might reduce the liquidity of government bonds.

2.2 Switches will concentrate liquidity across the yield curve by reducing the number of illiquid small issues, and consolidating them into larger more liquid stocks. While not a primary objective, over the long term, this enhanced market liquidity could reduce the government's interest expense and promote more efficient capital markets.

2.3 Switches will also be used as a cash management tool. They will reduce the refinancing risks by smoothing the domestic maturity profile, especially towards bond redemptions.

2.4 Switches will also be used to build-up the size of the benchmark bonds more quickly than can be achieved through conventional weekly auctions. This has become more important in the expected low-issuance environment amidst the goal of the National Treasury of introducing a strip market. The switches will be used to increase liquidity of the benchmark issues and accelerate the start of a strip market.

**3. Methodology:** A cash neutral switch method will be used **based on dirty prices pricing method.**

## **4. Proposals**

**4.1 Participation:** Exchanges are effected on voluntary basis. **Only primary dealers are eligible to submit offers.**

**4.2** The National Treasury reserves the right to buy back nothing or less than the announced amount if warranted by market conditions.

**4.3** The National Treasury may hold a number of switch auctions of a particular bond over a period of time, if necessary.

**4.4** The National Treasury will not fix the minimum size for source bonds after the switches.

**4.5** Only bonds with a minimum nominal outstanding debt of R1 billion will be considered as a source bond. Bonds with outstanding debt of less than R1 billion will only be considered for buy-backs (payment in the form of cash).

**4.6** The National Treasury will not issue a new bond through the process of a switch auction.

- 4.7 No bond will be a source bond in a switch auction within 12 months of its last auction date as a destination bond, except for bonds with only 24 months to redemption.
- 4.8 Switches between bonds will not be restricted to pairs within the same maturity bracket.
- 4.9 There will be no limitation on the number of offers for each security.
- 4.10 Switch auctions will be conducted on a multiple-price basis, where successful bidders will switch at the price they bid. There will not be a non-competitive bidding facility.
- 4.11 The bidding format would be that the market participants, following the publication by the National Treasury of an indicative clean price of the existing **source bond (at 10.30am)**, will bid a quantity of the **source bond**, in minimum units of R10 million nominal and multiples of 5 thereafter, and a clean price for the new destination bond (**3 Decimal places**), which will be assessed against the undisclosed fair market value that would have been determined in advance by the National Treasury. Whilst all bidding and the 10.30 am indicative price would be in terms of clean prices, the switch ratio will be based in terms of dirty (i.e. settlement) prices.
- 4.12 The National Treasury will retain the option not to allot bonds to bids at a switch auction if they are not regarded by the National Treasury as fair market value.
- 4.13 Settlement will be t+3

#### **4.14 Timetable for the Conduct of a Switch Auction**

- Switch auctions will be pre-announced in the **quarterly auction calendar**. The National treasury will schedule switch auctions for the forthcoming quarter on the last working day of the preceding quarter.
- **30 days before auction:** The National Treasury will preannounce the auction and settlement date(s) of switch auction(s) including the bonds involved.
- **A week before the auction (7 days),** a press notice will be issued confirming the details of the switch auction, settlement details and the maximum size.
- **On the day of the auction:**
- **At 10.30am,** the National Treasury will publish an indicative clean price for the source bond involved in the switch auction.
- **Between 10.30am and 11.00am,** the market participants will be allowed to offer their bids to switch a nominal quantity of the source bond into the destination bond at the clean price of the destination bond (given the indicated 10.30am clean price of the source bond).
- **By 11.30am** the Reserve Bank will aim to publish the results of the switch auction. These would include the highest, lowest and average clean prices of the destination bond which were successful, and their dirty price ratio equivalents; the percentage allotted of the bids at the lowest accepted price; the nominal amount of the source bond that will be switched; and the nominal amount of the destination bond that will be created as a result.

5. **Special Programme of dealing in odd amounts during the Switch Auction**  
The conversion of the source bond to the destination bond will usually have the implication of the nominal of the destination bond being an odd amount. The National Treasury is prepared to round off any odd amounts to the nearest R1 000,00 (one thousand rand). It has been decided that the auction process on the day of the tender should not be interrupted or delayed due to the rounding off of the nominal amount in respect to the destination bond. An option is now available to tenders to sell any odd amounts up to R1 000,00 to the National Treasury. These odd amounts that have been allocated during the auction process will be bought back at the same price that they have been tendered for. This option will only be available up to 11h00 the next working day following the auction.

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