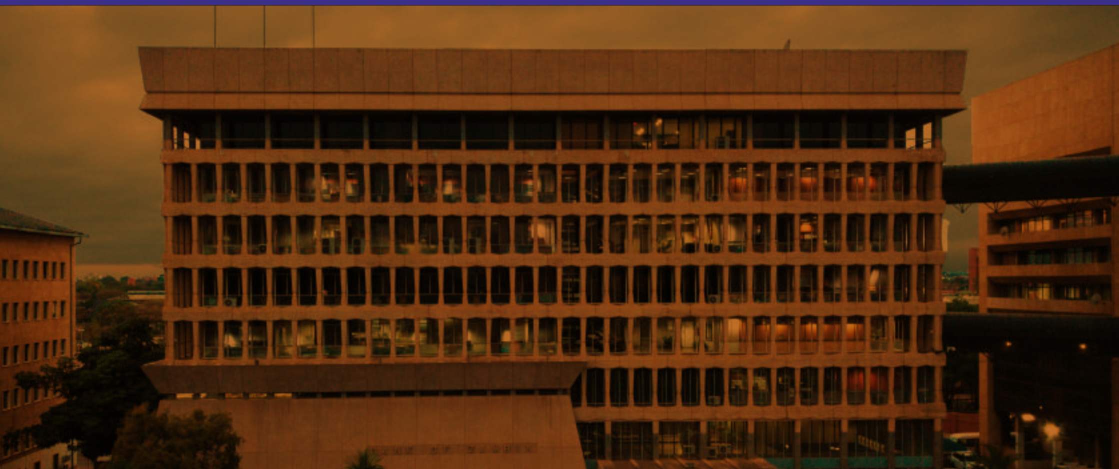
Bank of Zambia

FACT SHEET: PAR BOND ISSUANCE



January 2024

The Bank of Zambia recently announced a change in the issuance method of Government bonds. According to the announcement, Government bonds will be issued at par in the primary market effective January, 2024.

1. What does it mean to issue a bond at par?

A bond can be sold or issued to investors at a discount, par or premium. Under the current practice, Zambian Government bonds can be sold as any of these, although in recent times all bonds have been sold as discount bonds.

i. Discount Bonds: A bond is said to be sold at a discount if the coupon rate stated on the bond is lower than the interest rate. Expressed in terms of prices, a bond is issued at a discount when its issue price is less than its face value (par value), implying that the investor purchases the bond for an amount lower than the face value. The discount represents the difference between the issue price and the face value. For example, if a bond with a face value of K1,000 is issued at a price of K950, the K50 difference (K1,000 - K950) is the discount.

ii. Par Bonds: A bond is said to be sold at par if the coupon rate stated on the bond is equal to the interest rate. Expressed in terms of prices, a bond is issued at par when its issue price is equal to its face value. For example, a bond with a face value of K1,000 will be issued at a price of K1,000. This means that investors purchase the bond for an amount exactly equal to its par value (face value).

iii. Premium Bonds: A bond is said to be sold at a premium if the coupon rate stated on the bond is higher than the interest rate. Expressed in terms of prices, a bond is issued at a premium when its issue price is higher than its face value, implying that the investor purchases the bond for an amount greater than the face value. For example, if a bond with a face value of K1,000 is issued at a price of K1,050, the K50 difference (K1,050 - K1,000) is the premium the investor is paying to access a bond with a lower face value.

2. What are the cash flow characteristics of par bonds compared to discount bonds?

Generally, bonds have cash flow streams that are periodically paid to the investor. Regardless of whether issued at discount, par, or premium, all bonds pay coupons except zero-coupon bonds. There are coupon payments every six months after initial purchase of the bond and at maturity, the face value of the bond is paid out. Coupon payments are calculated by multiplying half the coupon rate by the face value of the bond.

For discount bonds, the initial investment is always less than the face value of the bond, and this difference is discount income from an investor's perspective.

A par bond will not have any discount because the cost and the face value of the bond will be the same. Your coupon amounts on par bonds will generally be higher than those on discounts for the same interest rate. This is because the discount is absorbed overtime in the coupon amounts.

3. How will the cost of a bond be determined?

For par bonds, the face value will be the amount that you invest i.e., what you receive at the end of your investment will be the same amount of money you paid at initial investment. The face value is equal to the cost amount paid.

4. How will the interest rate be determined?

The interest rate on each bond will still be determined competitively by market participants. The higher the demand for a particular bond the lower the interest rate is likely to be, and the lower the demand for the bond the higher the interest rate.

5. How will coupon rates be determined?

Currently, coupon rates are administratively fixed. Under the new method, the coupon rates on each of the Government bonds will no longer be fixed administratively. What this means is that the investor's stated interest rate will imply his/her stated coupon rate. For instance, if the interest rate is stated at 20%, that bid coupon rate will also be 20%.

6. The coupon rate for each instrument on auction will be the respective highest accepted interest rate. What does this mean?

This can be better understood with an example. Assume the Government is looking to borrow a total face value of K8,700,000 of bonds, and 8 investors have responded by stating their bid face values as well as bid interest rates as shown in Columns 2 and 3, respectively. Once the Bank of Zambia has received all the bids, it proceeds to adjudicate the auction by ranking all bids in ascending order from the lowest interest rate to the highest (see Column 3). In our example, Investor 1 is ranked first because his/her required interest rate is the lowest while Investor 8 is ranked last because his/her required interest rate is the highest. After this, the allocation process follows. The lowest interest rate will be allocated first, the second lowest next, and so forth until the amount on offer is exhausted. The amount on offer is exhausted by Investor 7 where the cumulative bid value, at K8,705,000, is just above the offer (Column 4). In our example, all bids except for Investor 8 are accepted. However, Investor 7's bid is partially filled to ensure that the cumulative accepted value (Column 6) is consistent with the amount of bond value on offer. The interest rate at which the amount on offer is exhausted will be the coupon rate for that bond issue. In our example, the highest accepted interest rate is 20.00%. This means that for this bond, the coupon rate will be 20.00%.

Column 1	Column 2	Column 3	Column 4	Column 5	Column 6	Column 7
Bidder Name	**Bid Face Value**	**Bid Face Yield**	**Cumulative Bid Value**	**Accepted Bid Value**	**Cumulative Accepted Value**	**Bid Status**
Investor 1	700,000	13.00%	700,000	700,000	700,000	Successful
Investor 2	700,000	15.00%	1,400,000	700,000	1,400,000	Successful
Investor 3	3,115,000	16.00%	4,515,000	3,115,000	4,515,000	Successful
Investor 4	1,000,000	16.50%	5,515,000	1,000,000	5,515,000	Successful
Investor 5	1,695,000	17.00%	7,210,000	1,695,000	7,210,000	Successful
Investor 6	650,000	19.50%	7,860,000	650,000	7,860,000	Successful
Investor 7	845,000	20.00%	8,705,000	840,000	8,700,000	Partially successful
Investor 8	845,000	20.50%	9,550,000			Unsuccessful

7. Will my past investment be affected by this change in issuance policy?

Your past investments in Government bonds remain unchanged. This means that the amount of coupons and the discount amounts on your current bonds are not affected. You will continue getting your coupons at the same amount and your discount will be the same at maturity date.

8. What will happen to non-competitive bidders?

There is no change to modalities for non-competitive bidders in terms of their allocation. Non-competitive bidders will be allocated their par bonds at the same coupon rate struck during competitive bidding.

9. Will the coupons be taxed? If yes, at what percentage?

As has been the case with all coupon payments under the previous issuance method, a withholding tax of 15% will continue to apply on all coupon payments payable to investors. Additionally, a 1% handling fee will be charged on coupons.

10. How will I, as an investor, make a profit?

The return on the investment will be paid out in form of coupon payments until bond maturity.

11. Am I losing my investment value by investing in a par bond?

While investing in a par bond does not pay a discount at maturity, this bond will generally pay higher coupons than a discount bond when evaluated at the same interest rate.

12. Does the change in issuance method mean the Government is restructuring bonds?

No. This change will have no impact in terms of nominal value and tenor of the bonds being held by investors. The debt restructuring that Zambia is implementing is restricted to public external debt and does not include Government securities.

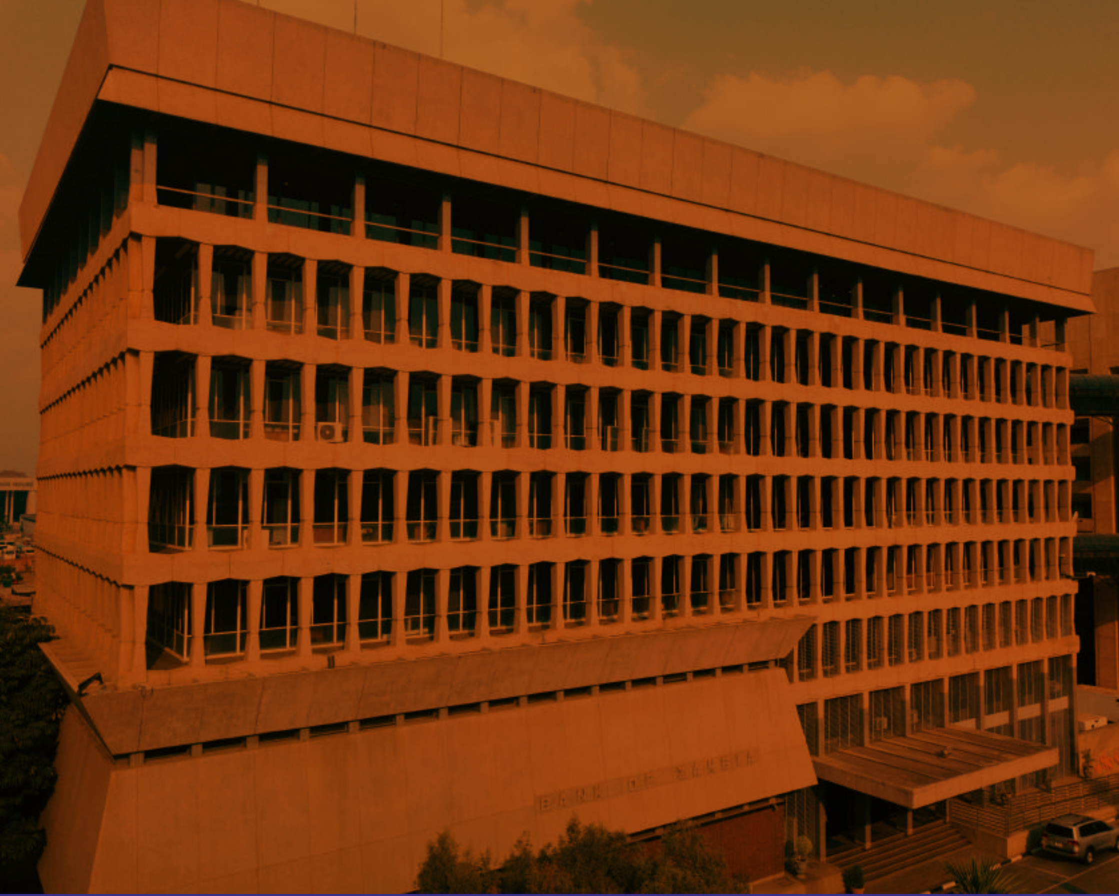
13. Will par bonds be tradable in the secondary market?

Yes. Just like discount bonds, par bonds are tradable in the secondary market. Should an investor choose to trade the bond on the secondary market, the prevailing market conditions will determine the pricing of the already-issued bond.

14. Will Treasury bills also be impacted by this change?

No, this change relates to Government bonds only. Treasury bills will continue to be issued at discount.

THIS FACT SHEET IS FOR INFORMATION ONLY. INVESTORS ARE ADVISED TO SEEK PROFESSIONAL ADVICE WHEN INVESTING IN ANY FINANCIAL PRODUCTS.



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