# BAHAMAS SAVINGS BONDS FRAMEWORK

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To continue to promote financial inclusion and resiliency, the Bahamas Government has agreed to introduce a savings bond as part of its suite of domestic debt instruments available to the public. The savings bond, while sharing some characteristics of the existing Bahamas Registered Stock (BRS), will serve as a gateway for new investors and an alternative to the standard commercial bank savings product. To facilitate introduction of the instrument, the Central Bank of The Bahamas ("the Central Bank") benchmarked the proposed domestic savings bond structure against those issued by other countries to promote outcomes consistent with international good practices. With individual participants continuing to account for a growing proportion of regular bond offering subscriptions in The Bahamas, the savings bond will provide an additional avenue for individual customer inclusion without competition from larger institutional investors.

## 1. Introduction

This paper outlines the framework for a Bahamas Government Savings Bond (BGSB) programme that aims to broaden the range of opportunities available to small retail (individual) investors and, over an extended horizon, augment the Government's sources of financing. The Central Bank is able to provide various advisory and debt management services to the Government supported by provisions of the Central Bank of The Bahamas Act 2020, the Public Debt Management Act 2021, and the Interagency Agreement between the Bahamas Government and the Central Bank of 21st April 2023. As such, the Central Bank developed this framework in close consultation with the Ministry of Finance.

The Bahamas Government will introduce a savings bond to further develop the domestic market for Government paper, while:

- broadening the investor base for public sector funding by increasing the access to individuals who might use commercial bank deposits as their primary form of savings and seek to diversify their options;
- facilitating increased financial inclusion and financial resilience through safe instruments that encourage and promote higher incidences of savings; and
- stimulating the development of new financial instruments.

While the BGSB would incorporate some characteristics of existing Government securities, they would not trade in a secondary market. Liquidity assurances would be provided though fixed interval redemption windows with the Central Bank, on behalf of the Government. This is intended to incentivize take-up, while limiting the volatility potential associated with conventional market principles, which would reprice existing bonds in the market over time. In line with risk reduction and some liquidity assurances, the bond would be priced to provide a coupon rate of return of 50 basis points[1] below the BRS coupon for instruments of the same or similar maturities.

## 2. Potential Impact of a Savings Bond on the Bahamian Market

By design, a savings bond would offer greater flexibility and access to a wider pool of domestic savers, promoting financial resilience through an expanded scope for financial inclusion. Many of these potential investors exist among depositors who hold low-value accounts in commercial banks. Such accounts earn either no or very low rates of return. The accumulated values held in these accounts also do not provide substantive opportunities to undertake existing investments in the amounts or lots that might be offered in either the primary or secondary markets. In contrast, a savings bond would provide more continuous access to smaller, incremental purchases, and the accumulation of term deposit-like holdings, at accessibly higher rates of return for disciplined savers. In particular, the annual savings bond issuance, on a net basis, could be targeted at no more than 5% of the aggregate of low-value savings and fixed balance accounts at commercial banks, yielding a range of \$10.2 million to \$17.1 million annually. Over time, establishing a ceiling on the aggregate stock of savings bonds could further constrain net issuance, with such a cap set as a fraction of the total stock of government debt.

As it relates to relevant deposit base metrics at the lower end of the depositor spectrum, as at June 2023, it was estimated that approximately 81.0% of residents with Bahamian dollar accounts at commercial banks held less than \$5,000 each, on average. The total value of these accounts was \$273.3 million—though only 3.2% of corresponding deposits. Including holdings of up to \$10,000 would increase the aggregate sum to \$464.6 million, comprising (87.1% of

[1] Estimated risk and liquidity premia for BRS vis-à-vis the savings bond.

accounts and just 5.5% of value). Taking just corresponding savings and fixed deposits into account, these represented between 82% and 90% of all accounts with financial institutions and a value of between $203.5 million to $342.5 million, according to whether holdings were up to $5,000 or up to $10,000. While the cumulative impact over time could be gradual, these holdings underscore the potential for financial flows to be attracted to essentially risk-free instruments, offering superior rates of return.

For additional context, the Bahamas Government domestic bond market has a current outstanding balance in excess of $4 billion. Of this market share, individual investors account for approximately $632 million (15.60%). Such investors also represent the target market for a savings bond, to the extent that there exists aversion to participating in the secondary market for traditional government bonds. In particular, the mean subscription for individual investors is approximately $28,000, with $10,000 being the median subscription size.

A savings bond would reduce pressures for retail investors to compete with larger institutions for BRS offerings. Such competition is expected to increase over the medium-term, as ongoing reforms in the BRS segment introduce competitive bidding for IPOs. In a transparent fashion, the foremost goal of this reform would be to achieve reasonable pricing for the Government, and only at a lesser, residual priority, make some IPO amounts available to non-competitive bidders. This change could also leave more retail investors having to transact in the secondary market, even at the phase of purchasing new issues of government bonds.

Although, a savings bond might be ideal for the small investor, the following points must be considered:

- **Investor Preference**: Individual BRS participants have historically shown preference for the long-term tenors, primarily to attract the highest available coupons. However, the longer maturities also expose such investments to greater market price sensitivity, as the Central Bank has sought to encourage secondary market repricing against a benchmark yield curve. Investors searching for liquidity have become acutely aware of repricing risks in recent years. The coupon return on a savings bond would continue to take maturity or duration into account, but at discounted rates, compared to similar BRS maturities, as secondary market pricing would remain fixed at face value of the bonds.

- **Saving Bond Liquidity**: While the Savings Bond scheme would be designed to discourage early redemption, it still anticipates that such needs would arise. The desired liquidity would be provided within pre-defined windows, with a penalty discount applied against interest already earned on the investments.
- **Rate Certainty**: Market participants have become accustomed to the fixed rate nature of the current bonds in circulation. The BGSB will build on this expectation and be issued at a fixed coupon rate to maturity.[2]

## 3. The Bahamian Framework

The Bahamian savings bond framework was developed following a benchmarking exercise against several countries that issue such instruments, with key features drawing on the lessons crystallized from at least five of these: the United States, Barbados, New Zealand, South Africa and India. The key characteristics of the proposed BGSB are those, which partially distinguish it from BRS, relating, among other things, to setting of the coupon interest rate, maturity tenor, minimum holding period, and caps on the aggregate amounts that could be invested.

1) **Coupon:** The BGSB would pay a coupon or rate of interest of 50 basis points (bps) below the respective yield on BRS of the same or similar maturity.
2) **Maturity Term Horizon**: The BGSB would be issued in four tenors: one, two, four and six years. In contrast, existing BRS are issued at maturities extending up to 30 years. The instrument would also seek to take advantage of any demand in the intervening medium-term tenors for BRS vis-à-vis the three-, five- and seven-year maturities at issue.

[2] In 2016, the Ministry of Finance discontinued the issuance of floating rate bonds. This followed recommendations from the Commonwealth Secretariat to mitigate various issues resulting from floating rate bonds such as lack of a yield curve; absence of market liquidity; the use of a policy rate rather than the market reference rate as the benchmark interest rate and complexity of pricing.

3) **Lock-in Period**: As the BGSB is also intended to serve as an alternative to term-like bank deposits, investors would be incentivized to avoid early redemptions. They would be required to hold each instrument for a minimum of six to 24 months, depending on the tenor, before the option to liquidate becomes available. This approach is taken in nearly half of the countries observed in the benchmarking exercise. It is also proposed that premature liquidations, after the minimum holding period, involve the forfeiture of 91-days' worth of interest from the face value of the investment.
4) **Maximum Investment**. While there is no limit to the overall amount that an individual investor can hold, the per-investor holding limit for each savings bond would be $50,000 per issue. A key driver of introducing the BGSB remains financial inclusion. As such, establishing an investment ceiling supports wider market reach, so that holdings can be more broadly distributed. Additionally, it would support programme continuity, as the framework is intended to encourage a sustained pattern of savings across new issuances rather than concentrated holdings in singular transactions. Moreover, investors would retain the option of making unrestricted larger purchases of BRS.
5) **Redemption Windows**: On predetermined days, early redemptions would be processed electronically over-the-counter (OTC), once the minimum holding period has been satisfied. In extraordinary cases, if holdings were liquidated outside of a redemption window, additional penalties would be incurred in the form of forfeiture of earned interest. This would differ from the established penalty-free practice for the early redemption of BRS, although such transactions are exposed, instead, to pricing risks.
6) **Availability for Purchase**: Investors would be able to purchase the savings bond OTC via the Central Bank on fixed quarterly dates.
7) **Early Redemption Pricing**: Bonds would continue to be priced at face value for early redemption. Redemptions would only be possible through the Central Bank, as registrar, on behalf of the Treasury.

## Savings Bond Summary Characteristics

| Characteristic | Bahamas (Proposed) | Benchmark | Rationale |
|---|---|---|---|
| Eligible Investors | Bahamian citizens and permanent residents. Individuals only; no institutional investors allowed | United States, New Zealand, Barbados | Aligned with investor criteria for Government securities |
| Coupon Type | Fixed | United States, Barbados | Promotes certainty and reduces risk |
| Issuer | Bahamas Government | United States, New Zealand, Barbados | The sovereign is the issuer |
| Physical or Electronic | Electronic | United States, New Zealand, Barbados | Aligned with dematerialization of Government securities; international best practice |
| Minimum, Maximum, Increments | $100 minimum; $100 increment; $50,000 max per issue (subsequent to the initial offer) | Parameters vary by jurisdiction | Attracts targeted investor group: individual Bahamian citizens and residents not currently invested in benchmark securities |
| Term | 1, 2, 4, 6 Years | Terms vary by jurisdiction | |
| Interest Payment Frequency | Semi-annual | South Africa, India | Aligned with traditional bond interest payment frequency |
| Coupon Setting | Set by the Ministry of Finance in consultation with the Central Bank; typically 50 bps below the benchmark treasury security | United States, New Zealand, Barbados | Aligned with existing practices for coupon setting and market transparency |
| Annual Issue | Net issuance of up to 5% of BSD savings deposits, based on aggregate accounts with balances of $5,000 to $10,000 | None | Security intended for small investors |
| Lock-in Period | 6, 12, 18, 24 months depending on tenor | United States, South Africa, India | Discourages early redemption and promotes investor base stability |
| Redemption Window | Biannually on interest payment date after lock-in period | None | Promotes investor base and provides emergency liquidity to the investor |
| Redemption | Redeemed at face value plus accrued interest, less penalty, if any. | None | Eliminates market volatility. Bonds redeemed on behalf of the Treasury; not intended for Central Bank balance sheet |

## Savings Bond Term Details

| Tenor | Lock-in Window | Redemption Penalty After Lock-in |
|---|---|---|
| 1 Year | 6 Months | 91 days' accrued interest |
| 2 Years | 12 Months | 91 days' accrued interest |
| 4 Years | 18 Months | 91 days' accrued interest |
| 6 Years | 24 Months | 91 days' accrued interest |

## 4. Implications for Government Debt Administration

The net financial efficiencies associated with operating a savings bond scheme are expected to be significantly less than the relative expense of raising financing from BRS or other domestic instruments. This reflects both the exclusively retail nature of the investor base, and lesser volume funding that the Government would raise through this market. However, from a financial inclusion and financial resilience point of view, it offers significant potential to strengthen attitudes towards savings and investment in the country. The savings bond is likely to involve an increased volume of back office work tied to servicing retail investors as a group. Key aspects of the work include processing a high volume of clerical operations and the need for a national distribution structure, which could provide reasonable accessibility for the whole population. The framework is also expected to generate increased investor engagement and a corresponding boost in operational resources dedicated to Government debt operations.

## 5. Conclusion

It is expected that an initial annual issuance of up to $20 million be targeted for the BGSB. Over the medium-term, the size of the market could remain scaled to a portion of the low-value Bahamian dollar deposit base holdings. In this regard, the bond would be available only to individuals, enhancing financial inclusion and financial resilience outcomes for domestic households. That said, beyond the capital markets enhancement result, it is not expected that the BGSB would be a material source of financing for the Government. However, over time, the outstanding liabilities could represent a moderate share of the total stock of debt.