Introduction

The Central Bank of Samoa introduced tenders of central bank securities in January 1998 as part of a package of reforms aimed at liberalising the financial sector. This pamphlet provides an overview of what central bank securities are, how they are issued, and why the Central Bank uses them.

What are Central Bank of Samoa securities?

A Central Bank of Samoa security is a short-term financial instrument, in much the same way that a bank deposit is a financial instrument. As with other financial instruments, there are two parties involved - the issuer, who is raising funds, and the investor. In this case, the Central Bank of Samoa is the issuer and raises funds by issuing the security, and the investors are those who purchase the security.

When the Central Bank receives the funds, it issues the investor with a certificate of title which acts as a receipt and evidence of ownership. This certificate is the actual security. It states how much has been invested, when the investment matures and how much the Central Bank will pay back when the investment matures. Repayment is ***guaranteed*** by the Central Bank of Samoa.

The securities are issued in accordance with the *Prospectus* for Central Bank of Samoa securities. The *Prospectus* is a legal document which stipulates the features of the securities and how the securities must be issued. This type of document protects the integrity of the tender, thereby protecting the interests of the investors.

How are the securities issued?

The securities are issued through a tender, or auction as the process is sometimes known. There are two ways of participating in a tender.

Participants in the tender - the bidders - can submit either a competitive bid or a non-competitive bid..

In placing a ***competitive bid***, the bidders submit bids for the amount of securities they want to purchase and the yield they want to receive, where the yield is the return on the funds invested. For example, a bidder might bid for $50,000 at a yield of 8 percent. At least 90 percent of the securities offered for sale are earmarked for competitive bidders.

Up to 10 percent of the securities offered for sale can be purchased by non-competitive bidders. For a ***non-competitive*** bid, bidders only bid the amount they wish to purchase. No yield is specified as the securities are allocated at the weighted average yield of the successful competitive bids. Non-competitive bids are therefore suitable for those who are not confident about bidding an interest rate or those that want to be certain of purchasing at least a small portion of the securities available.

The securities are issued at a discount. This means that if you are successful in the tender, then you pay less than the face value and then at maturity you get the face value of the security. The higher the yield bid, the lower the purchase price. For example, if the face value of the security is $1,000, and you were successful with your bid of 8 percent, then you would pay $980.44 when you purchase the security and you would receive $1,000 on maturity. You would pay less if the successful bid was for a yield of greater than 8 percent, as indicated above.

What maturities are available?

Initially, the securities will have a 91 day maturity. In the future, and once the investing public is more familiar with this type of security, the Central Bank intends to issue other maturities, such as 30 day and 182 day securities. Before introducing any new maturities, the Central Bank will be consulting with the financial institutions and the public on their preferences.

Who can participate in the tender?

Any Samoan resident over the age of 18 years is eligible to participate in the tenders. This means that banks, nonbank financial institutions, businesses, church groups, trusts and members of the public can all participate. Prior to bidding in a tender, bidders must have registered with the Central Bank of Samoa. Registration is straightforward and requires the bidder to complete a registration form.

How do these new securities differ from those that the Central Bank of Samoa issued in the past?

The Central Bank has been selling securities to banks at a fixed rate of interest since 1991, but only on a small scale. These securities were also issued at a discount to face value but the big differences with the new central bank securities is that banks are no longer the only ones eligible to hold the securities, the securities are allocated competitively and the interest rate is no longer be set by the Central Bank.

Why are the securities sold by tender?

A tender process has been chosen because this is the best way of promoting competition for the securities. The more the competition the lower the interest rate that the Central Bank will have to pay. The issuer is always looking to keep the costs of issuing the securities as low as possible.

Why does the Central Bank issue the securities?

Normally, an institution issues a security to raise funds to finance its expenditures. The situation is different when the Central Bank issues securities. It is not borrowing money to finance its own expenditures, or those of the Government. The Central Bank issues the securities for monetary policy reasons.

When the Central Bank issues securities, it is trying to slow down money and credit growth by withdrawing money from banks and the public. If the rate of credit growth or money supply growth is too high then there will be too much spending in the economy, relative to the amount of goods and services available to the economy. Too much money will be chasing the limited goods and services that are available. If this happens, inflation will be too high and the country's foreign reserves will decline with the increased demand for imports.

It is likely that the tenders will be held fortnightly but the timing of the auctions, and the amount of securities offered for sale, can vary depending on how the Central Bank views monetary conditions, its monetary policy stance, and the demand for the securities.

The tender cycle

There are five stages in the tender cycle: the Central Bank announces the auction details, bids are lodged, successful bids are determined, results are announced, and the securities are issued.

Announcing the tender

Once the Central Bank has decided to hold an auction, it issues an *Invitation to Bid* which gives details of the amount of securities to be sold in the tender, when and where bids can be lodged, and when the results of the tender will be announced.

Bidding

Bids are entered on a bid form and this is lodged at the Central Bank in a locked tender box. This box is only opened once the tender has closed.

Any single bid must be for at least $1,000 but there is no limit on the maximum amount that can be bid, subject of course to the total amount of securities that are being offered for sale at the tender.

Determining the successful bids

After opening the tender box, the Central Bank ranks the bids from the lowest interest rate to the highest interest rate. Starting with the lowest interest rate bid, it allocates the value of securities bid at that rate until the total amount of securities on offer in the tender has been allocated. When the amount remaining is less than the bids at the next highest interest rate, then this amount is allocated in proportion to the amount of the individual bids.

Announcing the results

Results are announced on the same day that the tender closes. Successful and unsuccessful bidders are informed by telephone and in writing. The Central Bank also issues a press release giving summary results on the total amount bid, the total amount issued, and the weighted average yield for successful bids. Details of individual bids and the identity of successful bidders are not divulged.

Issuing the securities

The securities are only issued on payment. There are special payment arrangements in place for banks since they have accounts with the Central Bank. For others, payment can be made by bank check, personal check, or cash. Where a personal check is used, the securities will not be issued until the check has been cleared. Cash payments are limited to $2,000.

Selling the security before maturity

If an investor wishes to sell the security before it matures, then this can be done by trading the security on the open market or selling the security back to the Central Bank.

The securities are ***transferable,*** which means that the holder of the security can sell it before its maturity date to anyone else who is eligible to hold the security. All that is required is for the original owner to sign the back of the certificate, which thus indicate that the original owner has relinquished ownership. This signature is known as an endorsement.

The securities are also ***negotiable*** which means that the buyer and the seller are free to negotiate between themselves the price at which the security will be sold.

The reason for making the securities transferable and negotiable is that it will make the securities more attractive investments to the public. The 'tradeability' of the securities is therefore enhanced.

If for some reason the holder of the security does not wish to sell to another member of the public or can not find someone who is willing to purchase the security, then the holder can still sell the security to the Central Bank but the Central Bank will pay a lower price than could be obtained elsewhere. The Central Bank does this in order to encourage securities trading among the buyers and sellers so that markets will develop for these financial instruments. When the Central Bank purchases securities in this way, the transaction is referred to as ***rediscounting***.

Issuing the securities at a discount makes trading easier. It is just like trading any other commodity. You buy at a lower price than that at which you expect to sell. The final sale price will be the face value of the security so you just set your purchase price relative to the face value.

Public Information Pamphlets* available from the *Central Bank of Samoa

No	**Title**
1	The Financial Sector Liberalisation - What You Need to Know
2	Central Bank of Samoa Securities
3	Monetary Policy in a Liberalised Financial System