

We wish you a Happy and Prosperous 2010

Two innovations: National Savings Bonds (NSB's) and Electronic Bond Trading Platform (EBND)

On 11 Jan 2010, NSB's were launched by the Central Directorate of National Savings (CDNS). On the same date, the State Bank of Pakistan (SBP) launched the EBND. We state below what we know about these as we write.

National Savings Bonds (NSB's)

The NSB leaflet contains the National Savings Bonds Rules, 2009. From this leaflet, and from the advertisement issued on 9 Jan 2010, it seems existing National Savings Schemes (NSS) will continue for the time being.

Salient points of the NSB Rules, 2009, are:

Rule 5: Maturity periods 3, 5 and 10 years.

Rules 6 & 7: Minimum investment Rs 20,000, no maximum. Issued in multiples of Rs 10,000.

Rule 8: Return paid half-yearly

Rule 9: NSB's not redeemable before maturity.

Rule 11: The maturity wise coupon will be announced a fortnight before each issue.

Rule 12: "The Bonds may be issued to individuals, mutual funds, provident, pension, gratuity funds or trusts, excluding body corporate and banks, irrespective of their residential status".

[The above wording is not quite clear. But the CDNS stated on the phone that although corporate bodies and banks cannot invest their own funds in NSB's, their provident, pension and gratuity funds may do so. If so, this would prevent an anomaly mentioned in the next paragraph.

No amendment in the Rules of existing NSS has been announced. So provident, pension and gratuity funds of banks and insurance companies cannot invest in SSC's, RIC's and DSC's, because banks and insurance companies themselves cannot do so. But the private corporate sector registered with the SECP, excluding banks and insurance companies, can invest in SSC's, RIC's and DSC's.]

Rule 13: NSB's will be in electronic form in Central Depository System accounts/sub-accounts. [The Central Depository Co Ltd will be the Registrars.]

Rule 14: The Bonds will be listed and traded on all three Stock Exchanges. [As at the date of writing, leading stock brokers were working out the details, including their brokerage rates.]

Rule 15: Trading shall be closed for 7 days before each coupon payment or redemption.

Rule 17: "Profit" earned shall be subject to withholding tax under the Income Tax Ordinance, 2001. [The CDNS confirmed on the phone that Recognised Provident Funds, Approved Pension and Gratuity Funds and Charitable Trusts will be exempt, if they file the necessary documents.]

Rule 18: Zakat will not be deducted.

NSB's will not be on tap

Unlike existing NSS, NSB's will not be on tap. Issues will be announced from time to time, and subscriptions will be open for a limited period.

The 1st issue was open from 12 Jan to 26 Jan 2010. It was open-ended as to size. But the size of future issues may be limited, which may give rise to interesting problems.

The Table compares the returns if held to maturity under the 1st NSB issue with existing

NSS. For NSS, the yields shown are for new investments from 1 July 2009 till date.

Term (years)	Security	Nominal return pa pre tax	IRR pa pre tax
3	NSB	12.50 %	12.89 %
	NSS Special Saving Certs (SSC's)	11.67 %	11.99 %
5	NSB	12.55 %	12.94 %
	NSS Regular Income Certs (RIC's)	12.00 %	12.68 %
10	NSB	12.60 %	13.00 %
	NSS Defence Savings Certs (DSC's)	N/A	12.16 %

(SSC's IRR assumes ½ yearly returns rolled up)

The nominal yield on Bahbood/ Pensioner Benefit Accounts (PBA's) is 14.16%.

Are NSB's better than SSC's, RIC's and DSC's?

The market value of NSB's before maturity will depend on the ruling rate of return. If this is higher than the coupon rate, the market value will fall. If this is lower than the coupon rate, the market value will rise. Time will tell how large and active the trading will be.

For Provident, Pension and Gratuity Funds, expert opinion should be taken as to whether International Accounting Standard 26 permits them to be classified as "held to maturity", or whether market valuation is mandatory.

Existing NSS's offer (a) guaranteed encashable values, (b) the option to encash and re-invest if

yields on new investments increase, (c) under SSC's, half-yearly profits may be "rolled up" at the underlying rate of return. Investors will have to judge whether the higher yields on NSB's are worth the sacrifice of these features.

Electronic Bond Trading Platform

The secondary market in Monthly Treasury Bills (MTB's), Pakistan Investment Bonds (PIB's) and Ijara Sukuks is opaque. One has to make the rounds of banks to get quotes.

Under the Electronic Trading Platform (EBND) announced by the SBP, Bloomberg terminals will be available, for a monthly charge in US \$'s, which would show current prices in real time.

For Primary Dealer Banks, it will be mandatory to use this platform for market making in sovereign paper. In future, the platform would be used to conduct Primary Auctions, Open Market Operations and other instruments.

Government bonds are widely traded on many stock exchanges abroad. When PIB's were announced in 2000, it was stated that they would be tradable on our Stock Exchanges. Unfortunately this has not happened yet.

So the EBND is a step forward for banks and other large institutions, for whom Bloomberg terminals are affordable, having regard to the size of their portfolios.

Montgomery's favourite limerick

The late British Field Marshal Lord Montgomery of Alamein had a humourless image. Yet this was his favourite limerick:

"There was an old soldier from Lyme,
Who married three wives at a time,
When asked why the third,
He said "One's absurd,
And bigamy, Sir, is a crime."

Readers should take expert advice on legal, tax and investment matters

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