OFFICIAL OPERATIONS IN THE GILT-EDGED MARKET

OPERATIONAL NOTICE BY THE UK DEBT MANAGEMENT OFFICE

United Kingdom
Debt Management Office

January 2004

Official Operations in the Gilt-Edged Market

Operational Notice by the UK Debt Management Office (DMO)

This Notice (the "Operational Notice") sets out the objectives and procedures for the DMO's operations in the gilt-edged market, acting as the Government's debt manager. It replaces all earlier such notices.

The Notice sets out the normal market operations which the DMO undertakes in the gilt-edged market. In exceptional circumstances, the DMO may on occasion undertake other operations at its discretion. The DMO may also announce variations in these arrangements, or new forms of market operation, either by special announcement or by means of a supplement to this Operational Notice.

The DMO's cash management operations are outlined separately in the "Exchequer Cash Management Operational Notice".

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I Framework for Gilt-Edged Operations

1. The framework for gilt-edged operations is set out in the Report of the Debt Management Review produced jointly by HM Treasury and the Bank of England in July 1995[1]. With the transition in debt management responsibilities from the Bank to the DMO from 1 April 1998, this framework now applies to the DMO's operations. A full description of all the DMO's responsibilities, objectives and lines of accountability is also set out in its Framework Document, first published in March 1998, and most recently revised in July 2001.

2. The objective of debt management, as stated in the Debt and Reserves Management Report, is "to minimise over the long term the cost of meeting the Government's financing needs, taking into account risk, whilst ensuring that debt management policy is consistent with the objectives of monetary policy".

3. In March each year, the Government will publish a Debt and Reserves Management Report and Gilts Remit to the DMO, setting out advance details of the annual issuance programme[2]. This will include a planned maturity structure for the issuance of conventional stocks for the year and an indication of the likely scale of the issuance of index-linked stocks. Within that published framework, the Government will aim each year to sell sufficient gilts, Treasury Bills and National Savings products to finance the Central Government Net Cash Requirement (plus maturing debt and any net change in the foreign exchange reserves).

4. This Notice describes the arrangements for the primary and secondary market operations which the DMO undertakes in implementing the Gilts Remit. It covers conventional and index-linked auctions, switch auctions, reverse auctions, taps and tenders, conversions, sales to and from official portfolios, and other secondary market operations. In all sections, references to Gilt-edged market makers (GEMMs) should be read as applying to all GEMMs recognised by the DMO when referring to conventional gilts, but only to those GEMMs on the specialist index-linked market makers list approved by the DMO when referring to index-linked gilts.

5. Any changes to the arrangements described below will be published through updates to the relevant sections of this Operational Notice.

6. This Operational Notice should be read in conjunction with the Information Memorandum on the Issue, Stripping and Reconstitution of British Government Stock published in January 2004.

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[1] Copies are available from the Publishing Unit, HM Treasury, 1 Horseguards Road, London, SW1A 2HQ.

[2] In the event that the annual Budget is held in April, a provisional remit will be published in March and a final remit in April.

II Auctions

7. Auctions constitute the primary means of both conventional and index-linked gilt issuance.

Prior Notice of Auction Details

8. The Gilts Remit for each financial year will indicate:
   - the number of auctions in each broad maturity band[3] to be held during the year;
   - the dates planned for each auction;
   - a range for the size of the auctions in cash terms for both conventional and index-linked stock;

9. The issuance programme, and in particular the number and timing of auctions, may be varied during the year in the light of substantial changes to any of the following:
   - the Government's forecast of the Central Government Net Cash Requirement;
   - the level and shape of the gilt yield curve;
   - market expectations of future interest and inflation rates;
   - market volatility;
   - any other criteria specified in the relevant annual Remit.

   Any revisions will be announced.

10. At the end of each calendar quarter (typically at 3.30pm on the last business day) plans for the auctions, including switch and/or reverse auctions, to be held in the following quarter will be announced. These will indicate either the individual stock(s) (where relevant indicating a new stock) or, where further feedback would be valuable, a maturity range.

11. The DMO will publish the auction details at 3.30pm, on the DMO's wire services pages, then in a press notice and on the DMO's website, normally on the Tuesday in the week preceding each auction: the stock, amount offered (including, if relevant, the amount of any extra marketable stock forming the Commissioners for the Reduction of the National Debt (CRND) non-competitive allowance) and any other details needed, including prospectuses for the issue. If the DMO is creating a new stock for auction, the coupon and maturity date (if not previously announced) will also be announced at this stage. When-issued (WI) trading in the stock may then begin.

12. Further issues of existing stocks will usually be fungible with the parent issue from the settlement date of the auction.

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[3] The DMO defines broad maturity bands as follows: shorts 1-7 years to maturity, mediums 7-15 years, and longs 15+ years.

(1) Conventional Stocks

(a) Structure of auctions

13. Auctions are open to all bidders. They are conducted on a bid price basis, where successful competitive bidders are allotted stock at the prices which they bid. The DMO does not set a minimum price.

14. There is a distinction between competitive bids (Gilt-edged Market Makers (GEMMs) only) and non-competitive bids.

15. Competitive bids in auctions of conventional stock must be for one amount and at one price, expressed in multiples of £0.01, i.e. to two decimal places, as a clean price. Bids must be in round multiples of £1 million nominal.

16. There is also a facility for non-competitive bids, which are allotted in full at the weighted average of the successful competitive bid prices. GEMMs can each make a single non-competitive bid of up to 0.5% of the nominal amount on offer in £100,000 denominations. Other approved bidders can make a non-competitive bid of up to £500,000 nominal, subject to a minimum application of £1,000 nominal and a limit of one bid per applicant, in £1,000 multiples.

17. Public sector bodies, including the CRND (who manage various public funds), have a continuing investment demand for government securities and so may bid for stock at auctions. The CRND is entitled to bid, non-competitively, for up to £50 million nominal of any conventional auction. Although marketable stock, this amount is in addition to the amount available for auction to the market, not part of it. As previously stated above (paragraph 11), these amounts will be published beforehand.

(b) Bidding procedure

18. The bidding procedure is as follows:

- Each auction will close at 10.30am;
- **GEMMs** may bid by telephone, on their own behalf or for clients, direct to the DMO's dealing desk. GEMMs may make competitive and non-competitive bids by telephone:
  - On the morning of the auction, they may make an unlimited number of competitive bids up to 10.20am and a further 10 competitive bids between 10.20am and 10.30am. Competitive bids by telephone must be for one amount and at one clean price expressed as a multiple of 0.01 of £1; and for at least £1 million nominal and multiples thereof;

- Each GEMM may submit its one non-competitive bid by telephone at any time up to 10.30am in multiples of £0.1 million nominal up to the full 0.5% of the nominal amount on offer. If a GEMM does not request its full non-competitive amount the balance will be added to the amount of stock available for competitive bidders;

– **Other applicants**, who are members of the DMO's Approved Group of Investors[4], may bid non-competitively by delivering a completed application form to the DMO by either of the following means:

- to arrive at the Registrar[5], not later than 10.00am on the day of the auction; or
- to be lodged at the DMO at Eastcheap Court not later than 10.00am on the day of the auction.

(c) Determination of the results

19. As already noted, auctions are typically conducted on a bid price basis with no minimum price. There are no formal underwriting arrangements, but the DMO expects all GEMMs to participate actively in the auction process and to bid on a competitive basis at auctions, as part of their commitment to the market.

20. The DMO reserves the right not to allot all of the stock on offer, although it would consider this only in exceptional circumstances, e.g. where the auction was covered only at an unacceptably deep discount to the prevailing market level. If stock is unallotted at an auction, the unallotted part of the amount on offer would be held by the DMO. It would not subsequently be made available to the market at a price below the lowest accepted price for a period of at least one month after the relevant auction, and in any event, not before market conditions had stabilised, and a 'purdah' period of approximately ten days had elapsed.

21. The DMO will allot stock to individual bidders at its absolute discretion. In particular, it may decline to allot stock to an individual bidder if it appears that to do so would be likely to lead to market distortion. As a guideline, successful bidders, either GEMMs or end-investors, should not expect to acquire at the auction for their own account more than 25% of the amount on offer (net of a GEMM's short position in the WI and/or parent stock); in the case of GEMMs, the DMO will take account of bids submitted on behalf of clients, but non-competitive bids will be included in such calculations.

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[4] The Approved Group of Investors is a group of investors who have satisfied the evidentiary requirements of the DMO regarding the identity of any applicant for Stock or of any person for whom an applicant is acting as agent. Requests to be admitted to the Approved Group can be made at any time but failure to provide satisfactory evidence of identity will result in an applicant being refused admission to the Approved Group.

[5] HM Treasury's designated Registrar, currently the Bank of England Registrar's Department, Southgate House, Southgate St, Gloucester GL1 1UW.

22. Allocations at the lowest accepted price are made to the nearest half percentage point and all such allocations are in multiples of £1,000 nominal of stock. In addition, a very small amount of the stock is retained to cover roundings and any uncertainties in dealing with applications.

(d) Publication of the results

23. The DMO aims to publish the result of each auction within 40 minutes of the deadline for bids, i.e. by 11.10am. It publishes summary statistics including the highest, average and lowest accepted prices (with the pro rata scaling rate at the lowest accepted price); the gross redemption yields equivalent to those prices (which indicate the tail); the total value of accepted non-competitive bids, split between GEMMs and non-GEMMs; and the ratio of bids received to the amount on offer (the cover), including bids rejected in whole or in part on account of price. These details are first made available on the DMO's wire services pages, and then in a press notice, and on the DMO's website.

24. If an auction were uncovered, the DMO would make an announcement to that effect and state the amount of unallotted stock held by the DMO. The DMO would also remind the market of the procedures described above (paragraph 20) for keeping unallotted stock off the market for a period.

(2) Index-Linked Stocks

(a) Auction Procedure

25. Competitive bids may only be made by GEMMs. The auctions will be conducted on a uniform price basis. Competitive bids must be for one amount and at one clean price expressed as a multiple of 0.01 of £1; and for at least £1 million nominal and multiples thereof. All successful bidders will receive stock at the same price: where a GEMM's bids are above this price it will be allotted in the full amount bid; allotments for bids at the striking price may be scaled. The DMO will not publish a minimum price.

26. There is also a facility for non-competitive bids, which will be allotted in full at the striking price of the successful competitive bids. A total of 10% of the nominal amount on offer will be made available to the GEMMs, and each of the GEMMs' access to this facility will be related pro rata to their successful competitive bidding at the previous three auctions. (Following the commencement of WI trading, the DMO will communicate to each GEMM its non-competitive bidding entitlement). Other bidders can make a non-competitive bid by post of up to £250,000 (nominal), subject to a minimum application of £1,000 (nominal) and a limit of one bid per applicant, in multiples of £1,000.

27. There are no formal underwriting arrangements, but the DMO expects all the GEMMs to participate actively in the auction process and to bid on a competitive basis at auctions.

28. The CRND is entitled to bid, non-competitively, for up to £20 million nominal of any index-linked auction. Although marketable stock, this amount is in addition to the amount available for auction to the market, not part of it. As previously stated above (paragraph 11), these amounts will be published beforehand.

(b) Bidding procedure

29. The bidding procedure is as follows:

- Each auction will close at 10.30am;
- **GEMMs** may bid by telephone, on their own behalf or for clients, direct to the DMO's dealing room. GEMMs may make competitive and non-competitive bids by telephone:
  - On the morning of the auction, they may make an unlimited number of competitive bids up to 10.20am and a further 10 competitive bids between 10.20am and 10.30am. Competitive bids by telephone must be for one amount and at one clean price expressed as a multiple of 0.01 of £1; and for at least £1 million nominal and multiples thereof;
  - Each GEMM may submit its one non-competitive bid, in multiples of £0.1 million up to its individual limit, by telephone at any time up to 10.30am. If a GEMM does not request its full non-competitive amount the balance will be added to the amount of stock available for competitive bidders;
- **Other applicants** who are members of the DMO's Approved Group of Investors may bid non-competitively by completing an application form which must be received in one of the following ways:
  - to arrive at the Registrar not later than 10.00am on the day of the auction; or
  - to be lodged at the DMO at Eastcheap Court not later than 10.00am on the day of the auction.

(c) Determination of the results

30. The DMO reserves the right not to allot all of the stock on offer, although it would consider this only in exceptional circumstances, e.g. where the auction was covered only at a level unacceptably below the prevailing market level. If stock is unallotted at an auction, the unallotted part of the amount on offer would be held by the DMO. It would not subsequently be made available to the market at a price below the allotment price for a period of at least

one month after the relevant auction, and in any event not before market conditions had stabilised, and a 'purdah' period of approximately ten days had elapsed.

31. The DMO will allot stock to individual bidders at its absolute discretion. In particular it may decline to allot stock to an individual bidder if it appears that to do so would be likely to lead to market distortion. As a guideline, successful bidders, either GEMMs or end-investors, should not expect to acquire at the auction for their own account more than 40% of the amount on offer (net of a GEMM's short position in the WI and/or parent stock); in the case of GEMMs, the DMO will take account of bids submitted on behalf of clients, but non-competitive bids will be included in such calculations.

32. Allocations at the clearing price are rounded down to the nearest half percentage point and all such allocations are in multiples of £1,000 nominal of stock. In addition, a very small amount of the stock is retained to cover roundings and any uncertainties in dealing with applications.

(d) Publication of the results

33. The DMO aims to publish the result of each auction within 40 minutes of the deadline for bids, i.e. by 11.10am. It will publish summary statistics including the common allotment price; the pro rata scaling rate at this price; the real yield equivalent to that price (and the inflation assumption used in calculating the real yield); the total value of accepted non-competitive bids; the allotment split between GEMMs and non-GEMMs; and the ratio of bids received to the amount on offer (the cover), including bids rejected in whole or in part on account of price. These details are first made available on the DMO's wire services pages, and then in a press notice, and on the DMO's website.

34. If an auction were uncovered, the DMO would make an announcement to that effect and state the amount of unallotted stock held by the DMO. The DMO would also remind the market of the procedures described above (paragraph 30) for keeping unallotted stock off the market for a period.

(3) Switch Auctions

Paragraphs (a) to (e) below should be read as applying to switch auctions in conventional stocks. Index-linked stocks are covered in paragraph (f) below.

(a) Objectives and limitations

35. As with outright gilt conversion offers (see Section IV below), the aim of switch auctions is to:

    - build-up the size of new gilt benchmark stocks more quickly than can be achieved through outright auctions alone;
    - increase the size and proportion of strippable issues faster than would otherwise be possible.

    In addition, however, switch auctions also:

    - allow the DMO to smooth the immediate gilt redemption profile by offering switches out of large ultra-short issues into the current 5-year benchmark or other short-term instruments;
    - facilitate switching by index-tracking funds as a particular stock is about to fall out of a significant maturity bracket or index, so contributing to market stability.

36. Switch auctions are held only for a proportion of a stock that is too large to be considered for an outright conversion offer. In order to ensure that a sufficient amount of source stock remains outstanding for a viable, liquid market still to exist, the DMO will not hold a switch auction out of a stock that would reduce the amount in issue to below £4.5 billion (nominal).

37. Switch auctions are not used as a means to issue entirely new stocks to the market. The destination stock of a switch auction would need to have been auctioned outright at least once prior to any switch auction.

38. Switch auctions are only held where both the respective stocks are within the same maturity bracket, although here the maturity brackets overlap (short and ultra-short 0-7 years; medium 5-15 years; longs 14 years and over).

39. The DMO will not hold a switch auction that significantly impinges on the liquidity or trading of gilt futures contracts. Hence, the DMO will not hold a switch auction out of a stock that is cheapest-to-deliver, or has a reasonable likelihood of becoming cheapest-to-deliver, for any of the 'active' (i.e. with open interest) gilt futures contracts on euronext liffe (or any other recognised investment exchange). The DMO could, however, switch into such a stock.

40. The DMO will not hold a switch auction into a stock that had been auctioned outright less than 21 days earlier, unless both such auctions had previously been announced in a regular DMO quarterly auction announcement. A stock will not become a source stock in a switch auction within eighteen months of its most recent auction date.

41. The (nominal) size of any single conventional switch auction will be £0.5 billion to £2 billion of the source stock. The actual maximum size of the amount of the source stock available for switching at a particular switch auction is normally published, on the DMO's wire services pages and website, at 3.30pm on the Tuesday in the week preceding the auction.

(b) Structure of switch auctions

42. Switch auctions are open to all holders of the source stock, although non-GEMMs must route their bid through a GEMM. They are conducted on a competitive bid price basis, where successful competitive bidders are allotted the destination stock at the prices which they bid.

43. There is no non-competitive facility and the DMO does not set a minimum price.

(c) Bidding procedure

44. The procedure is as follows:

- At 10.00am the DMO will announce a fixed clean price of the source stock at which it will settle the switch;
- GEMMs may bid by telephone, for their own account or on behalf of clients, direct to the DMO's dealing desk. Between 10.00am and 10.20am they may make an unlimited number of bids. Between 10.20am and 10.30am each GEMM is limited to 10 further bids;
- Each bid will consist of the quantity of the source stock offered, in round £millions nominal, and the clean price bid for the destination stock, expressed as a multiple of 0.01 of £1, i.e. to 2 decimal places;
- Bidding closes at 10.30am.

(d) Determination of the results

45. As already noted, switch auctions are conducted on a competitive bid price basis with no minimum price. The DMO would rank the bids according to the prices bid for the destination stock and allot the switch to the highest bidders.

46. Before accepting any bids, the DMO will be mindful of fair value in the market and reserves the right to reject any bids it judges to be at an excessive discount. Any shortfall from the pre-announced maximum simply means that less of the destination stock will be created.

47. The DMO will allot stock to individual bidders at its absolute discretion. In particular it may decline to allot stock to an individual bidder, GEMM or end-investor, if it appears that to do so would be likely to lead to market distortion. The DMO may, at its discretion, impose a maximum individual limit on the size of either the bids to be accepted and/or the amount to be allocated. Any such limitations would be detailed in the initial announcement, normally at 3.30pm on the Tuesday in the week preceding the auction.

48. Allocations at the lowest accepted price are made to the nearest one percentage point and all such allocations are in multiples of £1,000 nominal of the source stock.

(e) Publication of the results

49. The DMO aims to publish the result of each auction within 40 minutes of the deadline for bids, i.e. by 11.10am. It publishes summary statistics including the highest, average and lowest accepted prices of the destination stock (and the dirty price ratios relating to these prices), the nominal amount of the source gilt offered and the nominal amount successfully switched, the nominal quantity of the destination gilt created, the new amounts outstanding following the switch auction, the pro rata percentage scaling for bids submitted at the lowest accepted price itself and the ratio of bids received to the amount on offer (the cover), including bids rejected in whole or in part on account of price. These details are first made available on the DMO's wire services pages, and then in a press notice and on the DMO's website.

(f) Index-linked switch auctions

50. These are conducted in the same way as conventional switch auctions (above) with the following exceptions. Firstly, index-linked switches will only be held where both the respective stocks have longer than 4 years to maturity, and where the source stock has not been auctioned in the previous six months. Secondly, the (nominal) size of any single index-linked switch auction is limited to £250 million to £750 million of the source stock, and the DMO will not hold a switch auction that would leave an index-linked stock with a resultant amount outstanding of less than £1.5 billion nominal. Thirdly, the auctions are conducted on a uniform bid price basis, whereby all successful bidders will receive stock at the same price. Where a GEMM's bids are above this price it will be allotted in the full amount bid, but allotments for bids at the striking price may be

scaled. Published results will include the common allotment price; the pro rata rate at this price; the real yield equivalent to that price (and the inflation assumption used in that calculation), and the ratio of bids received to the amount on offer (the cover).

(g) Settlement

51. Settlement and creation of the new stock normally takes place on the following business day. The nominal quantities of the destination stock created and allocated to each GEMM will be calculated as the ratio of the dirty prices of the two gilts, which is rounded to the nearest 4th decimal place, multiplied by the nominal quantity of the source stock. Source stock that was successfully switched will be cancelled at the same time as the new stock is created. The DMO expects all successful bidders to be able to deliver their commitment of source stock on that day.

(4) Reverse Auctions

(a) Objectives and limitations

52. Through purchases of less liquid stocks, the DMO has been able to maintain the supply of benchmark issues at times of low financing requirements, which makes a contribution to market liquidity in the issues most demanded by investors. Plans for any future reverse auctions would be announced, if appropriate, in the Annual Remit from HM Treasury to the DMO.

53. At a reverse auction the DMO invites offers in one or more pre-announced stocks. These stocks will normally be of similar duration and maturity.

54. The DMO will not hold a reverse auction that significantly impinges on the liquidity or trading of gilt futures contracts. Hence, the DMO will not hold a reverse auction out of a stock that is cheapest-to-deliver, or has a reasonable likelihood of becoming cheapest-to-deliver, for any of the 'active' (i.e. with open interest) gilt futures contracts on euronext liffe (or any other recognised investment exchange).

55. The minimum (cash) size of any single reverse auction is normally £500 million, and the maximum (cash) size is £1 billion. However, the DMO reserves the right, in exceptional circumstances, not to purchase some or all of the stock offered, if it deems the prices tendered to be excessively 'expensive'. The actual size of the amount available for reverse auction in any one operation is normally published, first on the DMO's wire services pages, at 3.30pm on the Tuesday in the week preceding the auction and then in a press notice and on the DMO's website.

(b) Structure of reverse auctions

56. Reverse auctions are open to all holders of the relevant stock(s), although non-GEMMs must route their offer(s) through a GEMM. They are conducted on a competitive offer price basis, where successful competitive offerers sell stock at the prices which are offered.

57. There is no non-competitive facility and the DMO does not set a maximum price.

(c) Offering procedure

58. The procedure is as follows:

- GEMMs may offer stock(s) by telephone, for their own account or on behalf of clients, direct to the DMO's dealing room. Between 10.00am and 10.20am they may make an unlimited number of offers. Between 10.20am and 10.30am each GEMM is limited to 10 further offers in each stock;
- Each offer will consist of the name and quantity of the stock offered, in round £millions nominal, and the clean price offered, expressed as a multiple of 0.01 of £1, i.e. to two decimal places;
- Offering closes at 10.30am.

(d) Determination of the results

59. As already noted, reverse auctions are conducted on a competitive price basis, with no maximum price. The DMO will convert prices offered to yield equivalents, subtract from these values the theoretical yield for each stock, as calculated by the DMO's yield curve model, and allot acceptances to the highest relative yields offered. Allotment continues until the maximum stated cash amount of stock is purchased. There are no limits on allocation of purchases to particular stocks or GEMMs. This could mean that the DMO accepts offers in only one stock, and/or from only one GEMM.

60. Before accepting any offers, the DMO will be mindful of fair value in the market and reserves the right to reject any offers it judges to be at an excessive premium. Any shortfall from the pre-announced maximum simply means that less stock is purchased, and subsequently cancelled.

61. Acceptances at the highest accepted price are made to the nearest one-tenth of a percentage point for each stock and all such acceptances are in multiples of £1,000 nominal of stock.

(e) Publication of the results

62. The DMO aims to publish the result of each auction within 40 minutes of the deadline for bids, i.e. by 11.10am. It publishes summary statistics including the highest, average and lowest accepted prices of each of the stocks, the nominal amounts of the gilts offered, purchased and remaining, the pro rata percentage scaling of offers submitted at the highest accepted price itself for each stock and the ratio of the cash value of offers received to the cash amount the DMO is prepared to bid for (the cover), including offers rejected in whole or in part on account of price. These details are first made available on the DMO's wire services pages, then in a press notice, and on the DMO's website.

(f) Settlement

63. Settlement normally takes place on the following business day. Any stock purchased by the DMO will normally be cancelled at the same time. The DMO expects all successful sellers to be able to deliver their commitment on that day.

III Taps, Reverse Taps and Switch Taps

64. Taps and Reverse Taps are tenders conducted directly with GEMMs by the DMO's dealing desk.

65. Switch taps are covered in subsection (g) overleaf.

(a) Objectives

66. (Reverse) Taps are not used as a routine means of (de)financing, but function primarily as a market management mechanism.

(b) Circumstances of tapping

67. Taps are brought only in extreme conditions of temporary excess demand in a particular stock or sector. The opposite will apply in the case of reverse taps.

(c) Composition of tap packages

68. (Reverse) Taps may comprise a single stock or a package of stocks, possibly including a mixture of conventional and index-linked stocks. Taps will normally be for additional fungible amounts of existing issues.

69. The amount of each tap in a package comprising conventional and/or index-linked gilts will typically be in the range of £50-500 million by cash value. An overall package will not normally be larger than £500 million. Reverse tap operations may be for similar sizes. Note that any stock bought in a reverse tap operation will normally be cancelled upon settlement, and the issue's amount outstanding reduced accordingly.

(d) The tender

70. The procedures for operating both conventional and index-linked taps will be the same, as follows:

- the DMO reserves the right to announce or issue taps at any time, but will endeavour to give at least one hour's notice of such an operation;
- tap issues may have a minimum price. Where the initial tender is not subject to a minimum price, the DMO may allow a greater delay between the announcement of the tap and the tender; such cases will be made clear in the initial announcement;
- the initial announcement will comprise the stock(s) and the maximum amount(s) in the tap package, and the time of the

tender. The DMO may, at its discretion, limit the maximum size of bids acceptable from individual GEMMs;

- if appropriate, the DMO will announce the minimum price a few minutes after the initial announcement; this will typically be the market price of the parent stock at the time the tap was announced;
- the tender will be open to all GEMMs. Bids are made by telephone to the DMO's dealers by the time published in the prior announcement and must be for multiples of £1 million nominal. GEMMs are permitted up to six bids per stock, where clean prices bid are expressed in multiples of 0.01 of £1;
- the tender will be conducted on a uniform price basis. That is, all accepted bids will be allocated at the lowest accepted price, with bids at higher prices being allotted in full and bids at the lowest accepted price being pro-rated if necessary. Any shortfall from the pre-announced maximum simply means that less of the stock will be created/sold;
- there is no non-competitive bidding facility;
- the DMO will aim to announce the result of the tender as soon as possible. It will publish for each stock in the package:
  - the striking price, the yield at that price, and the pro rata percentage scaling for bids submitted at the lowest accepted price itself;
  - the amount sold and new amount outstanding in the stock.

(e) The reverse tender

71. The procedures for operating both conventional and index-linked reverse taps will be the same, as follows:

- the DMO reserves the right to announce or hold reverse taps at any time, but will endeavour to give at least one hour's notice of such an operation;
- reverse taps may have a maximum price. Where the initial tender is not subject to a maximum price, the DMO may allow a greater delay between the announcement of the reverse tap and the tender itself; such cases will be made clear in the initial announcement;
- the initial announcement will comprise the stock(s) and the maximum amount(s) in the reverse tap package, and the time of the initial tender. The DMO may, at its discretion, limit the maximum size of offers acceptable from individual GEMMs;.
- if appropriate, the DMO will announce the maximum price a few minutes after the initial announcement; this will typically be the market price of the stock at the time the tap was announced;

- the reverse tender will be open to all GEMMs. Offers are made by telephone to the DMO's dealers by the time published in the prior announcement and must be for multiples of £1 million nominal. GEMMs are permitted up to six bids per stock, where clean prices bid are expressed in multiples of 0.01 of £1;
- the tender will be conducted on a uniform price basis. That is, all accepted offers will be allocated at the highest accepted price, with offers at lower prices being allotted in full and offers at the highest accepted price being pro-rated if necessary. Any shortfall from the pre-announced maximum simply means that less of the stock will be cancelled/bought;
- there is no non-competitive offering facility;
- the DMO will aim to announce the result of the tender as soon as possible. It will publish for each stock in the package:
  - the striking price, the yield at that price, and the pro rata percentage scaling for offers submitted at the highest accepted price itself;
  - the amount bought and to be cancelled and new amount outstanding in the stock.

(f) Settlement

72. Settlement (and, where applicable, creation or cancellation of the stock) will normally take place on the following business day. The DMO expects all counterparties to be able to honour their commitment(s) on that day.

(g) Switch taps

73. Switch taps are only used as an infrequent market management tool in conditions of severe demand for a particular gilt, and are not used to issue large amounts of the destination gilt. As a result, such operations will be limited to a maximum of £500 million or £250 million nominal of the source gilt for conventional and index-linked gilts respectively. The choice of switch tap stocks is constrained by the same considerations as for switch auctions (see paragraphs 35-40 and 50 above), except that the maturity brackets shall not apply to index-linked stocks.

74. The DMO will usually announce its intention to operate a switch tap, on its wire services pages at 3.30pm on the business day preceding that of the tap, and then on its website. This initial announcement will also detail the source gilt against which the switch will occur; the destination stock; and the maximum nominal amount of the source gilt allowable for switching. The DMO may, at its discretion, limit the maximum size of bids acceptable from individual GEMMs.

75. Typically at 10.00am on the day of the switch tap, the DMO will announce a fixed clean price of the source stock at which it will settle the switch.

76. Bidding lines to the DMO are opened thereafter and are open to all GEMMs. Bids are made by telephone to the DMO's dealers by 10.30am and must be for multiples of £1 million nominal of the source stock. GEMMs are permitted up to six bids, where clean prices bid are expressed in multiples of 0.01 of £1.

    - the tender will be conducted on a uniform price basis. That is, all accepted bids will be allocated at the lowest accepted price, with bids at higher prices being allotted in full and bids at the lowest accepted price being pro-rated if necessary;
    - there is no minimum price set and no non-competitive bidding facility;
    - the DMO will aim to announce the result of the tender as soon as possible. It will publish:
        - the nominal amount of the source gilt offered and the nominal amount successfully switched, the nominal quantity of the destination gilt created, the new amounts outstanding following the switch tap, the striking (clean) price of the destination gilt and the pro rata percentage scaling for bids submitted at the lowest accepted price itself.

77. Settlement and creation of the new stock takes place on the following business day. The nominal quantities of the destination stock created and allocated to each GEMM will be calculated as the ratio of the dirty prices of the two gilts, which is rounded to the nearest 4th decimal place, multiplied by the nominal quantity of the source stock. Source stock that was successfully switched will be cancelled at the same time as the new stock is created.

78. The DMO reserves the right not to allot bids if they were at too great a discount to prevailing market terms. If the switch tap attracted insufficient demand to clear at an acceptable price, the remainder of the destination stock would not be created, and an announcement would be made to this effect.

IV Conversions

(a) Objectives, methodology and limitations

79. From time to time, the DMO may announce a conversion offer. The aim of conversions generally is to:

- build-up the size of new gilt benchmark stocks more quickly than can be achieved through auctions alone;

80. In August 1998, the DMO published a consultation document[6] on conversion methodology. Further details can be found therein, but the main features are as follows:

- **Maturity of conversion candidates:** no consideration will be given to conversions of stock with less than around five years to maturity;
- **Size of conversion candidates:** no consideration will be given to candidate stocks with £5.5 billion[7] (nominal) or more in issue;
- **Timing of offers:** the DMO will normally aim not to schedule offers so that the fixed conversion terms on any two offers run concurrently. Moreover conversion offers will not be scheduled to coincide with a gilts auction in the same maturity area;
- **Interaction of conversion offers with deliverable stocks into futures contracts**: conversion offers will not be made for a stock that is cheapest-to-deliver, or has a reasonable likelihood of becoming cheapest-to-deliver, for any gilt futures contracts (with any outstanding open interest). Also, an offer will not be made for any deliverable stock between the date on which the futures exchange publishes the official list of deliverable gilts for a particular contract and the end of the delivery period itself.

(b) Announcement of terms

81. Conversions may be announced on any day, first on the DMO's wire services pages, then in a press release and on the website. At the time of the announcement the DMO will publish the source and destination stocks, and the fixed price terms of the conversion offer. Other details, such as the exact timetable for, and method of acceptance of, the offer will also be published at this stage.

82. The price terms of the conversion offer will be decided by the DMO, using its own yield curve model to provide a benchmark ratio for the offer. The DMO will then (at its own discretion) adjust this ratio to take some account of the observed cheap/dear characteristics of the source and destination stocks.

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[6] "Gilt-edged stock conversion offers: rationale and methodology". This document was published as a consultation document in August 1998; the results of the consultation were announced with the final press notice in November 1998 detailing the amount of 8% Treasury 2009 converted.

[7] The original limit of £5 billion was increased in the 2001-02 Remit.

83. Conversion offers remain open for a period of three weeks from the date of the initial announcement of the fixed ratio. The appropriate amount of accrued interest on both gilts is incorporated into the calculation of the dirty price ratio, for forward settlement. The conversion itself will involve no exchange of cash flows, and will therefore be free of payment.

(c) Procedure for acceptance

84. Holders have until the prescribed time on the pre-announced closing date to notify the Registrar, via CREST, of their intention to 'assent' to the conversion. Non-CREST holders should notify the Registrar directly of their intention to 'assent' to the conversion.

85. Any holder that owns the stock, but has lent it out in the repo market or elsewhere, still has the right to choose whether or not to accept the terms of the conversion offer, but he must communicate his intention to the borrower in sufficient time for him to be able to assent the stock on behalf of the owner.

(d) Announcement of results

86. The DMO will announce the results of the conversion offer first on its wire services pages and then on its website. This will usually be at 8.30am on the first business day following the closing date of the conversion offer. The announcement will include the nominal amount of the source stock assented, that amount's percentage of the existing amount outstanding and the nominal amount of the stock remaining unconverted. It will also detail the nominal amount of new destination stock created, and the new total outstanding amount of that stock. At this stage, and if appropriate, the DMO may also announce whether the source stock has been assigned 'rump' status (see paragraph 88 below).

V Other Official Operations

87. The DMO undertakes a number of other official operations in the secondary market, with the GEMMs, in its role as debt manager. These include:

- purchases of "rump" and other selected stocks;
- trading in near maturity stocks;
- purchases and sales of small amounts of stock for official portfolios;
- sales via the Shop Window;
- activity in other exceptional circumstances;
- creating stock for repo purposes.

(a) Purchases of "rump" and other selected stocks

88. The DMO is prepared, when asked by a GEMM, to bid a price of its own choosing for stock where the amount in issue is considered too small for a two-way market to be reasonably expected to exist (e.g. the rumps of certain stocks which have previously been subject to conversion offers). The DMO will publish a list of such stocks from time-to-time; the current list is attached as Annex 1 to this Notice. Any amendments to this list will be published on the DMO's wire services pages and website. When so requested, the DMO is prepared to make a bid for forward settlement, up to and including T+5 business days.

(b) Trading in near-maturity stocks

89. For purposes of smoothing redemption cash flows, the DMO is prepared, when asked by a GEMM, to bid a price of its own choosing for any stock that has less than six months left before its maturity (i.e. after a semi-annual stock's penultimate coupon payment). As these are essentially money market instruments by this stage, the price bid will be dictated by the DMO's cash management position at the time of the request. In August 2003, the DMO, with the consent of the Gilt-Edged Market Makers' Association (GEMMA), became a recognised gilt market counterparty of gilt Inter-dealer brokers in order to help preserve its anonymity when trading in near-maturity stocks only.

(c) Purchases and sales of stock for official portfolios

90. The DMO will occasionally purchase stock from the market, on behalf of the CRND, for funds under their management. Such purchases will normally be for small sizes. In such circumstances, the DMO will check offer prices from at least three randomly-chosen GEMMs before dealing.

91. Similarly, the DMO may acquire stock from the CRND, from funds under their management. Smaller size sales will be made to the market by checking the bids of at least three randomly-chosen GEMMs before dealing. Larger size disposals will be made by offering the stock to all GEMMs simultaneously via the Shop Window process (see below).

(d) Sales via the Shop Window

92. With the exception of rumps and other selected stocks, near maturities and small sales from official portfolios, the DMO may offer stock for resale via the Shop Window facility as follows:

- At 8.30am the DMO will post on its screen pages a list of the amount of any stock available for resale to the market (the "Shop Window");
- A distinction may be drawn between those holdings in the Shop Window for which the DMO is prepared to be bid, and those for which it may only entertain switch proposals. Auction stocks, and stocks in the immediate maturity area of a forthcoming auction, may be withdrawn;
- The DMO will be open to be bid by the GEMMs between 8.30am and 5.00pm. Whether or not to accept bids will be entirely at the DMO's discretion. A necessary, but not sufficient, condition of a bid being accepted is that it will need to be at or above the prevailing market price;
- For smaller holdings, any bids which are accepted will be accepted on a first come, first served basis;
- The DMO will update the Shop Window screens as soon as possible after a sale. Where stock in the Shop Window is switched for another stock, the stock sold by the DMO will be deducted from the Shop Window as soon as possible after the transaction, and the stock acquired by the DMO added to the relevant page;
- Larger amounts of stock may be offered for sale through a tender, following the procedures outlined in the section 'Taps, reverse taps and switch taps' in Section III.

(e) Purchases of conventional and index-linked stocks in exceptional circumstances

93. The DMO reserves the right to purchase conventional and index-linked stock offered by the GEMMs, but would do so only in exceptional circumstances.

94. In such exceptional circumstances, the procedure would be as detailed in the section on taps, reverse taps and switch taps (Section III above):

(f) Standing repo facility

95. In response to a previous consultation exercise, the DMO introduced, in June 2000, an automatic non-discretionary standing repo facility, whereby any GEMM, or other DMO counterparty, who has signed the relevant documentation, may request the temporary creation of any non-rump stock for repo purposes. The minimum size of such a request is £5 million nominal, and the DMO will charge an overnight penal rate equivalent to 10% of the Bank of England's prevailing repo rate at the time. The operation will normally entail a back-to-back, cash-for-cash reverse repo of gilt collateral at the Bank's repo rate. The facility is available from 12.30pm on the previous day to 11.30am on the same day of settlement. Participants may roll the facility on a day-to-day basis, but the DMO does not anticipate accommodating a continuous roll for a period of more than two weeks. Details of the amount and terms of any such operation will be announced first on the DMO's screen pages and then on its website. The counterparty(ies) involved will remain anonymous, although the DMO reserves the right to share such information with other official regulatory bodies in appropriate circumstances. None of the stock created for such purposes will be eligible for inclusion in the calculation of FTSE or iBoxx gilt indices.

(g) Creating stock for repo for market management purposes

96. If the DMO considers that there is sufficient evidence of severe market dislocation or disruption, it may create stock which will be used to repo to all GEMMs who have signed the required legal agreements with the DMO. The terms and availability of such stock will be announced on the DMO's wire service pages and website. Such circumstances will need to have been persistent and are not likely to be tied to any single event, or difficulties encountered by individual market participants. For example, the DMO would be unlikely to consider short-term problems connected with the delivery process into a single futures contract as indicative of severe market dislocation. The terms of the facility, including any rate of repo, which may or may not be penal, and the amount of any stock created will be announced on the DMO's screen pages and website, as will the cancellation of the stock, when it is judged that the facility is no longer required. Such operations will usually also involve a back-to-back, cash-for-cash reverse repo of gilt collateral at the Bank of England's prevailing repo rate. As above, none of the stock created for such purposes will be eligible for inclusion in the calculation of FTSE or iBoxx gilt indices.

VI Provision of Reference Prices

(a) Intra-day benchmark prices

97. Between the hours of 8.30am and 4.18pm, the DMO collates and publishes a composite page of indicative mid-prices in a selection of benchmark gilts. These prices represent the average of contributions from GEMMs to the wire services, discarding the highest and lowest outlier quotes for each stock. The DMO's composite page will therefore be updated every time a new GEMM contribution in any one stock is sufficient to change the overall average price. Note that these reference prices do not constitute an offer to buy or sell securities, and other market participants should contact a GEMM for a firm dealing price. Ownership of the input data remains with the contributing GEMMs and it may not be used for current or historical database collection purposes, nor redistributed in any way on a chargeable basis. A list of the relevant wire services pages is attached in Annex 2.

(b) End-of-day GEMMA reference prices

98. The DMO, on behalf of the Gilt-Edged Market Makers Association (GEMMA), collates and publishes end-of-day reference prices in every gilt-edged stock – conventional, index-linked and strips.

99. At 4.18pm every day, each GEMM is required to provide a mid-market clean price for every stock in which they make a market. These prices are collated by the DMO and then published on its dedicated wire services pages, usually at 5.00pm. For further details of the precise method of calculation, please see the relevant GEMMA pages, or the DMO website[8]. These prices are for reference purposes only, and do not constitute an offer to buy or sell securities. These prices will be published on the DMO website later that evening.

[8] "GEMMA Reference Prices: Calculation Methodology" June 1999 under 'Technical Publications on the DMO website.'

VII Announcements to the Market

100. In the interests of transparency and predictability, the DMO strives to release announcements at a set time of the day. Unless otherwise mentioned, announcements to all market participants are generally released at 3.30pm, and occasionally at 7.30am, simultaneously on all recognised wire services and as soon as possible thereafter on the DMO website, although the DMO does reserve the right to make an announcement at any time, in exceptional circumstances.

101. The interest and redemption payments for all index-linked gilts with first issue dates before 2002 are fixed by the Bank of England. The Bank aims to announce details of these payments by 2.30pm on the day that the relevant value of the General Index of Retail Prices (RPI) is published. For index-linked gilts first issued from 2002 onwards, the DMO is responsible for fixing and announcing the interest and redemption payments. The DMO aims to announce details of these payments by 3.30pm on the day that the relevant RPI value is published. On days on which both the Bank and the DMO publish details of index-linked gilt interest or redemption payments the DMO announcement will also incorporate details of the payments published by the Bank.

Annex 1

List of gilt-edged stocks for which the DMO will provide bids on request

The Operational Notice provides for the DMO to bid a price for a gilt-edged stock where the amount in issue is considered too small for there to be a liquid market. The following stocks are currently covered by this provision. The DMO will issue updates of this list from time to time, as necessary.

13½% Treasury 2004/2008
10% Treasury 2004
9½% Conversion 2004
10½% Exchequer 2005
9¾% Conversion 2006
9% Treasury 2008
8% Treasury 2009
9% Treasury 2012
12% Exchequer 2013/2017
2½% Annuities (undated)
2¾% Annuities (undated)
2½% Consolidated (undated)
3½% Conversion (undated)
3% Treasury (undated)
4% Consolidated (undated)

Annex 2

List of DMO information pages

Website

www.dmo.gov.uk

Index and market announcements pages

Reuters – DMO/INDEX, DMO/GILTS1 et seq
MoneylineTelerate – 21290, 22550 et seq
Bloomberg – DMO <GO>, DMO1 <GO>
Topic – 44799, 44700 et seq
Bridge – K:2366, K:3327 et seq

GEMMA reference pages

Reuters – GEMMA01 – GEMMA22
MoneylineTelerate – 47216 et seq, 21291 et seq
Bloomberg – DMO5 <GO>, DMO6 <GO>
Topic – 44800 et seq, 44850 et seq
Bridge – K:3358 – K:3379

Benchmark composite pages

Reuters – DMO/BENCH1, DMO/GILTS12
MoneylineTelerate – 22557
Bloomberg – DMO2 <GO>
Topic – 44720 - 44721
Bridge – K:3338

Shop Window page

Reuters – DMO/GILTS11
MoneylineTelerate – 6518
Bloomberg – DMO3 <GO>
Topic – 44718
Bridge – K:3337

United Kingdom
Debt Management Office

Eastcheap Court
11 Philpot Lane
London EC3M 8UD

The United Kingdom
Debt Management Office
is an Executive Agency of
HM Treasury