



# **OFFICIAL OPERATIONS IN THE GILT-EDGED MARKET**

## **Operational Notice by the UK Debt Management Office**

September 2006

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**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 or revision to this Operational Notice.

The DMO’s cash management operations are outlined separately in the “Exchequer Cash Management Operational Notice”.

This Operational Notice should be read in conjunction with the Information Memorandum on the Issue, Stripping and Reconstitution of British Government Stock published in December 2004, as amended by subsequent DMO notices dated 13 May 2005 and 13 September 2005, and the ‘Guide to the Roles of the DMO and Primary Dealers in the UK Government Bond Market’, also re-issued in September 2006. All of these publications are available on the DMO website at - [www.dmo.gov.uk](http://www.dmo.gov.uk).

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If you have any queries on this Notice, please contact Tim Simmonds, UK Debt Management Office, Eastcheap Court, 11 Philpot Lane, London, EC3M 8UD; Tel 0845 357 6511; or e-mail *tim.simmonds@dmo.gsi.gov.uk*

## 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<sup>1</sup>. 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 April 2005.
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 aims of monetary policy".
3. Alongside the Budget each year (usually in March), the Government publishes a Debt and Reserves Management Report, including a debt management Remit to the DMO, setting out advance details of the annual issuance programme<sup>2</sup>. This includes a planned maturity structure for the issuance of conventional gilts for the year and an indication of the likely scale of the issuance of index-linked gilts. Within that published framework, the Government aims each year to sell sufficient gilts, Treasury Bills and National Savings and Investments 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 debt management Remit. It covers conventional and index-linked auctions, syndicated offerings, 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 those GEMMs recognised by the DMO as specialists in that particular sector of the market – conventional, index-linked or both.*
5. Throughout this document, in respect of index-linked gilts all references to clean prices relate to real clean prices for 3-month lag and 'uplifted' clean prices for 8-month lag index-linked gilts respectively.
6. Any changes to the arrangements described below will be published through updates to the relevant sections of this Operational Notice.

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<sup>1</sup> Copies are available from the Publishing Unit, HM Treasury, 1 Horseguards Road, London, SW1A 2HQ, and on the DMO website.

<sup>2</sup> 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 debt financing Remit for each financial year will indicate:

- the number of auctions in conventional and index-linked gilts comprising pre-committed issuance (the 'core programme');
- for conventionals, the number in each broad maturity band<sup>3</sup> to be held during the year
- planned auction dates;
- a range for the size of the auctions in cash terms for both conventional and index-linked gilts;
- the target amounts of cash to be raised in each sector, including any split between the core programme and any remaining amount ('supplementary issuance') to be allocated throughout the year according to market demand and portfolio considerations.

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 gilt sales 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. In addition to the above, the 2006-07 financing remit includes some temporary provisions – (i) a split between pre-committed issuance (the 'core programme') and an 'unallocated' tranche of financing to be allocated throughout the year in a broadly even-flow manner; (ii) scope for increasing the size of scheduled auctions and/or the scheduling of additional auctions to achieve the supplementary issuance; and (iii) provisions for announcements about supplementary issuance in the regular quarterly funding announcement.

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<sup>3</sup> The DMO defines broad maturity bands as follows: shorts 1-7 years to maturity, mediums 7-15 years, and longs 15+ years.

11. With the exception of the first quarter in the financial year, issuance plans for each calendar quarter will be announced a month in advance (typically at 3:30pm on the last business day of May, August and November), including any switch and/or reverse auctions. The calendar for April-June will typically be published on the last business day of March. This announcement will detail which gilts will be auctioned on which dates, and where a new gilt is being created, its maturity date and whether it will have a short or long first coupon period.
12. The DMO will publish final auction terms and conditions, on the DMO's wire services pages and in a press notice (which will subsequently appear on the DMO's website), normally at 3:30pm on the Tuesday in the week preceding each auction - the gilt, amount offered and any other details, including identifier codes and prospectuses for the issue. When-issued (WI) trading in the gilt may then begin. If a gilt is to become strippable following a particular auction, this will also be declared. If the DMO is creating a new gilt for auction, the coupon will also be announced at this stage..
13. Further issues of existing gilts will usually be fungible with the parent issue from the settlement date of the auction.

## **(1) CONVENTIONAL GILTS**

### **(a) Structure of auctions**

14. 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.
15. There is a distinction between competitive bids (GEMMs only) and non-competitive bids.
16. *Competitive bids* in auctions of conventional gilts must be for one amount and at one price, expressed in multiples of £0.01, i.e. to 2 decimal places, as a clean price. Bids must be in round multiples of £1 million nominal.
17. There is also a facility for *non-competitive bids*, which are allotted in full at the weighted average of the successful competitive bid prices. 10% of each auction is set aside for this facility for GEMMs, with individual GEMM allowances<sup>4</sup> split evenly. GEMMs can each make a single non-competitive bid in £50,000 denominations, up to their individual limit. In addition, other Approved Group bidders (see below) can make a non-competitive bid for 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.

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<sup>4</sup> Rounded to the nearest £50,000 nominal

18. There are no formal or informal underwriting arrangements, but the DMO expects all GEMMs to participate actively in the auction process and to bid on a competitive basis at all auctions, as part of their commitment to the market.

### **(b) Bidding procedure**

19. 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 £50,000 nominal up to their individual limit. If any 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<sup>5</sup>, may bid non-competitively by delivering a completed application form to the DMO by either of the following means:
  - to arrive at the Registrar<sup>6</sup>, 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.

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<sup>5</sup> 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.

<sup>6</sup> HM Treasury's designated Registrar, currently Computershare Investor Services plc, The Pavilions, Bridgwater Road, Bristol, BS99 7NH, tel no. 0870 702 0005, website [www.computershare.com](http://www.computershare.com).

### **(c) Determination of the results**

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 two weeks after the relevant auction, and in any event, not before market conditions had stabilised, and a 'purdah' period of at least one week 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 gilt); in the case of GEMMs, the DMO will take account of bids submitted on behalf of clients and sales executed in the WI period, but non-competitive bids will be included in such calculations.
22. Allocations at the lowest accepted 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 residual amount of the gilt may be retained by the DMO 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, ie. 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 in a press notice, and shortly thereafter 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 for keeping unallotted stock off the market for a period.

### **(e) Settlement**

25. Gilt auctions will normally settle on the following business day, in accordance with the T+1 convention in the gilt market. For auction settlement purposes, accrued interest is rounded to six decimal places per £100 nominal, and all

successful primary dealer bidders are expected to match the DMO's settlement instructions in CREST and to meet their commitments on the day and in good time.

## **(2) INDEX-LINKED GILTS**

### **(a) Structure of auctions**

26. Competitive bids may only be made by index-linked 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 of bids *at the striking price* may be scaled *pro rata*. The DMO will not publish a minimum price.
27. 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 index-linked 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.
28. There are no formal or informal underwriting arrangements, but the DMO expects all the GEMMs to participate actively in the auction process and to bid on a competitive basis at all auctions.

### **(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 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, in multiples of £50,000 nominal, 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 delivering a completed application form to the DMO by either of the following means:
  - 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 two weeks after the relevant auction, and in any event not before market conditions had stabilised, and a 'purdah' period of at least one week 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 and sales executed in the WI market, 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 gilt may be retained by the DMO 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, ie. by 11:10am. It publishes summary statistics including the common allotment price; the pro rata scaling rate at this price; the real yield equivalent to that price (and, for 8-month lag index-linked gilts, 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 in a press notice, and shortly thereafter 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 for keeping unallotted stock off the market for a period.

### **(3) SWITCH AUCTIONS**

This section should be read as applying to switch auctions in *conventional* gilts only.

#### **(a) Objectives and limitations**

35. As with outright gilt conversion offers (see Chapter V below), the aim of switch auctions is to:
  - build-up the size of new benchmark gilts 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 may 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.
36. Switch auctions are held only for a proportion of a gilt that is too large to be considered for an outright conversion offer. In order to ensure that a sufficient amount of the source gilt remains outstanding for a viable, liquid market still to exist, the DMO will not hold a switch auction for a gilt 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 gilts to the market. The destination gilt 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 gilts are within the same maturity bracket, although here the maturity brackets overlap (ultra-short and short 0-7 years; medium 5-15 years; and longs 14 years and over).
39. The DMO will not hold a switch auction that would significantly impinge on the liquidity or trading of gilt futures contracts. Hence, the DMO will not hold a switch auction out of a gilt 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 gilt.
40. The DMO will not hold a switch auction into a gilt 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 gilt will not become a source gilt in a switch auction within eighteen months of its most recent auction date.
41. The maximum size of any single switch auction operation will be limited to the same upper limit specified for conventional gilt auctions in the relevant year's remit. The actual maximum size of the (nominal) amount of the source gilt available for switching at a particular switch auction is normally published, on the DMO's wire services pages and in a press notice, 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 gilt, 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 gilt 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 gilt 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 gilt offered, in round £millions nominal, and the clean price bid for the destination gilt, expressed as a multiple of 0.01 of £1, ie. 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 gilt 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 gilt 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 gilt.

#### **(e) Publication of the results**

49. The DMO aims to publish the result of each auction within 40 minutes of the deadline for bids, ie. by 11:10am. It publishes summary statistics including the highest, average and lowest accepted prices of the destination gilt (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 made available on the DMO's wire services pages and in a press notice, and shortly thereafter on the DMO's website.

#### **(f) Settlement**

50. Settlement and creation of the new gilt normally takes place on the following business day. The nominal quantities of the destination gilt 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 4<sup>th</sup> decimal place, multiplied by the nominal quantity of the source gilt. 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 the source gilt on that day.

### **(4) REVERSE AUCTIONS**

### **(a) Objectives and limitations**

51. Through purchases of less liquid gilts, the DMO has in the past 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, on the DMO's wire services pages and in a press notice, and shortly thereafter on the DMO's website.
52. At a reverse auction the DMO invites offers in one or more pre-announced gilts. These gilts will normally be of similar duration and maturity.
53. 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 gilt that is cheapest-to-deliver, or has a reasonable likelihood of becoming cheapest-to-deliver, for any of the 'active' (ie. with open interest) gilt futures contracts on Euronext.liffe (or any other recognised investment exchange).
54. The maximum size of any single reverse auction operation will be limited to the same upper limit specified for conventional and/or index-linked gilt auctions in the relevant year's remit. 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 on the DMO's wire services pages and in a press notice at 3:30pm on the Tuesday in the week preceding the auction, and shortly thereafter on the DMO's website.

### **(b) Structure of reverse auctions**

55. Reverse auctions are open to all holders of the relevant gilt(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 gilts at the prices which are offered.
56. There is no non-competitive facility and the DMO does not set a maximum price.

### **(c) Offering procedure**

57. The procedure is as follows:
  - GEMMs may offer gilt(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 gilt;

- Each offer will consist of the name and quantity of the gilt offered, in round £millions nominal, and the clean price offered, expressed as a multiple of 0.01 of £1, ie. to 2 decimal places;
- Offering closes at 10:30am.

**(d) Determination of the results**

58. As already noted, reverse auctions are conducted on a *competitive price basis*, with no maximum price. If the operation is in multiple instruments, the DMO will convert prices offered to yield equivalents, subtract from these values the theoretical yield for each gilt, 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 gilts or GEMMs. This could mean that the DMO accepts offers in only one gilt, and/or from only one GEMM.

59. 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 fewer gilts are purchased, and subsequently cancelled.

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

**(e) Publication of the result**

61. The DMO aims to publish the result of each auction within 40 minutes of the deadline for bids, ie. by 11:10am. It publishes summary statistics including the highest, average and lowest accepted prices of each of the gilts, 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 gilt 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 made available on the DMO's wire services pages and in a press notice, and shortly thereafter on the DMO's website.

**(f) Settlement**

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

### **III TAPS, REVERSE TAPS AND SWITCH TAPS**

63. Taps and reverse taps are tenders conducted directly with GEMMs by the DMO's dealing desk.

64. Switch taps are covered in subsection (g) below.

#### **(a) Objectives**

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

#### **(b) Circumstances of tapping**

66. Taps are brought only in extreme conditions of temporary excess demand (surplus) in a particular gilt or sector.

#### **(c) Composition of tap packages**

67. (Reverse) Taps may comprise a single gilt or a package of gilts, possibly including a mixture of conventional and index-linked gilts. Taps will be for additional fungible amounts of existing issues. The size of any such operation is unlikely to exceed that of a regular, scheduled gilt auction in the relevant sector.

68. *Note that any gilts bought in a reverse tap operation will normally be cancelled upon settlement, and the issue amount(s) outstanding reduced accordingly.*

#### **(d) The tender**

69. 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 gilt(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 may announce the minimum price a few minutes after the initial announcement or a few minutes before the bidding window opens, depending on the circumstances. This will typically be the market price of the gilt(s) at the time;

- the tender will be open to all GEMMs. Bids must be 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 gilt, 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 gilt 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 gilt 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 gilt.

#### **(e) The reverse tender**

70. 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 issue 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 gilt(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 or a few minutes before the offering window opens, depending on the circumstances. This will typically be the market price of the gilt(s) at the time;
- 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 in multiples of £1 million nominal. GEMMs are permitted up to six offers per gilt, where clean prices offered 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 gilt will be bought/cancelled;
- 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 gilt 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 gilt.

#### **(f) Settlement**

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

#### **(g) Switch taps**

72. Switch taps are also 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. The choice of switch tap gilts is constrained by the same considerations as for switch auctions (see paragraphs 35-40 above), except that the maturity brackets shall not apply to index-linked gilts and the size of such an operation is likely to be relatively small.

73. 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. This initial announcement will also detail the source gilt against which the switch will occur; the destination gilt; 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.

74. Typically at 10:00am on the day of the switch tap, the DMO will announce a fixed clean price of the source gilt at which it will settle the switch.

75. 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.

76. Settlement and creation of the new gilt takes place on the following business day. The nominal quantities of the destination gilt 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 4<sup>th</sup> decimal place multiplied by the nominal quantity of the source gilt. Source stock that was successfully switched will be cancelled at the same time as the new stock is created.

77. 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 gilt would not be created, and an announcement would be made to this effect.

#### **IV SYNDICATION**

78. Although auctions constitute the primary means of gilt issuance, the DMO has in the past launched a new gilt by means of a syndicated offer. The relevant annual debt management Remit (contained in the Debt and Reserves Management Report) will make clear whether any such offerings are permitted and/or planned in any one financial year.

79. Should the decision to syndicate an issue of gilts be taken, the DMO would make an announcement to this effect as soon as practicable, on its wire services pages and in a press notice, also detailing any consequences of the decision (such as the cancellation of a scheduled auction), and any available timing or operational details regarding the selection of managers and/or of the actual syndicated offer itself.

80. In allocating managerial roles to investment banks in the syndicated issue, the DMO would expect to offer all relevant GEMMs the opportunity to present their advice and credentials on a fair and equal basis, although other factors (such as primary and secondary market shares, expertise in the relevant sector of the market, etc.) would also be taken into account in the final

selection decision. The DMO would not expect to appoint any non-GEMM to any role in the managerial group.

81. The precise format of the group and method of sale may vary from issue to issue. The DMO would take such decisions based on its own policy and portfolio preferences at the time and advice from GEMM firms on prevalent best practices and their recommendations for the particular issue.
82. The DMO will endeavour, via screen and web announcements, press notices and/or communiques from lead managers, to keep all market participants informed of developments in the syndication process at all key stages of the operation.

## **V CONVERSIONS**

### **(a) Objectives, methodology and limitations**

83. From time to time, the DMO may announce a conversion offer. The aim of conversions generally is to:
  - build-up the size of new benchmark gilts more quickly than can be achieved through auctions alone; or
  - concentrate liquidity across the gilt yield curve by reducing old, illiquid or smaller issues, and converting them into current coupon, larger gilts of roughly similar maturity or duration.
84. In August 1998, the DMO published a consultation document<sup>7</sup> 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 gilts with less than five years to maturity;
  - **Size of conversion candidates:** no consideration will be given to candidate gilts with £5.5 billion<sup>8</sup> (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 gilt that is cheapest-to-deliver, or has a reasonable likelihood of becoming cheapest-to-

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<sup>7</sup> "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.

<sup>8</sup> The original limit of £5 billion was increased in the 2001-02 Remit.

deliver, for any gilt futures contracts (with any outstanding open interest). Also, an offer will not be made for any deliverable gilt 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**

85. Conversions may be announced on any day, first on the DMO's wire services pages and in a press release, and shortly thereafter on the website. They are open to *all* holders of the source gilt. At the time of the announcement the DMO will publish the source and destination gilts, 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.
86. 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 gilts.
87. 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**

88. 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 by returning the form which will have been sent to them with details of the offer.
89. Any holder that owns the gilt, 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 this intention must be communicated to the borrower in sufficient time for the borrower to be able to assent the gilt on behalf of the lender.

**(d) Announcement of results**

90. The DMO will announce the results of the conversion offer first on its wire services pages and in a press notice, and shortly thereafter 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 gilt assented, that amount's percentage of the existing amount outstanding and the nominal amount of the gilt remaining unconverted. It will also detail the nominal amount of new destination gilt created, and the new total outstanding amount of that gilt. At this stage, and if appropriate, the DMO may also announce whether the source gilt has been assigned 'rump' status (see paragraph 92 below)

## **VI OTHER OFFICIAL OPERATIONS**

91. The DMO undertakes a number of other official operations in the secondary market, with the GEMMs, in its role as debt manager or to assist cash management. These include:

- purchases of “rump” and other selected gilts;
- trading in near maturity gilts;
- offsetting larger positions accumulated as a result of its dealings for the retail Purchase and Sale Service;
- purchases and sales of gilts for other official portfolios;
- purchases and sales via the Shop Window;
- activity in other exceptional circumstances;
- creating gilts for repo purposes.

### **(a) Purchases of “rump” and other selected gilts**

92. The DMO is prepared, when asked by a GEMM, to bid a price of its own choosing for a gilt where the amount in issue is considered too small for a two-way market to be reasonably expected to exist (eg. the rumps of certain gilts which have previously been subject to conversion offers). The DMO publishes a list of such gilts on its website. Any amendments to this list will be announced by the DMO. 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 gilts**

93. To assist cash management in smoothing redemption cash flows, the DMO is prepared, when asked by a GEMM, to bid a price of its own choosing for any gilt, including any STRIP, that has less than six months left before its maturity (ie. after a semi-annual paying gilt's penultimate coupon payment). As these are essentially money market instruments by this stage, the price bid will be dictated by relevant money market rates and 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 gilts only.

### **(c) Gilt Purchase and Sale Service**

94. Since December 2004, the DMO has assumed responsibility for the transaction of orders received from members of the public under the Gilt Purchase and Sale Service. This is a low-cost, execution-only service in gilts offered to smaller investors who have registered on the DMO's Approved

Group. The service is administered by Computershare Investor Services PLC as agent of the DMO.

95. Under normal circumstances, the DMO will transact these orders from its own portfolio, but in times of heightened demand to purchase or sell (a) particular gilt(s), DMO dealers may choose to offset the effect on its portfolio by buying or selling gilts from GEMMs. Such transactions will normally be on a T+3 basis, in line with the settlement convention in the Gilt Purchase and Sale Service.
96. In the interests of transparency to investors, the DMO will publish on its website, on a daily basis, prices at which Purchase and Sale transactions have been executed on that day. This will take the form of a 'snapshot' of bid and offer prices in *all* gilts<sup>9</sup>, taken at the time that prices were confirmed to Computershare, regardless of whether or not an order was actually received in each gilt. The exact timing of the snapshot will vary from day to day, but will usually be at around midday.

#### **(d) Purchases and sales of gilts for official portfolios**

97. From time to time, the DMO may be asked to execute market transactions in gilts on behalf of funds under the management of CRND or other UK Government entities. These may be purchases or sales. In such circumstances, the DMO will request bids or offers as relevant from three randomly chosen GEMMs and deal on the best price received, provided that the order is for 'normal' market size. Where the size is smaller-than-average, the DMO may ask for prices from 'retail' GEMMs only, and where the size is deemed larger-than-average, the DMO may advertise the order on its Shop Window page (see below) or run a mini (reverse) tender, following the process described in Chapter III, paragraphs 69 and 70 above.

#### **(e) Purchases and sales via the Shop Window**

98. Where the DMO has a larger-than-usual position to sell, or buy order to fulfil, it may advertise the fact on its Shop Window pages on the wire services. In the interests of transparency, these pages are available for viewing by all market participants, but the DMO will only entertain dealing proposals from GEMMs, or from index-linked GEMMs only for index-linked gilts, either for their own account or on behalf of clients.
99. The Shop Window pages will be operational between the hours of 8:05am and 5:00pm. Details posted will include the identity and size of any gilt advertised for sale or purchase, plus any restrictions (eg. minimum/maximum prices or sizes, time deadlines, etc.) that may be imposed at the DMO's own discretion. The DMO also retains discretion on whether or not to accept bids/offers submitted by GEMMs. These pages will be updated as soon as possible to reflect any resultant transactions.

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<sup>9</sup> Bids only in rump gilts.

**(f) Purchases or sales of conventional and index-linked gilts in exceptional circumstances for market management reasons**

100. The DMO reserves the right to purchase or sell conventional and index-linked gilts offered by (or to) GEMM firms, but would do so only in exceptional circumstances.

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

**(g) Standing repo facility**

102. 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 gilt 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 other 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 shortly thereafter 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 gilts created for such purposes will be eligible for inclusion in the calculation of FTSE's or iBoxx gilt indices.

**(h) Creating gilts for repo for market management purposes**

103. If the DMO considers that there is sufficient evidence of severe market dislocation or disruption, it may create gilts 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 gilts will be announced on the DMO's wire service pages. 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, as will the cancellation of the gilt, 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 other gilt collateral at the Bank of England's prevailing repo rate.

## **VII PROVISION OF REFERENCE PRICES**

### **(a) Intra-day benchmark prices**

104. Between the hours of 8:05am and 4:15pm, 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 gilt. The DMO's composite page will therefore be updated every time a new GEMM contribution in any one gilt 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 the Annex.

### **(b) End-of-day GEMMA reference prices**

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

106. At 4:15pm every day, each GEMM is required to provide a mid-market clean price for every gilt 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<sup>10</sup>. 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.

## **VIII ANNOUNCEMENTS TO THE MARKET**

107. 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.

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<sup>10</sup> "GEMMA Reference Prices: Calculation Methodology" June 1999 (and as updated thereafter) available on the DMO website.

108.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. In any case, all coupon fixings are posted on the website.

**UK Debt Management Office**

**September 2006**

## **ANNEX**

### **List of DMO information pages**

#### **Website**

www.dmo.gov.uk

#### **Index and market announcements pages**

Reuters/Telerate – DMO/INDEX, DMO/GILTS1 *et seq*  
Bloomberg – DMO <GO>, DMO1 <GO>  
Thomson/Topic – 44799, 44700 *et seq*

#### **GEMMA reference pages**

Reuters/Telerate – GEMMA01 > GEMMA35  
Bloomberg – DMO5 <GO>, DMO6 <GO>  
Thomson/Topic – 44800 *et seq*, 44850 *et seq*

#### **Benchmark composite pages**

Reuters/Telerate – DMO/BENCH1, DMO/GILTS12  
Bloomberg – DMO2 <GO>  
Thomson/Topic – 44720, 44721

#### **Shop Window page**

Reuters/Telerate – DMO/GILTS10, DMO/GILTS11  
Bloomberg – DMO3 <GO>  
Thomson/Topic – 44717, 44718