

**Revised rules pertaining to auctions of  
Government of Canada securities and the Bank of Canada's  
surveillance of the auction process**

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Final Report

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## **1. Summary**

The Bank of Canada and the Department of Finance have been working closely with market participants in a series of initiatives to maintain and enhance a well-functioning market in Government of Canada debt. In this context, plans were announced in discussion papers dated 19 December 1996 and 8 April 1998 to introduce measures designed to reinforce the integrity of the auction process for Government of Canada securities, and to encourage participation in it by reducing the potential for manipulative behaviour prior to and during auctions. Proposals for revisions to the administrative arrangements pertaining to auctions of Government of Canada securities were presented and comments on these proposals were received. The consultation process with interested parties was intended to assure all parties that the final measures were given due consideration. This paper presents the final terms and conditions for auctions after taking into account the comments received. The Bank and Finance are grateful for the thoughtful recommendations and comments provided by a broad range of market participants during this project.

The initiatives include both changes in auction rules and an increase in the Bank of Canada's auction-related monitoring activities. In broad terms, the measures seek to ensure that the auction process is free of, and is perceived to be free of, manipulation. In this way, confidence in the auction process can be maintained and investor and dealer participation enhanced. The revisions include a new classification of government securities distributors and a subgroup of large dealers called primary dealers, a definition of a bidding entity, procedures for the submission of bids, new bidding limits for government securities distributors, and bidding limits for customers of government securities distributors. In addition, the Bank of Canada intends to enhance its surveillance of Government of Canada securities markets including ongoing reporting by auction participants and special reporting to help ensure market integrity. These measures are reflected in the new Terms of Participation for government securities distributors and customers respectively.

In response to comments received on the second discussion paper, two further changes will be made to the auction rules. The first is that dealers will be subject to an aggregate bidding limit of 40 per cent of the tender for bids on their own behalf and on behalf of customers. This change is in response to concerns that a 50 per cent aggregate limit on access to tenders, as proposed in the second paper, could contribute to undue concentration. This change is described in Sections 5.4 and 5.5 on bidding limits for bonds and treasury bills, respectively. The second change is that small distributors will have access to at least 5 per cent for bids on behalf of customers. This change is intended to allow small distributors enhanced ability to service customer interest and growth opportunities, and is described in Section 5.4 on bidding limits for bonds.

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## **2. Introduction**

The government and market participants share an interest in promoting the efficiency, liquidity and integrity of the market for Government of Canada debt. Canada's domestic debt market is generally very liquid, featuring active turnover and tight bid/offer spreads. Initiatives taken to maintain the liquidity and efficiency of this market include adjustments to the debt program and improvements in the transparency of the debt strategy. Because of a number of "squeezes", however, a concern has developed among participants about the rules and practices in the primary and secondary markets for Government of Canada securities. The increased frequency of such squeezes has brought into question the integrity of the market.

Ongoing questions about the efficiency, liquidity and integrity of a market hamper activity. For example, participants may be reluctant to take short positions if there is a significant risk that it will be difficult to cover those positions, and this affects the distribution process for securities. Over time, such questions could also affect the size of the investor base and, in turn, the price-discovery process. These implications have the potential to increase debt costs to the government and to a variety of other issuers.

Discussion Paper 1, which was issued in December 1996, highlighted concerns about the effectiveness of the current auction guidelines in an environment featuring a declining supply of securities and a larger, more integrated financial services industry whose participants have increased leveraging capacity. It noted that manipulation can occur under the current system because participants are able to acquire control through the when-issued process and tender access, even though such activities are against the spirit of the existing rules, and because there is no effective limit on the amount of securities customers can acquire. The paper then presented a number of proposals designed to reinforce the integrity of the auction process by reducing the scope for manipulative behaviour. Finally, it requested comments from interested parties on the proposed rules and surveillance measures. Discussion Paper 2, dated 8 April 1998, was a continuation of the process and had the same underlying principles.

This final report reiterates the main issues contained in the second discussion paper and makes two changes in response to comments, both written and through consultation with market participants. Readers requiring detailed background, such as a description of the current auction process and a summary of comments on the first paper, are referred to the earlier papers.

Through the initiatives in the new auction rules, the intention is to assure market participants that the auction process will not result in undue concentration. These new rules and surveillance procedures will also have a balanced and fair impact on market participants, both investors and intermediaries. However, revisions to the rules alone could not deal with attempts to accumulate large amounts of securities in ways that do not involve the auction process, such as in the secondary market. The Investment Dealers Association of Canada (IDA) has taken an important step forward with the adoption of a code of conduct for

secondary market activity (IDA Policy No. 5), which was developed in consultation with Finance and the Bank and is currently in the regulatory review process. This code of conduct involves procedures to review situations in which market manipulation is suspected and to impose sanctions when warranted. These primary and secondary market initiatives with respect to Government of Canada securities are linked through the new terms of participation for government securities distributors and customers. Government securities distributors are required to comply with, and customers to abide by, the code of conduct. Together, these changes provide a broad-based approach to improve the functioning and integrity of Government of Canada debt markets.

This paper is organized into sections dealing with individual components of the new auction terms and conditions. Each section provides a summary of the new rules, and the rationale for the revisions being made. In the two cases where further changes are being made in response to comments on the second discussion paper, these comments are summarized.

Of note is the new nomenclature for those eligible to participate directly in the tender process, reflecting a change in their roles in recent years. Primary distributors will be called government securities distributors, and a subgroup of this broad class (those that maintain a certain threshold of activity) will be called primary dealers instead of jobbers (underlined terms are defined in Appendix 1). The primary dealer designation can be attained in either treasury bills or bonds, or both.

### **3. Principles and Rationale for Action**

As noted, the government and market participants share an interest in the development and maintenance of well-functioning domestic capital markets. In this regard, the guiding principles are that the market for Government of Canada debt should be transparent, active and competitive, and that there should be broad participation in the market by investors and intermediaries.

The primary concern addressed in this paper is the risk that the auction process may be used to manipulate or “squeeze” the market for Government of Canada securities. Squeezes occur when an auction participant, or group of participants, gains control of the stock of a security and withholds the supply from the cash or repo markets. In these situations, market participants who have entered into contracts to deliver a security at some future date are then unable to purchase or borrow that security for delivery. Such activities are possible under the current auction rules because an intermediary or customer who has accumulated large holdings in the when-issued or secondary markets can still acquire more supply through the auction process. Of note, there is currently no limit on auction orders that customers can place with intermediaries.

There are a number of indicators of a possible “squeeze” in the market. These indicators include special repo rates, how far specific issues trade off the theoretical yield curve, declines in market volume, and increases in concentration of specific issues. Any of these

situations can occur under normal market conditions and, in and of themselves, are not a cause for concern. There is a concern, however, with those situations in which price distortions are large and persistent and when liquidity in the relevant securities in the cash and repo markets is seriously impaired.

The negative consequences of having a system that allows squeezes are numerous and are related mainly to an undermining of the price-discovery process and a general loss of confidence in the system. Clearly, it is often very costly for those caught in a squeeze to meet their contractual obligations to deliver the security. If the system allows squeezes to persist, intermediaries will become reluctant to establish short when-issued positions, and reluctant to engage in other market-making activities or to participate in auctions. Investors would also face a less liquid and less efficient debt market, and investor participation in auctions and the secondary market may decline. These developments would tend to raise the cost of borrowing for various issuers, including the federal government and issuers of securities that are benchmarked relative to Government of Canada securities.

Recent examples indicate that the problem of auction-related squeezes has occurred since Discussion Paper 1 was released in 1996, and it is unlikely that this situation would improve without changes to the auction process. In fact, these problems could intensify given the environmental changes identified in the earlier papers, including the possibility of further global integration of the financial industry and prospective declines in the federal debt stock. The experience to date with squeezes and the ongoing risk of such events occurring are inconsistent with the objectives of the government and market participants for the market in Government of Canada debt. The implication is that the existing auction rules, for which the Government of Canada and Bank of Canada have responsibility, need to be revised.

#### **Examples of Recent Squeezes**

Case 1: 4-per-cent bonds due 15 March 1999

- *In August 1997 a very large amount of these bonds was tightly held and some large short positions existed.*
- *The issue traded as much as 50 basis points below the yield on bonds with a similar maturity, and repo rates occasionally fell well below 1 per cent (general repo rates were about 3.25 per cent).*
- *The Bank of Canada exchanged \$600 million of this issue from its portfolio (through an auction) for bonds with a similar maturity to help alleviate the problem.*

Case 2: 1-year treasury bill due 6 August 1998

- *The problem developed through the auction process in August 1997.*
- *The issue was reopened as part of the normal auction cycle in the amount of \$1 billion, but was still held by only a few parties and there was no available supply to be traded.*
- *A further reopening of \$500 million outside of the regular auction cycle was needed to make some market supply available.*

## **4. Overview of Initiatives**

Consistent with the desire to ensure that the auction process for Government of Canada debt will not aggravate squeezes in the market, the objectives with respect to the new auction rules are the following:

- To assure market participants that undue amounts of Government of Canada securities cannot be accumulated at auctions by either investors or market intermediaries.
- To assure the market that the Bank of Canada, on behalf of the government, maintains oversight of the auction process in order to ensure that Government of Canada auctions function in the public interest.

The initiatives detailed in this paper fall into three categories:

- A more precise definition of bidders at auction.
- New bidding limits for distributors and the introduction of limits for customers.
- Careful monitoring of auction participation through reporting requirements and enhanced market surveillance to help ensure market integrity.

### **4.1 The Definition of a Bidder**

The type of entity that may bid at auction, either directly or indirectly, is limited to the following legal entities: corporations, partnerships, governments and government-related entities, foreign central banks (as well as governments of foreign states or international organizations), trusts and individuals. All bidders must certify that they will not bid in concert with any other bidder, and entities not at arm's length will be considered to be a single bidder for the purpose of auction bidding limits. There will be a provision to allow affiliated parties to be separate bidders if they are a separate legal entity and are organized so that there is no exchange of information on auction bidding and strategies.

### **4.2 Bidding Limits for Distributors and Customers**

Under the new bidding limits, limits for government securities distributors will apply only to bids on their own behalf, and customers will bid separately through distributors under their own bidding limits. New bidding limits for primary dealers will be set at 25 per cent for treasury bills and from 10 to 25 per cent for bonds. Primary dealer bidding limits for bond auctions will be tiered in line with their performance in the primary and secondary markets. The less active distributors will have a 10-per-cent limit for treasury bill auctions, and limits ranging from 1 to 9 per cent for bond auctions, again tiered in line with their market performance. Bidding limits for customers will be 25 per cent for both treasury bills and bonds.

The new rules mean that a customer's ability to purchase securities through the auction process will be limited in the same way as a distributor's. Under the present system,

customer bids are included in the distributors' bidding limits, and there is no restriction on the overall bidding or winnings of customers. It would thus be possible for a customer to obtain virtually all of an issue by placing bids through three or more dealers, or through a combination of auction bidding and when-issued trading. In contrast, distributors have bidding limits that restrict the amount for which they can bid.

The new bidding limits will also account for the bidder's net position in the when-issued market and in previously-issued securities. At present, a bidder holding a large amount of the security outstanding (in the case of a reopening) and/or holding a large long position in the when-issued market could still use its full bidding limit, thus making it possible for one participant to control an issue. Under the new rules, this will no longer be possible: the maximum amount that any entity will be able to bid will be its bidding limit times the amount of the security outstanding when the security auctioned that day is delivered, less its long position in the issue. These changes will eliminate the ability of auction participants to acquire a large proportion of the amount outstanding through the auction process and therefore make it more difficult to use a concentration of holdings of the security to affect its availability and price in the market. Furthermore, the aggregate amount of bids a dealer can submit on its own behalf and on behalf of its customers will be limited to 40 per cent of the tender. In this way, a dealer and its customers will not be able to control a large portion of the issue through the auction process.

#### **4.3 Reporting Requirements and Market Surveillance**

The new reporting rules will require any market participant wishing to bid at auction to submit to the Bank of Canada its position in the when-issued market and in outstanding securities in order to adjust its bidding limit for these holdings. In addition, the new terms of participation for government securities distributors more clearly define the requirements for enhanced market and position reporting to the Bank of Canada to help ensure market integrity.



## **5. Description of Auction Rules**

A summary table of the new rules is presented in Appendix 2.

### **5.1 Bidder Definition**

- *The new bidder definition covers all government securities distributors and customers, and applies to the following legal entities: corporations, partnerships, governments and government-related entities, foreign central banks (as well as governments of foreign states or international organizations), trusts and individuals.*
- *All bidders must certify that they will not bid in concert with any other bidder.*
- *Entities that do not have a strict arm's-length relationship with one another (i.e., affiliates) will be considered one bidder for the purposes of Government of Canada securities auctions. To avoid being considered a single bidder, affiliated entities will have to certify that they do not exchange information about yields, amounts, positions they hold or plan to hold, or their investment strategies with respect to the securities being auctioned.*
- *Entities are affiliates of one another if one is controlled by the other or if both are controlled by the same entity. The specific definition of control includes formal voting control along with direct and indirect controlling influence over management and policies.*
- *Affiliated entities that wish to be treated as separate bidders must certify that they will not act in concert in formulating strategy or auction bids.*
- *Any entity that implements the conditions necessary to be considered a separate bidder must direct all of its bids and purchases through a non-affiliate.*

### **Rationale**

A more precise concept of the bidding entity is an essential component of the new regime, and is necessary to prevent manipulation of securities. This definition reflects the increasing integration of bank treasury operations with those of bank-owned government securities distributors. The new bidder definition also limits the ability of related entities to act in concert and manipulate securities by, for example, evading auction limits by holding securities in areas of the institution that remain under the bidder's realm of effective control or by obtaining knowledge of who holds the securities, along with their intended investment strategy. Accordingly, under the new auction rules, all affiliated parties within an organizational structure will be treated as a single bidder, unless there are clear policies and procedures in place that prevent the transmission of information about investment strategies and holdings (described below). In addition, all bidders must certify that they will not bid in concert with any other bidder.

Some concern was expressed that the new bidder definition would reduce auction access, but an analysis of dealer positions and bidding for the period May to August 1997 indicated that the impact of the new definition would have been minimal in most cases. One significant reason for this finding is that, under the new auction rules, bids that distributors submit on behalf of customers are subject to separate auction limits, rather than being included under the participant's auction limit, as is currently the case.

### **5.1.1 Definition of Affiliated Party**

The type of entity that may bid at auction, either directly or indirectly, is limited to legal entities. Various operational components, departments or divisions within the same legal entity will not be considered separate bidders at auction. Under the new definition of a bidder, only legal entities that are not affiliated with any other bidder may submit a separate auction bid for Government of Canada securities. Entities that are considered under the new rules to be affiliated will be treated collectively as a single bidder unless they can meet, to the satisfaction of the Bank of Canada and the Department of Finance, the criteria set out for treating otherwise affiliated parties as separate bidders.

Two persons are affiliated if one is controlled by the other or if both are controlled by the same person.<sup>1</sup> The specific definition of control is presented in Appendix 3. Briefly, a person controls a corporation if that person beneficially owns securities that are sufficient to enable that person to control the corporation. A person controls a limited partnership if that person is a general partner. In the case of an unincorporated entity other than a limited partnership, a person exercises control if 50 per cent of the ownership interests, however designed, into which the entity is divided are beneficially owned by the person and that person is able to direct the business and affairs of the unincorporated entity. A person also controls a corporation, a limited partnership or an unincorporated entity if the person controls an entity that in turn controls the corporation, limited partnership or unincorporated entity, respectively. In addition, a person controls any entity if that person has any direct or indirect controlling influence over the management and policies of the entity, whether alone or in combination with other persons and whether through the beneficial ownership of securities, through one or more other persons or otherwise.

### **5.1.2 Requirements to Establish Non-affiliated Status within a Corporate Group**

The new definition of a bidder will permit an otherwise affiliated entity within a corporate group to bid separately if it is prepared to organize itself in such a manner that there is no exchange of information on auction bidding and strategy between itself and other affiliated entities. Specifically, two or more entities that are affiliated may submit separate bids provided that each affiliate has certified to the Bank of Canada that it meets certain specified criteria meant to prevent the exchange of information on auction bidding and strategy, and that it has established written policies and procedures designed to ensure continued compliance. The criteria include: (i) the affiliate does not act jointly or in concert with any of the other affiliates with respect to securities; (ii) no director, officer, partner, employee or agent of the affiliate that purchases Government of Canada securities at auction or advises with respect to, participates in the formulation of, has influence over, or has knowledge of decisions or information relating to holdings, investment or bidding strategies in or for Government of Canada securities by or on behalf of that affiliate, also engages in any of the same activities

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1. For the purposes of this section, "person" means a natural person, an entity within the meaning of Appendix 3 or a personal representative.

or has any of the same knowledge in respect of Government of Canada securities for or on behalf of any of the other affiliates;<sup>1</sup> (iii) the affiliate does not exchange information related to bidding at auctions with any of the other affiliates and (iv) its records relating to holdings of and investment and bidding strategies for Government of Canada securities are maintained separate and apart from the records of any of the other affiliates.

Any affiliate that provides the Bank of Canada with the above certification must promptly notify the Bank of Canada, in writing, if any of the circumstances that enable the affiliate to qualify for separate-bidder status change, or if the certification is no longer valid, such that the affiliate is no longer entitled to non-affiliated status.

## **5.2 Submission of Bids**

### **Government Securities Distributors**

- *Government securities distributors will be able to bid on their own behalf subject to auction limits. Government securities distributors will also have a separate limit for the aggregate amount of bids they place on behalf of customers. These bids must be listed separately from the distributor's own bids.*

### **Customers**

- *Customers will be able to bid by submitting bids through government securities distributors subject to their own auction limit. Customer bids must be listed separately from the distributor's own bids, and competitive bids must be accompanied by the customer's unique bidder number received from the Bank of Canada.*
- *Customers will be required to obtain a unique bidder identification number from the Bank of Canada before they can bid competitively. An application form for a unique bidder identification number will be available by facsimile or from the Bank of Canada Web page (<http://www.bank-banque-canada.ca>).*
- *Customers will not settle directly with the Bank of Canada. Government securities distributors will be responsible for the settlement of customer bids that they have submitted, and shall be liable to the Bank of Canada for any losses incurred as a result of those sales failing to settle in the Debt Clearing System (DCS) of the Canadian Depository for Securities.*

## **Rationale**

In order to help ensure integrity and to reinforce equity and competition through the auction process, separate customer bidding limits have been introduced. Until these changes, customer access to tenders may have been constrained to the extent that dealers were able to accommodate both their proprietary and customer bids under a single limit. On the other

1. This criterion does not apply in respect to (i) individuals who are either involved in senior management or engaged solely in clerical or administrative activities and who do not in either case make decisions relating to holding, investing and bidding for Government of Canada securities and (ii) knowledge of information that has been generally and publicly disseminated.

hand, under that system, there was no effective limit on customers who could access unrestricted supply by placing orders through a number of distributors. This unlimited access for customers could have led to control of the supply. Therefore, to ensure auction integrity and to promote equity, customers will now be subject to bidding limits in the same way as distributors.

All customer bids will continue to be submitted through government securities distributors. In the course of consultations, some customers expressed the desire for direct access to the auction, as is available in the U.S. process. This could lead to increased competition by broadening direct access to tenders and help the government lower its costs of issuing debt at auctions. On the other hand, primary dealers play an important function for all market participants with respect to market-making and the provision of market intelligence, and they ensure the success of auctions for the government. Weighing these considerations, it was concluded that the current role of dealers as intermediaries with direct access should be maintained, while customers should be provided with their own bidding limits to promote competition.

### **5.3 Competitive Auction Limits**

- *The amount that any distributor or customer can bid on a competitive basis at an auction (its auction limit) will equal its bidding limit less its excess net long position, which is its net long position in excess of the product of its percentage bidding limit and the par value of any outstanding stock of the security being auctioned.*
- *All bidders, both government securities distributors and customers, must report their net positions prior to an auction (see the section on reporting requirements for details). For the purposes of computing the auction limit, the bidder's net position will include the par amount of (i) cash holdings of a security with the same International Securities Identification Number (ISIN), (ii) when-issued positions, (iii) futures contracts that require delivery of the specific security being auctioned but not futures contracts for which the security being auctioned is one of several securities that may be delivered, and not futures contracts that are cash-settled, (iv) forward contracts, (v) holdings of the residual component of a stripped bond of the security being auctioned, and (vi) any position in the security not covered by the above types of contracts, including "guaranteed" trades. For repurchase agreements or securities lending, the entity that owns the security, not the one that has borrowed it, must report the repoed or lent security as part of its position. All positions are based on trade date rather than delivery date.*
- *Customer bids will not be netted against the limits of government securities distributors.*
- *Bidding limits for bond and treasury bill auctions are discussed below.*

#### **Rationale**

It is important to take the bidder's long position into account in the calculation of the auction limit, so that bidders cannot use the auction process to accumulate a controlling position. While there may be some additional administrative burden involved in submitting data on net

positions, this burden is relatively small compared with the potential benefit. It is good business practice for companies to have such information, and the task of reporting the information to the Bank of Canada would represent little additional work.

The data collected from dealers in recent months indicate that taking long positions into account in calculating auction limits would not, in general, have had a significant impact on actual bidding or winnings in treasury bill and bond auctions (especially taking into account the other revisions, including the separate bidding limit for customers and the increase in the maximum bidding limit for bonds). This provision would have interfered only rarely with actual bidding in auctions that were reopenings (more than two-thirds of auctions for Government of Canada securities are reopenings). There would tend to be some impact in the first auction of a security when any long position of a bidder would have a direct impact on auction limits. However, in general, distributors' long positions in when-issued securities tend to be relatively small at the time of the first auction of a security. Moreover, it is desirable in the cases in which a bidder has a substantial long position (either in an initial auction or in a reopening) to reduce its access to tender.

#### **5.4 Bidding Limits for Bonds**

##### **Government Securities Distributors**

- *Primary dealers will have bidding limits tiered from 10 to 25 per cent of the auctioned amount for bids on their own account for Government of Canada bonds. Other government securities distributors will have limits tiered from 1 to 9 per cent.*
- *Each distributor will also have a customer submission limit that will cover bids submitted on behalf of its customers. This limit will equal the greater of 5 per cent and the limit set on bidding for its own account.*
- *The aggregate limit for the sum of the bids submitted by a primary dealer on its own behalf and on behalf of its customers will be 40 per cent of the tender less the dealer's excess net long position (up to the dealer's bidding limit).*
- *Bidding limits for distributors will be tiered in line with their performance in auctions of Government of Canada bonds and in secondary markets for such securities over the preceding year. For the purpose of determining these bidding limits, winning bids submitted on behalf of customers will be taken into account in the assessment of the government securities distributor's performance at auction.*

##### **Customers**

- *A customer will be able to bid through government securities distributors for up to 25 per cent of the amount auctioned. A customer can use as many government securities distributors as it chooses to submit its bids as long as the total amount of its bids does not exceed its auction limit. Customer bidding through a specific distributor may be constrained by that distributor's bidding limit and allocation of its aggregate limit.*
- *It is the responsibility of each customer to ensure that the total of its bids through all government securities distributors does not exceed its auction limit.*

## **Comments on the Proposal in Discussion Paper 2**

Concerns were raised over the proposal that a large dealer could submit bids of up to 25 per cent on its own behalf and another 25 per cent on behalf of its customers, thereby potentially controlling 50 per cent of the issue. It was also noted that the customer limits for small distributors or new entrants would make it too difficult for these distributors to satisfy customer interest or develop this business.

### **Rationale**

The maximum bidding limits are being increased from 20 per cent to 25 per cent, reflecting the view that a 20-per-cent limit may be too restrictive, particularly in combination with the decision to take into account the long positions of the bidder and its related parties when calculating the limit for any particular auction. If long positions are taken into account in the calculation of bidding limits for any specific auction, any individual bidder cannot come out of an auction with more than 25 per cent of the issue as a result of the auction process. This is in contrast to the current situation, where long positions are not taken into account and therefore there is no limit on a bidder's holdings coming out of an auction. Bidding limits of up to 25 per cent of the amount being auctioned mean that at least four bidders would win some of the bonds being auctioned.

In response to the concern that a maximum 50-per-cent aggregate limit for a dealer and one customer was excessive, there will be an aggregate limit of 40 per cent of the tender imposed on a dealer's bidding on its own behalf and on behalf of its customers. This limit will be adjusted to reflect the lesser of the dealer's bidding limit and the dealer's net long position in excess of the product of its percentage bidding limit and the par value of any outstanding stock of the security being auctioned. It will be the responsibility of the dealer to allocate this aggregate limit between its own and its customer bids. Examples of aggregate limits for primary dealers and their customers are attached as Appendix 4.

In order to give smaller distributors and new entrants a better opportunity to service customer interest or develop this business, the distributor's bidding limit on behalf of customers will equal the greater of 5 per cent and the limit on bidding for its own account.

Customer winning bids will be taken into account in determining future bidding limits for the distributors who submitted the bids on the customer's behalf. This provision recognizes the role that distributors play in the distribution of Government of Canada securities by soliciting and facilitating customer bids, and provides an incentive for distributors to continue this role.

The bidding limit for customers will be set at 25 per cent, a level equivalent to that of the largest dealers. This limit was viewed as the appropriate balance between the interests of the dealers and customers to ensure broad-based participation and a more competitive environment, and to possibly enhance coverage at tender.

## 5.5 Bidding Limits for Treasury Bills

### **Government Securities Distributors**

- *Primary dealers will have a bidding limit of 25 per cent of the auctioned amount for bidding on their own behalf. Other government securities distributors, who are less active in the treasury bill auctions and in the secondary market, will have a limit of 10 per cent of the auctioned amount.*
- *Distributors will have an additional bidding limit for the total amount of bids they submit on behalf of customers. This limit will equal the limit set on bidding for their own account.*
- *The sum of the bids submitted by a primary dealer on its own behalf and on behalf of its customers cannot exceed 40 per cent of the tender less the dealer's excess net long position (up to the dealer's bidding limit).*

### **Customers**

- *The bidding limit for a customer will be 25 per cent of the amount auctioned. A customer may use as many distributors as it chooses to submit bids, as long as the total amount of its bids does not exceed its auction limit. Customer bidding through a specific distributor may be constrained by the distributor's bidding limit and allocation of its aggregate limit.*
- *It is the responsibility of each customer to ensure that the total of its bids through all government securities distributors does not exceed its auction limit.*

### **Comments on the Proposal in Discussion Paper 2**

As noted in the previous section on bonds, concerns were raised over the proposal that a large dealer could submit bids of up to 25 per cent on its own behalf and another 25 per cent on behalf of its customers, thereby potentially controlling 50 per cent of the issue.

### **Rationale**

The maximum bidding limit for treasury bills will be lowered from 33 1/3 per cent to 25 per cent. This lower limit will mean that at least four bidders will win newly auctioned bills, reducing the potential for one or two participants to hold a controlling share of the newly auctioned bills.

Bidding limits at treasury bill auctions for distributors will not be tiered in the same way as for bonds because the current system for treasury bill auctions appears to be working well. Nevertheless, some differentiation will be introduced between primary dealers and other government securities distributors. This recognizes the additional responsibilities of primary dealers, while still providing some auction access to smaller distributors.

In response to the concern that a maximum 50-per-cent aggregate amount of a dealer's own bids and those on behalf of its customers was excessive, an aggregate limit of 40 per cent of the tender will be imposed on bidding (in addition to the 25-per-cent maximum for a dealer or its customers individually). This limit will be adjusted for the lesser of the dealer's bidding limit and the dealer's net long position. It will be the dealer's responsibility to allocate this limit

between its own and its customer bids. A summary of competitive bidding limits for both treasury bills and bonds is shown below. Note that the actual auction limits for both distributors and customers will be reduced to reflect net long positions.

<b>Bidder</b>	<b>Competitive Bidding</b>
Distributor Submission - for own account	Up to 25 per cent as determined by a formula based on primary and secondary market participation.
- for customers	The sum of customer bids cannot exceed the distributor's own bidding limit.
- in aggregate	The sum of the bids submitted by a dealer on behalf of itself and its customers cannot exceed 40 per cent of the tender less the dealer's excess net long position (up to the dealer's bidding limit).
Customer Bidding Limit	25 per cent

## **5.6 Non-competitive Bidding**

- *Each government securities distributor will be able to make one non-competitive bid, in addition to any competitive bids, in auctions of Government of Canada bonds and each tranche of treasury bills.*
- *The ceiling on non-competitive bids for each participant will be \$3 million for Government of Canada bonds and for each tranche of treasury bills.*
- *All government securities distributors will also be able to bid non-competitively on behalf of customers. The total amount of customer non-competitive bids that each government securities distributor can submit will be limited to \$3 million.*

### **Rationale**

Non-competitive bidding for treasury bills will be introduced as a way for distributors and customers who are less familiar with the market and who may not have the knowledge required to make a successful competitive bid to acquire small amounts of securities.

<b>Bidder</b>	<b>Non-competitive Bidding</b>
Distributor Submission - for own account	\$3 million
- for customers	The sum cannot exceed \$3 million.
Customer Bidding Limit	\$3 million



## 5.7 Reporting Requirements

### Reporting of Net Positions

- *Government securities distributors must report their aggregate net positions in the auctioned security to the Bank of Canada when submitting their own bids or bids on behalf of customers. The net position must be reported regardless of whether it is a long or short position. This position must be updated with each re-submission of bids.*
- *Government securities distributors are responsible for ensuring that their customers are informed that they must report their net position either indirectly through the distributor or directly to the Bank of Canada before their competitive bids will be included in an auction.*
- *Customers bidding competitively at auction must report their net position in the auctioned security. If no net position is reported, the bid will be rejected automatically.*
- *Customers can submit that report either directly to the Bank of Canada or through a government securities distributor that is submitting a bid on their behalf. A customer reporting its net position directly to the Bank of Canada may do so up to 30 minutes before the bidding deadline on the day of the auction.*
- *Bidders are required to re-submit their position, by the bidding deadline, if it changes by more than \$25 million. Customer position changes must be reported directly to the Bank of Canada.*
- *Customers may make non-competitive bids without submitting a net position report.*

### Bid Certification and Verification

- *Government securities distributors must ensure that bidding customers are aware of the reporting requirements and that, upon completion of the auction, customers are informed of any auction allotments. The Bank of Canada will rely on a process of spot checks of customer bids to ensure their validity.*
- *As part of the proposed certification and confirmation process, all government securities distributors and customers must provide annual certificates of compliance from their internal audit departments.*

### Market Information

- *The Bank of Canada requires regular reporting of distributor activities related to Government of Canada debt, including firm-wide positions. In order to help ensure market integrity, the Bank of Canada may require that government securities distributors provide general information concerning their customers' activities relating to Government of Canada securities. In the event that the Bank of Canada is of the view that there is or has been trading in Government of Canada securities in an unusual manner for a persistent period of time, it may require distributors to disclose the names and activities of customers involved in such trading.*
- *The Bank of Canada maintains the discretion to (i) investigate whether activity outside the auction rules has occurred, (ii) notify the appropriate regulatory authorities if other questionable activities are found, (iii) refer incidents of questionable secondary market activity to the Investment Dealers Association of Canada for investigation of possible violations of its Policy No. 5, and (iv) sell securities from its own portfolio. The Department of Finance maintains the discretion to reopen an issue outside the timetable provided by the Quarterly Bond Schedule and the usual treasury bill issuance cycle.*

## **Rationale**

### **5.7.1 Reporting of Net Positions and Bid Certification**

The Bank of Canada and the Department of Finance are conscious of the potential administrative burden that the new reporting requirements will impose on auction participants, and thus are reluctant to impose additional responsibilities unless the resulting benefits clearly outweigh any potential costs. After due consideration, the Bank of Canada and the Department of Finance believe that position reporting is essential in preventing undue concentration. The burden of reporting should not be particularly onerous, as prudent risk management practices would suggest that auction participants should already have systems in place to monitor their securities positions. Given the potential damage that squeezes can have on the efficiency of the Government of Canada securities market, it is believed that the benefits of the new position reporting requirements more than offset the administrative inconvenience.

Other components of the reporting regime have been reviewed by the Bank of Canada and the Department of Finance in light of the feedback on the discussion papers. The annual certification requirement proposed in the first discussion paper will be retained, because it provides an important assurance, from a source not directly involved in the trading and distribution of Government of Canada securities, that participants respect the auction rules. The additional administrative burden in complying with this requirement is minimal, as the process of certification should easily fall out of the normal annual internal audits of government securities distributors and other auction bidders.

Comments regarding the potential complexity of the customer reporting requirements and concerns expressed about client confidentiality have resulted in a number of changes. These will simplify the reporting process and provide customer bidders with the option of reporting net positions directly to the Bank of Canada. Under the new reporting rules, all customers bidding competitively at auction must report their net positions, regardless of the amount of their bids and existing holdings of the auctioned securities. This change will eliminate any confusion over when a customer should or should not report. Although government securities distributors will still be responsible for notifying their customers of their responsibilities, the burden of that activity is reduced by virtue of the standardization of customer responsibilities and because customers will already be aware of their reporting requirements through the application process for a unique identification number.

### **5.7.2 Market Information**

All market participants share the responsibility for the integrity of the secondary market. The IDA has recently taken a positive step to enhance market integrity with the adoption of its Policy No. 5, and other major financial industry groups involved in the secondary market have been encouraged to adopt similar principles. The Bank of Canada has been involved in these initiatives, and plays a role in helping to ensure integrity of the Government of Canada debt

market. Through the IDA Policy No. 5, the new auction rules and the new terms of participation, there is a requirement to provide enhanced market information in those special circumstances when the integrity of the government of Canada debt market is in question. The Bank of Canada requires regular reporting of distributor activities related to Government of Canada debt, including firm-wide positions. In relation to market integrity, the Bank of Canada may require that government securities distributors provide general information concerning their customers' activities relating to Government of Canada securities. In the event that the Bank of Canada is of the view that there is or has been trading in Government of Canada securities in an unusual manner for a persistent period of time, it may require distributors to disclose the names and activities of customers involved in such trading.

Principal indicators as to whether the level of surveillance for a particular Government of Canada security should be intensified include repo rates (the degree of "specialness"), the amount of the outstanding stock controlled by one or more participants, the turnover of the security, and the extent to which the security trades away from the yield curve. The Bank of Canada maintains the discretion to (i) investigate whether activity outside the auction rules has occurred, (ii) notify the appropriate regulatory authorities if other questionable activities are found, (iii) refer incidents of questionable secondary market activity to the Investment Dealers Association of Canada for investigation of possible violations of its Policy No. 5, and (iv) sell securities from its own portfolio. The Department of Finance maintains the discretion to re-open an issue outside the timetable provided by the Quarterly Bond Schedule and the usual treasury bill issuance cycle.

## **6. Conclusions**

Auctions should be free of, and perceived to be free of, manipulation, because it is very important that the confidence of direct participants and end investors in the auction process be sustained. The measures discussed in this paper seek to reinforce the integrity of the auction process. Taken together, the initiatives presented in this paper represent a significant change in the way the Government of Canada auctions its marketable debt. These changes are expected to help curb manipulative behaviour in the primary market.

These revisions are also intended to maintain broad-based involvement in auctions by ensuring that participants have confidence in the process. Anticipated benefits of the changes, as well as the joint initiatives in the secondary market, include a more open and level playing field for market intermediaries, a more efficient market for investors, a well-functioning capital market for the economy and cost-effective borrowing for the government.

## **Appendix 1**

### **Definitions**

*Government securities distributor* means an entity that has been given notice of its status as such by the Bank of Canada and has access to bid at Government of Canada auctions.

*Primary dealer* means a subset of government securities distributors whose participation in the primary and secondary markets for Government of Canada securities is above a threshold level. A distributor may be a primary dealer for bonds, for treasury bills, or for both.

*Bid* means an offer to purchase a stated par amount of securities at an auction, either on a competitive or non-competitive basis. An offer to purchase a stated par amount of securities submitted by a government securities distributor to fulfil a guarantee to sell a specified amount of securities at an agreed-upon price or a price fixed in terms of an agreed-upon standard is a bid of the government securities distributor and not a bid of a customer.

*Bidder* means a person or an entity that bids either directly or through an entity authorized to submit bids for customers in an auction. In some cases, two or more persons or entities are considered to be one bidder, based on their relationship.

*Submitter* means the entity that is permitted to submit bids, either on its own behalf or on behalf of customers, to the Bank of Canada for the auction of Government of Canada securities. Only government securities distributors and the Bank of Canada may be submitters.

*Customer* means a bidder on whose behalf a government securities distributor has been directed to submit a competitive or non-competitive bid for a specified amount of securities at a specific price.

*Bidding limit* means the distributor's or customer's limit prior to adjusting for long positions. If a distributor or a customer does not have a long position, its auction limit would equal its bidding limit.

*Auction limit* means the maximum amount for which a distributor or customer is allowed to bid at a specific auction. The auction limit is equal to the bidding limit adjusted for long positions in the securities being auctioned. An auction limit is equal to or smaller than the bidding limit.

*Customer submission limit* means the maximum amount of bids a distributor is allowed to submit on behalf of its customers.

*Aggregate limit* means the maximum amount for which a distributor and its customers can bid in combination.

## **Appendix 2**

### **Summary of Auction Rules**

#### **Bidder Definition**

- The new bidder definition covers all government securities distributors and customers, and applies to the following legal entities: corporations, partnerships, governments and government-related entities, foreign central banks (as well as governments of foreign states or international organizations), trusts and individuals.
- All bidders must certify that they will not bid in concert with any other bidder.
- Entities that do not have a strict arm's-length relationship with one another (i.e., affiliates) will be considered one bidder for the purposes of Government of Canada securities auctions. To avoid being considered a single bidder, affiliated entities will have to certify that they do not exchange information about yields, amounts, positions they hold or plan to hold, or their investment strategies with respect to the securities being auctioned.
- Entities are affiliates of one another if one is controlled by the other or if both are controlled by the same entity. The specific definition of control includes formal voting control along with direct and indirect controlling influence over management and policies.
- Affiliated entities that wish to be treated as separate bidders must certify that they will not act in concert in formulating strategy or auction bids.
- Any entity that implements the conditions necessary to be considered a separate bidder must direct all of its bids and purchases through a non-affiliate.

#### **Submission of Bids**

##### *Government Securities Distributors*

- Government securities distributors will be able to bid on their own behalf subject to auction limits. Government securities distributors will also have a separate limit for the aggregate amount of bids they place on behalf of customers. These bids must be listed separately from the distributor's own bids.

##### *Customers*

- Customers will be able to bid by submitting bids through government securities distributors subject to their own auction limit. Competitive bids must be listed separately from the distributor's own bids, and be accompanied by the customer's unique bidder number received from the Bank of Canada.
- Customers will be required to obtain a unique bidder identification number from the Bank of Canada before they can bid competitively. An application form for a unique bidder identification number will be available by facsimile or from the Bank of Canada Web page (<http://www.bank-banque-canada.ca>).
- Customers will not settle directly with the Bank of Canada. Government securities distributors will be responsible for the settlement of customer bids that they have submitted, and shall be liable to the Bank of Canada for any losses incurred as a result of those sales failing to settle in the Debt Clearing System (DCS) of the Canadian Depository for Securities.

## Competitive Auction Limits

- The amount that any distributor or customer can bid on a competitive basis at an auction (its auction limit) will equal its bidding limit less its excess net long position, which is its net long position in excess of the product of its percentage bidding limit and the par value of any outstanding stock of the security being auctioned.
- All bidders, both government securities distributors and customers, must report their net positions prior to an auction (see the section on reporting requirements for details). For the purposes of computing the auction limit, the bidder's net position will include the par amount of (i) cash holdings of a security with the same International Securities Identification Number (ISIN), (ii) when-issued positions, (iii) futures contracts that require delivery of the specific security being auctioned but not futures contracts for which the security being auctioned is one of several securities that may be delivered, and not futures contracts that are cash-settled, (iv) forward contracts, (v) holdings of the residual component of a stripped bond of the security being auctioned, and (vi) any position in the security not covered by the above types of contracts, including "guaranteed" trades. For repurchase agreements or securities lending, the entity that owns the security, not the one that has borrowed it, must report the repoed or lent security as part of its position. All positions are based on trade date rather than delivery date.
- Customer bids will not be netted against the limits of government securities distributors.
- Bidding limits for bond and treasury bill auctions are discussed below.

## Bidding Limits for Bonds

### *Government Securities Distributors*

- Primary dealers will have bidding limits tiered from 10 to 25 per cent of the auctioned amount for bids on their own account for Government of Canada bonds. Other government securities distributors will have limits tiered from 1 to 9 per cent.
- All distributors will also have a customer submission limit that will cover bids on behalf of customers. This limit will equal the greater of 5 per cent and the limit set on bidding for its own account.
- The aggregate limit for the sum of the bids submitted by a primary dealer on its own behalf and on behalf of its customers will be 40 per cent of the tender less the dealer's excess net long position (up to the dealer's bidding limit).
- Bidding limits for distributors will be tiered in line with their performance in auctions of Government of Canada bonds and in secondary markets for such securities over the preceding year. For the purpose of determining these bidding limits, winning bids submitted on behalf of customers will be taken into account in the assessment of the government securities distributor's performance at auction.

### *Customers*

- A customer will be able to bid through government securities distributors for up to 25 per cent of the amount auctioned. A customer can use as many government securities distributors as it chooses to submit its bids as long as the total amount of its bids does not exceed its auction limit. Customer bidding through a specific distributor may be constrained by that distributor's bidding limit and allocation of its aggregate limit.
- It is the responsibility of each customer to ensure that the total of its bids through all government securities distributors does not exceed its auction limit.

## **Bidding Limits for Treasury Bills**

### *Government Securities Distributors*

- Primary dealers will have a bidding limit of 25 per cent of the auctioned amount for bidding on their own behalf. Other government securities distributors, who are less active in treasury bill auctions and in the secondary market, will have a limit of 10 per cent of the auctioned amount.
- Distributors will have an additional bidding limit for the total amount of bids they submit on behalf of customers. This limit will equal the limit set on bidding for their own account.
- The sum of the bids submitted by a primary dealer on its own behalf and on behalf of its customers cannot exceed 40 per cent of the tender less the dealer's excess net long position (up to the dealer's bidding limit).

### *Customers*

- The bidding limit for a customer will be 25 per cent of the amount auctioned. A customer may use as many distributors as it chooses to submit bids, as long as the total amount of its bids does not exceed its auction limit. Customer bidding through a specific distributor may be constrained by the distributor's bidding limit and allocation of its aggregate limit.
- It is the responsibility of each customer to ensure that the total of its bids through all government securities distributors does not exceed its auction limit.

## **Non-competitive Bidding**

- Each government securities distributor will be able to make one non-competitive bid, in addition to any competitive bids, in auctions of Government of Canada bonds and each tranche of treasury bills.
- The ceiling on non-competitive bids for each participant will be \$3 million for Government of Canada bonds and for each tranche of treasury bills.
- All government securities distributors will also be able to bid non-competitively on behalf of customers. The total amount of customer non-competitive bids that each government securities distributor can submit will be limited to \$3 million.

## Reporting Requirements

### *Reporting of Net Positions*

- Government securities distributors must report their aggregate net positions in the auctioned security to the Bank of Canada when submitting their own bids or bids on behalf of customers. The net position must be reported regardless of whether it is a long or short position. This position must be updated with each re-submission of bids.
- Government securities distributors are responsible for ensuring that their customers are informed that they must report their net position either indirectly through the distributor or directly to the Bank of Canada before their competitive bids will be included in an auction.
- Customers bidding competitively at auction must report their net position in the auctioned security. If no net position is reported, the bid will be rejected automatically.
- Customers can submit that report either directly to the Bank of Canada or through a government securities distributor that is submitting a bid on their behalf. A customer reporting its net position directly to the Bank of Canada may do so up to 30 minutes before the bidding deadline on the day of the auction.
- All bidders are required to re-submit their position, by the bidding deadline, if it changes by more than \$25 million. Customer position changes must be reported directly to the Bank of Canada.
- Customers may make non-competitive bids without submitting a net position report.

### *Bid Certification and Verification*

- Government securities distributors must ensure that bidding customers are aware of the reporting requirements and that, upon completion of the auction, customers are informed of any auction allotments. The Bank of Canada will rely on a process of spot checks of customer bids to ensure their validity.
- As part of the proposed certification and confirmation process, all government securities distributors and customers must provide annual certificates of compliance from their internal audit departments.

### *Market Information*

- The Bank of Canada requires regular reporting of distributor activities related to Government of Canada debt, including firm-wide positions. In order to help ensure market integrity, the Bank of Canada may require that government securities distributors provide general information concerning their customers' activities relating to Government of Canada securities. In the event that the Bank of Canada is of the view that there is or has been trading in Government of Canada securities in an unusual manner for a persistent period of time, it may require distributors to disclose the names and activities of customers involved in such trading.
- The Bank of Canada maintains the discretion to (i) investigate whether activity outside the auction rules has occurred, (ii) notify the appropriate regulatory authorities if other questionable activities are found, (iii) refer incidents of questionable secondary market activity to the Investment Dealers Association of Canada for investigation of possible violations of its Policy No. 5, and (iv) sell securities from its own portfolio. The Department of Finance maintains the discretion to re-open an issue outside the timetable provided by the Quarterly Bond Schedule and the usual treasury bill issuance cycle.



## **Appendix 3**

### **Specific Definition of Control**

#### ***Combination of Affiliates Under a Single Bid***

“*Entity*” includes the following:

- corporations;
- partnerships;
- trusts;
- funds;
- unincorporated associations or organizations;
- Her Majesty in Right of Canada or of provincial governments;
- agencies of Her Majesty in either of such rights;
- governments of foreign countries or any political subdivision thereof and any agency thereof;
- foreign central banks and
- international organizations.

“*Person*” means a natural person, an entity or a personal representative.

Bids may be submitted by the following persons:

- corporations;
- partnerships;
- trusts;
- the Government of Canada;
- provincial governments;
- federal and provincial crown corporations and agencies;
- local governments (including, without limitation, municipalities, regional municipalities, counties and townships);
- individuals;
- foreign central banks;
- foreign governments and
- international organizations.

Only persons who are not affiliated with any other bidder may submit a separate bid. Persons who are affiliated must combine their bids in a single bid unless they can meet the criteria and provide the certification required in the following section for submitting separate bids.

Two persons are affiliated if one is controlled by the other or if both are controlled by the same person.

A person controls a corporation if:

- (a) securities of the corporation to which are attached more than 50 per cent of the votes that may be cast to elect directors of the corporation are beneficially owned by that person and the votes attached to those securities are sufficient, if exercised, to elect a majority of the directors of the corporation;

- (b) the aggregate of (i) any securities of the corporation that are beneficially owned by that person and (ii) any securities of the corporation that are beneficially owned by any entity controlled by that person is such that, if that person and all of the entities controlled by it that beneficially own securities of the corporation were one person, that person would control the corporation; or
- (c) that person controls an entity that controls the corporation.

A person controls a limited partnership if:

- (a) that person is a general partner of the limited partnership; or
- (b) that person controls an entity that controls the limited partnership.

A person controls an unincorporated entity, other than a limited partnership, if:

- (a) more than 50 per cent of the ownership interests, however designated, into which the entity is divided are beneficially owned by that person and that person is able to direct the business and affairs of the entity; or
- (b) that person controls an entity that controls the unincorporated entity.

A person controls any entity if that person has any direct or indirect controlling influence over the management and policies of the entity whether alone or in combination with one or more other persons and whether through the beneficial ownership of securities, through one or more other persons or otherwise.

In order to be able to submit a separate bid, a person must certify to the Bank that it will not intentionally act together with any other person with respect to bidding in an auction.

## Appendix 4

### Illustration of Aggregate Bidding Limits

This appendix provides illustrations of the aggregate limit, which states that the sum of the bids submitted by a primary dealer on its own behalf and on behalf of its customers cannot exceed 40 per cent of the tender less the dealer's excess long position (up to the dealer's bidding limit). This rule will only affect primary dealers with limits over 20 per cent.

#### **Example 1: Assume a new tender of \$2 billion**

If the dealer has a 25-per-cent bidding limit and no long position:

*Dealer auction limit on own behalf (25 per cent less excess long) = \$500 million*

*Dealer submission limit for customers (25 per cent) = \$500 million*

*Aggregate limit (40 per cent less excess long) = \$800 million*

The dealer must allocate bids between its own account and total customer bids to not exceed \$500 million each and \$800 million combined.

#### **Example 2: Assume a tender of \$2 billion (re-opening of a \$2 billion issue)**

**a)** If the dealer has a long position of \$500 million or less, it does not have an excess long position and its limits are the same as in Example 1.

**b)** If the dealer has a long position of \$750 million, its excess long position is \$250 million.

*Dealer auction limit on own behalf (25 per cent less excess long)*

*= \$500 million - \$250 million = \$250 million*

*Dealer submission limit for customers (25 per cent) = \$500 million*

*Aggregate limit (40 per cent less excess long) = \$800 million - \$250 million = \$550 million*

The dealer must allocate bids between its own account (not over \$250 million) and total customer bids (not over \$500 million) so that combined bidding does not exceed \$550 million.

**c)** If the dealer has a long position of \$1 billion, its excess long position is \$500 million.

*Dealer auction limit on own behalf (25 per cent less excess long)*

*= \$500 million - \$500 million = \$0*

*Dealer submission limit for customers (25 per cent) = \$500 million*

*Aggregate limit (40 per cent less excess long) = \$800 million - \$500 million = \$300 million*

The dealer cannot bid on its own account, and total customer bids cannot exceed \$300 million.

**d)** If the dealer has a long position of more than \$1 billion, its excess long position exceeds its bidding limit. Therefore, the 40-per-cent aggregate limit is reduced by the bidding limit rather than the excess long position. As a result, the customer limit is still \$300 million.

#### **Example 3: Assume a tender of \$2 billion (re-opening of a \$6 billion issue)**

**a)** If the dealer is long \$1,500 million or less, the limits are the same as in Example 1 (there is no excess long position).

**b)** If the dealer is long \$1,750 million, the limits are the same as in Example 2b.

**c)** If the dealer is long \$2 billion, the limits are the same as in Example 2c (the excess long position equals the bidding limit).

**d)** If the dealer is long more than \$2 billion, the limits are the same as in example 2c (the excess long position exceeds the bidding limit, and the 40 per cent is reduced by the bidding limit).