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

Discussion Paper 1

19 December 1996

SUMMARY: The Bank of Canada and Department of Finance are requesting comments on proposals to change the administrative arrangements pertaining to auctions of Government of Canada securities. This initiative is part of a broad-based effort by the government and market participants to improve the functioning of the Government of Canada debt market. Although the existing auction rules generally have been adequate, there is a need to clarify and strengthen certain rules to ensure the auction process functions appropriately. A number of developments point to this need, including the growing influence of individual market participants, the consolidation of the major banks and investment dealers and smaller financing requirements of the government. In addition, the pre-auction distribution of Government of Canada debt -- which contributes to the efficiency of the process and the smooth functioning of other Canadian fixed-income securities markets -- is low relative to that in the United States. This may result partly from differences in the auction rules of the two countries.

The proposals include both changes in auction rules and an increase in the Bank of Canada's auction-related monitoring activities. In broad terms, the proposed measures seek to reinforce the integrity of the auction process, and to enhance participation in it, by reducing the potential for manipulative behaviour prior to and during auctions. It is important that the auction process be free of, and be perceived free of, manipulation so that confidence in the process is maintained. Otherwise, the efficient functioning of the market for Government of Canada debt and other fixed income markets in Canada will be harmed, with repercussions for market-makers, investors, the economy and the government. A two stage consultation process with market participants is planned to assure that the final measures are given due consideration by all parties and that they are appropriate.

More specifically, the proposals include a definition of a bidding entity, new bidding limits for primary distributors, bidding limits for the customers of primary distributors, the separate submission of bids from investors to the Bank of Canada by primary distributors, and the sale of securities by the Bank of Canada to both primary distributors and their customers. Primary distributors would submit bids for their own-account and for the accounts of other bidders. Possible penalties for violations of the auction rules are also discussed.

The Bank of Canada intends to increase its auction-related monitoring activities. In this regard, it is proposed that the reporting requirements for primary distributors be broadened to include full disclosure of their activity in Government of Canada financings.

PROCESS: Comments must be received on or before 31 March 1997. A second discussion paper will summarize and evaluate the comments. It will also present for further comment detailed draft revisions to the terms and conditions for auctions and the primary distributor terms of reference.

ADDRESS: Comments should be sent to:

Bank of Canada
Financial Markets Department
4th Floor, East Tower
234 Wellington Street
OTTAWA, Ontario K1A 0G9

or via e-mail: comment@bank-banque-canada.ca

Comments received will be available for public inspection and copying, beginning April 2, 1997 at the Bank of Canada Library, 7th Floor, West Tower, 234 Wellington Street, Ottawa, Ontario, K1A 0G9. Comments received will also be available for public inspection on the Bank of Canada's Internet Home Page (http://www.bank-banque-canada.ca) beginning 2 April 1997.

FOR FURTHER INFORMATION CONTACT: Ron Parker, Deputy Chief, Financial Markets Department, Bank of Canada (613-782-8160; rparker@bank-banque-canada.ca) or Rob Stewart, Acting Chief, Financial Markets Division, Department of Finance (613-992-4468; stewart.rob@fin.gc.ca).

1 Overview

The purpose of this paper is to provide interested parties with the opportunity to comment on a number of possible changes to the terms and conditions pertaining to auctions of Government of Canada securities and the surveillance of the auction process by the Bank of Canada. The objective of these proposals is to maintain broad-based involvement in auctions by ensuring that participants can have confidence in the process. This would have several benefits: for market intermediaries, a more open and level playing field; for investors, a more efficient primary market; for the economy, a well functioning capital market; and for the government, the cost of borrowing would be reduced.

The measures discussed in the paper seek to reinforce the integrity of the auction process by reducing the scope for possible manipulative behaviour that could result in unanticipated economic losses to those involved in the distribution of government debt. It is very important that the confidence of direct participants and end-investors in the auction process be sustained. Auctions should be free of, and be perceived as being free of, manipulation so that there is no doubt end-investors are receiving fair value for the Government of Canada securities they are purchasing. Otherwise, the number of active participants in auctions could decline as confidence in the process is eroded. This would not only reduce the liquidity of the market for Government of Canada debt, but it could also impair the smooth functioning of other Canadian fixed-income securities markets because the prices of other securities are generally benchmarked relative to the price of Government of Canada debt instruments.

Most of the proposed auction rules presented in the paper are intended to limit the scope for "squeezes" (discussed below) in the primary market for Government of Canada securities, such as those observed in the U.S. Treasury market in 1990 and 1991.[1] Under the existing auction rules in Canada, for example, there is no effective limit on the purchases at auction by primary distributors because net long when-issued positions are not subtracted from bidding limits. Similar issues arise because there is no limit on auction orders that customers can place with primary distributors. It is therefore possible for a market participant to gain control of the stock of a security at an auction and to withhold the supply from the market. This possibility risks reducing the involvement of market makers and their customers in the market for Government of Canada treasury bills and bonds. Prospective reductions in the size of treasury bill and bond auctions could also mean that it would be relatively easier for primary distributors or customers to establish positions that would influence the price of government debt at auction and to unduly influence or control the availability of auctioned securities.

The discussion paper limits itself to concerns about the auction process for which the government has a clear and direct responsibility. The paper does not propose measures to deal with squeezes arising in secondary markets for which many participants, including the government, market makers, investors and regulators have shared responsibility. All parties will need to work together in this area to ensure that the Government of Canada securities market functions properly. In this vein, the paper also discusses the more general issues related to squeezes.

1. U.S. Department of the Treasury, et al., "Joint Report on the Government Securities Market," U.S. Government Printing Office (January, 1992).

1.1 The Current Auction Process

Government of Canada treasury bill and nominal bond auctions follow similar, though not identical processes.[2] In the case of treasury bills, the call for tender, which includes the dollar value of securities to be auctioned, is announced one week in advance, when the auction results for the current week are released. The process of distributing these securities then starts with primary distributors and their customers trading contracts to buy or sell the securities to be auctioned in what is known as the "when, and, as-if-issued" (when-issued) market.[3] In these contracts the parties undertake to buy or sell the security to be issued, on the settlement date of the auction, at an agreed price. The when-issued market provides investors with valuable information about the price at which market participants think the securities to be issued will be sold.

On the day of a treasury bill auction (normally Tuesday), primary distributors submit their bids to the Bank of Canada no later than 12:30 p.m. Customers can place "pre-tender" orders with primary distributors, which the primary distributors effectively commit to fill at a given price, within the bidding limits placed upon them. Customers can place pre-tender orders through as many primary distributors as they wish. Each primary distributor may submit any number of competitive tenders, one non-competitive tender, or both. The bids are ranked from the lowest yield to the highest yield and they are then accepted in ascending order until the issue size is reached, subject to the individual bidding limits of the primary distributors. The auction results are announced at 1:15 p.m.

2. Overviews of the markets in Government of Canada securities are provided by: Kevin Fettig, "The Government of Canada treasury bill market and its role in monetary policy," *Bank of Canada Review,* (spring 1994); and Andrew Branion, "The Government of Canada bond market since 1980," *Bank of Canada Review,* (fall 1995). See also, "Amendments to the administrative arrangements regarding the auction of Government of Canada securities," *Bank of Canada Review* (summer 1996).
3. See D. Graham Pugh, "The when-issued market for Government of Canada treasury bills: A technical note," *Bank of Canada Review,* (November 1992).

In the case of bond auctions, the call for tender is typically released on a Thursday afternoon, and the auction takes place the next Wednesday. When-issued trading in the bond market begins following the release of the call for tender and ends once the deadline for the submission of bids arrives. The timing of the settlement and delivery of the securities is usually the first or fifteenth day (or next business day) of any given month.

1.2. Auction Related Squeezes

The primary concern addressed in this paper is the risk that the auction process may be used to "squeeze" the market for a Government of Canada security. Squeezes generally occur when market participants enter into contracts to deliver a security at some future date, but are then unable to purchase or borrow that security for delivery on the specified date at a price close to that anticipated in the contracts because an end-investor or dealer, or a group of market participants, has monopoly control over ("cornered") the stock of the security. It is often very costly for those caught in the squeeze to meet their contractual obligation to deliver the security.

A squeeze will result in the security's repo rate falling significantly below market rates for loans of similar maturity and credit risk.[4] In this circumstance, the security is said to be "on special" in the repo market. It is noteworthy that as the supply of and demand for particular securities evolves, it is not unusual for its degree of "specialness" to vary for many reasons unrelated to market manipulation. However, these latter types of situations are not intended to be the subject of these proposals.

The adverse consequences of squeezes have an impact on all market participants. Primary distributors, as a group, tend to lose money because they pre-distribute the securities to investors

4. See Ron Morrow, "Repo, reverse repo and securities lending markets in Canada," *Bank of Canada Review*, (winter 1994-1995); and Darrell Duffie, "Special Repo Rates," *Journal of Finance*, (June 1996, volume LI, No. 2) pages 493-526.

prior to the auction through selling when-issued contracts. A particular squeeze may affect or not affect individual primary distributors, depending on the volume of when-issued contracts they have sold and how strongly they bid at the auction to cover their short position. However, over time, this group of market participants will consistently suffer losses because their role in the debt distribution process implies that they will be short the securities.

Investors experience the adverse consequences indirectly since most do not sell securities short, but it is clear that their long-term interest is harmed. The main indirect effect of persistent squeezes is that primary distributors will become even more reluctant to trade when-issue contracts, further impairing the liquidity of this market and making it more difficult for investors to be sure that the relative value of the securities to be auctioned vis-à-vis other similar debt instruments is correct. Over the longer run, investors will likely find not only the liquidity of the when-issued market is impaired by squeezes, but the liquidity of debt instruments priced in relation to Government of Canada debt, such as provincial and corporate debt, also may be reduced. The liquidity of other debt markets could be impaired because it would be riskier for dealers to go short recently-issued Government of Canada debt to hedge long provincial or corporate debt positions (a standard risk management practice) if there is a perception that the government debt market is subject to manipulation.

The general public also suffers from squeezes because the market for government debt is likely to become less liquid and efficient, which means that the cost of borrowing will be higher. This may translate into higher taxes, lower spending on government programs or higher deficits than otherwise.

The consequences of squeezes for the government debt market are clearly much broader than the narrow question of what group of market participants gain or lose over the short run.

Squeezes, or even the perception of the possibility of manipulation, can do permanent long-run damage to the fabric of a market. The examples cited below indicate that auction related squeezes are becoming more frequent and that it is probable that this trend will continue, and perhaps worsen, in the absence of changes to the auction rules.

The fear of being caught in a squeeze is likely acting to limit trading in when-issued contracts, which fundamentally undermines the price-discovery process for to-be-issued securities. In Canada, the volume of when-issued trading is quite low and tends to be concentrated in the period just before an auction. The comparison of the ratios of the volume of trade in when-issued bond contracts to the gross value of new bond issues for Canada and the United States presented in Table 1 underscore this point. These data show that when-issued trading in the United States is at least four times more active than in Canada.[5] Some of this difference might be attributable to the volume of U.S. dollar denominated bond issuance by foreigners that would be hedged through purchases and sales of when-issued contracts on U.S. Treasury notes and bonds. However, the rates of turnover in the secondary bond market of both countries, relative to their respective stocks outstanding, is quite similar. This tends to suggest that the risk of being "squeezed" may be one factor restraining when-issued trading in Canada.

5. The Canadian when-issued data include trades up to one-half hour before the deadline for the submission of bids, while the U.S. data include when-issued trades up to the day before the auction. When-issued trading on the day of an auction is usually quite active. Hence, these data understate the difference in the ratios.

Table 1

A Comparison of When-Issued Bond Trading In Canada and the United States
(ratio of trading in when-issued contracts to gross new issues)

	Canada	United States
July 1994 - November 1995	0.7	3.0

Sources: Gross new issuance of and when-issued trading in Government of Canada Bonds, Bank of Canada; gross new issuance of U.S. Treasury notes and bonds; U.S. Department of the Treasury Bulletin, Tables PO2 and PO3; primary dealer when-issued trading in U.S. Treasury notes and bonds, Federal Reserve Bank of New York. Comparable data are available between July 1994 and November 1995.

The empirical results of a recent report by Paul Halpern, provide some evidence of squeezes in all treasury bill maturities.[6] To alleviate squeezes, the author recommends netting the when-issued position of the bidders with their position at the auction when calculating the maximum portion of the tender that bidders may be awarded. He also suggests that consideration be given to re-opening issues that are being squeezed.

Market participants have generally acknowledged past squeezes in specific securities. A bond issue frequently cited as having been squeezed is the 8 per cent bond due 1 June 2023, first issued in August 1992. In addition, a short-term treasury bill (often referred to as a “cash management bill”) was squeezed on 26 July 1995; this led to the re-opening of the security the day following the auction. More recently, an investor or group of investors reportedly established a large position in the 6-month treasury bill auctioned on 2 July 1996, through purchases from a number of dealers in the when-issued market, gaining such tight control over the issue that it could often not be obtained at any price through the repo or secondary markets. Since early July, there have been persistent signs of squeezes in the treasury bill market as tender sizes have declined.

6. Paul Halpern, “The Treasury Bill Market: An Evaluation of Recent Initiatives,” *Department of Finance Debt Program Evaluation,* (October, 1995).

The scope for squeezes could be expanding as the financial services industry becomes more integrated and the size and leveraging capacity of the customers of primary distributors increase. The latter point is reflected by the growth in the relative importance of hedge funds, mutual funds, and other types of money managers in Canadian fixed income markets. With the large balance sheets and leveraging capacity of some accounts, it is possible for them to acquire a very large position in a security to be auctioned through the when-issued market and, at the same time, make purchases without limit at the auction by placing pre-tender orders with several primary distributors, to the extent that the distributors remain within their own existing limit. The risk of being caught out by investors using this type of trading strategy may lead primary distributors and other participants to become increasingly reluctant to be involved in the pre-auction distribution of Government of Canada securities.

The measures detailed in this paper are aimed at moderating some aspects of the auction rules that may provide opportunities for primary distributors and customers to create or participate in squeezes through the auction process. The proposed revisions to the auction rules are necessitated by the evolving realities of the market for Government of Canada debt and the need to reassure all primary distributors, end-investors, and the general public that the auction process is fair and it is not subject to manipulation. In this regard, the proposals are believed to represent a satisfactory solution to the problem and one that imposes a minimal burden on market participants. In addition to these new rules, it may be desirable to have increased self-regulation by the industry. The government seeks the industry’s views in this area.

1.3 Squeezes Outside of Government of Canada Auctions

Squeezes can affect both the primary and secondary markets for Government of Canada debt. As discussed previously, securities may go “on special” in the repo market simply because of normal commercial activities or of imbalances between demand and supply. On the other hand, the specialness of a security may increase because it is being squeezed as a result of manipulation. This situation can be harmful to all market participants. The government's direct responsibility is to avoid squeezes at the time securities are auctioned. To this end, the proposals take into account the consequences of large net long positions for auctions. However, squeezes arising through the establishment of large net long positions before and after auctions are the responsibility of all market participants.

A rules based approach can work effectively for the primary distribution of securities. However, it is unlikely to work well for secondary market squeezes. This is because there are numerous potential indicators of a secondary market squeeze (e.g. the amount of the stock and turnover controlled by one participant, and the repo rate on the security), but there is no definitive gauge that a squeeze is taking place. Therefore, a simple set of rules could be counter productive and potentially could reduce activity overall in the government securities market. A self-regulatory approach, perhaps supported by legislation, and the provision of information to the market on large positions (such as occurs in the stock market) may help to address this complex matter. In addition, the government can re-open issues to relieve market pressures but this may have negative implications for the general distribution process. The Bank of Canada jobbers and the IDA Capital Markets Committee have recently formed a sub-committee to look at this and other emerging capital market issues. The government is supportive of this effort by market participants and it intends to work with them.

2 Revisions to the Auction Rules and Procedures

In this section, the specific proposals to modify the auction rules are described (Box 1 provides a summary of the proposals). The proposals include changes in the procedures related to the submission of bids, settlement of the securities, the definition of a bidder, verification and confirmation procedures and the calculation of bidding limits. It is proposed that bidding limits be placed on the accounts of the primary distributors. Proposed penalties for the failure to comply with the terms and conditions of auctions are also presented.

2.1 The Submission of Bids and the Settlement of Securities

- Submission of bids. Primary distributors would submit separate, itemized bids to the Bank of Canada for their own account and on behalf of other bidders (customers). While customers may submit bids through primary distributors, only primary distributors may submit bids directly to the Bank of Canada.
- Settlement of securities. The Bank of Canada would sell securities directly to (i) primary distributors and (ii) other bidders (customers). All securities would settle through the Debt Clearing System (DCS) of the Canada Depository for Securities, as per standard industry practices. Bidders would be required to file settlement instructions prior to an auction.[7] The Bank of Canada would transmit settlement instructions to the DCS when the auction results are published.
- Each bidder, whether a primary distributor or a customer, would have a unique account number at the Bank of Canada.

7. Bidders other than primary distributors may be required to have a line of credit with their settlement agent to guarantee the availability of funds for settlement.

Box 1

Summary of the Proposed Changes to the Auction Rules*

The changes to the auction rules and procedures outlined here address the issues raised above. The major new features being considered for the standard terms and conditions for treasury bill and bond auctions are:

- Customers of primary distributors would be able to bid in the auction by submitting bids through primary distributors. Only primary distributors would be permitted to submit bids for the accounts of others.
- Primary distributors (submitters) would submit separate bids for their own accounts and for the accounts of other bidders (the customers of the primary distributors).
- There would be separate bidding limits for primary distributors and for the customers of primary distributors.
- Sales of securities would be directly from the Bank of Canada to (i) primary distributors and (ii) other bidders (customers) and would be settled by a transfer of securities from the Bank of Canada to the Debt Clearing Service (DCS) of the Canada Depository for Securities.
- Primary distributors would report their aggregate net long (short) position to the Bank of Canada at the time they submit their bids.
- Customers would report their aggregate net long (short) positions either directly to the Bank of Canada or to a primary distributor who would be submitting a bid to the Bank on behalf of the customer, when the total of all their bids plus the absolute value of their net long (short) position in the security being auctioned equals or exceeds $100 million.
- The bidding limit at auction for the "own" account of a primary distributor would be equal to its specific bidding limit less any net long position in excess of the product of its percentage bidding limit and the dollar value of any outstanding stock of the security being auctioned (conversely, a net short position of up to 10 per cent of the dollar value being auctioned would be added to the bidding limit). Customer bids would not be netted against the bidding limits of primary distributors.
- The bidding limit for a customer would be equal to its bidding limit less its net long position in excess of the product of its percentage bidding limit and the dollar value of any outstanding stock of the security being auctioned (conversely a net short position of up to 10 per cent of the dollar value being auctioned would be added to the bidding limit).
- Individual bidding limits may be set below the maximum at the discretion of the Bank of Canada.
- The aggregate maximum dollar value of bids that a primary distributor may submit on behalf of all its customers would be equal to the primary distributor's percentage bidding limit times the dollar value of securities being auctioned.
- The customers of primary distributors would be responsible for ensuring that the total of their bids through all primary distributors does not exceed their bidding limit.
- All bidders would be required to certify annually that the information they are providing to the Bank of Canada is correct. Customers would furnish a written trade confirmation to the Bank of Canada.
- The Bank of Canada, at its discretion, would spot check the customer bids submitted by the primary distributors.
- Penalties for a failure to comply with the auction terms and conditions are outlined in Section 2.5.

The Bank of Canada will be increasing its surveillance of trading in to-be-issued and recently issued Government of Canada securities. Primary distributors may be asked to provide, from time-to-time, detailed issue-specific trading reports to the Bank of Canada so that the reasons why specific securities are trading at prices above their underlying value may be understood more clearly. It should be noted that the Government of Canada has the authority to issue new, identical securities at any time, even if no clear explanation for a squeeze can be identified.

* See Appendix 1 for the definitions of the entities involved in the auction process.

Commentary:

The identification to the Bank of Canada of individual accounts participating at the auction is intended to provide assurance to bidders, and to the issuer, that no single entity or group of entities is acting in a manner that could be construed as manipulative or otherwise damaging to the integrity of the auction. The identity of individual bidders will be held as confidential information by the Bank, unless a violation of the auction rules occurs.

The Bank of Canada is proposing to settle auctioned securities directly with primary distributors and with other bidders so that both classes of bidders clearly would be purchasers of securities at the auctions.

2.2 Bidder Definitions

- Bidder definitions. Entities that do not have a strict arm's-length relationship with each other would be considered to be one bidder.[8] In order to be identified as separate bidders, entities within the same organization must certify that they do not exchange any information about the yields, amounts, positions they hold or plan to hold, or their investment strategies with respect to the securities being auctioned. Moreover, entities would undertake that they would not in any way intentionally act together with any other part of the corporate structure in formulating or entering bids at an auction.

Commentary:

The increasing integration of bank treasury operations and bank-owned primary distributors has given rise to questions as to whether off-balance sheet and other proprietary trading divisions within firms should be able to submit bids through the cash market bill and bond desks of other primary distributors. The definition of a bidder is intended to remove the ambiguity of the current

8. See the U.S. Department of the Treasury definition of a bidder in Appendix 2. A definition for the purposes of Government of Canada auctions would be developed to suit the Canadian legal situation.

situation. The bidder definition would also apply to other corporations, partnerships, government-related entities, foreign central banks (as well as governments of foreign states, or international organizations), trusts or other fiduciary estates, individuals, and any other types of bidders not otherwise described. The extension of the rule to other types of bidders is intended to limit the possibility of related entities acting together to manipulate auctions.

2.3 Bid Certification and Verification

- Certificate of compliance. Primary distributors and other bidders would certify that the information that they are providing is correct. Certificates to this effect would be forwarded annually by the internal audit departments of primary distributors and customers.
- Customer confirmation. Any customer submitting a winning bid would furnish a written confirmation to the Bank of Canada by 10 a.m. (EST) the day following the auction of (1) its bid (2) its award and (3) the size of a net long (short) position prior to the tender. Primary distributors would be responsible for notifying their customers of the net long (short) position reporting requirements when orders of $50 million or more are placed.
- Notification of Awards. Primary distributors would be responsible for notifying their customers of the awards following an auction.
- Spot checking. The Bank of Canada would perform spot checks on the customer bids submitted via primary distributors. In addition, all awards greater than or equal to $200 million to customers will be confirmed by telephone prior to settlement.

Commentary

The certificates regarding auction-related information are intended to provide assurance, from a source not directly involved in the trading and distribution of Government of Canada securities, that the auction rules are being respected. The provision of the certificates should be a minimal administrative burden to bidders, since the certification should follow from the normal annual audits of primary distributors and other bidders.

Bidder confirmations and spot checking by the Bank of Canada would help to ensure the validity of bids that were submitted. Primary distributors would be responsible for notifying customers of net long (short) position reporting requirements only when orders of $50 million or more are placed so as to avoid increasing the administrative burden associated with relatively small orders. Telephone confirmation of large awards prior to settlement and written confirmation of trades is in line with risk-management best practices.

Questions

- Can commentators provide estimates of the time and cost that would be incurred in providing the certificates of compliance?
- Is the $50 million threshold for requiring primary distributors to advise their customers of the net long (short) position reporting obligations too high or too low?

2.4 Bidding Limits

- <u>Net long positions</u>. A bidder's net long (short) position would include the par amount of (1) cash holdings of a security with the same International Securities Identification Number (ISIN), (2) when-issued positions, (3) 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), (4) forward contracts, and (5) any positions in the auctioned security not covered by the above types of contracts, including "guaranteed" trades.

Primary distributors would report their aggregate net long (short) position at the time they submit their bids to the Bank of Canada. Other bidders would report their aggregate net long (short) positions either directly to the Bank of Canada, or to a primary distributor who would be submitting a bid on behalf of the customer, when the total of all their bids plus the absolute value of their net long (short) position in the security being auctioned equals or exceeds $100 million. The timing and method of reporting net long positions by customers has yet to be determined; the Bank of Canada will be exploring the possibility of direct electronic submission of this information by customers.

If a bidder (such as an investment advisor) has control over (i.e., a “non-arm’s length” relationship) the net long (short) positions or bids of one or more other persons or entities, then the bidder would report a combined net long position that aggregates its own net long (short) position with the other net long (short) positions under its control. The person or entity exercising control would provide the name of each person or entity in whose name it is placing bids in the auction.

Commentary

Primary distributors would be expected to report their aggregate net long (short) position electronically at the time they submit their bids to the Bank of Canada. Other bidders would be given the option of reporting their net long (short) positions directly to the Bank of Canada so that they are not required to reveal their proprietary investment holdings to a third party. It is anticipated that it also would be possible for customers to elect to report a net long (short) position through a primary distributor. In this event, the net long (short) position would be communicated electronically to the Bank of Canada when the primary distributor submits the customer’s bid. The

$100 million reporting limit for other bidders is intended to reduce the administrative requirements imposed on smaller bidders.

Current risk-management practices suggest that it should not be difficult for firms to provide aggregate net long (short) positions at the time auction bids are submitted. Many primary distributors have operations that span the globe, and they have invested heavily in technology to provide their firms with aggregate, real-time risk exposures by type of security and by cash flow. In some instances it may be necessary to collect the required data manually, but this is most likely to be the case for smaller, less-frequent bidders. In any event, some time would be allowed for bidders to adjust to the new terms and conditions so that they can modify their policies and procedures as required.

The aggregation of net long (short) positions under the control of a bidder is consistent with the idea that a strict arm's-length relationship would exist across entities for them to be considered as separate for the purposes of these guidelines. The aggregation is intended to prevent a single bidder from exercising undue influence on auctions.

Questions

- Do commentators see as appropriate the $100 million threshold for the reporting by customers of their positions?

- Bidding limits for primary distributors. A primary distributor would be allowed to submit a bid for its own account equal to the product of its percentage bidding limit (expressed as a fraction) and the dollar value of securities being auctioned (per tranche) less its aggregate net long position (per tranche) in excess of the product of its percentage bidding limit and the dollar value of any outstanding stock of the security being auctioned. In the event that a primary distributor has a net short position, it would be allowed to submit a bid equal (i) to the product of its percentage bidding limit and the dollar value of securities being auctioned, plus (ii) the lesser of the dollar value of its net short position or 10 per cent of the dollar value of securities being auctioned.

Under the existing bidding limits, the maximum own-account bidding limit for a primary distributor would be 33 1/3 and 20 per cent, respectively, times the value of the treasury bills or nominal bonds being auctioned (per tranche) less (plus) its net long (short) position in excess of the product of its percentage bidding limit and the dollar value of any outstanding stock of the security being auctioned. Individual bidding limits may be set below this maximum at the discretion of the Bank of Canada. (Box 2 provides some illustrations of how the proposed rules would affect the maximum bidding limits of primary distributors).

Commentary

Primary distributors may currently submit bids for a maximum of 33 1/3 per cent of each tranche of a treasury bill auction. The percentage bidding limits for Government of Canada bonds vary by primary distributor based on their relative activity in the primary and secondary market for these securities. For example, Bank of Canada jobbers can bid for the equivalent of 20 per cent of conventional nominal bonds tendered at auctions.[9] Under the existing arrangements, primary distributors meet their own in-house demand for the securities, and any pre-tender orders from their customers, within their bidding limit. However, despite bidding limits, it is currently possible for a primary distributor to own the entire amount (or more) being auctioned by purchasing when-issued contracts prior to the auction. In effect, even though the maximum award at the auction is capped, primary distributors may engage in pre-auction trading and bidding at auctions that can result in their controlling the entire outstanding stock of a Government of Canada security.

9. The maximum bid is 25 per cent in the case of auctions of Real Return Bonds.

Box 2

Own-account Bidding Limits Under the Proposed Rules

This box provides a few illustrations of the implications for bidding limits of the proposed rules.

Suppose that the outstanding stock of a bond is $5.0 billion and that the government is offering a further $2.0 billion at auction. In addition, assume that the individual bidding limit of the primary distributor is 20 per cent.

Example 1

- Assume that a primary distributor has a net long position of $1.0 billion.
- The maximum own-account bid of the primary distributor will be $0.4 billion.

(a)	0.2 x $2.0 billion	= $0.4 billion
less (b)	$1.0 billion - (0.2 x $5.0 billion)	= $0 billion
equals (c)		= $0.4 billion

Example 2

- Assume that the primary distributor has a net long position of $1.2 billion
- The maximum own-account bid of the primary distributor will be $0.2 billion.

(a)	0.2 x $2.0 billion	= $0.4 billion
less (b)	$1.2 billion - (0.2 x $5.0 billion)	= $0.2 billion
equals (c)		= $0.2 billion

Example 3

- Assume that the primary distributor has a net long position of $1.4 billion.
- The primary distributor will not be eligible to submit a bid for its own-account.

(a)	0.2 x $2.0 billion	= $0.4 billion
less (b)	$1.4 billion - (0.2 x $5.0 billion)	= $0.4 billion
equals (c)		= $0 billion

Example 4

- Assume that the primary distributor has a net short position of $0.25 billion.
- The maximum own-account bid of the primary distributor will be $0.6 billion.

(a)	0.2 x $2.0 billion	= $0.4 billion
plus (b)	0.1 x $2.0 billion	= $0.2 billion
equals (c)		= $0.6 billion

The proposals attempt to moderate the scope for this type of activity by reducing the amount that a primary distributor may bid at auction by the amount that its net long position exceeds the maximum dollar value of securities that it could have been awarded at previous auctions. If a primary distributor has a net long position equal to its maximum bidding limit for the current auction plus the equivalent of the cumulative maximum dollar value of securities it could have acquired at previous tenders, the primary distributor would not be eligible to bid for its own account at the auction. While past experience indicates this type of situation occurs infrequently, it nevertheless has taken place on occasion, and it is fundamentally inconsistent with a sound auction process and a well-functioning market in Government of Canada securities. In allowing a primary distributor to hold up to the equivalent of its cumulative maximum award at prior auctions before the maximum bidding limit for the current auction is reduced, the proposal is intended to allow for the case that a portfolio manager(s) in a large integrated primary distributor may wish to own the security in his/her capacity as an end-investor(s).

It is proposed that a primary distributor be allowed to add a net short position of up to 10 per cent of the dollar value of securities being auctioned to its bidding limit to encourage the pre-auction distribution of securities. If primary distributors are not permitted some offset to their net short position, there would be less opportunity for them to engage in proprietary trading activity than otherwise. The scope for proprietary trading by primary distributors would be enhanced still further under the proposals since primary distributors would no longer meet pre-tender customer orders out of their own bidding limits.

One alternative route, on which comments are sought, might be to lower the maximum bidding limit for treasury bills from 33 1/3 per cent of the dollar value of securities being auctioned, less any net long position greater than the cumulative maximum dollar value of securities that could have been obtained at prior auctions, to reduce the possibility that the new supply of bills might be awarded to just three participants. Lowering this limit may mean that some participants, who have traditionally purchased large volumes of treasury bills at auction, would have to become more active in the when-issued market or purchase the bills in the secondary market following the auction. Thus, one possible benefit of a lower limit might be greater price transparency in the bill market since the underlying demand for the treasury bills would be more evident in when-issued trading prior to the auction and through secondary market trading after the auction.

- Bidding limits for customers. In keeping with present bidding limits for primary distributors, a customer would be allowed to submit a maximum bid equal to 20 per cent of the dollar value of bonds (33 1/3 per cent of the dollar value of treasury bills) being auctioned (per tranche) less its net long position (per tranche) in excess of the product of its percentage bidding limit and the dollar value of any outstanding stock of the security being auctioned. In the event a customer has a net short position, it would be allowed to submit a bid equal to (i) 20 per cent of the dollar value of bonds (33 1/3 per cent of the dollar value of treasury bills) being auctioned plus (ii) the lesser of the dollar value of its net short position or 10 per cent of the dollar value of securities being auctioned. [10,11]

  Commentary

Currently, customers may place pre-tender orders with primary distributors which, in turn, are submitted to the Bank of Canada as part of the primary distributor's bid. Thus, from the perspective of the issuer, there is no clear separation of the primary distributor's own bids and those of the primary distributor's customers. Another consequence of the existing arrangements is

10. As discussed above, views on the appropriateness of the maximum treasury bill bidding limits are being requested.
11. The illustrations provided in Box 2 would apply in an analogous manner to customers.

that customers may, in effect, make purchases without limit at auctions since they can place pre-tender orders with as many primary distributors as they wish. Furthermore, customers can (and do) accumulate large net long positions, principally through the purchase of when-issued contracts. The ability of customers to accumulate net long positions and to place orders without limit means that it can be very difficult for primary distributors to determine how aggressively they should bid at the auction to cover the short positions they have established through the pre-auction sale of securities. This type of uncertainty tends to limit the trading of when-issued contracts, thereby undermining the process of price discovery prior to auctions.

The changes being considered seek to meet end-investor requirements, while at the same time striving to provide assurance to all investors that the auction process is fair and that the market in Government of Canada securities is not amenable to being manipulated. The proposals are also intended to improve the price-discovery process, which is inherent in the trading of when-issued contracts, by reducing the risk that unexpectedly large customer bids, submitted through a number of primary distributors, will leave market makers unable to meet their contractual obligations.

- Maximum dollar value of customer bids submitted by a primary distributor. The maximum dollar value of bids that a primary distributor may submit on behalf of all customers, over and above what it bids for its own account, would be equal to the primary distributor's percentage bidding limit (expressed as a fraction) times the dollar value of securities (per tranche) being auctioned.

Commentary

Primary distributors are expected to bid at auctions in a manner that is reasonably linked to their scale of operations relative to the market. Primary distributors designated as jobbers by the Bank of Canada are also expected to make markets in Government of Canada securities, and as a group, jobbers are expected to submit bids to cover all auctions.[12] The proposed limitation on the aggregate dollar value of customer bids that could be submitted by a primary distributor is intended to encourage customers to place orders at a number of primary distributors and to underscore the important role played by the Bank of Canada jobbers through their coverage of treasury bill and bond auctions and through the provision of liquidity to the secondary market for all Government of Canada securities.[13] At the same time, because the bond auction bidding limits of primary distributors are set as a multiple of their trend activity in primary and secondary markets and revised over time, the proposed rule cannot be interpreted as preventing smaller firms from expanding their client base or as limiting the scope of the services provided to existing customers.

2.5 Penalties for the Failure to Comply to the Terms and Conditions of Auctions

- General. Appropriate penalties would be imposed for failure to comply with the requirements. The penalties would include prohibiting primary distributors and customers from participating in auctions and the publication of the penalties. Information that suggests illegal behaviour on the part of a market participant(s) will be forwarded to the appropriate authorities.

  Commentary

Compliance with the auction rules and with the terms of reference for primary distributors and jobbers is of critical importance to the integrity of the auction process. Otherwise, the number of active participants would dwindle as the goodwill underlying the process is eroded and the

12. Further details related to the responsibilities and performance requirements of the primary distributors and jobbers are described in “Amendments to the administrative arrangements regarding the auction of Government of Canada securities,” *Bank of Canada Review* (summer 1996).
13. The bond auction bidding limits of Bank of Canada jobbers are higher than those of other primary distributors. This means that they would be able to submit a larger volume of customer orders at bond auctions.

probability of serious economic losses rise. Declining participation in the auction process will ultimately result in higher borrowing costs for the government, owing to the size of the debt.

The length of suspensions of primary distributors and customers in the auction process could vary, depending on the severity of the infraction. Suspensions would likely be a significant deterrent in and of themselves. However, from a practical point of view, the knowledge that a suspension would be made public is likely to be an even greater deterrent, owing to the impact on a firm's reputation.

It is proposed that the government review questionable trading practices and notify the firm(s) involved before deciding on the course of action. The firm(s) would be given the opportunity to provide its (their) own input before any determination of whether the firm(s) had violated the rules would be rendered and the appropriate penalty.

3. Market Surveillance

- The repo market. The repo rates for recently issued Government of Canada securities would be used as a principal indicator as to whether the level of surveillance for a particular security should be intensified.[14] Other important indicators of squeezes resulting from market manipulation would be the amount of the outstanding stock controlled by the dominant holder and the turnover share in the security controlled by the dominant holder.[15] The steps that could be taken include (1) asking primary distributors for more detailed issue-specific trading reports, (2) determining whether trading outside the auction rules took place, (3) notifying the

14. See Ron Morrow, *ibid***.**
15. See Peter Fisher, "Remarks before the Money Marketeers of New York University", Federal Reserve Bank of New York, (October 8, 1996).

appropriate regulatory authorities if other questionable activities are found, and (4) re-opening an issue outside the timetable provided by the Quarterly Bond Schedule and the usual treasury bill issuance cycle.

- Bank of Canada monitoring. The Bank of Canada intends to broaden the scope of its review of market data and auction results.[16] It is proposed that during the when-issued period for a security that primary distributors submit electronically a daily report on,
  - cash positions in securities with the same ISIN as the security to be auctioned;
  - when-issued positions in the security; and
  - forward financing positions in a security with the same ISIN as the security to be auctioned.

In addition to the when-issued market, the Bank would be monitoring the markets for recently issued securities. As a regular matter in the case of treasury bills, this designation would be limited to the three most recent issues, identified by ISINs for each maturity. In the case of bonds, this designation would be limited to the three most recent offerings (including re-openings) for each maturity. In effect, the Bank of Canada would be monitoring one or two specific bond issues, identified by ISIN, for each benchmark maturity. In its discussions with primary distributors, the Bank would expect complete disclosure of their activities related to Government of Canada financings, including the names of accounts with whom they may have placed securities or from whom they may have purchased securities.

- Authority. The standard auction terms and conditions would be modified to provide for the actions and reporting described in this section. It is also possible that some changes would be made to the Government of Canada terms of reference for primary distributors.

16. See Appendix 3.

Questions

- Does the definition of “recently issued” encompass a period of time that is too long or too short?

APPENDIX 1 - Definitions

Bid means an offer to purchase a stated par amount of securities, either competitively or noncompetitively, in an auction. An offer to purchase a stated par amount of securities submitted by a primary 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 primary 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 or their actions in participating in an auction.

Customer means a bidder on whose behalf a primary distributor has been directed to submit or forward a competitive or noncompetitive bid for a specified amount of securities in a specific auction. Only primary distributors may act on behalf of customers to submit or forward bids to the Bank of Canada.

Primary distributor means an entity that has been given notice of its status as such by the Bank of Canada.

APPENDIX 2- EXCERPTS FROM THE U.S. TREASURY AUCTION RULES

General Information

3.1356.13 Net long position

(a) Reporting net long positions. (1) When bidding competitively, a bidder must report the amount of its net long position when the total of all of its bids in an auction plus the bidder's net long position in the security being auctioned equals or exceeds $2 billion. If the bidder either has no position or has a net short position and the total of all of its bids equals or exceeds $2 billion, a net long position of zero must be reported. In cases where a bidder that is required to report the amount of its net long position bids through more than one submitter or Federal Reserve Bank, the bidder's total net long position should be reported through only one submitter or Federal Reserve Bank to which a bid was submitted. A bidder that is a customer must report its net long position through one depository institution or dealer. (see @ 356.14(c).)

(2) If a person or entity (such as an investment adviser) is exercising control over the net long positions or competitive bids of one or more other persons or entities, then such net long positions and bids, as well as its own net long positions and competitive bids, must be combined for purposes of this paragraph (a)(2). If the combined amount of those net long positions and bids equals or exceeds $2 billion, then the person or entity exercising control must report: (i) A combined net long position that aggregates its own net long position with the other net long positions under its control; and (ii) the name of each person or entity in whose name it is placing competitive bids in the auction. The person or entity exercising control need not include in the combined amount any net long position less than $500 million of any person or entity in whose name it is not placing a competitive bid. The report required by this paragraph (a)(2) must be provided, prior to the closing time for receipt of competitive tenders, to a Federal Reserve Bank to which a competitive bid is being submitted.

(b) Determination of net long position. The net long position must be determined as of the designated reporting time, which is one-half hour prior to the closing time for receipt of competitive bids. a net long position includes the par amount of:

(1) Holdings of outstanding securities with the same CUSIP number as the security being auctioned;

(2) Positions, in the security being auctioned, in

(i) when-issued trading,

(ii) Futures contracts that require delivery of the specific security being auctioned (but not futures contracts for which the security being auction is one of several securities that may be delivered, and not futures contracts that are cash-settled), and

(iii) Forward contracts; and

(3) Holdings of STRIPS principal components of the security being auctioned, including when-issued trading positions of such principal components.

3.2356.14 Submitting bids for customers

Depository institutions and dealers may submit bids for their own account, for their customers, or for customers of intermediaries, subject to the requirements set out in paragraphs (a), (b), and (c) of this section. Others are permitted to submit bids only for their own account.

(a) Payment. By submitting a bid on behalf of its customer or a customer of any intermediary, a submitter agrees to remit payment for securities awarded as a result of such bid.

(b) Customer lists. A customer list must be submitted or be available, as provided in paragraphs (b) (1), (2) and (3), whenever bids for more than one customer are included on the same tender. The customer list must include direct customers of the submitter as well as customers of any intermediaries who are forwarding customer bids to the submitter.

(1) For competitive bids submitted by paper tender, the submitter must provide a separate tender for each yield or discount rate at which a bid is submitted. As a part of such tender, the submitter must provide a list that includes the full name of each customer and the amount bid by each customer. For competitive bids submitted by computer, the submitter may submit bids at multiple yields or discount rates on the same tender. On each such tender, the submitter must submit the full name of each customer and the amount bid at each yield or discount rate by each customer.

(2) For noncompetitive bids, a list must be provided that includes the full name of each customer and the amount bid by each customer. For mailed tenders, the customer list must be submitted with the tender. For other than mailed tenders, the customer list should accompany the tender. If the customer list is not submitted with the tender, information for the list must be complete and available for review by the deadline for submission of noncompetitive tenders, and must be received by the Federal Reserve Bank to which the tender was submitted by close of business on the auction day.

(3) Bids submitted on behalf of trusts or other fiduciary estates must identify on the customer list the full name or title of the trustee or fiduciary; a reference to the document creating the trust or fiduciary estate with date of execution; and the employer identification number of the trust or fiduciary estate.

(c) Net long position of customers. (1) A submitter or intermediary, when submitting or forwarding a competitive bid of $100 million or more for its customer, must inform that customer of the customer’s net long position reporting obligation as described in @ 356.13.

(2) A submitter or intermediary, when submitting or forwarding a competitive bid for a customer, must report the net long position amount if such amount is provided by the customer.

(3) If personnel of a submitter or intermediary who are directly involved in receiving or forwarding a customer’s bid know that the position information provided by a customer is incorrect, the customer’s bid shall not be submitted or forwarded by the submitter or intermediary.

(4) If the amount of a customer's net long position is to be reported by the submitter by paper tender, a separate tender must be submitted for that customer that includes the amount of the net long position.

3.3356.15 Certifications

(a) Submitters. By submitting a tender for a security, a submitter is deemed to have certified that it is in compliance with this part and the offering announcement governing the sale and issue of the security. Further, the submitter is deemed to have certified that the information provided on the tender with regard to bids for its own account is accurate and complete, and that the information provided on the tender with regard to bids for customers accurately and completely reflects information provided to it by its customers or intermediaries. Prior to submitting a computer tender, a submitter must have on file a written certification that the submitter is certifying, each time it submits a computer tender, that it is tin compliance with this part and the applicable offering announcement. The certification must be signed and dated by an authorized person on behalf of the submitter, be filed with the Federal Reserve Bank to which the computer tender is submitted, and be renewed at least annually.

(c) Customers. By bidding for a security, a customer is deemed to have certified that it is in compliance with this part and the offering announcement governing the sale and issue of the security and that the information it provided to the submitter or intermediary in connection with the bid is accurate and complete.

3.4356.22 Limitations on auction awards

(b) Awards to competitive bidders. The maximum award that will be made to any bidder is 35% of the public offering less the bidder's net long position as reportable under @ 356.13. For example, in a note auction with a $10 billion public offering, a bidder with a reported net long position of $1 billion could receive a maximum auction award of $2.5 billion. When the bids and net long positions of more than one person or entity must be combined as required by @ 356.13(a)(2), such combined amount will be used for the purpose of this award limitation.

3.5356.24 Notice of awards; confirmations

(d) customer confirmation. Any customer awarded a par amount of $500 million or more in an auction must furnish a confirmation including the information in paragraphs (d) (1) and (2) of this section to the Federal Reserve Bank to which the bid was submitted, no later than 10:00 a.m. on the day following the auction. The confirmation must be signed by the customer or authorized representative and must include the capacity in which such representative is acting. a submitter or intermediary submitting or forwarding a customer bid is responsible for notifying its customer of this requirement if the customer is awarded a par amount of $500 million or more as a result of bids submitted by the submitter or forwarded by the intermediary.

(1) A written confirmation of its bid, and

(2) A written statement indicating whether it had a reportable net long position as defined in @ 356.13, and, if a position had to be reported, the amount of any such position and the

name of the depository institution or dealer through which the customer requested that the position be reported.

Miscellaneous Provisions

3.6356.34 Remedies

(a) General. When a person or an entity fails to comply with the requirements of this part, the Secretary will consider the circumstances of such failure and determine an appropriate remedy. Such remedy may include prohibiting the person or entity from participating in future auctions for its own account, for the account of others, or both. The Secretary may refer such occurrences to the appropriate regulatory agency for enforcement action.

3.7 Appendix A to Part 356 -- Bidder Definitions

For the purpose of this part, the definitions set forth in this appendix describe all of the categories of bidders eligible to bid in Treasury auctions. These definitions are to be used by persons and entities in determining whether they are considered one bidder or more than one bidder for the purpose of bidding in auctions and for the purpose of complying with the requirements of this part. Notwithstanding these definitions, any persons or entities that intentionally act together with respect to bidding in a Treasury auction are considered, collectively, to be one bidder.

The following definitions will be used by the Department in applying competitive and noncompetitive award limitations and related requirements, as described in this part.

(a) Corporation -- A corporation and all affiliates, whether persons, partnerships, or other entities, hereinafter referred to as a corporate structure, are considered, collectively, to be one bidder.

An affiliate is any: entity that is more than 50% owned, directly or indirectly, by the corporation; entity that is more than 50% owned, directly or indirectly, by any other affiliate of the corporation; person or entity that owns, directly or indirectly, more than 50% of the corporation; person or entity that owns, directly or indirectly, more than 50% of any other affiliate of the corporation; or entity, a majority of whose board of directors or a majority of whose general partners are directors or officers of the corporation or of any affiliate of the corporation.

Under certain circumstances, one or more major organizational components (e.g., the parent or a subsidiary) in a corporate structure, either separately or together with one or more other organizational components in the corporate structure, may be recognized as a bidder separate from the larger corporate structure. All of the following criteria must be met for such component or components to qualify for recognition as a separate bidder:

(1) Such component or components must be prohibited by law or regulation from exchanging, or must have established written internal procedures (i.e., Chinese walls) designed to prevent the exchange of, information related to bidding in Treasury auctions with any other component in the corporate structure;

(2) Such component or components must not be created for the purpose of circumventing the Department’s bidding and award limitations;

(3) Decisions related to purchasing Treasury securities at auction and participation in specific auctions must be made by employees of such component or components. Employees of such component or components that make decisions to purchase or dispose of Treasury securities must not perform the same function for other components within the corporate structure; and

(4) The records of such component or components related to the bidding for, acquisition of, and disposition of Treasury securities must be maintained by such component or components. Those records must be identifiable -- separate and apart from similar records for other components within the corporate structure.

To obtain recognition as a separate bidder, each component or group of components must request such recognition from the Department, provide a description of the component or group and its position within the corporate structure, and provide the following certification:

[Name of the bidder] hereby certifies that to the best of its knowledge and belief it meets the criteria for a separate bidder as described in appendix A to 31 CRF part 356. The above-named bidder also certifies that it has established written policies or procedures, including ongoing compliance monitoring processes, that are designed to prevent the component or group of components from:

(1) Exchanging any of the following information with any other part of the corporate structure: (a) Yields or rates at which it plans to bid; (b) amounts of securities for which it plans to bid; (c) positions that it holds or plans to acquire in a security being auctioned; and (d) investment strategies that it plans to follow regarding the security being auctioned, or

(2) In any way intentionally acting together with any other part of the corporate structure with respect to formulating or entering bids in a Treasury auction.

(2) In any way intentionally acting together with any other part of the corporate structure with respect to formulating or entering bids in a Treasury auction.

The above-named bidder agrees that it will promptly notify the Department in writing when any of the information provided to obtain separate bidder status changes or when this certification is no longer valid.

(b) Partnership -- A partnership for which the Internal Revenue Service has assigned a tax-identification number; general partners acting on behalf of the partnership; and all affiliates, whether persons, corporations, or other entities; hereinafter referred to as a partnership structure, are considered, collectively, to be one bidder. A partnership structure that contains one or more corporations is considered one bidder under either this “partnership” category of the “corporation” category, but not both.

An affiliate is any: Entity that is more than 50% owned, directly or indirectly, by the partnership; entity that is more than 50% owned, directly or indirectly, by any other affiliate of the partnership; person or entity that owns, directly or indirectly, more than 50% of the partnership; person or entity that owns, directly or indirectly, more than 50% of any other affiliate of the partnership; or entity, a majority of whose general partners or a majority of whose board of directors are general partners or directors of the partnership or of any affiliate of the partnership.

Under certain circumstances, one or more major organizational components (e.g., the partnership or a subsidiary) in a partnership structure, either separately or together with one or more other organizational components in the partnership structure, may be recognized as a bidder separate from the larger partnership structure. All of the following criteria must be met for such component or components to qualify for recognition as a separate bidder:

(1) Such component or components must be prohibited by law or regulation from exchanging, or must have established written internal procedures (i.e., Chinese walls) designed to prevent the exchange of, information related to bidding in Treasury auctions with any other component in the partnership structure;

(2) Such component or components must not be created for the purpose of circumventing the Department's bidding and award limitations;

(3) Decisions related to purchasing Treasury securities at auction and participation in specific auctions must be made by employees of such component or components. Employees of such component or components that make decisions to purchase or dispose of Treasury securities must not perform the same function for other components within the partnership structure; and

(4) The records of such component or components related to the bidding for, acquisition of, and disposition of Treasury securities must be maintained by such component or components. those records must be identifiable -- separate and apart from similar records for other components within the partnership structure.

To obtain recognition as a separate bidder, each component or group of components must request such recognition from the Department, provide a description of the component or group and its position within the partnership structure, and provide the following certification:

[Name of the bidder] hereby certifies that to the best of its knowledge and belief it meets the criteria for a separate bidder as described in appendix A to 31 CRF part 356. The above-named bidder also certifies that it has established written policies or procedures, including ongoing compliance monitoring processes, that are designed to prevent the component or group of components from:

(1) Exchanging any of the following information with any other part of the partnership structure: (a) Yields or rates which it plans to bid; (b) amounts of securities form which it plans to bid; (c) positions that it holds or plans to acquire in a security being auctioned; and (d) investment strategies that it plans to follow regarding the security being auctioned, or

(2) In any way intentionally acting together with any other part of the partnership structure with respect to the formulating or entering bids in a Treasury auction.

The above-named bidder agrees that it will promptly notify the Department in writing when any of the information provided to obtained separate bidder status changes or when this certification is no longer valid.

(c) Government-related entity -- (1) the government of each of the 50 states and of the District of Columbia is considered to be one bidder.

(2) A unit of local government, including any county, city, municipality, or township, or other unit of general government, as defined by the Bureau of the Census for statistical purposes, is considered to be one bidder.

(3) The government of a commonwealth, territory, or possession of the United States is considered to be one bidder.

(4) A governmental entity, body, or corporation established under Federal, State, or local law is considered to be one bidder.

(5) A foreign central bank, the government of a foreign state, or an international organization in which the United States holds membership is considered to be one bidder.

An investment, reserve, or other fund of one of the above government-related entities, not otherwise meeting the definition of the "trust or other fiduciary estate" category, is considered part of that entity and not a separate bidder unless applicable law requires that the investments of such fund be made separately.

(d) Trust or other fiduciary estate -- A legal entity created under a valid trust instrument, court order, or other legal authority that designates a trustee or fiduciary to act for the benefit of a named beneficiary may be considered a bidder. To be considered a bidder, such legal entity must be able to be identified by the name or title of the trustee or fiduciary; specific reference to the trust instrument, court order, or legal authority under which the trustee or fiduciary is acting; and the unique IRS-assigned employer identification number (not social security number) for the entity. Further, it participation in auctions on behalf of the trust or fiduciary estate.

(e) Individual -- A person, whether acting in his or her individual capacity, as a sole proprietor, for any entity not otherwise defined as a bidder, or in ore than one such capacity, is considered to be one bidder. when a person meets the definition of an affiliate within a corporate or partnership structure as defined above, such person may only be considered a bidder in this "individual" bidder when acting in such capacity. A person, his or her spouse, and any children under the age of 21 having a common household are considered, collectively, to be one "individual" bidder.

(f) Other bidder -- A bidder defined by any of the above categories is not considered a bidder in this category. A bidder not defined by any of the above categories may possibly be considered a bidder in this category. For purposes of this definition, "other bidder" means an institution or organization with a unique IRS-assigned employer identification number. This definition of other bidder includes such entities as an association, church, university, union, or club. This category does not include any person or entity acting in a fiduciary or investment management capacity, a sole proprietorship, an investment account, an investment fund, a form of registration, or investment ownership designation.

Notwithstanding the definitions in this appendix, it is the intent of the Department that no auction participant receive a larger auction award by acquiring securities through other than it could have received had it been considered a bidder under these definitions.

SCHEDULE PDWI

Avg. Hours per Response: .25

APPENDIX 3
DAILY REPORT OF PRIMARY DISTRIBUTOR ACTIVITY
IN GOVERNMENT OF CANADA FINANCINGS
(Dollars in Millions at Par Value)

PD# ____________________________

DEALER NAME: _______________________

REPORT DATE CLOSE OF TRADING: ....

	SECURITY (1)	NET POSITIONS (2)	NET FORWARD FINANCING COMMITMENTS (3)	OUTRIGHT TRANSACTIONS	
				PURCHASES (4)	SALES (5)
(1)					
(2)					
(3)					
(4)					
(5)					
(6)					
(7)					
(8)					
(9)					
(10)	Totals (Lines 1-9)				

Return by 10:00 a.m. the following business day to:
Information and Systems Group
Attention: Sharron Hodgson
Bank of Canada
234 Wellington Street
4th Floor, East Tower
Ottawa, Ontario K1A 0G9
Facsimile number: (613) 782-8334

NAME OF PREPARER: __________________________

TELEPHONE NUMBER: __________________________

COMMENTS: ___________________________________

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