

# The gilt-edged market: auctions

*Notice issued by the Bank of England on 13 April 1987*

1 In its paper 'The future structure of the gilt-edged market: official operations' (18.9.86),<sup>(1)</sup> the Bank indicated its intention to explore with market participants possible arrangements for a series of auctions to cover a part of the Government's funding through conventional stocks. The Bank developed these ideas further in the paper 'The gilt-edged market: a possible experiment with auctions' (13.2.87). This notice now sets out, in the light of comments received from market participants and of further internal discussion, the Bank's proposals on the form of the experiment.

## General arrangements

2 The approximate timing of each auction will be announced some weeks in advance. The first will be in mid-May. It will relate to a conventional short-dated (up to 7-year) stock, will be for an amount of up to £1¼ billion and may be either fully or partly paid. The precise date and terms will be fixed having regard to the state of the funding programme and of the market at the time but will be announced not less than seven calendar days in advance of the auction. Decisions on further auctions will be taken in the light of experience with this first operation. Subsequent auctions might relate in turn to a long-dated (over 15-year) and then to a medium-dated (7 to 15-year) stock, in each case for an amount of up to £1 billion. The remainder of the gilt-edged funding programme will continue to be covered by the tender/tap arrangements described in the paper on 'Official operations' referred to in paragraph 1 above.

3 The Bank will not sell other stock of the same type (or, in the case of a short-dated auction, any short-convertible stock) through the tap system or otherwise between the time of the announcement of the details of an auction and a period ending 28 days after the auction. It will be free to sell stock of other maturity, or other type, eg low-coupon or index-linked, as usual during this 'fallow' period. The Bank will not necessarily resume selling stock of the type auctioned immediately the 'fallow' period has ended and, as a matter of normal market management, would not typically expect to do so unless it is satisfied that the auction had been fully absorbed. But the Bank will be free to make such sales if it is judged to be appropriate.

4 Auctions will be open to applications from the public at large, subject to a minimum application of £1,000 (cf £100 in tenders at present). The Bank will set no minimum price on the stock offered at the auction and will expect to allot the whole amount on offer. There will be no formal or informal underwriting arrangement for the auctions but the Bank encourages all gilt-edged market makers, as part of their commitment to the market, to participate actively in the auction process. The Bank reserves the right not to allot all the stock on offer in exceptional circumstances, eg where the auction is covered only at an unacceptably deep discount to

the prevailing market level. In that event, the Bank will take any stock not allotted into its own portfolio. The Bank will be free to sell such stock (but not other stock of that type) into the secondary market in the normal way, but during the 'fallow' period will undertake not to do so at a price below the minimum allotment price.

## Detailed arrangements

5 Bids must be received at the Registrar's Department, New Change by 10.00 am on the morning of the auction and, in the case of bids of more than £100,000, should be accompanied by payment in same-day funds. The Bank will in addition be prepared to accept, from gilt-edged market makers alone and again by 10.00 a.m., a maximum of three bids by telephone over the market makers' dedicated telephone lines to the Bank's dealing room. Such bids, once made, will be irrevocable. The corresponding application form and payment should reach Registrar's Department by 11.00 a.m.

6 Auctions, at least initially, will be on a bid price basis in which successful bidders are allotted stock at the price which they bid. The Bank will, as under the present tender arrangements, allot stock at its absolute discretion and may decline to allot more than 25% of the amount on offer to an individual bidder if it appears that to do so would be likely to lead to market distortion.

7 The Bank will be prepared to accept non-competitive bids (limited to one bid per applicant) for amounts of stock up to £100,000 nominal. These will be allotted in full at the average accepted price.

8 The Bank has discussed with interested parties arrangements for 'when-issued' trading in the context of auctions on the lines proposed. The Stock Exchange have now adopted a Rule (535.5c) allowing 'when-issued' trading between announcement of the details of an auction and the auction itself. The Bank is content for such trading to develop subject to certain conditions, in particular for prudential supervision of the credit risk to which gilt-edged market makers and inter-dealer brokers may become exposed. Market makers will not be required to observe their market-making commitment in respect of the stock to be auctioned during the 'when-issued' period.

9 The Bank proposes to publish, as soon as possible after allotments are determined, figures for the total amount of stock allotted in respect of competitive bids, the amount allotted in respect of non-competitive bids and the highest, lowest and average price of successful competitive bids.

(1) Reprinted in the December 1986 *Bulletin*, pages 569-74.