

EFFECTIVE 11 JANUARY 2010

TERMS OF PARTICIPATION IN AUCTIONS FOR CUSTOMERS

1. Bidder Definition¹

- 1.1 The bidder definition covers all government securities distributors and customers and applies to both legal entities (hereafter referred to as “entities”) and individuals. Refer to Appendix 2 for the definition of legal entities.
- 1.2 All bidders must certify that they are not bidding in concert with any other bidder.
- 1.3 Entities that are affiliated are considered one bidder for the purposes of Government of Canada securities auctions. To avoid being considered a single bidder, affiliated entities must certify that they do not exchange with one another information about yields, amounts, positions they hold or plan to hold, or their investment strategies with respect to the securities being auctioned. Refer to Appendix 2 for the definition of affiliated.
- 1.4 Entities are affiliates if one is controlled by the other or if both are controlled by the same person. The definition of control includes formal voting control along with direct and indirect controlling influence over management and policies. Refer to Appendix 2 for the definition of control.
- 1.5 An affiliate must promptly notify the Bank of Canada, in writing, of a change in the circumstances that enable the affiliate to qualify for separate-bidder status, or if their certification is no longer valid.
- 1.6 Any entity that implements the conditions necessary to be considered a separate bidder must direct all bids and purchases through a non-affiliated government securities distributor.
- 1.7 All customers must notify the Auction Manager at the Bank of Canada (613-782-7719) of any changes in auction contact information.

2. Submission of Bids

- 2.1 Bidding by each customer is subject to an auction limit (Section 4).
- 2.2 Each customer is required to obtain a unique bidder identification number from the Bank of Canada before it can bid competitively. An application form for obtaining a bidder identification number is available on the Bank of Canada’s website (<http://www.bankofcanada.ca/en/auction/aucfor3.pdf>). The Bank of Canada can de-activate the bidder identification number of any customer that has not participated competitively at an auction over a period of one year. Any customer whose bidder identification number has been de-activated must re-apply, no earlier than three months following the deactivation, to obtain a new bidder identification number from the Bank of Canada before it can resume competitive bidding.

¹ For an explanation of the terms used in this document, refer to Appendix 1.

- 2.3 Customers may bid at auctions by submitting bids through government securities distributors subject to auction limits. Competitive bids must be listed separately from the distributor's own bids and must be accompanied by the customer's bidder identification number.
- 2.4 Government securities distributors are responsible for the settlement in CDSX of customer bids that they have submitted and are liable to the Department of Finance and the Bank of Canada for any losses incurred as a result of those sales failing to settle.

3. Non-Competitive Bidding²

- 3.1 Each customer may submit non-competitive bids on its own account, in addition to any competitive bids, at auctions of Government of Canada bonds and for each tranche of a treasury bill auction.
- 3.2 The maximum non-competitive bid for each customer is \$3 million for Real Return Bonds and \$5 million for other marketable Government of Canada bonds and for each tranche of a treasury bill auction.
- 3.3 Customers must submit non-competitive bids through a government securities distributor. The total amount of customer non-competitive bids that each government securities distributor can submit is limited to \$3 million for Real Return Bonds and \$10 million for other marketable Government of Canada bonds and for each tranche of a treasury bill auction.
- 3.4 A bidder identification number is not required for the submission of non-competitive bids, but government securities distributors are required to provide the Bank of Canada with information on customers' non-competitive bids upon request.

4. Competitive Auction Limits³

- 4.1 The maximum amount that any customer can bid on a competitive basis at an auction (its auction limit) equals 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 (Examples are provided in Appendix 3).
- 4.2 To permit computation of the auction limit, customers must report their net positions prior to the auction. For the purposes of the computation of the auction limit, the bidder's net position includes 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; (vi) option contracts which require delivery of the specific security being auctioned weighted by the estimated probability that the option(s) will be exercised;⁴ and (vii) any position in the security not covered by the above types of contracts, including "guaranteed" trades. For repurchase agreements

² Non-competitive bids are made without specifying a price or yield. Non-competitive allocations are made at the average price or yield of the accepted bids at an auction (in the case of auctions of Real Return Bonds, non-competitive allocations are made at the allotment price).

³ Competitive bids are made at a specific price or yield.

⁴ For example, an option with an estimated 50 per cent probability of being exercised on a notional amount of \$100 million would represent a weighted position (long or short) in the auctioned security of \$50 million (\$100 million x 0.5).

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. Bidders are not required to post net positions for securities that share the same maturity date (fungible) as the auctioned security, unless they have been stripped and reconstituted into the auctioned security.

5. Competitive Bidding Limits for Auctions of Government of Canada Bonds

- 5.1 The bidding limit for a customer is 25 per cent of the amount auctioned. Customers that are affiliated will be considered one bidder for purposes of calculating their bidding limit.
- 5.2 A customer may submit its bids through more than one government securities distributor, as long as the total amount of its bids does not exceed the customer's auction limit.
- 5.3 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.
- 5.4 A customer's ability to bid through a government securities distributor might be constrained by the government securities distributor's limit for customer bids and allocation of its aggregate limit.

BIDDING LIMITS FOR BOND AUCTIONS		
	Competitive Bidding	Non-Competitive Bidding
Customers	25 per cent	\$3 million for Real Return Bonds and \$5 million for other marketable Government of Canada bonds.

6. Competitive Bidding Limits for Auctions of Treasury Bills

- 6.1 Government of Canada treasury bills that are issued with a term to maturity of three months or more (hereafter referred to as "regular treasury bills") and Government of Canada treasury bills that are issued with a term to maturity of less than three months and share a common maturity date with previously issued regular treasury bills (hereafter referred to as "fungible cash-management bills"), will be subject to the following bidding limits in each tranche of the auction:
- 6.1.1 A customer has a bidding limit of 25 per cent of the amount auctioned. Customers that are affiliated will be considered one bidder for purposes of calculating their bidding limit.
- 6.1.2 A customer may submit its bid through more than one government securities distributor so long as the total amount of its bids does not exceed the customer's auction limit.
- 6.1.3 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.
- 6.1.4 A customer's ability to bid through a government securities distributor might be constrained by the government securities distributor's limit for customer bids and allocation of its aggregate limit.

- 6.2 Government of Canada treasury bills that are issued with a term to maturity of less than three months and do not share a common maturity date with previously issued regular treasury bills (hereafter referred to as “non-fungible cash-management bills”), are subject to the following bidding limits.
- 6.2.1 The bidding limit for a customer is 100 per cent of the amount auctioned.
- 6.2.2 A customer may submit its bid through more than one government securities distributor so long as the total amount of the bids does not exceed the customer’s auction limit.
- 6.2.3 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.
- 6.2.4 A customer’s ability to bid through a government securities distributor might be constrained by the government securities distributor’s limit for customer bids and allocation of its aggregate limit.

BIDDING LIMITS FOR TREASURY BILL AUCTIONS			
	Competitive Bidding		Non-competitive Bidding (per tranche, treasury bills and cash-management bills)
	Regular treasury bills and fungible cash-management bills (per tranche)	Non-fungible cash-management bills (per tranche)	
Customers	25 per cent	100 per cent	\$5 million

7. Reporting Requirements

Reporting of Net Positions

- 7.1 Customers bidding competitively at auctions must report their net positions in the auctioned security. A customer bid submitted in the absence of a net position will be rejected automatically.
- 7.2 A customer can submit its net position either directly to the Bank of Canada or through a government securities distributor that is submitting a bid on its 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.
- 7.3 Each bidder is required to re-submit its net position if it changes by more than \$25 million before the bidding deadline.
- 7.4 A customer may make non-competitive bids without submitting a net position.

Bid Certification and Verification

- 7.5 Every bidder is required to certify that the information it provides to the Bank of Canada is correct. These certificates are to be forwarded to the Bank of Canada on an annual basis by customers.

- 7.6 In order to maintain market integrity, the Bank of Canada may verify the accuracy and completeness of customer bids submitted by government securities distributors.

Market Information - Customers Should Be Aware That:

- 7.7 In the event that the Bank of Canada is of the view that there is or has been unusual trading activity in a Government of Canada security for a persistent period of time, the Bank may require government securities distributors to disclose the names and activities of customers involved in such trading.
- 7.8 The Department of Finance and the Bank of Canada can, at their discretion, investigate whether activity has contravened auction rules. If the Department of Finance or the Bank of Canada suspects that there may have been an attempt to manipulate the market for Government of Canada securities, the Department of Finance or the Bank of Canada may: (i) notify the appropriate regulatory authorities; (ii) refer such incidents to the Investment Industry Regulatory Organization of Canada (IIROC) for investigation of possible violations of its Code of Conduct for IIROC-Regulated Firms Trading in Wholesale Domestic Debt Markets (Rule 2800); and (iii) sell securities from the Bank of Canada's own portfolio. The Government of Canada can, at its discretion, re-open an issue outside the timetable provided by the Quarterly Bond Schedule and the usual cycle for treasury bill issuance.

8. Code of Conduct

- 8.1 All customers must comply with the standards and principles of good practice and fairness reflected in IIROC Rule 2800, the Code of Conduct for IIROC-Regulated Firms Trading in Wholesale Domestic Debt Markets.

9. Monitoring and Compliance

- 9.1 The Department of Finance and the Bank of Canada may sanction a customer if they are of the view that the customer has: attempted to manipulate the market for Government of Canada securities; made an incorrect representation or certification; failed to provide information required under these Terms, or provided information that was incorrect, inaccurate, or incomplete; participated in any other breach of these Terms. The Department of Finance and the Bank of Canada may also refer the incident to IIROC or any other regulatory agency.
- 9.2 Before imposing a sanction, the Department of Finance and the Bank of Canada will contact the customer in question to notify the firm of their intention to impose a sanction, and to provide the firm with an opportunity to explain the situation.
- 9.3 The sanctions that the Department of Finance and the Bank of Canada may impose include suspending the customer from participating in one or more future auctions; and changing, on a temporary or permanent basis, the customer's bidding limits. In the event of behaviour that the Department of Finance and the Bank of Canada consider to be fundamentally incompatible with a firm continuing to act as a customer, the Department of Finance and the Bank of Canada may revoke the customer's access to auctions.
- 9.4 Sanctioning of customers in the case of an infraction related to these Terms is based on a surveillance framework that ensures the fair and consistent treatment of all parties involved.

- 9.5 Any outstanding obligations or liabilities owed by a customer to the Bank of Canada or the Government as a result of past participation in auctions shall survive the imposition of any sanction on that customer.

Appendix 1 – Explanation of Terms

A *government securities distributor* is 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.

A *primary dealer* is a member of the subset of government securities distributors whose participation in the primary and secondary markets for Government of Canada securities is above a threshold level, and who acts as a principal for customers and other financial intermediaries in the purchase and sale of Government of Canada securities. A government securities distributor may be a primary dealer for bonds, or treasury bills, or for both.

A *bid* is 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 fulfill 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.

A *bidder* is 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.

A *submitter* is an 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.

A *customer* is 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 government securities 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 government securities 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 government securities distributor is allowed to submit on behalf of its customers.

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

Appendix 2 – Affiliated vs. Non-Affiliated Parties

2.1 Definition of Affiliated Party

Legal entities (hereafter referred to as “entities”) may bid at auctions, either directly or indirectly. Various operational components, departments, or divisions within the same entity will not be considered separate bidders at auctions. Only 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 these 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. Individuals may only bid indirectly at an auction, i.e., through one or more government securities dealers.

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

A person is affiliated with an entity if that person is a director or senior officer of the entity.

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 a trust if:

- (a) that person is a trustee of the trust, or
- (b) that person controls a trustee of the trust

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.

For the purpose of determining control, the term “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 subdivisions thereof and any agencies thereof
- foreign central banks
- international organizations.

“Person” means an individual or an entity.

2.2 Requirements to Establish Non-Affiliated Status within a Corporate Group

The definition of a bidder permits 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 it 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 auctions 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 or has any of the same knowledge in respect of Government of Canada securities for or on behalf of any of the other affiliates;⁵ (iii) the affiliate does not exchange information related to bidding at auctions with any of the other affiliates; and (iv) each affiliate maintains its records relating to holdings of and investment and bidding strategies for Government of Canada securities separate and apart from the records of any of the other affiliates.

⁵This criterion does not apply with 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.

Appendix 3 — Illustration of Primary Dealer Aggregate Bidding Limits

This appendix provides examples 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 affects primary dealers with limits over 15 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:

$$\begin{aligned} \text{Dealer auction limit on own behalf (25 per cent less excess long)} &= \$500 \text{ million} \\ \text{Dealer submission limit for customers (25 per cent)} &= \$500 \text{ million} \\ \text{Aggregate limit (40 per cent less excess long)} &= \$800 \text{ million} \end{aligned}$$

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.

$$\begin{aligned} \text{Dealer auction limit on own behalf (25 per cent less excess long)} \\ &= \$500 \text{ million} - \$250 \text{ million} = \$250 \text{ million} \\ \text{Dealer submission limit for customers (25 per cent)} &= \$500 \text{ million} \\ \text{Aggregate limit (40 per cent less excess long)} &= \$800 \text{ million} - \$250 \text{ million} = \$550 \text{ million} \end{aligned}$$

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.

$$\begin{aligned} \text{Dealer auction limit on own behalf (25 per cent less excess long)} \\ &= \$500 \text{ million} - \$500 \text{ million} = \$0 \\ \text{Dealer submission limit for customers (25 per cent)} &= \$500 \text{ million} \\ \text{Aggregate limit (40 per cent less excess long)} &= \$800 \text{ million} - \$500 \text{ million} = \$300 \text{ million} \end{aligned}$$

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 2d (the excess long position exceeds the bidding limit, and the 40 per cent is reduced by the bidding limit).