

Terms of Participation in Auctions for Government Securities Distributors

The classification of “government securities distributors” applies to those bidders eligible to participate directly in the tender process. All government securities distributors must: (i) be members, or affiliates of members, of the Investment Dealers Association of Canada, and (ii) have their core trading and sales operations for Government of Canada securities resident in Canada.

The classification of “primary dealers” applies to a subgroup of government securities dealers whose activity is above a certain threshold. The primary dealer designation can be attained for either treasury bills or bonds, or both. A government securities distributor who reaches a threshold level of primary and secondary market activity will become a primary dealer, with the commensurate responsibilities.

1. Bidder Definition

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

2. Submission of Bids

- 2.1 Government securities distributors will be able to bid on their own behalf subject to an auction limit.
- 2.2 Government securities distributors will also have a separate limit for the total amount of bids they place on behalf of customers (the customer submission limit). These bids must be listed separately from the distributor’s own bids. Distributors will not be able to submit pre-tender orders from customers under the distributor’s own bidding limit.
- 2.3 Each customer bidder will have its own auction limit.
- 2.4 Customers will not settle directly with the Bank of Canada. Government securities distributors will be responsible for the settlement of customer bids which they have submitted and shall be liable to the Bank of Canada for any losses incurred as a result of those sales failing to settle in the Debt Clearing System.

3. Competitive Auction Limits¹

- 3.1 The amount that any distributor can bid on a competitive basis at an auction (its auction limit) will equal its bidding limit less its excess net long position, which is its net long position in excess of the product of its percentage bidding limit and the par value of any outstanding stock of the security being auctioned.
- 3.2 To permit computation of the auction limit, government securities distributors must report their net positions prior to auction. For the purposes of the computation of the auction limit, the bidder's net position will include (i) the par amount of cash holdings of a security with the same International Securities Identification Number (ISIN), (ii) the par amount of when-issued positions, (iii) the par amount of 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) the par amount of option contracts which require delivery of the specific security being auctioned weighted by the estimated probability that the option(s) will be exercised², and (vii) the par amount of any position in the security not covered by the above types of contracts, including "guaranteed" trades. For repurchase agreements or securities lending, the entity that owns the security, not the one that has borrowed it, must report the repoed or lent security as part of its position. All positions are based on trade date rather than delivery date.
- 3.3 Customer bids will not be netted against the limits of government securities distributors.

4. Non-competitive Bidding³

- 4.1 Each government securities distributor will be able to submit one non-competitive bid for its own account, in addition to any competitive bids, in auctions of Government of Canada bonds and each tranche of treasury bills.
- 4.2 The maximum amount of non-competitive bids for each participant will be \$3 million for Government of Canada bonds and for each tranche of treasury bills.
- 4.3 All government securities distributors will also be able to bid non-competitively on behalf of customers. The total amount of customer non-competitive bids that each government securities distributor can submit will be limited to \$3 million.
- 4.4 A customer identification number is not required for the submission of non-competitive bids, but distributors will be required to provide the Bank of Canada with information on customer non-competitive bids upon request.

5. Reporting Requirements

Reporting of Net Positions

- 5.1 Government securities distributors must report their aggregate net positions in the auctioned security to the Bank of Canada when submitting their own bids or bids for their customers. The

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

2. 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).

3. 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 RRB auctions, non-competitive allocations are made at the allotment price).

net position must be reported regardless of whether it is a long or short position. This position must be updated with each re-submission of bids.

- 5.2 Government securities distributors are responsible for ensuring that their customers are informed that they must report their net position either indirectly through the distributor or directly to the Bank of Canada before their bids will be included in an auction.
- 5.3 All bidders are required to re-submit their position if it changes by more than \$25 million before the auction bidding deadline.

Bid Certification and Verification

- 5.4 All bidders are required to certify that the information they provide to the Bank of Canada is correct. These certificates are to be forwarded to the Bank of Canada on an annual basis by the internal audit departments of government securities distributors.
- 5.5 The Bank of Canada, at its discretion, will spot check customer bids submitted by distributors.

Market Information

- 5.6 The Bank of Canada requires regular reporting of distributor activities related to Government of Canada debt, including firm-wide positions. In order to help ensure market integrity, the Bank of Canada may require that government securities distributors provide general information concerning their customers' activities relating to Government of Canada securities. In the event that the Bank of Canada is of the view that there is or has been trading in Government of Canada securities in an unusual manner for a persistent period of time, it may require distributors to disclose the names and activities of customers involved in such trading.
- 5.7 Government securities distributors will be required to make available real-time information on fixed-income prices and yields. Government securities distributors will also, from time to time, be required to (i) report secondary market trading; and (ii) provide detailed issue-specific trading reports to the Bank of Canada. The purpose of such reports will typically be to clarify the reasons for specific securities to trade in the cash and repo markets at prices divergent from issues of similar maturity.
- 5.8 The Bank of Canada maintains the discretion to investigate whether activity in contravention of the auction rules has occurred. If the Bank of Canada suspects that there may have been an attempt to manipulate the market for Government of Canada securities, it may: (i) notify the appropriate regulatory authorities; (ii) refer such incidents to the Investment Dealers Association of Canada for investigation of possible violations of its Code of Conduct; and (iii) sell securities from its own portfolio. The Government of Canada maintains the discretion to re-open an issue outside the timetable provided by the Quarterly Bond Schedule and the usual treasury bill issuance cycle.

Other

- 5.9 Government securities distributors will submit weekly statistical reports on their fixed-income activities to the Bank of Canada.
- 5.10 To provide assurance that government securities distributors are maintaining a sound financial position, distributors authorize the Bank of Canada to periodically obtain information on their capitalization and profitability from their regulatory authority.

6. Bidding Limits for Auctions of Canada Bonds

- 6.1 For Government of Canada bonds, primary dealers will have bidding limits tiered from 10 to 25 per cent of the auctioned amount for bids on its own account. Other government securities

distributors will have limits tiered from 1 to 9 per cent. A government securities distributor will become a primary dealer for bonds with the commensurate responsibilities when its bidding limit reaches 10 per cent.

- 6.2 Government securities distributors will have an additional customer submission limit for bids on behalf of customers. The limit for bidding by a distributor on behalf of customers will equal the greater of 5 per cent or its bidding limit for its own account.
- 6.3 The sum of the bids submitted by a primary dealer on its own behalf and on behalf of its customers (its aggregate limit) cannot exceed 40 per cent of the tender less the dealer's excess net long position (up to the dealer's bidding limit).
- 6.4 Bidding limits will be calculated on the basis of a formula (the formula calculation) that takes into account each distributor's winnings at auctions of Government of Canada bonds and its activity in the secondary market for bonds over the previous four quarters.
- 6.5 Primary market activity will have a greater weighting than secondary market activity.
- 6.6 For the purposes of calculating bidding limits, winning customer bids and non-competitive bids will be included in the distributor's share of auction winnings.
- 6.7 Bidding limits calculated by the formula calculation will be rounded upward to the nearest percentage point.
- 6.8 Bidding limits will equal the lesser of the formula calculation or 25 per cent of the auctioned amount and will be re-calculated every 6 months.
- 6.9 In assessing criteria for a new government securities distributor, the Bank may use data on bids entered on the applicant's behalf by other distributors over a specified period.

BIDDING LIMITS FOR BOND AUCTIONS		
	Competitive Bidding	Non-competitive Bidding
Primary Dealer - for own account	From 10 to 25 per cent	\$3 million
- for customers	The sum of customer bids cannot exceed the primary dealer's bidding limit.	The sum of customer bids cannot exceed \$3 million.
- in aggregate	The sum of the bids submitted by a primary dealer on its own behalf and on behalf of its customers cannot exceed 40 per cent of the tender less the dealer's excess net long position (up to the dealer's bidding limit).	
Government Securities Distributor - for own account	From 1 to 9 per cent	\$3 million
- for customers	The sum of customer bids cannot exceed the greater of 5 per cent or the distributor's bidding limit.	The sum of customer bids cannot exceed \$3 million.

7. Bidding Limits for Auctions of Treasury Bills

- 7.1 For auctions of Government of Canada treasury bills, primary dealers will have a bidding limit of 25 per cent of the auctioned amount for bidding on their own behalf. Government securities distributors will have a bidding limit of 10 per cent of the auctioned amount. A government securities distributor will become a primary dealer for treasury bills with the commensurate responsibilities when the same calculation as is used to determine bond bidding limits provides a result of at least 10 per cent (see 6.4 to 6.9).
- 7.2 Primary dealers and other government securities distributors will have an additional bidding limit for the total of bids submitted on behalf of customers. The bidding limit for bids submitted on behalf of customers will equal the distributor's limit for bidding on its own account.
- 7.3 The sum of the bids submitted by a primary dealer on its own behalf and on behalf of its customers cannot exceed 40 per cent of the tender less the dealer's excess net long position (up to the dealer's bidding limit).

BIDDING LIMITS FOR TREASURY BILL AUCTIONS		
	Competitive Bidding (per tranche)	Non-competitive Bidding (per tranche)
Primary Dealer - for own account	25 per cent	\$3 million
- for customers	The sum of customer bids cannot exceed 25 per cent.	The sum of customer bids cannot exceed \$3 million.
- in aggregate	The sum of the bids submitted by a primary dealer on its own behalf and on behalf of its customers cannot exceed 40 per cent of the tender less the dealer's excess net long position (up to the dealer's bidding limit).	
Government Securities Distributor - for own account	10 per cent	\$3 million
- for customers	The sum of customer bids cannot exceed 10 per cent.	The sum of customer bids cannot exceed \$3 million.

8. Change in Primary Dealer Status

- 8.1 If a primary dealer's performance has caused its calculated bidding limit to fall below 10 per cent, it will be given one or two quarters to improve its performance before having its primary dealer designation removed.
- 8.2 A government securities distributor will become a primary dealer with the commensurate responsibilities when its calculated bidding limit reaches 10 per cent.
- 8.3 When distributors merge, the bidding limit for the new entity will be determined by the combined activity of the pre-merger entities, subject to the 25-per-cent maximum bidding limit.

9. Code of Conduct

- 9.1 All government securities distributors must agree to comply with the IDA Policy No. 5, The Code of Conduct.

10. Primary Dealer Responsibilities

10.1 Minimum Bidding

- i. at every auction, a primary dealer must bid a minimum of 50 per cent of its auction limit (see 3.1) or 50 per cent of its formula calculation (see 6.4), rounded upward to the nearest percentage point, whichever is less.
- ii. the minimum level of bidding must be at reasonable price levels in relation to the range of accepted bids.

In what the Bank of Canada considers to be normal conditions in the market for fixed income securities, a bid will be considered to be at a reasonable price level if its implicit yield to maturity (being that rate of return which makes the cash flow remaining during the term of the security equal to the security's current market price) is no more than 5 basis points above the lowest bid accepted by the Bank of Canada for that issue of Government of Canada Securities.

- 10.2 On average, accepted bids should be approximately equal to the primary dealer's secondary market share over a specified time period.
- 10.3 A primary dealer is expected to make two-sided markets (bid and offer) under normal market conditions.
- 10.4 As noted above, a primary dealer will be obliged to provide market information, including trade activity and position reports, to the Bank of Canada, on request, in a timely and expeditious manner.

11. Monitoring and Compliance

- 11.1 As noted in section 6.8, the Bank will recalculate bidding limits every six months, and inform government securities distributors of their recalculated limits. In the event that a firm's bidding limit changes significantly during a recalculation period, the Bank will contact that firm to discuss the circumstances giving rise to the change in the limit.
- 11.2 Also, the Bank will analyse bidding after each auction to determine whether primary dealers have complied with the minimum bidding obligations (in section 10.1). In the event that a primary dealer has not met its minimum bidding obligations, the Bank will contact the primary dealer shortly after the auction to discuss the circumstances pertaining to the auction.
- 11.3 If the Bank is of the view that a primary dealer's behaviour at a particular auction, or over the course of several auctions, represents a material disregard for its minimum bidding obligations, the Bank may sanction that primary dealer.
- 11.4 The Bank may sanction a government securities distributor if it is of the view that the distributor has attempted to manipulate the market for Government of Canada securities; made an incorrect representation or certification; failed to provide information required under the Terms, or provided information that was incorrect, inaccurate or incomplete; or participated in any other breach of the Terms.
- 11.5 Prior to imposing a sanction, the Bank will contact the primary dealer or government securities distributor in question to notify the firm of the Bank's intentions, and to provide the firm with an opportunity to explain the situation.

- 11.6 The sanctions that the Bank may impose include suspending the distributor from participating in one or more future auctions; and changing, on a temporary or permanent basis, the distributor's bidding limits. In the event of behaviour that the Bank considers to be fundamentally incompatible with a firm continuing to act as a government securities distributor, the Bank may revoke the distributor's status as a government securities distributor.
- 11.7 Any outstanding obligations or liabilities owed by a government securities distributor 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 government securities distributor.