

Response to DMO consultation on Electronic bidding at auctions

July 2004



1. Introduction

The DMO published its consultation document on electronic bidding at auctions on 12 March 2004. The consultation closed on 30 April 2004 by which time the DMO had received 16 responses. The DMO is grateful for the helpful and constructive comments received from all those that responded.

As expected, the vast majority of responses were from the Gilt-edged Market Makers (GEMMs), since electronic bidding will particularly impact and ultimately benefit the issuance and other operations affecting gilts.

This response to the consultation summarises the feedback the DMO received from the market. It does not attempt to answer all the issues that were raised, either in the original consultation paper, or as a result of the responses received. Analysis has been undertaken on the responses but more to gauge the level of market consensus rather than to reach a definitive conclusion. All the comments will contribute towards the requirements definition and selection process of the final business model.

2. Findings and Conclusions

The responses confirmed the view that there is overwhelming support for the introduction of an electronic bidding system for gilt auctions and Treasury bill tenders. In particular, the respondents recognised the advantages of entering and amending bids right up to the close and, for gilt auctions, the removal of the need to restrict the number of bids in the closing minutes.

Generally speaking, the respondents expressed similar opinions on most matters. The areas that saw more mixed views were on the balance between fast turnaround times and checking bids, the identification of client bids and the technology to be adopted. Clearly, all these factors are inter-related (i.e. checking the validity of a bid, whether for accuracy or client identification reasons, impacts on the turnaround time). Similarly, the chosen technology may restrict how quickly this information is collected and processed. Therefore, it is not possible to look at these aspects in isolation, but the consultation has helped understand the respondents' views on the main priorities.

The comments received have helped the DMO to start defining the main system requirements. This process has already begun internally and the DMO expects to involve representatives from market participants in due course.

3. Turnaround Times

There was a varied response regarding turnaround times. They ranged from respondents preferring an instantaneous result to ensuring operational risk was minimised by having a longer time to check bids. On balance, expectations are that an electronic system should reduce the turnaround times, even if the DMO retained an element of discretion in its allocation of stock. Therefore, any reduction is considered to be an improvement on the current situation but there is a view that there comes a point where it is not worth reducing it any further at the risk of an inaccurate result. The most common interpretation of a “reasonable” turnaround time was between 5 and 10 minutes.

A commitment to faster turnaround times also increases the likelihood of market speculation as to the reasons for any delay that might occur. This could potentially disrupt the market unnecessarily.

It is likely the DMO will consider a staggered approach to implementing faster turnaround times. This will allow new systems and procedures to be established, not only centrally at the DMO but at the user end as well.

The main findings of the critical factors deemed to affect the turnaround time are detailed below.

4. Client Bids

It was evident from the responses that the subject of client bids provoked the greatest number of comments, and this is an area that the DMO is therefore reviewing carefully.

The consultation paper stated that the introduction of electronic bidding is not intended to change the operational arrangements for auctions, issues of tap stock

or Treasury bill tenders, except where the current process is dictated by the need to receive bids over the telephone. However, it is clear that the verification and evaluation of client bids represent controls that have the greatest constraint on turnaround times and hence the automation is key to delivering the benefits that the quicker publication of results brings to the gilt market. In other words, unless the client identification process can be automated, the DMO will not be able to reduce the turnaround times by any significant degree.

The current intention is for the DMO to retain its maximum allocation limit for individual GEMMs, taking into account client bids and existing long/short positions. A facility is envisaged to monitor the quantity of client bids, and which still permits individual client identification. The consultation paper proposed that clients would need to be given an identifier prior to any auction. Some responses suggested that this could prove problematic for new clients deciding to bid on the day of the auction. This could be alleviated by restricting the percentage that could be allocated to non-identified clients, although this risks making the process unduly complicated. It may prove sufficient to make this a post-auction process (i.e. aggregate client bids used for calculation of allocation limits for GEMMs with a breakdown provided after publication of the results). In these circumstances, breaches of limits at this level could be dealt with after the auction and may prejudice the GEMM's relevant participation in subsequent auctions.

It is the DMO's intention to consider the client bid process further as part of the requirements definition stage of the project.

5. Bid Validation

There was unanimous support for having sufficient plausibility limits to minimise bid input errors. In the original consultation paper, it was suggested that limits could be set centrally (i.e. by the DMO), although it did raise the concern that it might be perceived the issuer was trying to influence the clearing price. Setting a reference market price at an agreed time before the auction close could alleviate this. The DMO could then set parameters, depending on the instrument type and maturity being auctioned, around this reference price and bidders would then over-ride the parameters as they wished. Alternatively, a system may be designed whereby a reference market price could be fed in, either from wire

services pages or from bidders' own in-house systems, around which users could set their own price parameters. A similar facility could also cover bid size restrictions.

On balance, respondents recognised that electronic bidding would place greater responsibility on each individual bidder to ensure the validity of bids. The majority commented that it should therefore be their role to set the parameters, or over-ride those set by the DMO, especially as they would suffer the consequences of any inputting errors. Ultimately though, the DMO would retain the right to query the validity of a particular bid.

6. DMO Discretion

Some issuers have an entirely rules based system which means the results are generated with little or no intervention from the issuer and are therefore much quicker to publish. The DMO intends to retain the right not to allot all the stock on offer in exceptional circumstances, e.g. where the auction is covered only at a level unacceptably below the prevailing market level. The majority of respondents agreed with this approach. Given that a certain amount of time needs to be reserved to allow analysis of the results, the DMO will look at ways of automating the process without compromising its ability to intervene to avoid market disruption.

7. IT Systems

Although it was largely the favoured approach, there remains some concern over using an internet-based solution, particularly with regards to security and performance/reliability issues. It is recognised as being the most flexible and economical communication method but there are some reservations over its use for such a critical operation. The DMO acknowledge that a robust and well-functioning technology platform with the capability for seamless contingency is the single most important aspect of an electronic auction system and will continue to have a significant influence on the solution chosen.

8. Next Steps

The DMO is continuing its research into potential solutions and defining the system requirements taking into account the feedback from this consultation exercise. The DMO plans to engage market participants in this process in the coming months.

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9. Responses to Individual Questions

Below is a short summary of the responses to each of the questions in the consultation.

Q1 Should the DMO aim to deliver the results announcement in the shortest time available, potentially at the cost of increased operational risk to market participants, or would the market prefer the DMO to retain some discretion in the process at a cost of slower announcement of the results? What does the market see as a reasonable turnaround time?

The general response is covered in paragraph 3. Reasonable turnaround times were expressed as ranging from 2 to 20 minutes, with the most common expectation of around 5-10 minutes.

Q2 Does the market see any issues with the ability to amend or delete bids up to the auction close?

There was a unanimous view that bidders should be able to amend and/or delete bids up to the auction close. Indeed, the ability to change bids up to the close of the auction/tender an unlimited number of times was seen as one of the main benefits of electronic bidding. There were also comments on the functionality and method of bid entry and submission (e.g. should it be a single template containing all bids or should they be submitted individually?). These will be considered as part of the requirements definition stage.

Q3 Does the requirement to identify client bids at point of input (rather than in the post auction report) raise any practical implications for potential bidders?

The response to this question is covered under paragraph 4.

Q4 For simultaneous tenders, would the market prefer to operate a combined template of bids for multiple instruments or through discrete templates?

The majority favoured discrete templates for each instrument. The main benefit was seen to be the reduced chance of input errors for the wrong instrument. Comments will be considered as part of the requirements definition stage.

Q5 The DMO would welcome views on its proposal for a central database of client identifiers. Would pre-registration cause practical difficulties for bidders?

The response to this question is covered under paragraph 4.

Q6 The DMO would welcome users' views on the benefits of plausibility limits as part of an electronic auction system. Would bidders wish to be able to input bids outside of the plausibility limits? Would bidders prefer to have control over their own limits or prefer for them to be controlled centrally?

The response to this question is covered in paragraph 5.

Q7 Would bidders welcome a facility to receive allocation confirmations through the electronic auction system?

All respondents welcomed the concept of receiving allocations in this way, with some recognising the potential to facilitate straight through processing. However, the DMO sees this as a possible consequence of electronic bidding rather than a primary requirement, and therefore will not significantly influence any assessment of a solution.

Q8 Do users have strong preferences on the choice of communication for an auction system and, in particular, the acceptability of an internet-based system?

The response to this question is covered in paragraph 7.

Q9 Will a telephone bidding option meet users' business continuity requirements in the event of a business interruption affecting the bidder?

All respondents agreed that a telephone back up would be essential for business continuity purposes. It was also commented that any extension to the deadline would have to apply to all other bidders as well. Also, if several GEMMs needed to make telephone bids during the same auction, there it might be necessary to restrict the number of bids, as is currently the case.

Q10 The DMO would welcome views on its proposal that use of an electronic auction system should become mandatory for all GEMMs and regular participants in DMO auctions.

All respondents agreed that it has to become mandatory to make best use of the benefits.

Q11 The DMO would like to hear from any market participants interested in being involved in the development process, as part of a stakeholder focus group. Please provide contact details.

Several respondents offered their services for a stakeholder focus group. The DMO will issue details on this in due course.

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