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## PRESS NOTICE

### **FUTURE PROVISION OF GILT AND TREASURY BILL REFERENCE PRICES: FEEDBACK ON STAKEHOLDER ENGAGEMENT**

Further to the announcement on 12 March 2015 regarding the future provision of gilt and Treasury bill reference prices, currently produced by the DMO on behalf of GEMMA, the DMO is now providing an update on stakeholder feedback received to date.

The DMO has spoken to a wide range of stakeholders, including GEMMs, investors and other market participants as well as market infrastructure providers, potential new price providers and market authorities. As highlighted in the 12 March announcement, the purpose of the engagement process has been to explore the market's preferences and requirements for gilt and Treasury bill reference prices.

The feedback received during the engagement process has focused on two key areas – the current uses of reference prices and the issues that stakeholders have identified as requiring consideration as part of any future price provision, which are summarised below.

The DMO is grateful for stakeholders' engagement in the feedback process. It anticipates publishing details of next steps in due course.

## FEEDBACK RECEIVED FROM STAKEHOLDER ENGAGEMENT

The sections below set out the feedback that the DMO has received during its initial phase of engagement with market and other participants.

### Current uses of end-of-day reference prices

Since the introduction of the gilt reference end-of-day prices in 1996 (and Treasury bill reference prices in 2003), these prices have come to be used by market participants for a wide range of purposes. The growth in use of the gilt reference prices reflects the manner of their introduction in the 1990s, summarised in the Bank of England's 1997 Quarterly Bulletin<sup>1</sup>, which noted that, "these prices (the reference prices) are used in the CGO<sup>2</sup> system for valuation purposes and by the market as a whole".

As gilts are primarily traded over-the-counter (OTC), the main identified uses of reference prices by wholesale market participants are for:

- portfolio and transaction valuation purposes;
- the valuation of collateral (including by market infrastructure providers);
- use as a reference in derivative contracts for the calculation of payments;
- index construction, in published and custom indices;
- benchmarking and performance measurement in fund management;
- transition management and portfolio rebalancing;
- fair value accounting; and
- trading purposes, reflecting their use in benchmarks and indices.

As with other sovereign markets, gilts can act as a pricing benchmark for a range of other issuers, including corporates, supranationals and public bodies, both for bond issuance and in pricing of similar instruments such as loans, or for internal transfer pricing. Reference prices may be used for these purposes, depending on the specific requirements of the issuer.

Other stakeholders also make significant use of gilt prices: this includes retail investors, whose use of gilt reference prices includes the valuation of holdings (e.g. for probate), as well as academic users for research purposes, where data continuity and availability is important.

### Future reference price provision

#### *Future price sources*

As part of the engagement process, stakeholders considered the potential impact of a move to multiple providers of prices in the future. There was a widespread view that this would be less

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<sup>1</sup> Bank of England (1997). *Quarterly Bulletin*, May 1997. 37 (2).  
<http://www.bankofengland.co.uk/archive/Documents/historicpubs/qb/1997/qb9702.pdf>.

<sup>2</sup> Central Gilts Office. For more information, see <http://www.bankofengland.co.uk/markets/Pages/paymentsystems/cgmo.aspx>.

efficient and sustainable than an outcome in which one source was identified as, or became, the market's generally accepted price reference.

It was noted that while it is the case that other sovereign bond markets typically do not have a unique provider of reference prices, the existence of gilt reference prices for the last 19 years has meant that the market and related infrastructure has developed around a single set of prices. In addition, the structure of the UK repo market (Delivery By Value (DBV) vs. tri-party repo) means that a common source of prices is of greater significance in the UK than in other markets.

Some stakeholders highlighted a need to amend existing contracts that use current reference prices, or a requirement to nominate a successor price source. It was noted that either would be simpler to arrange across multiple counterparts if there was one generally accepted set of reference rates.

#### *Regulatory treatment of reference prices*

Wholesale market participants using reference prices generally indicated a preference that gilt reference prices should become a regulated benchmark in future. At a minimum, it was expected that any prices should be prepared in line with the International Organization of Securities Commissions (IOSCO) principles for financial benchmarks<sup>3</sup>.

Reflecting on the existing provision of reference prices by a public body, a number of stakeholders suggested that it would be important for reference prices to be produced with appropriate controls, potentially through an independent source, to minimise any possible conflicts of interest.

#### *Future charging model for price provision and availability of prices*

As part of the engagement process, stakeholders considered the probability that any future providers would charge for reference price provision. Feedback during the engagement process highlighted that reference rates elsewhere were available through a commercial charging model or alternatively via a 'public utility' model where charges are set on a cost-recovery basis.

The engagement process highlighted the importance of continued ready access to reference prices for wider public use, including by retail investors and for academic purposes. Feedback noted the potential for a tiered approach to charging, with the possibility of no charge (or a much lower charge) for prices offered on a non-real-time basis, or with specific restrictions.

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<sup>3</sup> See <https://www.iosco.org/library/pubdocs/pdf/IOSCOPD415.pdf>.

### *Calculation of reference prices*

Feedback from stakeholders highlighted a requirement for the ongoing provision of prices for all existing instruments: gilts, strips and Treasury bills. In the case of prices for Treasury bills (and for gilt strips), the lower liquidity of these instruments led stakeholders to anticipate that these would be calculated analytically, as at present<sup>4</sup>.

The current method for capturing inputs for gilt reference prices is to utilise a 'submission-based' approach, in which the GEMMs submit sets of gilt prices to the DMO, with the inputs being used to calculate an average price for each instrument. As part of the engagement process, stakeholders considered the possibility of moving to a different basis for producing gilt prices. Feedback suggested that a general direction of travel by other benchmarks away from submissions-based approaches had been observed.

An alternative method for deriving gilt reference prices would be to use a 'streaming' approach. This would involve the price provider capturing inputs for reference prices by 'scraping' individual gilt prices that are streamed by market makers to one or more trading platforms. This approach was noted to have potentially lower overhead costs for the parties involved compared with a submissions-based approach, including costs associated with meeting regulatory requirements.

### *Lead time for transition*

Stakeholders noted that they would require sufficient lead time from the point at which any new provider announced that it would start to produce reference prices in order to facilitate their transition. Feedback indicated that stakeholders would expect to continue to use current reference prices, published by the DMO, until this transition period had completed. Whilst estimates were lower in some cases, a number of stakeholders suggested that a minimum of six months' lead time would be required.

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<sup>4</sup> The Annex to the Press Notice of 12 March sets out the methodology for the calculation of all existing instruments.

## NOTES TO EDITORS

The DMO announced on 21 January 2015 its strategic intention to withdraw in due course from the provision of daily end of day Gilt-edged Market Maker Association (GEMMA) and Treasury bill reference prices. As part of this process, the DMO is engaging with market participants to explore the requirements for gilt and Treasury bill prices, to build stakeholder consensus around the conditions for the DMO ceasing to provide reference prices, and to help stakeholders to identify potential alternative ways that requirements can be met. The DMO will continue to provide reference prices during the engagement and transition process.

The DMO currently formally publishes reference prices in all gilts on behalf of GEMMA. GEMMA reference prices were introduced in July 1996 and were published by the Bank of England until April 1998, when the responsibility transferred to the DMO. The DMO currently requires all GEMMs to contribute closing reference prices in all liquid gilts. Every evening the DMO uses these contributions to produce end of day reference prices and associated redemption yields for each gilt. It also derives and publishes prices for the less liquid gilts (including strips) on behalf of GEMMA.

The DMO has been publishing reference prices for Treasury bills since September 2003 and these are intended to provide indicative prices for the purpose of CREST valuation of collateral transfers. These prices are calculated by the DMO from prevailing General Collateral (GC) repo rates adjusted by a spread which reflects the results from recent Treasury bill tenders.

The gilt and Treasury bill reference prices, including those derived by the DMO, are published to the DMO's wire services pages, on the DMO's website, and transmitted directly to various stakeholders.

This press notice will be appearing on the DMO's website at: [www.dmo.gov.uk](http://www.dmo.gov.uk)