

United Kingdom

**Debt
Management
Office**

Eastcheap Court
11 Philpot Lane
LONDON EC3M 8UD

OFFICIAL OPERATIONS IN THE GILT-EDGED MARKET

Operational Notice by the UK Debt Management Office

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OFFICIAL OPERATIONS IN THE GILT-EDGED MARKET

OPERATIONAL NOTICE BY THE UK DEBT MANAGEMENT OFFICE (DMO)

This Notice (the "Operational Notice") sets out the objectives and procedures for the DMO's operations in the gilt-edged market, acting as the Government's debt manager. It replaces all earlier such notices.

The Notice sets out the normal market operations which the DMO undertakes in the gilt-edged market. In exceptional circumstances, the DMO may on occasion undertake other operations at its discretion. The DMO may also announce variations in these arrangements, or new forms of market operation, either by special announcement or by means of a supplement or revision to this Operational Notice. The DMO's cash management operations are outlined separately in the "Exchequer Cash Management Operational Notice".

This Operational Notice should be read in conjunction with the Information Memorandum on the Issue, Stripping and Reconstitution of British Government Stock published in December 2004, as amended by subsequent DMO notices dated 13 May 2005, 13 September 2005 and 14 May 2007, and the 'Guide to the Roles of the DMO and Primary Dealers in the UK Government Bond Market', also re-issued in May 2007. All of these publications are available on the DMO website at: www.dmo.gov.uk.

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If you have any queries on this Notice, please contact Martin Duffell, UK Debt Management Office, Eastcheap Court, 11 Philpot Lane, London, EC3M 8UD; Tel 0845 357 6517; or e-mail martin.duffell@dmo.gsi.gov.uk

I FRAMEWORK FOR GILT-EDGED OPERATIONS

1. The framework for gilt-edged operations is set out in the Report of the Debt Management Review produced jointly by HM Treasury and the Bank of England in July 1995¹. With the transition in debt management responsibilities from the Bank to the DMO from 1 April 1998, this framework now applies to the DMO's operations. A full description of all the DMO's responsibilities, objectives and lines of accountability is also set out in its Framework Document, first published in March 1998, and most recently revised in April 2005.

2. The objective of debt management, as stated in the Debt and Reserves Management Report, is "to minimise over the long term the cost of meeting the Government's financing needs, taking into account risk, whilst ensuring that debt management policy is consistent with the aims of monetary policy".

3. Alongside the Budget each year (usually in March), the Government publishes a Debt and Reserves Management Report, including a debt management Remit to the DMO, setting out advance details of the annual issuance programme². This includes a planned maturity structure for the issuance of conventional gilts for the year and an indication of the likely scale of the issuance of index-linked gilts. Within that published framework, the Government aims each year to sell sufficient gilts, Treasury Bills and National Savings and Investments products to finance the Central Government Net Cash Requirement (plus maturing debt and any net change in the foreign exchange reserves).

4. This Notice describes the arrangements for the primary and secondary market operations which the DMO undertakes in implementing the debt management Remit. It covers conventional and index-linked auctions, syndicated offerings, switch auctions, reverse auctions, taps and tenders, conversions, sales to and from official portfolios, and other secondary market operations. *In all sections, references to Gilt-edged Market Makers (GEMMs) should be read as applying to those GEMMs recognised by the DMO as specialists in that particular sector of the market – conventionals, index-linked or both.* Any timings mentioned refer to London time (GMT/BST as relevant).

5. Throughout this document, in respect of index-linked gilts, all references to clean prices relate to real clean prices for 3-month lag and 'uplifted' clean prices for 8-month lag index-linked gilts respectively.

6. Any changes to the arrangements described below will be published through updates to the relevant sections of this Operational Notice.

¹ Copies are available from the Publishing Unit, HM Treasury, 1 Horseguards Road, London, SW1A 2HQ, and on the DMO website.

² In the event that the annual Budget is held in April, a provisional remit will be published in March and a final remit in April.

II THE PRIMARY MARKET

POLICY AND THE GILT REMIT

7. Since 1995³, auctions have constituted the primary means of issuance for both conventional and index-linked gilts, as the government regards such operations as the fairest, most transparent and most cost-effective way of issuing gilts over the long run. However, the DMO may, on occasion, issue gilts via a syndicated offering.

8. The auction calendar for an entire financial year (April-March) forms part of the financing remit⁴ given to the DMO by HM Treasury. The DMO remit is usually published alongside the Budget, in the Debt and Reserves Management Report (DRMR), every spring and is released after the Chancellor of the Exchequer has delivered his Budget speech.

9. The remit itself is formulated and published after the Debt and Reserves Management (DRM) team at HM Treasury has consulted with the DMO, primary dealers, investors and other market participants. Primary dealer firms and other market investors are invited to send a representative to annual meetings, chaired by the responsible Minister, the Economic Secretary to the Treasury, in order to air views on the content of the forthcoming year's remit, the perceived needs and demands of the market, and any other topical issues of the time.

10. The financing remit for each financial year will indicate; (a) the (minimum) number of auctions in each broad maturity band⁵ to be held during the financial year, (b) the dates planned for each auction, (c) a range for the sizes of the auctions in cash terms for both conventional and index-linked gilts, (d) the target amounts of cash to be raised in each sector, (e) the planned change in the level of Treasury bills, and (f) any predetermined contingency arrangements to cover an increase or decrease in the Central Government Net Cash Requirement (CGNCR).

11. In 2006-07, the financing remit included a split between pre-committed issuance (the 'core programme') and an 'unallocated' tranche of financing that was allocated throughout the year, on a quarterly basis, in a broadly even-flow manner. This temporary change was intended to allow greater responsiveness in gilt issuance by the DMO during 2006-07, given uncertain prevalent market conditions and a large borrowing requirement. No such measures were contained in the 2007-08 Remit.

12. The issuance programme, and in particular the number and timing of auctions, may be varied during the year in the light of any substantial changes to any of the following: (a) the CGNCR, (b) the level and/or shape of the yield curve, market expectations of future interest and/or inflation rates, (c) market volatility, or (d) any other criteria specified in the relevant annual Remit. In practice, variations are most likely to occur in regular quarterly issuance announcements, or at the time of publication of the outturn of the previous year's CGNCR in late April, and/or at the time of the Chancellor's Pre-Budget Report (PBR), usually in November or December. Any revisions will be announced by the DMO.

³ See <http://www.dmo.gov.uk/documentview.aspx?docname=remit/report95.pdf>

⁴ Available on the DMO website or in hardcopy upon application.

⁵ The DMO defines broad maturity bands as follows: shorts 1-7 years to maturity, mediums 7-15 years, and longs 15+ years.

PRIOR NOTICE OF GILT AUCTIONS

13. The DMO itself hosts quarterly consultation meetings with representatives of GEMMs and end investors. These meetings are normally held towards the middle of March, May, August and November, and are intended to inform the DMO of the market's preferences for the issuance of individual gilts in forthcoming quarters (April-June, July-September, October-December and January-March), within the constraints of the published remit. Summary minutes of these meetings are published on the DMO's wire services and web pages as soon as practicable the following day.

14. On a quarterly basis, the DMO will announce its plans for auctions (including any switch or reverse auctions) to be held over the following one to four months, typically at 3:30pm on the last business days of March, May, August and November. These announcements will normally indicate the identity of the individual gilt(s) or, if relevant, the creation of any new one(s), although coupons on new bonds are usually fixed closer to the auction date itself.

15. At 3:30pm on the Tuesday in the week preceding a scheduled auction, the DMO will publish the final terms and conditions of an auction, including the nominal amount of stock on offer, ISIN and SEDOL codes etc, and, where the gilt is a new one, the coupon, which will normally be set at current market yields for the relevant maturity, where possible rounded to the nearest 1/4% for conventional bonds, 1/8% for index-linked. Further issues of already existing gilts will usually be fungible with the parent issue from the settlement date of the auction.

AUCTION MECHANICS

16. With the exception of small retail bids from members of the DMO's Approved Group scheme (see below), all bids at gilt auctions must be submitted by, or through, a recognised primary dealer firm, via the Bloomberg Auction System (BAS), or, in emergency circumstances only, a direct telephone line to the DMO's dealing desk. This means that all other investors wishing to participate in the auction process must submit their bid to a GEMM firm of their choosing, who is in turn obliged to submit that bid to the DMO, without charge.

17. Bids may be submitted at any time from the opening of the bidding window (usually 8:00am on the morning of a scheduled auction), up until the published deadline (usually 10:30am), after which no further bids can be accepted.

18. Each competitive bid, from a GEMM or a client bidder, must be for one amount and at one clean price, expressed as a multiple of 0.01 of £1, for at least £1 million nominal and round multiples thereof.

19. Dealers bidding on behalf of clients, or other non-GEMM dealers in their firm, must enter a client code in the relevant field on their bid input screen. These codes are allocated and maintained by the DMO dealers, and any client institution intending to participate in the auction should apply directly to DMO dealers for allocation of a code. Applications may be made by e-mail, Bloomberg message, company fax or letter. Such codes are allocated on a once-only basis, and will be retained for use in

future auctions. However, *the assignment of such a code should not be taken as a signal that the DMO has verified the legitimacy of the client institution, and GEMM firms are expected to conduct their own due diligence validations.* GEMM dealers or salespeople may not apply to the DMO on behalf a client, but the latter is expected to reveal their code when submitting a bid to a GEMM. New applications for codes should be made to the DMO by the close of business on the evening before any auction.

20. Primary dealers are also offered a non-competitive allowance at each conventional or index-linked auction. The DMO sets aside a total of 10% of the nominal amount on offer to provide the GEMM community with the assurance of a guaranteed minimum allocation, in order that they are more willing to carry short positions into the auction itself. In conventional gilt auctions, the 10% allowance is divided equally amongst GEMM firms, while in index-linked auctions individual firms' allowances, within the 10% aggregate total, are determined by reference to that firm's successful competitive bidding results in the three previous index-linked auctions. Allowances are calculated to the nearest £50,000 nominal in conventional gilt auctions, and £100,000 for index-linked. Non-competitive bids are filled at the average accepted price in conventional gilt auctions, and at the lowest accepted price in index-linked auctions.

21. Other applicants, who are members of the DMO's Approved Group of Investors⁶, may bid non-competitively by delivering a completed application form to the DMO by either of the following means: (a) to arrive at the Registrar⁷, not later than 10:00am on the day of the auction; or (b) to be lodged at the DMO at Eastcheap Court not later than 10:00am on the day of the auction. Approved Group bidders can make a non-competitive bid for up to £500,000 nominal in conventional gilt auctions, £250,000 in index-linked, subject to a minimum application of £1,000 nominal and a limit of one bid per applicant, in £1,000 multiples.

22. Further details on all aspects of auction bidding, including operational aspects of BAS and contingency arrangements, can be found in the GEMM Handbook "A guide to the roles of the DMO and Primary Dealers in the UK Government bond market" and the user guide "Bloomberg Primary Market Auction System – User guide for operations conducted by the United Kingdom Debt Management Office", issued to all GEMMs in May 2007, and also available upon request to the DMO.

⁶ The Approved Group of Investors is a group of investors who have satisfied the evidentiary requirements of the DMO regarding the identity of any applicant for Stock or of any person for whom an applicant is acting as agent. Requests to be admitted to the Approved Group can be made at any time but failure to provide satisfactory evidence of identity will result in an applicant being refused admission to the Approved Group.

⁷ HM Treasury's designated Registrar, currently Computershare Investor Services plc, The Pavilions, Bridgwater Road, Bristol, BS99 7NH, tel no. 0870 702 0003, website www.computershare.com.

23. In processing auction results and allocations, the DMO may, at its own discretion, decline to allot stock to a bidder if it is deemed likely that a large allocation may lead to post-auction market distortion. In conventional auctions, the maximum permitted allocation for any single bidding institution is set at 25% of the nominal amount on offer, and in index-linked auctions the figure is 40%. In the case of GEMMs, the DMO will take account of any net short position already accumulated in the When-Issued dealing period, thus raising their potential maximum allowance proportionally. Should there be a need to scale back any allotments, the DMO will discard the lowest competitive bid(s) first, up to the relevant cut-off point. Non-competitive bids and bids on behalf of unrelated clients will be unaffected by this measure. The maximum allocation limit for client bidders is absolute, and any client bidding for more than 25/40% may be scaled back by the same method (ie. lowest priced successful bids first) and, if necessary on a pro-rata basis per GEMM, where multiple bids are at the same price.

24. Allocations at the lowest accepted price are scaled pro rata to the nearest half percentage point, and all such allocations are in multiples of £1,000 nominal of stock. In addition, a small amount of the gilt (typically less than £1 million nominal per auction) is retained by the DMO to cover roundings and any uncertainties in dealing with retail applications.

25. Results of the auction will be released on the DMO's wire services pages and in a press notice, simultaneously to all market participants, as soon as all the necessary calculations, allocations and checks have been performed internally by the DMO.

26. Gilt auctions will normally settle on the following business day, in accordance with the T+1 convention in the gilt market. For auction settlement purposes, accrued interest is rounded to 6 decimal places per £100 nominal.

27. All successful primary dealer bidders are expected to match the DMO's settlement instructions, and to meet their commitments on the day and in good time.

28. The procedures described above apply commonly to all conventional and index-linked gilt auctions conducted by the DMO. The following paragraphs identify areas where procedures and regulations may differ from one type of auction to another:

29. The minimum and maximum size range for conventional and index-linked auctions is set out each financial year in the annual Debt and Reserves Management Report, published by HM Treasury at the time of the Budget. As a general rule, the DMO will tailor the sizes of individual auctions to take account of the amount of risk being offered to the market in each operation. This means that auctions for shorter-dated gilts will generally be for larger sizes than those for longer-dated gilts, although there is no formulaic correlation. In determining the size of individual auctions, the DMO may also take into account specific market events (eg. index changes, redemptions, coupon flows etc), perceived levels of demand, plus any portfolio considerations of its own.

CONVENTIONAL GILT AUCTIONS

30. Conventional gilt auctions are held on a bid price basis (ie. successful bidders pay the price that they bid), with non-competitive bids allocated at the average accepted price.

31. Direct bidding is open to all primary dealers recognised as a GEMM in conventional gilts, and permissioned as such in BAS.

32. As stated above, Approved Group bidders may each submit non-competitive bids for a maximum of £500,000 nominal.

33. The published results of a conventional gilt auction will include details of the highest, average and lowest accepted prices (with the pro rata scaling rate at the lowest accepted price); the gross redemption yields equivalent to these prices; the total nominal value of accepted non-competitive bids (split between GEMMs and non-GEMMs); the total value of all bids received, including those rejected in whole or in part on account of price; and the ratio of this total to the amount on offer (the 'cover').

INDEX-LINKED GILT AUCTIONS

34. Index-linked gilt auctions are held on a single price basis (ie. all successful bidders pay the lowest accepted price), with non-competitive bids also allocated at this lowest accepted price.

35. Direct bidding is open to those primary dealers recognised as an index-linked GEMM, and permissioned as such in BAS.

36. As stated above, Approved Group bidders may each submit non-competitive bids for a maximum of £250,000 nominal.

37. The published results of an index-linked gilt auction will include details of the common allotment price (with the pro rata scaling rate at this lowest accepted price); the real yield equivalent to that price (and any inflation assumption contained therein); the total nominal value of accepted non-competitive bids (split between GEMMs and non-GEMMs); the total value of all bids received, including those rejected in whole or in part on account of price; and the ratio of this total to the amount on offer (the 'cover').

UNCOVERED AUCTIONS

38. The DMO reserves the right not to allot all of the stock on offer at a conventional or index-linked auction, although it would consider this only in exceptional circumstances, where it judges bids to be at an unacceptably deep discount to the prevalent market level. This is particularly pertinent, but not exclusive, to the index-linked sector, where the nature of the single price auction format means that the entire auction is allocated at the same low price, rather than individual outlier bids. In some circumstances, this could even mean that allocating a larger nominal amount of stock would actually lead to a lower amount of revenue being raised. In such cases, the DMO is likely to reject the lower bids. In other circumstances, an auction may still not be 100% covered, even if all bids submitted are accepted.

39. Where a regular conventional or index-linked auction is uncovered, for whatever reason, it is likely that the remaining gilts will still be created and the unsold balance will then be held by the DMO on an official portfolio for a certain period of 'purdah' in order to allow market conditions to stabilise. The DMO may then offer the balance for re-sale at a time of its choosing, but no sooner than one week after the original auction, if the market price of the gilt has subsequently risen from the clearing level, or two weeks if the prevalent market price has fallen. These arrangements will be detailed in a screen announcement to be published immediately after the results of an uncovered auction. Depending upon the amount of gilts involved, the re-sale of the unsold balance is likely to be via a tender or the DMO's Shop Window screen (see below, paragraphs 57-61 and 84-85).

SWITCH AUCTIONS

40. Switch auctions were designed to allow the DMO, and the market, to execute large-scale switches out of one gilt into another. This process involves the cancellation of the relevant amount of the source gilt and the creation of an extra corresponding amount of the destination gilt. Switch auctions may be employed in various circumstances – (a) to maintain a supply of current benchmark gilts in a low issuance environment, or (b) to allow the DMO to smooth the immediate gilt redemption profile. Note that switch auctions are no longer employed as a means of facilitating index extension events and the like. The decision on whether or not to offer a switch auction is entirely at the discretion of HM Treasury and the DMO, but any planned operations (date of auction and gilts involved) will be announced in the regular quarterly funding announcement.

41. The DMO will not hold a switch auction that would reduce the amount in issue of the source gilt to less than £4.5 billion nominal in conventionals, or £1.5 billion nominal in index-linked, nor will it hold a switch auction out of any gilt that has been auctioned in the previous eighteen (six for index-linked) months, or one that is, or has a reasonable likelihood of becoming, the cheapest-to-deliver gilt in any active gilt futures contract. The DMO could, however, switch into such a gilt. The DMO will not launch an entirely new gilt by means of a switch auction.

42. The DMO will only offer a switch auction where the source and destination gilts fall into the same maturity bracket⁸, and the maximum size of any such operations will be limited to the same upper constraints as on regular auctions, as specified in the relevant year's remit. Details of the size of any operation will be announced at 3:30pm on the Tuesday in the week preceding the scheduled date.

43. The bidding mechanics of a switch auction are similar to those of regular auctions, in terms of who may bid directly (i.e. GEMMs only), utilisation of BAS, timings, bid denominations etc. Conventional switch auctions are held on a competitive bid price basis, index-linked switch auctions are single price format.

44. The differences are as follows:

- The DMO will fix its bid price for the source gilt 30 minutes before the bidding deadline, at the prevalent mid-market price, and publish this price on its wire services pages,
- GEMMs, either for their own account or on behalf of clients, submit 'bids' in terms of the amount of source stock that they are offering and the clean price at which they are willing to buy destination stock,
- There is no non-competitive bidding facility,
- Maximum bidding and/or allocation limits are discretionary – any limitations would be pre-announced by the DMO on the preceding Tuesday.

45. The DMO will not set a minimum bidding price, but, before accepting any bids, it will be mindful of fair value in the market, and reserves the right to reject any bids it judges to be at an excessive discount. Any shortfall from the pre-announced maximum simply means that less of the destination gilt will be created.

46. The published results of a switch auction will include, where applicable, details of the highest, average and lowest accepted prices of the destination gilt (and the dirty price ratios relating to these prices); the nominal amounts of the source gilt offered and accepted; the nominal quantity of the destination gilt created; the new amounts outstanding following the switch auction; any pro-rata scaling percentage for bids submitted at the lowest accepted price; and the ratio of bids received to the amount on offer (the 'cover').

47. Switch auctions are cash neutral operations, hence successful bidders will be allocated nominal amounts of the destination stock calculated as the ratio of the dirty prices of the two stocks, rounded to the nearest 4th decimal place. Source gilts that were successfully switched will be cancelled at the same time as the new stock is created. The DMO expects all successful bidders to be able to deliver their commitment of the source gilt on the settlement date.

⁸ Defined in this case as 0-7 years, 5-15 years, and over 14 years in conventionals. The split is not applicable for index-linked gilts.

REVERSE AUCTIONS

48. In times of low financing requirements, the DMO's remit, set out in the annual Debt and Reserves Management Report, may include provisions for reverse auctions, whereby the DMO, on behalf of HM Treasury, will make an offer to buy back and subsequently cancel pre-announced amounts of one or more gilts. The scheduling of any reverse auction(s) would be announced as part of the usual quarterly funding announcement.

49. Where offers in multiple gilts are invited, the gilts involved will normally be of a similar duration and/or maturity. The DMO will not hold a reverse auction in any gilt that is, or has a reasonable likelihood of becoming, the cheapest-to-deliver gilt in any active gilt futures contract. The maximum size of such an operation will be limited to the same upper constraints as on regular auctions, as specified in the relevant year's remit— the actual sizes and gilt(s) involved would be announced at 3:30pm on the Tuesday in the week preceding the operation.

50. The mechanics of a reverse auction are again similar to those of regular auctions, in terms of who may offer directly (i.e. GEMMs only), use of BAS, timings, denominations, price increments etc. Conventional reverse auctions are held on a competitive offer price basis, index-linked reverse auctions are single price format.

51. As with switch auctions, there is no non-competitive facility and the DMO will not set a maximum price, but, before accepting any offers, it will be mindful of fair value in the market, and reserves the right to reject any offers it judges to be at an excessive premium. Any shortfall from the pre-announced maximum simply means that less stock is purchased, and subsequently cancelled.

52. In determining the results of a multiple gilt operation, the DMO will convert prices offered to yield equivalents, subtract from these values the theoretical yield for each gilt, as calculated by the DMO's own yield curve model, and allot acceptances to the highest relative yields offered. Allotment continues until the maximum pre-announced cash amount of stock is purchased. There are no limits on allocation of purchases to particular gilts or bidders.

53. Acceptances at the highest accepted price are made to the nearest 1/10th of a percentage point for each gilt, and all such acceptances are in multiples of £1,000 nominal of stock.

54. The published results of a reverse auction will include details of the highest, average and lowest accepted prices of each of the gilts involved; the nominal amounts offered, purchased and remaining in each; any pro rata scaling percentages at the highest accepted price in each; and the ratio of the cash value of offers received to the cash the DMO offered to bid for (the 'cover').

55. Any gilt purchased by the DMO in such an operation will normally be cancelled on the settlement date. The DMO expects all successful sellers to be able to deliver their commitment on that date.

III TAPS AND TENDERS

56. Taps (and reverse taps) are tenders, or mini auctions, conducted directly with GEMMs by the DMO's dealing desk. They are no longer used as a routine means of (de)financing, but function primarily as a market management mechanism, in circumstances where the DMO judges there to be excess demand (supply) in a particular stock or sector, temporary or otherwise, such that the secondary market has become, or is likely to become, dislocated. The size of any such operation is unlikely to exceed that of a regular, scheduled gilt auction in the relevant sector.

57. The DMO reserves the right to announce and conduct such operations at any time, but will endeavour to give at least one hour's notice to the market, via a screen announcement. This announcement will detail the identity of the gilt(s) involved; the intended size of the operation; any applicable limitations on participation (eg. minimum (maximum) acceptable prices, number of bids permissible, allocation limits etc); and other operational details. Tenders in both conventional and index-linked gilts will normally be held on a single price basis, with bids (offers) at the striking price subject to the usual pro rata scaling. There is no non-competitive facility.

58. GEMMs will be invited to submit bids (offers), via BAS, either for their own account or on behalf of clients, in the usual denominations, within the timetable outlined in the screen announcement. Results of the operation, including new amounts outstanding, will be published as soon as possible, with settlement and, where appropriate, creation (or cancellation) of the relevant gilt(s) taking place on the following business day. Again, the DMO expects all counterparties to be able to honour their commitments on that day.

59. By their nature, tap (and reverse tap) operations will have the effect of creating (cancelling) stock, which in turn will affect the Government's financing requirement correspondingly. As a result, subsequent auction sizes may be decreased (increased) accordingly.

60. It is also possible that the DMO might offer to conduct a cash neutral switch tap operation as an alternative. Such an operation would work in the same way as a switch auction (detailed above), except that it is likely to be for smaller size and be held on a single price basis, regardless of whether it involves conventional or index-linked gilts. The DMO would pre-announce any such operation at 3:30pm on the day before.

61. The DMO may also use the tender process described here for larger-scale secondary market operations, such as the subsequent sale of unsold auction stock following an uncovered auction, or the acquisition or disposal of stock on behalf of other HM Government funds, under the management of CRND or others.

IV SYNDICATION

62. Although auctions constitute the primary means of gilt issuance, the DMO has in the past launched a new gilt by means of a syndicated offer. The relevant annual debt management Remit (contained in the Debt and Reserves Management Report) will make clear whether any such offerings are permitted and/or planned in any one financial year.

63. Should the decision to syndicate an issue of gilts be taken, the DMO would make an announcement to this effect as soon as practicable, on its wire services pages and in a press notice, also detailing any consequences of the decision (such as the cancellation of a scheduled auction), and any available timing or operational details regarding the selection of managers and/or of the actual syndicated offer itself.

64. In allocating managerial roles to investment banks in the syndicated issue, the DMO would expect to offer all relevant GEMMs the opportunity to present their advice and credentials on a fair and equal basis, although other factors (such as primary and secondary market shares, expertise in the relevant sector of the market, etc.) would also be taken into account in the final selection decision. The DMO would not normally expect to appoint any non-GEMM to any role in the managerial group.

65. The precise format of the group and method of sale may vary from issue to issue. The DMO would take such decisions based on its own policy and portfolio preferences at the time and advice from GEMM firms on prevalent best practices and their recommendations for the particular issue.

66. The DMO will endeavour, via screen and web announcements, press notices and/or communiqués from lead managers, to keep all market participants informed of developments in the syndication process at all key stages of the operation.

V CONVERSION OFFERS

67. From time to time, the DMO may announce a conversion offer, usually with the aim of building up the size of a new gilt benchmark and retiring an old, 'off-the-run' one.

68. In determining which gilts might be candidates for conversion, the DMO will not consider any conventional gilts that have more than £5.5 billion nominal in issue, or any that is, or has a reasonable likelihood of becoming, cheapest-to-deliver into any active⁹ gilt futures contract. The DMO will not normally schedule offers so that fixed conversion terms on any two offers run concurrently. Moreover, a conversion offer will not be scheduled to coincide with a gilts auction in the same maturity area.

69. Conversions may be announced on any day, normally at 3:30pm, on the DMO's wire services pages, in a press notice and on the web site. This announcement will contain details of the source and destination stocks, the fixed price terms of the offer, and the timetable and method of acceptance. The price terms of the offer will be decided by the DMO, using its own yield curve model to provide a benchmark (dirty price) ratio and, where necessary, adjusting this ratio to take account of any observed cheap/dear characteristics in the market for the relevant gilts.

70. Conversion offers are open for a period of three weeks from the date of the initial announcement of the fixed ratio. The appropriate amount of accrued interest on both source and destination gilts is incorporated into the calculation of the dirty price ratio, for forward settlement. The conversion itself will involve no exchange of cash flows, and will therefore be free of payment.

71. Holders have until the pre-announced prescribed time on the closing date to notify the Registrar (Computershare) via CREST of their intention to 'assent' to the conversion. Non-CREST holders should notify the Registrar directly if they intend to assent. Notice to assent, once given, is irrevocable.

72. Any holder who is the beneficial owner of source stock, but who has lent it out in the repo market or elsewhere, still has the right to choose whether or not to accept the offer (and, if the term of the repo/loan goes over the closing date, to receive the destination gilt instead), but the holder must communicate his intention to the borrower in sufficient time for the latter to be able to assent the stock on behalf of the owner.

73. The DMO will usually announce the results of a conversion offer at 8:30am on the first business day following the closing date of the offer. This announcement will include the nominal amount of source stock assented, the percentage rate of take up and any amount remaining unconverted. It will also detail the nominal amount of new destination stock created, and the revised total nominal outstanding in that gilt. If appropriate, the DMO may also announce whether the source gilt has been assigned 'rump' status.

⁹ 'Active' means a contract that already has outstanding open interest.

VI OTHER OFFICIAL OPERATIONS

74. The DMO undertakes a number of other official operations in the secondary market, with the GEMMs, in its role as debt manager or to assist cash management. These include:

- purchases of "rump" and other selected gilts;
- trading in near maturity gilts;
- offsetting larger positions accumulated as a result of its dealings for the retail Purchase and Sale Service;
- purchases and sales of gilts for other official portfolios;
- purchases and sales via the Shop Window;
- activity in other exceptional circumstances;
- creating gilts for repo purposes.

(a) Purchases of "rump" and other selected gilts

75. 'Rump' gilts are those stocks on the gilt portfolio that the DMO considers to have too small an amount in issue to reasonably expect a liquid two-way market to exist (e.g. the residual amounts of gilts that have previously been subject to a conversion offer). Consequently, the obligation on market makers to provide prices in these gilts is relaxed, although any GEMM may still elect to do so, provided that they are aware of the inherent risks.

76. In order to provide holders of these gilts some form of exit before maturity, the DMO is prepared, between the hours of 8:05am and 5:00pm, to make a bid only price on request from a GEMM. The DMO is also prepared to make bids for forward settlement, up to and including T+5 business days. Note that the DMO will not, as a matter of course, be prepared to offer rump gilts to any GEMM or cash management counterparty who is short, nor will it lend such bonds out on repo.

77. A list of those gilts that have been declared 'rumps' by the DMO is maintained on the DMO's website and in various publications. Any changes to this list will be announced.

78. Periodically, the DMO is likely to dispose of some or all of its holdings in rump gilts by selling them back to the National Loans Fund for cancellation. This is most likely to be on an annual basis, usually in March, but the DMO reserves to right to cancel at other times if circumstances dictate. Any cancellations and/or changes to the outstanding amount of any issue will be announced.

(b) Dealing in near-maturity gilts

79. To assist cash management in smoothing redemption cash flows, the DMO is prepared, when asked by a GEMM, to bid a price of its own choosing for any gilt, including any strip, that has less than six months left before its maturity (i.e. after a semi-annual paying gilt's penultimate coupon payment). As these are essentially money market instruments by this stage, the price bid will be dictated by relevant money market rates and by the DMO's cash management position at the time of the

request. In August 2003, the DMO, with the consent of the Gilt-edged Market Makers Association (GEMMA), became a recognised gilt market counterparty of gilt Inter-dealer Brokers (in order to help preserve its anonymity) when trading in near-maturity gilts only.

(c) Gilt Purchase and Sale Service

80. Since December 2004, the DMO has assumed responsibility for the transaction of orders received from members of the public under the Gilt Purchase and Sale Service. This is a low-cost, execution-only service in gilts offered to smaller investors who have registered on the DMO's Approved Group. The service is administered by Computershare Investor Services PLC as agent of the DMO.

81. Under normal circumstances, the DMO will transact these orders from its own portfolio, but in times of heightened demand to purchase or sell (a) particular gilt(s), DMO dealers may choose to offset the effect on its portfolio by buying or selling gilts from GEMMs. Such transactions will normally be on a T+3 basis, in line with the settlement convention in the Gilt Purchase and Sale Service.

82. In the interests of transparency to investors, the DMO will publish on its website, on a daily basis, prices at which Purchase and Sale transactions have been executed on that day. This will take the form of a 'snapshot' of bid and offer prices in *all* gilts¹⁰, taken at the time that prices were confirmed to Computershare, regardless of whether or not an order was actually received in each gilt. The exact timing of the snapshot will vary from day to day, but will usually be at around midday.

(d) Purchases and sales of gilts for official portfolios

83. From time to time, the DMO may be asked to execute market transactions in gilts on behalf of funds under the management of CRND or other UK Government entities. These may be purchases or sales. In such circumstances, the DMO will request bids or offers as relevant from three randomly chosen GEMMs and deal on the best price received, provided that the order is for 'normal' market size. Where the size is smaller-than-average, the DMO may ask for prices from 'retail' GEMMs only, and where the size is deemed larger-than-average, the DMO may advertise the order on its Shop Window page (see below) or run a mini (reverse) tender, following the process described in Chapter III, paragraphs 58-63 above.

(e) Purchases and sales via the Shop Window

84. Where the DMO has a larger-than-usual position to sell, or buy order to fulfil, it may advertise the fact on its Shop Window pages on the wire services. In the interests of transparency, these pages are available for viewing by all market participants, but the DMO will only entertain dealing proposals from GEMMs, or from index-linked GEMMs only for index-linked gilts, either for their own account or on behalf of clients.

85. The Shop Window pages will be operational between the hours of 8:05am and 5:00pm. Details posted will include the identity and size of any gilt advertised for sale or purchase, plus any restrictions (e.g. minimum/maximum prices or sizes, time deadlines, etc.) that may be imposed at the DMO's own discretion. The DMO also retains discretion on whether or not to accept bids/offers submitted by GEMMs. These pages will be updated as soon as possible to reflect any resultant transactions.

¹⁰ Bids only in rump gilts.

(f) Purchases or sales of conventional and index-linked gilts in exceptional circumstances for market management reasons

86. The DMO reserves the right to purchase or sell conventional and index-linked gilts offered by (or to) GEMM firms, but would do so only in exceptional circumstances.

87. In such exceptional circumstances, the procedure would be as detailed in the section on taps, reverse taps and switch taps (Chapter III above).

(g) Standing repo facility

88. In June 2000, in response to a previous consultation exercise, the DMO introduced an automatic non-discretionary standing repo facility whereby any GEMM, or other DMO counterparty who has signed the relevant documentation, may request the temporary creation of any non-rump gilt for repo purposes. The minimum size of such a request is £5 million nominal, and the DMO will charge an overnight penal rate equivalent to 10% of the Bank of England's prevailing repo rate at the time. The operation will normally entail a back-to-back, cash-for-cash reverse repo of other gilt collateral at the Bank's repo rate. The facility is available from 12:30pm on the previous day to 11:30am on the same day of settlement. Participants may roll the facility on a day-to-day basis, but the DMO does not anticipate accommodating a continuous roll for a period of more than two weeks. Details of the amount and terms of any such operation will be announced first on the DMO's screen pages, and shortly thereafter on its website. The counterparty(ies) involved will remain anonymous, although the DMO reserves the right to share such information with other official regulatory bodies in appropriate circumstances. None of the gilts created for such purposes will be eligible for inclusion in the calculation of FTSE's or iBoxx gilt indices.

(h) Creating gilts for repo for market management purposes

89. If the DMO considers that there is sufficient evidence of severe market dislocation or disruption, it may create gilts which will be used to repo to all GEMMs who have signed the required legal agreements with the DMO. The terms and availability of such gilts will be announced on the DMO's wire service pages. Such circumstances will need to have been persistent and are not likely to be tied to any single event, or difficulties encountered by individual market participants. For example, the DMO would be unlikely to consider short-term problems connected with the delivery process into a single futures contract as indicative of severe market dislocation. The terms of the facility, including any rate of repo, which may or may not be penal, and the amount of any stock created will be announced on the DMO's screen pages. Any subsequent cancellations or withdrawal of the facility will be also announced in a similar fashion. As with the standing repo facility, such operations will usually involve a back-to-back, cash-for-cash reverse repo of gilt collateral with the same counterparty(ies) at the Bank of England's prevailing repo rate, and none of the stock thus created will be eligible for inclusion, temporary or otherwise, in the calculation of FTSE or iBoxx gilt indices.

VII PROVISION OF REFERENCE PRICES

(a) Intra-day benchmark prices

90. Between the hours of 8:05am and 4:15pm, the DMO collates and publishes a composite page of indicative mid-prices in a selection of benchmark gilts. These prices represent the average of contributions from GEMMs to the wire services, after discarding the highest and lowest outlier quotes for each gilt. The DMO's composite page will therefore update every time a new GEMM contribution in any one gilt is sufficient to change the overall average price. Note that these reference prices do not constitute an offer from the DMO to buy or sell securities, nor are they in any way intended to be binding on GEMMs dealing with other market participants. Ownership of the input data remains with the contributing GEMMs, the output with the DMO, and no GEMM or third party may re-distribute them, in any format, on a chargeable basis. The composite prices are published to various wire services providers and are available to all subscribers to those services, without charge and without discrimination over access. A list of the relevant wire services pages is attached in the Annex.

(b) End-of-day GEMMA reference prices

91. The DMO, on behalf of the Gilt-edged Market Makers Association (GEMMA), collates and publishes end-of-day reference prices in every gilt – conventional, index-linked and strips.

92. At 4:15pm every day, each GEMM is required to provide a mid-market clean price for every gilt in which they make a market. These prices are collated by the DMO and then published on its dedicated wire services pages, usually at 5:00pm. These prices will be published on the DMO website later that evening. For further details of the precise method of calculation, please see the relevant GEMMA pages, or the DMO website¹¹. These prices are for reference purposes only, and do not constitute an offer to buy or sell securities.

¹¹ "GEMMA Reference Prices: Calculation Methodology" June 1999 (and as updated thereafter) available on the DMO website.

VIII ANNOUNCEMENTS TO THE MARKET

93. In the interests of transparency and predictability, the DMO strives to release announcements at a set time of the day. Unless otherwise mentioned, announcements to all market participants are generally released at 3:30pm, and occasionally at 7:30am, simultaneously on all recognised wire services and as soon as possible thereafter on the DMO website, although the DMO does reserve the right to make an announcement at any time, in exceptional circumstances.

94. The interest and redemption payments for all index-linked gilts with first issue dates before 2002 are fixed by the Bank of England. The Bank aims to announce details of these payments by 2:30pm on the day that the relevant value of the General Index of Retail Prices (RPI) is published. For index-linked gilts first issued from 2002 onwards, the DMO is responsible for fixing and announcing the interest and redemption payments. The DMO aims to announce details of these payments by 3:30pm on the day that the relevant RPI value is published. On days on which both the Bank and the DMO publish details of index-linked gilt interest or redemption payments, the DMO announcement will also incorporate details of the payments published by the Bank. In every case, all coupon fixings are published on the DMO website.

UK Debt Management Office

May 2007

ANNEX

List of DMO information pages

Website

www.dmo.gov.uk

Index and market announcements pages

Reuters/Telerate – DMO/INDEX, DMO/GILTS1 et seq

Bloomberg – DMO <GO>, DMO1 <GO>

Thomson/Topic – 44799, 44700 et seq

GEMMA reference pages

Reuters/Telerate – GEMMA01 to GEMMA35

Bloomberg – DMO4 <GO>, DMO5 <GO>, DMO6 <GO>, DMO7 <GO>

Thomson/Topic – 44800 et seq, 44850 et seq

Benchmark composite pages

Reuters/Telerate – DMO/BENCH1, DMO/GILTS12

Bloomberg – DMO2 <GO>

Thomson/Topic – 44720, 44721

Shop Window page

Reuters/Telerate – DMO/GILTS10, DMO/GILTS11

Bloomberg – DMO3 <GO>

Thomson/Topic – 44717, 44718

United Kingdom

Debt

Management

Office

Eastcheap Court

11 Philpot Lane

LONDON EC3M 8UD