

## Best Practices for Auction Systems

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A single European auction system procedure (Auction System<sup>1</sup>) would be preferable from a market perspective. A single Auction System indeed would eliminate the need for market participants to adapt their trading each time they approach a different sovereign's debt. Subsequently, a single Auction System would lead to savings in resources, effort and time for purposes of placing Government debt. At the same time, the Primary Dealers (PDs) acknowledge sovereign issuers' need for autonomy. Debt may be issued for a variety of reasons and sovereigns must be able to exercise independent judgement with regard to their issuance and must have discretion with regard to the approach they employ. Therefore, the PDs realise that a single Auction System may not be an option in Europe at the present state of evolution of the relationship among Member States. Issuance of debt within Europe is still conducted on an individual country basis, as opposed to issuance at the European level and, as a result, each sovereign must have the prerogative to shape its strategic decision-making with regard to auctioning Government debt. However, whilst a single Auction System may not be possible, the ability for a third party provider to connect via an API to each Auction System in Europe would satisfy to a certain extent most of the best-practices quoted hereinafter.

Nevertheless, the PDs respectfully submit the following best-practices objectives with a view to synchronising auction practices. Although it may not be possible for a single Auction System to become a reality, the PDs believe that further harmonisation of practices across sovereign issuers' auction practices would lead to increased market efficiency and cost-savings.

### I. Interface Characteristics

#### 1. Auction Systems and Dedicated Infrastructure

The PDs encourage the European Debt Management Offices (DMOs) to consider promoting the development of auction systems that do not require dedicated infrastructure. More specifically, auction systems such as standardized web-based systems<sup>2</sup>, terminal-based systems or those that leverage existing trading infrastructure are appropriate and efficient solutions. This arrangement would allow PDs to integrate their individual infrastructures with the various Auction Systems. Auctions systems requiring dedicated infrastructure only for auctions should be avoided, *i.e.* bespoke auction solutions that have their own front-end and leased lines and cannot be shared with any other services should be avoided. Terminal based systems are those like Bloomberg<sup>3</sup> where the auction system is bundled in free of

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<sup>1</sup> We define Auction System to mean a *procedure* employed by a particular Euro-zone Government, which incorporates the draft best-practices contained herein. We do not mean to imply that Government issuers should surrender any extent of sovereignty or strategic decision making. We also do not encourage or publicize the use of any one particular commercial provider of auction systems.

<sup>2</sup> By web-based system we refer to a system which allows an auction to be conducted via Internet connectivity and not necessarily requiring the use of a browser.

<sup>3</sup> Six (6) issuers in Europe currently use the Bloomberg Auction System: Belgium, Finland, Ireland, Portugal, Slovenia and the United Kingdom.

charge with subscription based terminal fee thereby not requiring an additional cost outlay by PDs.

Therefore, light solutions using the Internet or solutions that leverage already subscribed terminals or use existing infrastructure for other services are encouraged (“flexible systems”). It should be emphasized that flexible systems substantially reduce or eliminate the costs of connection and maintenance. The technological sophistication of flexible systems enhances their practicability because they contain the requisite security measures and can guarantee the integrity of the auction process without the need for a separate infrastructure. For example, web-based systems of trading are employed by the major MTFs and exchanges.

Alternatively, issuers who would not be in a position to develop proprietary web-based systems, since these require large outlays of capital, may avail themselves of the services of independent commercial providers of web or terminal based auction systems (a “commercial system”), such as Bloomberg and MTS or any other entrant into the business.

A commercial web-based system could substantially reduce the costs of auctions. Such a system would contribute to the smooth functioning of the primary European Government bills and bonds market without impacting each Euro-zone country’s own debt strategy. Many sovereign issuers already use such commercial web-based systems in their issuance.

All flexible systems should permit the results of the auction (at least for that PD) to be exported to an excel spreadsheet in order to allow smooth interaction with the PD back office systems. Alternatively, Auction Systems should be open through the use of a standardised or familiar API.

PDs would therefore recommend the availability of one common third party software that connect to every Auction System in Europe via APIs in order to enter bids for all the Euro-zone auctions thereby satisfying most of our best practice suggestions and facilitating investors’ participation if desired.

In October 2000, the Euro-zone debt managers concluded that, due to the single currency debt issuances, there is an impetus for a common discussion among the public debt managers relating to the functioning of the bills and bonds markets.<sup>4</sup> Support for a standard web-based or commercial web-based system would be consistent with the Thomsen Group Committee’s mandate to promote an efficient functioning and integration of the European Union’s (EU) primary Government debt markets. The EPDA stands ready to assist with additional industry support and expertise if the Thomsen Group Committee should consider providing a standard web-based system for all Auction Systems.

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<sup>4</sup> Economic and Financial Committee Progress Report on National Issuing Calendars and Procedures for EU National, Government Bills and Bonds- October 2000, published at [http://europa.eu.int/comm/economy\\_finance/publications/efc/report2.pdf](http://europa.eu.int/comm/economy_finance/publications/efc/report2.pdf).

## 2. Robustness of the Bid Submissions System

Each Auction System should be technically robust and comply with outsourcing guidelines for IT systems produced by EU Member State regulators (as is expected of MTFs and exchanges). Industry best practice should be standardised so that the execution of auctions is predictable and guaranteed. In particular, an Auction System should have acceptable system availability and response times in order to minimise outages during normal business. Each auction system operator must make an undertaking that members would be treated impartially, as well as set in place sanctions for the breach of such contractual undertakings. Quality control must be exercised and systems routinely tested and run in accordance with defined management procedures.

In circumstances where issuers opt for a commercial system, the PDs suggest that sovereigns execute agreements with the providers stipulating that the providers ascertain that their systems employ industry best practice. Alternatively, the PDs suggest that sovereigns make the provision of industry best practice and the regular monitoring of compliance with such practice conditions to selecting a particular commercial provider. Such measures should be aimed at creating incentives for commercial providers to examine their practices and implement the most robust procedures in situations where their particular business models may not provide an impetus to do so.

## 3. Flexible Access from Various Locations

The PDs recommend relinquishing any kind of location requirement that exists with regard to the Auction Systems as it does not support the operation of efficient, open and integrated markets within the EU. Because of the sophistication of web-based technology, the justification for location-specific auctions is no longer viable. Such barriers ought to be removed as they run counter to the purpose and spirit of the EU Financial Services Action Plan. This further demonstrates the advantage of an Auction System that provides flexible and alternative connectivity options without the need to maintain dedicated infrastructure, thus allowing the PDs to relocate this activity easily as well as to access an auction from various locations. Moreover, a harmonised web-based system minimises errors and promotes efficiency by facilitating the direct auction participation of traders responsible for a particular issuer's debt coverage. The PDs believe that most issuers either have already moved to a flexible system or are in the process of doing so and they would like to emphasize their support for such developments.

## 4. Language of System

The PDs respectfully request that any Auction System operate alternatively in the English language. This should include any error messages that the system provides. Due to the globalisation of the Primary Dealer businesses, the PDs consider it feasible and efficient that Auction Systems operate alternatively in the English language.

The PDs recommend that sovereign issuers' systems (or the systems provided by commercial firms) support English as the alternative language without the need for development of

additional systems or the acquisition of another layer of “translator” software from 3<sup>rd</sup> parties as such practices have proven extremely costly. The PDs support an exception for circumstances where translator software is part of larger package, which is required to be used by a PD for other trading activities.

## **II. Auction Protocol Characteristics**

### **1. Seamless Functioning and Automatic Corrections**

In order to ensure a seamless functioning of auctions, any Auction System should be capable of accepting or rejecting bids extremely quickly. This would also give the participants the ability to send bids just before the cut off time to minimize delay, *i.e.*, within 3-5 seconds or, at a minimum, an Auction System must, subject to further consultation, implement best practice times which should be backed up by a service level agreement issued by the Service Provider where there exists a commercial relationship.

Moreover, the PDs propose that Auction Systems employ technology which allows the automatic correction of bids without the need of a preceding cancellation. The PDs believe that this approach would enhance the economy of an Auction System.

### **2. Price and Size Protection**

The PDs recommend that any Auction System must have a price protection on all bids as a minimum safety measure to prevent large bidding errors. Thus, in addition to parameters that the issuer applies during an auction for a particular security (*e.g.* maximum bid size), issuers should aim to provide functionality allowing traders to configure their own limits for price and size protection purposes. The PDs would like to emphasize that they support a price protection mechanism which derives from, and is triggered with respect to, the current market price and not a rigid mechanism termed in absolute values.

Furthermore, Auction Systems should have error policies and appropriate safeguards in place, such as are used in the secondary market: *e.g.*, price protection, price range protection and size protection. For example, issuers may set size protection mechanisms which send a warning if a bid size is not within a certain percentage permitted to be won by a single PD at an auction.

It is further advisable that systems which employ price and size protection have a capability which allows them to flash a “warning signal” before refusing a bid which is out of the price/size protection range in order that the PD may override the warning if desired.

### **3. Speed of Response of Auction Results**

The PDs recommend that any Auction System should be able to provide the auction results within 1-3 minutes after the scheduled cut-off time (which should be backed up by a service level agreement issued by the service provider where there is a commercial relationship).

More specifically, for standard single-security auctions, it is suggested that the auctions summary should be available within 1-3 minutes after bidding stops. The evaluation time required by individual issuers is dependent on many factors and thus a 1-3 minute limit may not be possible in all cases. In such circumstances, each issuer should agree (with its respective group of PDs) a reasonable time limit within which complex, multi-security auctions will be closed. In particular, PDs note that the expeditious provision of auction results such as cut-off price, amount allocated at cut-off price and average price, is essential to the efficient functioning of auctions.

The PDs recognise that certain sovereigns are concerned that some delays are caused by the placement of erroneous bids by dealers and that this presents a tension with tight timelines for announcement of auction results. The PDs believe that no further sanctions should be imposed upon dealers who have placed erroneous bids since the market self-corrects by “penalizing” a dealer who has placed an erroneous bid: *e.g.*, such dealer generally either misses the auction or is compelled to pay an excessive price. Moreover, where adequate automatic correction facilities, price and size protection exist, erroneous bids by bidders would be significantly minimised.

There are circumstances in which the publication of results is delayed due to technical faults. The PDs respectfully request that in such cases, sovereign issuers communicate to the market, within 1-3 minutes of the auction close, that there will be a delay and the delay is due to such faults, so as to alleviate the pressure of anticipation.

There are further circumstances in which the publication of results is delayed because a sovereign issuer has reserved the option to re-consider placing the debt where prices offered have been out of its range of expectations or one PD would be successful in the auction for more than a certain stated cut-off percentage of the total to be issued. The PDs further request that sovereign issuers communicate to the market the reasons for a delay in such circumstances, within 1-3 minutes of the auction close, in order to allow the market to function without interruption.

#### 4. Publications of Results

The PDs recommend that the publication of auction results should not, in any circumstances, be transmitted to news services such as Reuters and Bloomberg before being transmitted to the particular bidding system in order to reduce the risk of front running by other market participants.

This aims at ensuring that auctions function smoothly. The PDs do not request an unfavourable advantage; on the contrary, the PDs only request that priority in distribution of results not be given to the outside market in preference to the bidding system. This may be achieved by the results being transmitted to all parties at the same time. The results would be displayed on the auction system almost instantaneously, whereas the news services will usually disseminate with at least a few seconds’ delay. This would enable dealers to understand their respective positions post-auction.

## 5. Bidding Grid

Auction results and bidding grids should be published consistently in all Auction Systems to provide transparency and accountability to the market. The published bidding grid should contain all successful or unsuccessful bids, as well as all competitive and non-competitive bids where permitted. The bidding grid may be published some minutes after the publication of the auction results and should be provided at least to the PDs.

The PDs appreciate the need for “blind” publication of bidding grids (*i.e.*, without disclosing the identities of the respective bidding entities) and, indeed, prefer blind publication. The bidding grids may be supplied as part of a minimum standard for publication of results in order to allow sovereign issuers the ability to publish other information which they may deem beneficial to the market.

## 6. Straight Through Processing (STP)

PDs suggest that all Auction Systems offer STP where their auction positions are automatically sent to the settlement agent / institution and confirmed to the dealer in order for their back office to match the auction result with the automatic confirmation.

## 7. Issuance Calendar

The market agrees that the current flexibility with regard to the issuance calendar decided by each individual DMO is beneficial. It is, however, inevitable to have several auctions occurring during the same period. The PDs therefore believe that:

- Concentration of auctions on one day should be avoided if possible and specifically at the exact same time; and
- Any coincidence with the release of economic data that may impact auction prices should be avoided as well. Either, Eurostat should move economic data releases away from auctions or vice versa.