

DPMFi SECURITY AUCTIONS

I. Traditional Auctions

Most issues of papers included in the Federal Domestic Public Securities Debt - DPMFi are carried out through competitive auctions with multiple prices (exceptions are the LFT and NTN-B auctions carried out according to the Dutch auction or single price auction system). These auctions are carried out within the Central Bank electronic system. Depending on the terms set out in the auction directive, each participant (banks, brokers, distributors and other institutions registered at Selic) may submit up to five bids for each one of the securities offered.

There are no tap-type systems (the public debt manager sets the sale price of the security in question). The major system for issuing competitive papers is the traditional auction. Currently, auctions of fixed rate papers (LTN and NTN-F) take place on Thursday weekly, with issuance and settlement on Friday. In January 2002, the National Treasury introduced the Treasury Direct Program, which is designed to provide the general public with access to the public securities market. In this case, the tap security purchase and sale system is utilized and benchmark prices are stipulated based on observed primary and secondary market parameters.

Securities offered in auction as well as those issued through the Treasury Direct Program are processed exclusively in book-entry form through registration of the respective credit rights, and any assigns of such rights, in a centralized settlement and custody system known as SELIC. Redemptions of principal and earnings on these papers are also credited through the use of this system.

The auction process is initiated by release of the National Treasury Secretariat Release, announcing the specific conditions for each auction, including:

- type, quantity, term, interest rate (when appropriate) and other characteristics of each security offered;
- base date, when appropriate, which will be used as the reference date for updating the nominal value of the papers in question;
- date and time limit for presentation of proposals (traditionally set at 12:00 to 13:00);
- date and time at which the auction result will be announced (traditionally on the day of the auction, as of 14:30 hours);
- date of issue, financial settlement and maturity of the papers;
- proposal selection criteria; and
- electronic system to be utilized.

Institutions registered in the Central Bank electronic system are entitled to participate in the auctions directly and to present bids. Other corporate entities and individual people may also participate in public auctions, but only through the aforementioned institutions.

The proposals are listed in decreasing order of prices (increasing order of rates), in the case of sale auctions (the opposite occurs in purchase auctions) and selection of the winning proposals is based on one of the following criteria:

- best price for the National Treasury (traditional criterion); or
- single price for all proposals accepted. In other words, in sale auctions, those with prices equal to or greater than the minimum price defined will be accepted and, in the case of purchase auctions, those equal to or below the maximum price stipulated.

II. NTN-B Auctions

National Treasury Notes Series B – NTN-B are medium and long-term papers with values that are updated monthly according to the IPCA, with half-year interest payments of 6%.

The National Treasury carries out these auctions periodically with the following objectives in mind:

- Reduce the number of financial instruments issued by the National Treasury, concentrating their maturities in such a way as to increase secondary market liquidity and, consequently, reduce debt management costs;
- Create parameters for construction of a long-term interest curve for internal public debt securities, in such a way as to create domestic benchmarks for long-term transactions involving public and private funding operations;
- Provide adequate instruments for backing the long-term operations of economic agents including, for example, open and closed complementary pension fund entities;
- Lengthen the federal public debt profile in order to optimize liability management in terms of market risk.

NTN-B auctions are carried out in two stages. In the first, the uniform price auction is used for pricing the accepted proposals. Purchase proposals are received through the Special System of Settlement and Custody - SELIC, organized and selected in decreasing price order. The first stage is reserved to claims in cash. The cutoff price in the first stage determines the NTN-B price in the second stage (should any of the papers offered not be sold in the first stage, the Treasury will define the issuance price of that paper in the second stage and will announce that price in a Directive or release), in which the Treasury accepts competitive proposals for the sale of securitized debt instruments, which are accepted in exchange for NTN-B through the Integrated Market System – SIM and the Custody and Settlement Clearinghouse - CETIP. The proposals are settled through transfers of securities for which the Treasury is liable.

In these auctions, which have been carried out since August 2000, the profitability of each one of the papers accepted is compared to the profitability of the sovereign curves composed of papers for which the National Treasury is responsible, using the same indexing factor at the point in which the median duration of such papers is compatible with the sovereign curves in question.

II. Other Types of Auctions

Aside from the traditional auctions, the National Treasury carries out three other types:

- **Steady offers:** this type of auction is used to issue longer-term papers on the market, when a consensus as to rates has not been reached. In this process, National Treasury Secretariat – STN/General Public Debt Operations Coordinating Staff - CODIP and the Open Market Department - DEMAB/Central Bank of Brazil - BACEN dealer institutions send purchase proposals (commitment to negotiation) to the STN in the first stage, involving specific securities. Once the National Treasury accepts these proposals, the papers are offered in a traditional auction open to all institutions in the second stage. The institutions included in the first stage commit themselves to participate in the second stage with price proposals equal to or greater than those proposed in the preliminary stage. The overall result of the two stages defines the auction result;
- **Purchase auctions:** utilizing this instrument, the National Treasury acquires outstanding securities on the market. These auctions have two objectives: to mitigate maturities concentration and to incentivated secondary market liquidity;
- **Exchange auctions:** has the same objective as purchase auctions, while also aiding in improving public debt indicators, including average terms and profile. However, the National Treasury places new securities on sale and, as payment, receives outstanding securities on the market already defined in the auction directive.