The Debt Management Office's Exchequer cash management remit for 2011-12

Exchequer cash management objective

1.1 The Government's cash management objective is to ensure that sufficient funds are always available to meet any net daily central government cash shortfall and, on any day when there is a net cash surplus, to ensure this is used to best advantage. HM Treasury and the DMO work together to achieve this.

1.2 HM Treasury's role in this regard is to make arrangements for a forecast of the daily net flows into or out of the National Loans Fund (NLF); and its objective in so doing is to provide the DMO with timely and accurate forecasts of the expected net cash position over time.

1.3 The DMO's role is to make arrangements for funding and for placing the net cash positions, primarily by carrying out market transactions in the light of the forecast; and its objective in so doing is to minimise the costs of cash management while operating within the risk appetite approved by Ministers.

1.4 The Government's preferences in relation to the different types of risk taking inherent in cash management are defined by a set of explicit limits covering four types of risk which, taken together, represent the Government's overall risk appetite[1]. The risk appetite defines objectively the bounds of appropriate Government cash management in accordance with the Government's ethos for cash management as a cost minimising, rather than profit maximising, activity and playing no role in the determination of interest rates. The DMO may not exceed this boundary, but, within it, the DMO will have discretion to take the actions it judges will best achieve the cost minimisation objective.

The DMO's cash management objective

1.5 The DMO's cash management objective is to minimise the cost of offsetting the Government's net cash flows over time, while operating to a risk appetite approved by Ministers. In so doing, the DMO will seek to avoid actions or arrangements that would:

- undermine the efficient functioning of the sterling money markets; or
- conflict with the operational requirements of the Bank of England for monetary policy implementation.

Instruments and operations used in Exchequer cash management

1.6 The range of instruments and operations that the DMO may use for cash management purposes is set out in its Operational Notice[2]. The arrangements for the issuance of Treasury bills,

[1] The four types of risk are liquidity risk, interest rate risk, foreign exchange risk and credit risk. An explanation of these risks and the Government's cash management operations more generally is set out in Chapter 5 of the DMO's Annual Review 2004-05, which is available on the DMO's website: http://www.dmo.gov.uk/documentview.aspx?docname=publications/annualreviews/gar0405.pdf&page=Annual_Review

[2] The current edition of Exchequer Cash Management Operational Notice and Treasury Bill Information Memorandum is available on the DMO's website at: http://www.dmo.gov.uk/documentview.aspx?docname=publications/moneymarkets/cmopnot180210.pdf&page=money_markets/publication

and the management of the Treasury bill stock in market hands, is set out in, and operated according to, the DMO's Operational Notice.

1.7 One component of the debt sales planned to meet the Government's annual financing requirement is the year-on-year change in the outstanding stock of Treasury Bills, excluding bills issued solely for collateral purposes (see 1.11).

1.8 During the financial year, the DMO will manage the level of the Treasury bill stock and may increase or reduce the stock *vis à vis* the end year target level, in order to support the implementation of Government cash management. The DMO will announce the dates of Treasury bill tenders on a quarterly basis. The precise details of the maturity and the amount of the Treasury bills on offer at specific tenders will be announced one week in advance. In addition to the bills issued at weekly and ad hoc tenders, the DMO is able to reopen, on request from its counterparties, existing issues of Treasury bills on a bilateral basis to raise funds for cash management.

1.9 As a contingency measure, the DMO may issue Treasury bills to the market at the request of the Bank of England and, in agreement with HM Treasury, to assist the Bank of England's operations in the sterling money market for the purpose of implementing monetary policy while meeting the liquidity needs of the banking sector as a whole. In response to such a request, the DMO may add a specified amount to the size(s) of the next bill tender(s) and deposit the proceeds with the Bank, remunerated at the weighted average yield(s) of the respective tenders. The amount being offered to accommodate the Bank's request will be identified in the DMO's weekly Treasury bill tender announcement. Treasury bill issues made at the request of the Bank will be identical in all respects to Treasury bills issued in the normal course of DMO business. The DMO may also raise funds to finance advances to the Bank of England and would, in conjunction with HM Treasury, determine the appropriate instruments through which to raise those funds.

DMO collateral pool

1.10 To assist the DMO in the efficient execution of its cash management operations an amount of gilts, which shall be chosen to have a negligible effect on relevant indices, may be issued to the DMO on the third Wednesday of April, July and October 2011 and January 2012. Any such issues to the DMO will only be used as collateral in the DMO's cash management operations and will not be available for outright sale. The precise details of any such issues to the DMO will be announced in advance. If no issue is to take place in a particular quarter, the DMO will announce that this is the case in advance.

1.11 In the event that the DMO requires collateral to manage short-term requirements, the DMO may create additional Treasury bill collateral. Any such issues to the DMO will only be used as collateral and will not be available for outright sale.

1.12 The DMO's collateral pool may also be used to support HM Treasury's agreement to provide gilt collateral for the purpose of the Bank of England's Discount Window Facility (DWF)[3]. The gilt collateral will be held by the DMO and lent to the Bank of England on an 'as needed' basis; gilts created for this purpose will not be sold or issued outright into the market.

Active cash management

1.13 The combination of HM Treasury's cash flow forecasts and the DMO's market operations characterises the active approach to Exchequer cash management. In 2007-08, a new

[3] More information about the Discount Window Facility can be found on the Bank of England's website at: http://www.bankofengland.co.uk/markets/money/dwf/index.htm

performance measurement framework for active cash management - in which discretionary decisions, which are informed by forecast cash flows, are evaluated against a range of indicators -was introduced. These include quantifying excess returns to active management by measuring the net cost of cash management, after deducting an interest charge, equivalent to the Government's marginal cost of funds. Performance against key indicators, including quantitative and qualitative measures, is reported in the DMO's Annual Review[4].

[4] For the latest report See Annex D of the DMO Annual Review 2009-10, which can be found on the DMO's website at: http://www.dmo.gov.uk/documentview.aspx?docname=publications/annualreviews/gar0910.pdf&page=Annual_Review