5 The Debt Management Office's financing remit for 2007-08

Objectives

5.1 The UK Debt Management Office (DMO), an Executive Agency of HM Treasury, has been given the following objectives in respect of Government debt management:

- to meet the annual remit set by HM Treasury Ministers for the sale of gilts, with due regard to long-term cost minimisation taking account of risk;
- to advise Ministers on setting the remit to meet the Government's debt management objectives and to report to Ministers on the DMO's performance against its remit, objectives and targets;
- to develop policy on, and promote advances in, new instruments, issuance techniques and structural changes to the debt markets that will help lower the cost of debt financing, liaising as appropriate with the Bank of England, Financial Services Authority, London Stock Exchange and other bodies and to provide policy advice to HM Treasury Ministers and senior officials accordingly;
- to conduct its market operations, liaising as necessary with regulatory and other bodies, with a view to maintaining orderly and efficient markets and promoting a liquid market for gilts;
- to provide, including in liaison with Computershare Investor Services plc and CRESTCo, a high quality efficient service to investors in government debt and to deal fairly and professionally with market participants in the gilt and money markets, consistent with achieving low cost issuance;
- to contribute to HM Treasury's work on the development of the medium-term approach for the debt portfolio; and
- to make information publicly available on the debt markets and DMO policies where that contributes through openness and predictability to efficient markets and lower costs of debt issuance.

Quantity of gilt sales

5.2 The DMO, on behalf of the Government, will aim for gilt sales of £58.4 billion (cash)[10] in 2007-08. As in 2005-06, all conventional gilt issuance is pre-allocated to short, medium or long maturities in 2007-08. The split of total gilt issuance between conventional and index-linked gilts is also pre-allocated.

5.3 In January 2007, at consultation meetings with GEMMs and investors, there was some support for retaining remit flexibility in 2007-08. Remit flexibility had been introduced to allow the DMO greater capacity to respond to the possibility that the unusual conditions observed in the market at the end of the previous financial year would continue in 2006-07. Recent developments in demand for long-conventional and index-linked gilts are set out in Box 3.2. Consistent with its commitment to predictability, and given the anticipated strong and sustained demand for long-maturity gilts over the medium term, remit flexibility introduced for 2006-07 will not be continued for 2007-08.

[10] Figures in Chapter 5 are in cash terms unless otherwise stated.

Amount and maturity of conventional gilt issuance

5.4 The planned amount of issuance and maturity mix of conventional gilts in 19 auctions in 2007-08 is:

- 4 auctions in the short (1-7 years) maturity area, aiming to raise £10.0 billion cash;
- 4 auctions in the medium (7-15 years) maturity area, aiming to raise £10.0 billion cash; and
- 11 auctions in the long (15 years and over) maturity area, aiming to raise £23.4 billion cash.

5.5 The DMO will aim to build up new 5- and 10-year maturity conventional benchmarks through quarterly issuance of short and medium-dated gilts and frequent long-dated conventional gilt issuance.

Amount of index-linked gilt issuance

5.6 In 2007-08, the DMO aims to sell £15.0 billion (cash) in index-linked gilts.

5.7 15 auctions of index-linked gilts are planned in 2007-08. This will include frequent issuance at long maturities.

Size of gilt auctions

5.8 The gilt sales targets in paragraphs 5.4 and 5.6 above are specified in cash terms, but the gilt auctions are sized in nominal terms, typically in £0.25 billion increments for conventional gilts and £0.025 billion increments for index-linked gilts. Therefore all gilt sales targets are expressed in approximate terms.

Method of issuance of gilts

5.9 Auctions will constitute the primary means of issuance of all gilts (conventional and index-linked). All auctions will be single auctions held on the day indicated.

5.10 Each outright auction of conventional gilts is planned to be between £1.5 billion and £4.0 billion (cash) on a competitive bid-price basis. Each outright auction of index-linked gilts will be between £0.5 billion and £2.0 billion (cash) on a uniform price basis.

5.11 The expected timing of gilt sales is set out in the auction calendar in Table 5.1 below. A more detailed auction calendar for the first quarter of the financial year, including the gilts to be auctioned on each date, will be announced by the DMO at 3.30pm on Friday 30 March 2007. For the rest of 2007-08 the quarterly calendar announcements will be made at 3.30pm on 31 May, 31 August and 30 November[11]. Full details of all auctions will normally be announced at 3.30pm on the Tuesday of the week preceding the auction.

[11] The November announcement is subject to confirmation following the Chancellor's decisions on the Budgetary timetable.

Table 5.1: Gilt auction calendar 2007-08

Date	Type
2007	
3 April	Conventional
12 April	Index-linked
24 April	Index-linked
3 May	Conventional
22 May	Index-linked
24 May	Conventional
5 June	Conventional
21 June	Conventional
26 June	Index-linked
3 July	Conventional
10 July	Index-linked
26 July	Index-linked
9 August	Conventional
11 September	Conventional
13 September	Conventional
26 September	Index-linked
2 October	Conventional
10 October	Index-linked
24 October	Index-linked
1 November[1]	Conventional
6 November[1]	Conventional
20 November[1]	Index-linked
28 November[1]	Conventional
4 December[1]	Conventional
12 December[1]	Index-linked
2008	
8 January	Conventional
17 January	Index-linked
29 January	Index-linked
5 February[1]	Conventional
14 February[1]	Conventional
27 February[1]	Index-linked
4 March[1]	Conventional
13 March[1]	Conventional
27 March[1]	Index-linked

1. Any auction in November/December 2007 or February/March 2008 is subject to confirmation following the Chancellor's decisions on the Budgetary timetable.

5.12 The above programme of conventional and index-linked gilt auctions and any others that may be added during the year may be supplemented between auctions by official sales of gilts by the DMO "on tap". Taps of gilts will be used only as a market management instrument in exceptional circumstances.

5.13 The DMO has no plans to issue gilts by syndicated offering in 2007-08.

5.14 After an auction, the DMO will generally refrain from issuing gilts of a similar type or maturity to the auctioned gilt for a reasonable period, unless already pre-announced, or if there is a clear market management case for doing so.

5.15 For the purposes of market management, the DMO may create and repo out gilts in accordance with the provisions of its Standing Repo Facility launched on 1 June 2000.

Reverse auctions

5.16 The DMO has no current plans for a programme of reverse auctions in 2007-08.

Conversions and switch auctions

5.17 The DMO has no current plans for a programme of conversion or switch auctions in 2007-08.

Coupons

5.18 As far as is practical, coupons on new issues will be set to price the gilt close to par at the time of issue.

Buy-ins of short maturity debt

5.19 The DMO will have responsibility for buying in gilts close to maturity to manage Exchequer cash flows.

Revisions to the remit

5.20 Any aspect of this remit may be revised during the year, in the light of exceptional circumstances and/or substantial changes in the following:

- the Government's forecast of the gilt sales requirement;
- the level and shape of the gilt yield curve;
- market expectations of future interest and inflation rates; and
- market volatility.

5.21 Any revisions to this remit will be announced.

6 The Debt Management Office's Exchequer cash management remit for 2007-08

Exchequer cash management objective

6.1 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.

6.2 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.

6.3 The DMO's role is to make arrangements for financing 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.

6.4 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[12]. 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 a 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

6.5 The DMO's cash management objective is to minimise the cost of offsetting the Government's net cash flows over time, while operating within 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

6.6 The range of instruments and operations that the DMO may use for cash management purposes is set out in its Operational Notice[13]. The arrangements for the issuance of Treasury bills, and the management of the Treasury bill stock in market hands, will be set out in, and operated according to, the DMO's Operational Notice.

[12] The four types of risks 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 at: http://www.dmo.gov.uk/documentview.aspx?docname=publications/annualreviews/gar0405.pdf&page

[13] 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/index.aspx?page=publications/money_markets

6.7 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). This change is announced as part of the financing remit given by HM Treasury to the DMO (see Chapter 5).

6.8 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 (see paragraph 4.8). 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.

6.9 As a contingency measure, the DMO may also issue Treasury bills in the market to assist the Bank of England in its management of the sterling money markets. In response to a request from the Bank, 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 offered to accommodate the Bank's request will be identified in the DMO's weekly Treasury bill tender announcement. Treasury bills issued at the request of the Bank will be identical in all respects to Treasury bills issued in the normal course of DMO business.

DMO collateral pool

6.10 To assist the DMO in the efficient execution of its cash management operations, a combination of Treasury bills and 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 2007 and January 2008. 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.

Review of cash management

6.11 The combination of HM Treasury cash flow forecasts and DMO market operations characterises the active approach to Exchequer cash management. A review of cash management operations since the DMO took over cash management in 2000 was conducted jointly by HM Treasury and the DMO during 2004-05. To help enhance public accountability, this review recommended the introduction of a performance measurement framework for active cash management in which discretionary decisions that are informed by forecast cash flows can be evaluated against a range of indicators. These include measuring, in a quantified way, the actual cost of cash management compared with the notional cost associated with a benchmark strategy.

6.12 Implementation of the 2004-05 review recommendations began in June 2005 with the development of a quantified internal performance measure against which active cash management can be compared.

6.13 Subsequent HM Treasury analysis conducted in 2006 concluded that the benchmark comparator, which represents a default 'passive' or 'neutral' strategy that might be applied in the absence of forecasting or cash dealing operations, together with the risk limits proposed in 2004-05 remained valid[14]. No conceptual problems had been encountered in the first year of operation, although the array of risk limits should be reassessed after more experience has been gained of operating in the sterling money markets following implementation of the Bank of England's money market reforms[15]. It recommended that formal reporting of the performance of active cash management would take place in 2007-08, which would be the first full year of operating under the new cash management regime, and should be considered for the 2006-07 outturn. The analysis cautioned that DMO and HM Treasury should not look at the performance against the benchmark issuance strategy in isolation because active cash management performance must be evaluated against a series of key performance indicators that together reflect the ethos and objectives of the Government.

6.14 The quantitative comparison of active cash management against a benchmark is one such measure. Other indicators and controls that are used to monitor and assess performance in meeting the Government's cash management objectives are listed in Box 6.1 below.

[14] The risk limits are covered in detail in DMO's Annual Review 2004-05 http://www.dmo.gov.uk/documentview.aspx?docname=publications/annualreviews/gar0405.pdf&page

[15] The Bank of England's money market reforms, which were implemented in May 2006, required the DMO to adjust its cash management operations.

Box 6.1 Exchequer's cash management objectives and key performance indicators and controls

Cash management objective	Key performance indicators & controls
DMO must supply sufficient cash each day to enable the Government to meet its payment obligations. This is fundamental and unconditional.	Ways and Means transfers must be avoided by ensuring that there is a positive end-of-day balance on the Debt Management Account (DMA). HM Treasury is responsible for monitoring and reporting performance of the forecasting function against outturns.
Cash management operations and arrangements should be conducted in a way that does not interfere with monetary policy operations.	The DMO will conduct market operations with a view to achieving, within a very small range, the weekly cumulative target for the DMA balance as agreed with the Bank of England. The DMO will maintain formal and informal channels of communication with the Bank on conditions in the Sterling money markets. The DMO will seek to avoid holding weekly or ad hoc Treasury bill tenders when the Bank conducts its weekly open market operations.
Cash management operations and arrangements should be conducted without impeding the efficient working of the Sterling money markets	The DMO will advise HM Treasury as appropriate on the impact of Exchequer cash flows on liquidity conditions in the Sterling money markets.
The DMO should maintain a system in which the costs and risks are transparent, measured and monitored and the performance of government cash management is assessed. The DMO maintains an ethos of cost minimisation rather than profit maximisation.	The DMO will report to HM Treasury on a quarterly basis the details of its cash management activity, its performance against the benchmark and the market and credit risks incurred. Performance may also be reported in the DMO Annual Review.
The DMO should maintain a credible reputation in the market that leads to lower costs in the long term and a cash management system that is sustainable.	The DMO should maintain channels of communication with money market participants and Treasury bill counterparts both formally and informally to explain, as far as possible, the nature and intent of its operations in the money markets. The DMO should monitor compliance with its operational market notices; provide complete, accurate and timely instructions to counterparties, agents, external systems and operators; and achieve the successful settlement of agreed trades on the due date.