5 The Debt Management Office's financing remit for 2009-10

Objectives

5.1 The 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 Ministers on the DMO's performance against its remit, objectives and targets;
- 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 Euroclear UK and Ireland, 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 strategy 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 lowers costs of debt issuance.

Quantity of gilt sales

5.2 The DMO, on behalf of the Government, will aim to deliver gilt sales of £220.0 billion (cash)[9] in 2009-10. Auctions will remain the Government's primary method by which to issue gilts. In addition, the Government has decided to use supplementary methods to issue gilts in 2009-10. In particular, the Government has decided to use syndication, and to extend the use of mini-tenders, which were first introduced in October 2008, to issue gilts.

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

5.3 Gross gilt issuance is projected at £220.0 billion in 2009-10. It is anticipated that:

- £183.0 billion (83 per cent of total issuance) will be issued by pre-announced auctions;
- £25.0 billion (11 per cent of total issuance) will be issued by syndication; and
- £12.0 billion (6 per cent of total issuance) will be issued by mini-tenders.

5.4 The planning assumption for gilt issuance in 2009-10 by method of issue, type and maturity is shown in table 5.A.

Table 5.A: Planned gilt issuance split by method of issue, type and maturity 2009-10

	Auction	Syndication	Mini tender	Total
Short				
£ billion	74	-	-	74
Per cent				33.7
Medium				
£ billion	70	-	-	70
Per cent				31.8
Long				
£ billion	27	13	6	46
Per cent				20.9
Index-linked				
£ billion	12	12	6	30
Per cent				13.6
Total	183	25	12	220.0

Source: Debt Management Office

Amount and maturity of conventional gilt issuance at auction

5.5 The planned amount of issuance and maturity mix of conventional gilts in 58 auctions in 2009-10 is:

- 15 auctions in the short (1-7 years) maturity area, aiming to raise £74.0 billion cash;
- 19 auctions in the medium (7-15 years) maturity area, aiming to raise £70.0 billion cash; and
- 12 auctions in the long (15 years and over) maturity area, aiming to raise £27.0 billion cash.

Amount of index-linked gilt issuance at auction

5.6 In 2009-10, the DMO aims to sell £12 billion (cash) in index-linked gilts in 12 auctions. These auctions will include frequent issuance at long maturities.

Size of gilt auctions

5.7 The gilt sales targets in paragraphs 5.4 and 5.5 above are specified in cash terms, but the gilt auctions are sized in nominal terms, typically in £50 million increments for conventional gilts and £25 million increments for index-linked gilts. Therefore, all provisional gilt sales targets are expressed in approximate terms.

Post auction top up facility

5.8 In 2009-10, the DMO may give an option to successful bidders at auctions (both GEMMs and investors) to top up gilt purchases by up to 10 per cent of the amount allocated to them at the auction, at the average accepted price at conventional auctions and the clearing (or strike) price at index-linked auctions. Further details of this facility will be available in the DMO's gilt market operational notice.

5.9 Any additional amounts sold via this facility will count towards the remit sales targets in paragraphs 5.4 and 5.5 above and may progressively reduce the required average sizes for the remaining auctions of the maturity/type of gilt in question. If exercised consistently, the option may allow the cancellation of future auctions, but any such cancellation would be announced well in advance as part of the regular issuance calendar announcements and/or at the 2009 Pre-Budget Report.

Method of issuance of gilts

5.10 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.

5.11 Each outright auction of conventional gilts is planned to be between £1.5 billion and £6.0 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.

5.12 The expected timing of gilt sales at auction is set out in the calendar in Table 5.B below. This includes the specific gilts to be sold in April and May 2009, as announced on 31 March 2009. For the rest of 2009-10 the remaining issuance calendar announcements will be made at 3.30pm on Friday 22 May, Friday 28 August and Monday 30 November.[10] Full details of all auctions will normally be announced at 3.30pm on the Tuesday of the week preceding the auction.

5.13 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.

[10] The announcement in November is subject to change depending on the date of the 2009 Pre-Budget Report.

Table 5.B: Gilt auction calendar 2009-10[1]

Date	Type
2009	
1 April	4¾% Treasury Stock 2015
2 April	4¼% Treasury Gilt 2039
7 April	4½% Treasury Gilt 2019
8 April	1¼% Index-linked Treasury Gilt 2032
16 April	2¼% Treasury Gilt 2014
28 April	4% Treasury Gilt 2022
30 April	17/8% Index-linked Treasury Gilt 2022
6 May	4½% Treasury Gilt 2019
12 May	4¾% Treasury Gilt 2030
14 May	0¾% Index-linked Treasury Gilt 2047
21 May	2¼% Treasury Gilt 2014
28 May	1¼% Index-linked Treasury Gilt 2032
2 June	Conventional
3 June	Conventional
9 June	Conventional
11 June	Index-linked
23 June	Conventional
1 July	Conventional
2 July	Conventional
7 July	Conventional
8 July	Index-linked
21 July	Conventional
29 July	Conventional
4 August	Conventional
11 August	Conventional
20 August	Index-linked
2 September	Conventional
3 September	Conventional
8 September	Conventional
17 September	Conventional
29 September	Conventional
1 October	Conventional
6 October	Conventional
7 October	Index-linked
14 October	Conventional
22 October	Conventional
3 November	Conventional
4 November	Conventional
10 November	Conventional
12 November	Index-linked
24 November	Conventional
1 December	Conventional
2 December	Conventional
8 December	Conventional
9 December	Index-linked
2010	
6 January	Conventional
13 January	Conventional
21 January	Conventional
2 February	Conventional
3 February	Conventional
9 February	Conventional
11 February	Index-linked
24 February	Conventional
2 March	Conventional
3 March	Conventional
9 March	Conventional
11 March	Index-linked
24 March	Conventional

1. Auctions in Q3 and Q4 are subject to confirmation depending on the dates of the Pre-Budget Report and Budget 2010

Syndication

5.14 The Government has decided to use syndication to issue £25.0 billion of gilts in 2009-10. The planning assumption is that £13.0 billion of long maturity and £12.0 billion of index-linked gilts will be issued by syndication (including new issues). The DMO will discuss plans for syndication in the consultation meetings throughout the year and will announce its intention to hold such operations in its issuance calendar announcements, subject to market conditions. Further details of any planned syndications will be announced around two weeks in advance. There will be no syndications scheduled for April-May 2009.

5.15 The Government's decision to use syndication and other supplementary distribution methods is outlined in Box 5.A.

Box 5.A: Composition of gilt issuance and use of supplementary methods by which to issue gilts

In December 2008, the Debt Management Office (DMO) launched a public consultation on whether supplementary distribution methods might be introduced as a supplement to auctions. Respondents to the consultation, while noting that the auction system was working well and should remain the primary method by which the DMO should issue gilts, voiced support for the use of syndication and the extended use of mini-tenders. On 18 March 2009, the DMO published its response to the consultation along with its provisional conclusions.

In the light of the conditions in financial markets – from which gilt markets are not immune - and support revealed in the responses to the DMO's consultation, the Government has decided to use supplementary distribution methods to facilitate the primary market distribution process.

The use of supplementary distribution methods is particularly valuable to facilitate the issuance of long maturity and index-linked gilts. Such gilts are in particular demand by pension funds as they seek assets with similar characteristics to their liabilities. However, the risk characteristics associated with such gilts, in particular, their 'duration risk' – the sensitivity of the value of the gilt to a given change in yields – and the 'lumpy 'nature of demand for such gilts, which means that demand may not materialise on a particular day, are also relevant considerations.

The Government believes that the use of supplementary distribution methods to issue gilts – namely syndication and the extended use of mini tenders - can facilitate the issue of long maturity and index-linked gilts in particular. The use of supplementary distribution methods would enable greater issuance of these types of gilts than would be possible via the auction system alone.

The Government's planning assumption is that all gilts issued by way of syndication and min tenders will be long maturity and index-linked gilts. In 2009-10, in total, the Government is projected to issue £46 billion and £30 billion of long maturity and index-linked gilts respectively, of which £13 billion and £12 billion of long maturity and index-linked gilts respectively will be issued by syndication and £6 billion each of long maturity and index-linked gilts will be issued by mini tender.

Mini tenders

5.16 The DMO plans to issue £12.0 billion (cash) of gilts via a series of mini-tenders in 2009-10. The planning assumption is that the £12.0 billion of issuance will be split equally between long maturity and index-linked gilts. The DMO envisages holding at least one mini-tender per month and will announce the weeks in which tenders are to be held in its quarterly issuance calendar announcements. Mini-tenders will be no larger than half the size of outright auctions of the same maturity/type.

5.17 The above programme of long maturity and index-linked gilt auctions (and any others that may be added during the year) and mini-tenders and syndications 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.

5.18 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 as most recently revised on 5 March 2009.[11] Any gilts so created will not be sold to the market and will be cancelled on return.

Reverse auctions

5.19 The DMO has no current plans for a programme of reverse auctions in 2009-10.

Conversions and switch auctions

5.20 The DMO has no current plans for a programme of conversion or switch auctions in 2009-10.

Coupons

5.21 As far as possible, 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

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

Revisions to the remit

5.23 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.

5.24 Any revisions to the remit will be announced.

[11] The announcement of 5 March 2009 is available on the DMO website at: http://www.dmo.gov.uk/documentview.aspx?docname=giltspress/sa050309.pdf

5.25 In March 2009, the Bank of England commenced a programme of asset purchases as part of its implementation of monetary policy including the purchase of gilts in the secondary market (see Box 2.2 in chapter 2 Budget 2009). The potential interaction between monetary policy by way of purchase of gilts and debt management policy is discussed in Box 5.B.

Box 5.B: Quantitative easing of monetary policy and debt management policy

On 19 January 2009, the Government established the Asset Purchase Facility (APF) to enable the Bank of England to ease credit conditions in corporate debt markets by making purchases of private sector assets. On 5 March 2009, the Monetary Policy Committee of the Bank of England (MPC) announced its decision to use the APF for monetary policy purposes by purchasing £75 billion of assets (the majority of which would be gilts) in the following three months financed by the provision of central bank reserves. The asset purchases are designed to influence the quantity of broad money as a supplement to setting the level of the Base Rate.

The Bank is purchasing gilts in the secondary market. As at 21 April 2009 the Bank had purchased £38 billion of gilts.

There are potential linkages between the implementation of monetary policy by the purchase of gilts financed by the provision of central bank money and debt management policy.

On 17 February 2009, the Governor of the Bank of England wrote to the Chancellor setting out his proposals to use the APF for monetary policy purposes. The Governor sought assurances that:

'If the facility were to be used to purchase gilts, it would be important that the Government's debt management policy remain consistent with the aims of monetary policy. It should not alter its issuance strategy as a result of the transactions that are undertaken through the Asset Purchase Facility for monetary policy purposes. I should be grateful if you could confirm that this will be the case.'

On 3 March 2009, the Chancellor responded to the Governor providing the assurance that debt management policy would not change, stating that "the Government would not alter its (gilt) issuance strategy as a result of the asset transactions undertaken by the Bank".
The Chancellor also reiterated the Government's debt management objective:

"The debt management objective remains *'to minimise, over the long-term, the costs 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'."'*

Consistent with the debt management objective, the gilt issuance strategy announced in this Report for 2009-10 has not been altered as a result of the asset transactions undertaken by the Bank.

6 The Debt Management Office's Exchequer cash management remit for 2009-10

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 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.

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 risks, 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 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 that 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 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.

[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: www.dmo.gov.uk/gilts/public/annual/gar0405.pdf

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, is set out in, and operated according to, the DMO's Operational Notice.

6.7 As part of its cash management, the DMO uses weekly and ad hoc tenders. In November 2007, the DMO introduced a facility that allowed it to reopen existing Treasury Bills upon request from its counterparties (see Box 6.A).

[13] The current edition of Exchequer Cash Management Operational Notice and Treasury Bill Information Memorandum is available on the DMO's website at www.dmo.gov.uk/cash/cashops110903.pdf

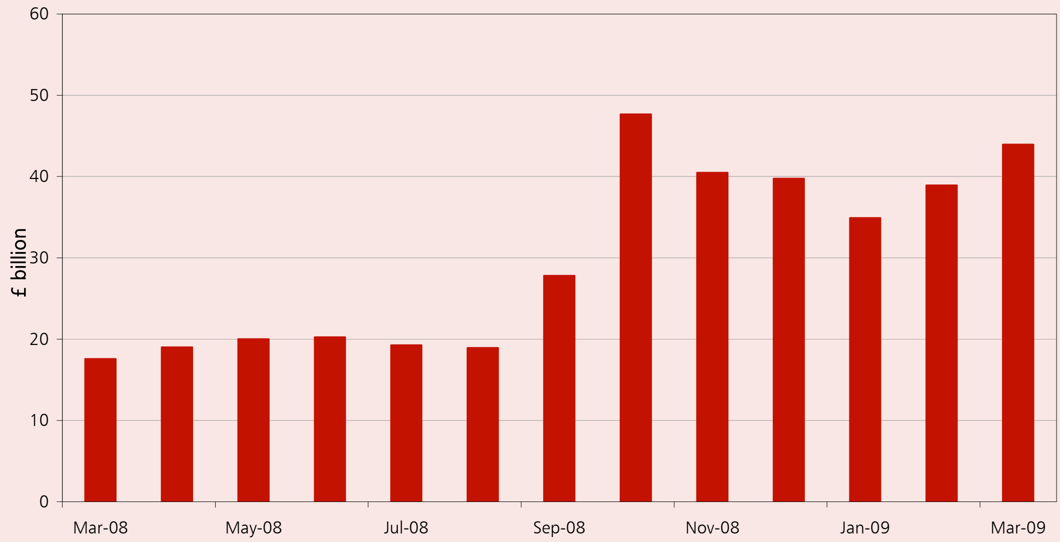
Box 6.A: Treasury bills for cash management operations

The context in which government cash management operated in 2008-09 was particularly challenging. Money markets in sterling and all major currencies were extremely volatile and experienced protracted periods of low liquidity, particularly for transactions other than at very short maturities. Exchequer cash flow forecasts were also unusually volatile in the light of exceptional government payments, notably, relating to government action in support of the financial sector.

Government cash management met these challenges through increasing the size and frequency of its operations and concentrating bilateral transactions in the most liquid parts of the secured sterling money markets, principally through sale and repurchase agreements (repos and reverse repos). It also was able to meet the strong investor demand for short-term government assets that materialised over the second half of 2008-09 by increasing the size of Treasury bill sales (see Chart A below). The size of the weekly tenders rose from a total of £1.6 billion, split across 1 month, 3 month and 6 month maturity Treasury bills, at the start of 2008-09, to £3.3 billion by the end of the year. Further, the complementary bilateral Treasury bill facility, which was introduced in the 2007-08 cash management remit and implemented by the DMO in November 2007, developed into a particularly useful cash management tool in 2008-09. This facility permits the reopening of existing Treasury bills at the request of market participants, provided that, in so doing, it contributes to achieving the DMO's cash management objective. Bilateral bills issued by the end of the financial year totalled £9.7 billion.

The DMO announced, on 19 January 2009, that finance to support the purchase of up to £50 billion of high quality private sector assets by the Bank of England's Asset Purchase Facility (APF) would be raised through a combination of Treasury bill sales and DMO cash management operations. These arrangements were suspended on 26 February 2009 with a total of £984 million of purchases of assets having been financed in this way. This financing will fall as the relevant assets mature. The option of using Treasury bills to finance such asset purchases will remain open.

Chart A: Treasury bill stock (Mar 2008 – Mar 2009)



Source: Debt Management Office

6.8 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). In addition to the bills issued at weekly 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. This change was announced as part of the financing remit given by HM Treasury to the DMO in 2007-08.[14]

6.9 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.

6.10 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 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 (see Box 6.A).

DMO Collateral Pool

6.11 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 July and October 2009 and January 2010. 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.

6.12 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.

6.13 The DMO's collateral pool may also be used to support HM Treasury's agreement to provide gilt collateral for the Bank of England's Discount Window Facility (DWF).[15] In addition, on 22 October 2008, an approximate £50 billion of gilt collateral was created and issued to the DMO in connection with the DWF. 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.

[14] See Chapter 4 (paragraph 4.8) of the *Debt and reserves management report 2007-08*.

[15] 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/discount/index.htm

Active cash management

6.14 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 performance measurement framework for active cash management in which discretionary decisions, that 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 interest changes equivalent to the Government's marginal cost of funds. Performance against key indicators, including quantitative measures for years 2006-07 and 2007-08, was reported in DMO's Annual Review 2007-08.[16]

[16] http://www.dmo.gov.uk/documentview.aspx?docname=publications/annualreviews/gar0708.pdf&page=Annual_Review