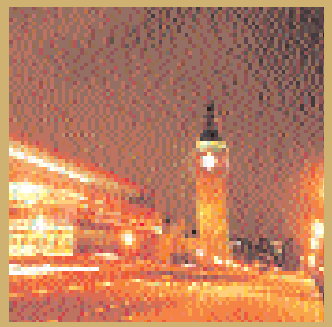
United Kingdom
Debt Management Office




UK Government Securities: *a Guide to 'Gilts'*

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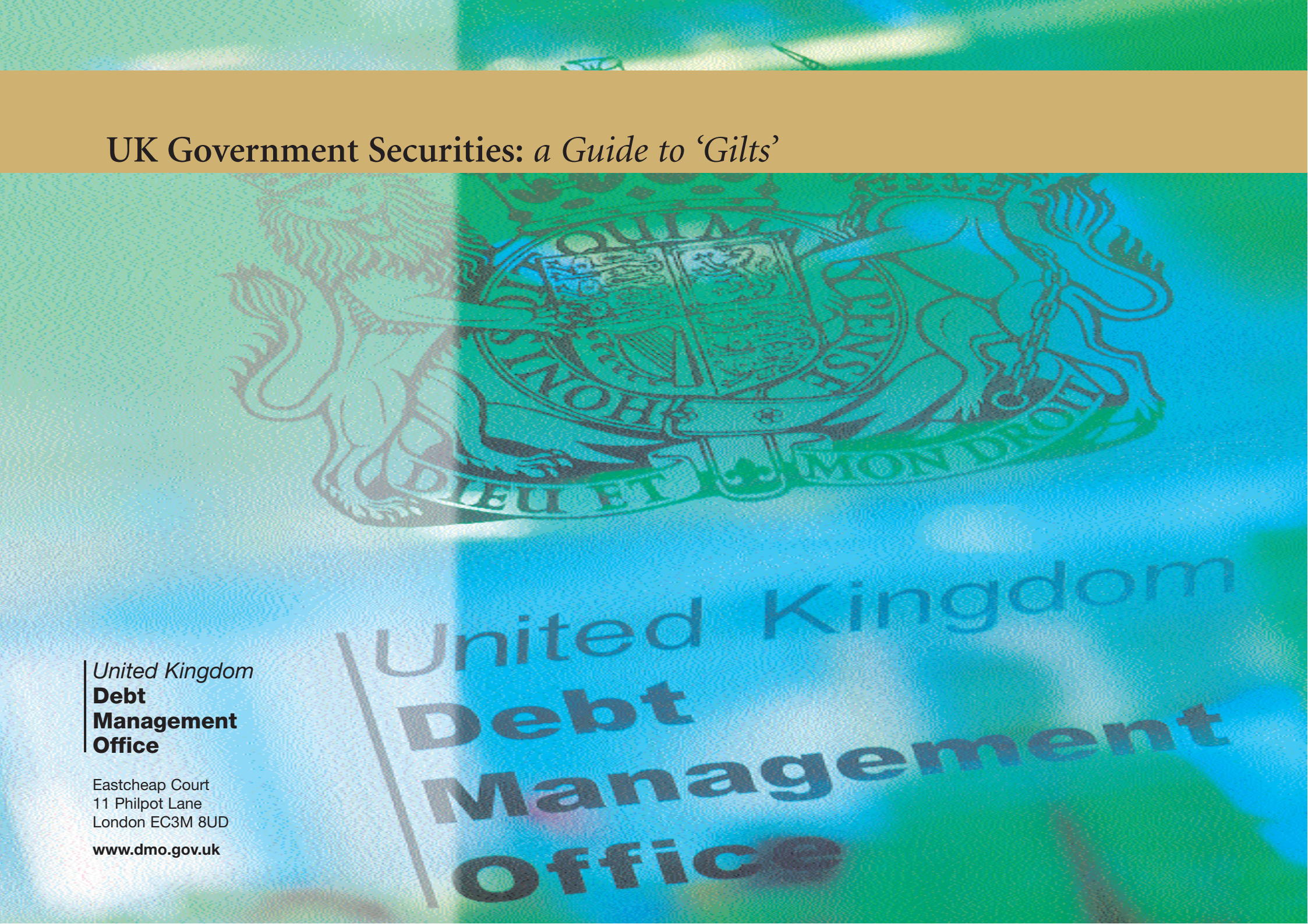

United Kingdom
Debt Management Office

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www.dmo.gov.uk

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Introduction UK Government Securities: 'gilts'

A gilt is a UK Government security issued by HM Treasury.

The term 'gilt' (or 'gilt-edged') is a reference to the primary characteristic of gilts as an investment: their security. The British Government has never failed to make interest or principal payments on gilts as they fall due.

The UK Government has the highest, AAA credit rating.

This brochure is intended to help those who have an interest in investing in gilts and would like to know more about the essential features of the instruments. It does not constitute an offer to buy or sell securities, nor does it offer investment advice.

The UK Debt Management Office (DMO) has tried to ensure that the legal and factual information is accurate but this brochure cannot be a comprehensive statement of all the intricacies of law and practice relating to gilts, nor can it take account of the circumstances of every investor. Therefore, reliance should not be placed on the brochure: investors who want advice on which gilt or other investment may be best suited to them, or on trading strategies, should consult a professional advisor. Except where specifically indicated, the brochure describes the position as at 31 December 2003. The reader should not assume that anything described in it is still accurate at a later date.

As gilts are marketable securities, their market value may go down as well as up. The DMO issues gilts to the market on behalf of the Government of the United Kingdom, and holds gilts itself for market management purposes.

The DMO does not in any way guarantee the liabilities of the financial institutions referred to in this brochure.

Foreword by the DMO Chief Executive, Robert Stheeman

This brochure is intended to introduce the UK gilts market to those thinking of investing in UK Government securities. Although the gilts market can trace its ancestry back to the 17th Century, the procedures for debt issuance, debt management and the resultant features of the gilt portfolio have been transformed into a modern market over the past decade. It continues to be denominated in sterling and as such offers a viable alternative to the US dollar and euro bond markets. The UK gilts market currently comprises some 5% (7% excluding Japan) of international government bond indices.[1]

The UK operates a highly predictable and transparent debt management and issuance regime with gilt auction dates published up to a year in advance - the longest period of pre-commitment internationally. The UK Debt Management Office (DMO), an agency of HM Treasury has managed the gilt issuance programme on behalf of the UK Government since 1998.

Gilt sales have been rising steadily over the past few years from £13.7 billion in 2001-02 to £26.3 billion in 2002-03 and plans of £49.7 billion in 2003-04 - the highest level for a decade. Forecasts indicate that these relatively high levels are set to continue.

Partly as a consequence of this, turnover in the gilts market is rising rapidly as outright issuance rises - average daily turnover has risen from £7.6 billion in 2001-02, to £8.7 billion in 2002-03 and £11.0 billion in the first half of 2003-04 - all reflecting increased liquidity in the market.

I hope this brochure is seen as a valuable addition to the range of publications available on UK Government securities. Please contact the DMO or access our website **www.dmo.gov.uk** if you require further information.

Robert Stheeman, **Chief Executive**
16 February 2004

[1] Source: JP Morgan/Lehmans Bros

Recent Developments in the Gilts Market

The gilts market has modernised considerably since the mid 1990s – the major developments have been:

- Following a review of debt management policy in 1995[2], HM Treasury and the Bank of England introduced a number of reforms to the way gilts were issued to enhance the transparency of gilt sales and liquidity in the market and to provide market participants with greater certainty as to the issuance programme of the Government.
- Since April 1998, gilts have been issued by the UK Debt Management Office (DMO), an Executive Agency of HM Treasury[3]. The reorganisation followed the transfer of operational responsibility for setting official UK interest rates from HM Treasury to the Bank of England in May 1997.
- Financing plans are published a year ahead in the DMO's remit from HM Treasury. The financing remit includes the breakdown between conventional and index-linked gilt sales, the maturity split within conventional sales and the dates and types of auctions.
- The financing arithmetic may be updated during the year (with possible consequent changes to the auction programme) primarily to take account of changes in the Treasury's published forecast for the public finances. Typically this happens toward the end of the calendar year in the Pre-Budget Report (PBR).

[2] Report of the Debt Management Review, July 1995, published jointly by HM Treasury and the Bank of England – available on the DMO website at ***www.dmo.gov.uk/remit/1995_report.pdf***

[3] The Bank of England had previously been responsible for issuing gilts on behalf of HM Treasury.

Recent Developments in the Gilts Market

- Gilts are issued entirely by auction (unless there are exceptional circumstances). The DMO retains the ability to issue gilts in smaller quantities (by tap) at short notice but only for the purposes of market management. All scheduled issuance of conventional gilts has been by auction since April 1996 and of index-linked gilts since November 1998.
- In order to enhance market liquidity the DMO has directed conventional gilt issuance to building up large benchmark issues. This has resulted in fewer gilts but of larger size.
- The number of conventional gilts in issue fell from 80 at end-March 1992 to 68 by end-March 1998 and 47 by-end March 2003 (of which 17 were small "rump" stocks for which market-making obligations are relaxed and for which the DMO is prepared to bid a price).
- The gilt portfolio has become more concentrated in larger individual issues. In 1992 the largest conventional gilt had £4.9 billion (nominal) in issue and the average size of non-rump stocks was £1.8 billion (nominal). At end-December 2003 there were 20 conventional gilts with over £5 billion in issue and 12 with £10 billion or more in issue. The average size of non-rump stocks was £8.7 billion (nominal).
- The proportion of index-linked gilts in the portfolio has risen steadily since their launch in 1981, with the nominal uplifted amount reaching £78.9 billion (25.4% of the gilt portfolio) at end-December 2003 (the largest proportion of any major government bond issuer). The UK is committed to a minimum supply of £2.5 billion (cash) of index-linked gilts for the foreseeable future.
- At end-December 2003 the nominal value of the gilt portfolio was £311.25 billion[4] with a market value of £340.48 billion. Gilts accounted for 93% of the UK Government's marketable sterling debt at that time[5].
- The list of gilts in issue at 31 December 2003 appears in Annex A.

[4] Including index-linked uplift.

[5] The remaining 7% (£24.0 billion) was accounted for by Treasury bills (1-, 3- and 6-month maturity paper).

Objectives of UK Government debt management

The primary objective of UK debt management is:

"to minimise over the long term, the cost of meeting the Government's financing needs, taking account of risk, whilst ensuring that debt management policy is consistent with the objectives of monetary policy."

Insofar as gilts are concerned, this objective is to be realised by:

- pursuing an issuance policy that is open, predictable and transparent;
- issuing conventional gilts that achieve a benchmark premium;
- adjusting the maturity and nature of the Government's debt portfolio, by means of the maturity and composition of debt issuance and other market operations including switch auctions, conversion offers and buy-backs, and;
- developing a liquid and efficient gilts market.

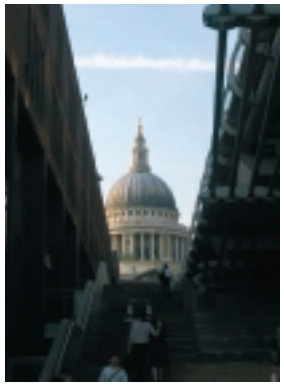
Maturity and composition of debt issuance

In order to determine the maturity and composition of debt issuance the Government takes into account a number of factors including:

- investors' demand for gilts;
- the Government's own attitude to risk, both nominal and real;
- the shape of both the nominal and real yield curves and the expected effects of issuance policy, and;
- changes to the levels of Treasury bill stocks and other short-term debt instruments.

Why the UK Government issues gilts

The UK gilt issuance programme is designed to finance two major components in the national accounts:



The Central Government Net Cash Requirement (CGNCR)

This is essentially the difference between central Government's income and expenditure in cash terms. For the early period of the DMO's existence the Government's cash requirements were negative, particularly in 2000-01 (reflecting the impact of the proceeds from the 3G telecommunication spectrum auctions). However, in recent years the UK Government's cash requirements have been rising steadily.

Table 1: CGNCRs 1998-99 to 2003-04

CGNCR £ bn	
1998-99	-4.6
1999-00	-9.1
2000-01	-35.3
2001-02	2.8
2002-03	21.6
2003-04 forecast	40.5

The redemption of maturing gilts

In recent years some £15-20 billion has been repaid to investors each year as gilts mature. The amounts needed to finance these repayments is taken into account when setting the annual gilt financing requirement.

Future financing projections

The 2003 Pre-Budget Report (PBR) published on 10 December 2003 included forecasts for the CGNCR out to 2008-09; these, together with current forecasts of redemptions for these years are shown in *Table 2* below to produce illustrative financing requirements.

2002-03 was the first year of positive net gilt issuance[6] since 1997-98, but this is a feature which is expected to continue over the coming years on the basis of the forecasts published in the Budget of April 2003 *(see Chart 1)*. Gross financing requirements in excess of £40 billion per year are forecast for the next few years.

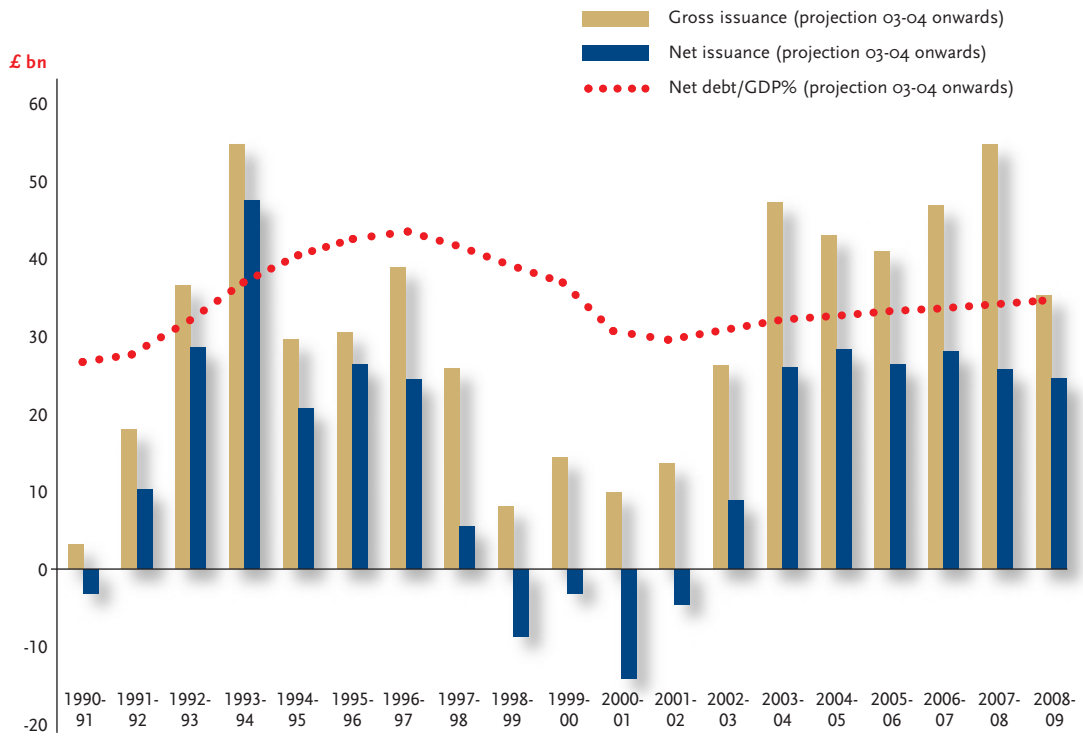
Table 2: Illustrative future financing requirements at PBR 2003

£ bn	2004-05	2005-06	2006-07	2007-08	2008-09
CGNCR projections (PBR)	33	32	32	28	26
Redemptions	15	15	18	29	15
Financing Requirement*	48	47	50	57	41
Change since Budget	5	6	4	3	na

**indicative gross financing requirement*

[6] i.e. gross issuance of gilts at auctions exceeded the amount of gilts redeemed.

Chart 1: Gross and net gilt issuance (including illustrative projections)



Gilts market turnover

Annual turnover by value in the gilts market has been rising markedly since 1999-2000. Activity increased by almost 14% in 2002-03 compared with the previous year – with average daily turnover reported to the DMO increasing from £7.63 billion to £8.67 billion. Trading intensity (as measured by the turnover ratio[7]) rose even more significantly in 2002-03, by almost 20% compared to the previous year, from 6.00 to 7.17. This trend accelerated in the first half of 2003-04 with average daily turnover rising to £11 billion per day and the turnover ratio rose to 8.3. The increase in turnover can be attributed in part to sharply rising outright issuance.

Turnover was heavily weighted towards the medium and longer-term maturities, with the 7-10-year maturity band most actively traded. Long-dated maturities were the second most actively traded sector *(see Chart 3)*.

[7] The turnover ratio for 2002-03 equals the aggregate turnover to the market value of the portfolio at the start of the financial year.

Chart 2: Gilts market turnover

***2003-04 data covers first six months only. Source: GEMMs*

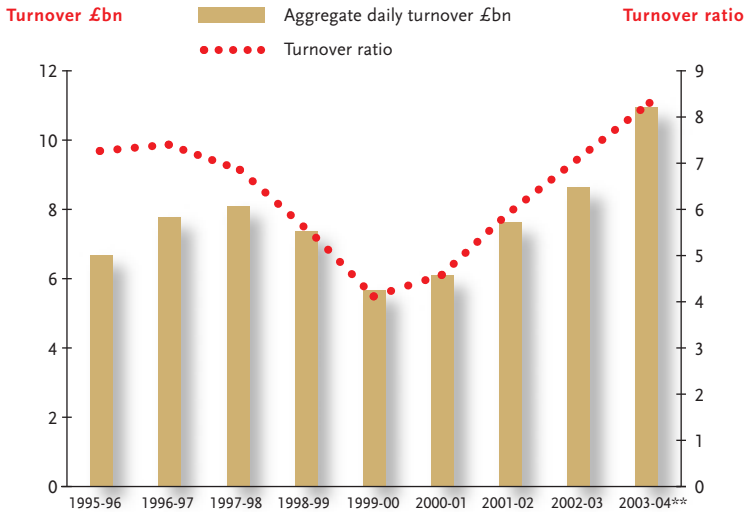
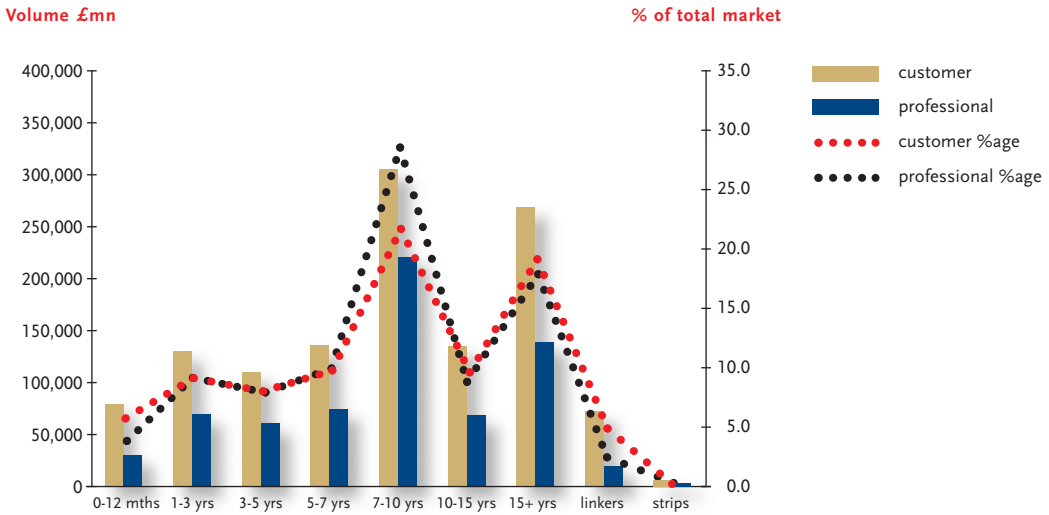


Chart 3: Gilts turnover by maturity 2002-2003

Source: GEMMs



Different types of gilts

The gilts market has a number of different securities with different features.

- Conventional gilts
- Index-linked gilts
- Double-dated gilts
- Undated gilts

Only the first two of these are currently issued for financing purposes.

Conventional gilts

Conventional gilts are the simplest form of government bond and constitute the largest share of liabilities in the UK Government's portfolio. At end-December 2003, conventional gilts comprised 74.6% of the portfolio (by nominal value, including index-linked uplift within the overall portfolio).

A conventional gilt is a liability of the UK Government which guarantees to pay the holder of the gilt a fixed cash payment (coupon) every six months until the maturity date, at which point the holder receives the final coupon payment and the return of the principal. The prices of conventional gilts are quoted in terms of £100 principal.

A conventional gilt is denoted by its coupon rate and maturity (e.g. 5% Treasury Stock 2014). The coupon rate usually reflects the market interest rate at the time of the first issue of the gilt. Consequently there is a wide range of coupon rates available in the market at any one time, reflecting how rates of borrowing have fluctuated in the past.

The coupon indicates the cash payment per £100 nominal that the holder will receive per year. This payment is made in two equal semi-annual payments on fixed dates six months apart (these payments are rolled forward to the next business day if they fall on a non-business day).

Conventional gilts also have a specific maturity date. In the case of 5% Treasury Stock 2014 the principal will be repaid to investors on 7 September 2014. In recent years the Government has concentrated issuance of conventional gilts around the 5-, 10- and 30-year maturity areas.

Conventional gilts have been issued by the DMO with aligned coupon dates (7 March/7 September and 7 June/7 December). This is to permit fungibility between the individual coupon strips from different bonds – *(see Annex D)*.

New conventional gilts are now all referred to as "Treasury Stock" but some older stocks are referred to as "Conversion Stock" or "Exchequer Stock". The names are of no significance so far as the underlying obligation to repay is concerned.

Index-linked gilts

Index-linked gilts (IGs) accounted for 25.4% of the Government's gilt portfolio (including the inflation uplift) at end-December 2003.

The UK was one of the earliest developed economies to issue index-linked bonds for institutional investors, with the first issue being in 1981. Since then it has issued nineteen different index-linked gilts of which nine have since matured. As with conventional gilts, the coupon on an index-linked gilt reflects borrowing rates available at the time of first issue. However, as index-linked coupons reflect the *real* borrowing rate for the Government there is a much smaller variation in index-linked coupons, reflecting the smaller variation in real yields over time.

Index-linked gilts differ from conventional gilts in that the semi-annual coupon payments and the principal are adjusted in line with the General Index of Retail Prices in the UK (also known as the RPI). Both the coupons and the principal on redemption paid on these gilts are adjusted to take account of accrued inflation since the gilt's issue.

Each coupon payable on index-linked gilts consists of two elements:

- half the annual real coupon. The real coupon is quoted in the gilt's title and is fixed (e.g. $2^1/_2$% Index-linked Treasury Stock 2009 pays a real coupon of $1^1/_4$% twice a year);
- an adjustment factor applied to the real coupon payment to take account of the change in the RPI since the gilt's issue.

To calculate the inflation adjustment two RPI figures are required - that applicable to the stock when it was originally issued and that relating to the current interest payment. In each case the RPI figures used are those applicable eight months before the relevant dates (e.g. for a November coupon date the previous March RPI figure is used). This "indexation lag" is required so that the size of each forthcoming interest payment is known at the start of the coupon period, thereby allowing the accrued interest to be calculated. For index-linked gilts whose first issue date is before July 2002, the Bank of England performs the function of calculating and publishing the uplifted coupons on each index-linked gilt following the release of each RPI figure which is relevant to it. For later index-linked gilts, the DMO performs this function; the first of which was for 2% Index-linked Treasury Stock 2035, first issued on 11 July 2002. The uplifted redemption payment is calculated and published similarly, following the release of the RPI figure relating to eight months before the month of redemption.

The UK has no current plans to issue index-linked gilts linked to the Consumer Price Index (CPI) formerly called (HICP) despite this measure of inflation being substituted for RPIX for inflation targeting purposes by the UK authorities. The RPI will continue to be published and payments for index-linked gilts will continue to be linked to the RPI.

If, in the future, the DMO were to consider issuing new index-linked gilts linked to CPI it would consult market participants in a transparent way before making such a decision.

More details on the mechanics of index-linked gilts are included in the DMO's publication "Gilts: An Investors Guide". Also available on the DMO website is an index-linked gilt cash flow calculation document at **www.dmo.gov.uk/gilts/indexlink/f2lin.htm**

Different types of gilts

Double-dated gilts

In the past, the UK Government issued double-dated gilts with a band of maturity dates. At end-December 2003 there were four of these remaining in issue (comprising 0.6% of gilts outstanding), most with first and final maturity dates fairly close together (2-5 years apart). The Government can choose to redeem these gilts on any day between the first and final maturity dates, subject to giving not less than three months' notice in the *London Gazette*. Where the coupon on a double-dated gilt is higher than the prevailing market rate, the Government will usually have an incentive to redeem on the first maturity date and refinance the gilt at the lower prevailing rate. Double-dated gilts tend to be less liquid than conventional gilts, because of greater uncertainty over the redemption date. Also, because of their age, they mostly have higher coupons and smaller amounts outstanding.

Undated gilts

There are currently eight undated gilts still in issue (comprising 1% of the gilt portfolio). These are the oldest remaining gilts in the portfolio, some dating back to the nineteenth century. The redemption of these bonds is at the discretion of the Government, but because of their age, they all have low coupons and so there is little current incentive for the Government to redeem them. Most undated gilts pay interest twice a year; however, some[8] pay interest four times a year.

The redemption of undated gilts is subject to certain conditions being met, which vary between the different gilts. For example, some require not less than three months' notice in the *London Gazette* (e.g. 2½% Treasury), some not less than one month's notice (e.g. 2½% Annuities) whilst others can only be redeemed on an interest payment date (e.g. 4% Consolidated Stock). Holders are advised to check the terms and conditions of individual prospectuses.

[8] 2½% Annuities, 2¾% Annuities and 2½% Consolidated Stock.

Gilts market operations

Gilt auctions

All scheduled issuance of conventional gilts has been by auction since April 1996 and of index-linked gilts since November 1998. Until the early 1990s gilts were usually issued by tap[9] *(see below)*, but now the use of taps is restricted to a market management mechanism in exceptional circumstances.

The move to reliance on a pre-announced auction schedule reflects the UK Government's commitment to transparency and predictability in gilt issuance. Transparency and predictability should reduce the amount the Government is charged for market uncertainty (the "supply uncertainty premium"). Predictability should also allow investors to plan and invest more efficiently, in the knowledge of when and in which maturity band supply will occur.

The UK Government uses two different auction formats to issue gilts:

- Conventional gilts are issued through a multiple price auction;
- Index-linked gilts are auctioned on a uniform price basis.

The two different formats are employed because of the different nature of the risks involved to the bidder for the different securities.

Conventional gilts are viewed as having less primary issuance risk. There are often similar gilts already in the market to allow ease of pricing (or, if more of an existing gilt is being issued, there is price information for the existing parent stock); and auction positions can be hedged using gilt futures, swaps and other tools. The secondary market is also liquid. This suggests that bidders are not significantly deterred from participation by not knowing what the rest of the market's valuation of the gilts on offer is. A multiple price auction format also reduces the risk to the Government of implicit collusion by strategic bidding at auctions.

In contrast, positions in index-linked gilts cannot be hedged as easily as conventional gilts. The secondary market for index-linked gilts is also not as liquid as for conventional gilts. Both of these factors increase the uncertainty of pricing at index-linked auctions and increase the 'winner's curse' for successful bidders – that is the cost of bidding high when the rest of the market bids low. Uniform price auctions thus reduce this uncertainty for auction participants and encourage participation. In addition, there are fewer index-linked gilts than conventionals in issue and the index-linked derivatives market is not so liquid, so pricing a new bond may be harder than for a new conventional.

Competitive bids at auctions must be directed via the UK's primary dealers – the Gilt-edged Market Makers (GEMMs)[10] who have direct links into the DMO's dealing desk. For details on auction procedures see the gilts market Operational Notice on the DMO website at **www.dmo.gov.uk/gilts/public/technical/opnot160104.pdf**

[9] Taps are tenders for amounts of stock, normally with a minimum price, announced on the morning of the tender for bids to be received 30 minutes later (see below).

[10] The current list of GEMMs is in Annex B.

Gilts market operations

Conversion offers

From time to time the DMO offers stockholders the opportunity to convert their holding of one gilt into another gilt at a fixed rate of conversion related to the market prices of each stock. For the investor, conversions offer the prospect of transferring out of a gilt that may trade infrequently into a more liquid benchmark gilt.

Switch auctions

The DMO introduced conventional gilt switch auctions in October 1999. They were designed as a further tool to build up benchmark gilts, in addition to conversion offers at a time of low outright issuance, by switching a proportion of stock from a source stock into a new current coupon stock. New stocks are not launched by switch auctions – they will have been auctioned outright at least once prior to any switch auction into them. Switch auctions may also be used as a tool for managing trading flows relating to significant changes in bond indices.

Reverse auctions

Reverse auctions were originally held in the late 1980s and were re-introduced by the DMO in 2000 as part of the strategy for dealing with the large financial surplus in 2000-01. The buy-back programme added to the financing requirement in 2000-01 and allowed the DMO to add to gross issuance to help maintain liquidity in the market at a time of strong demand.

Tap issues (Taps)

Taps have not been used as a routine means of financing since April 1996 for conventional gilts, and not since November 1998 for index-linked gilts. They are intended now to be used as a market management mechanism in conditions of temporary excess demand in a particular stock or sector only. Taps can be used either to supply incremental amounts of stock to the market, or, via reverse taps, to buy stock back from the market.

Full details of the DMO's operations in the gilts market can be found in its gilt market Operational Notice, available from the DMO and on its website at **www.dmo.gov.uk/gilts/public/technical/opnot160104.pdf**

Gilt-edged Market Makers (GEMMs)

The UK Government bond market operates with a primary dealer system. At end-December 2003 there were 16 firms recognised as GEMMs by the DMO *(see list in Annex B)*. Each GEMM must be a member of a Recognised Investment Exchange (in practice the London Stock Exchange) and undertakes a number of market-making obligations, in return for certain privileges.

The obligations of a GEMM include:

- to make effective two-way prices to customers on demand in all non-rump gilts in all market conditions, thereby providing market liquidity for customers wishing to trade;
- to participate actively in the DMO's gilt issuance programme, broadly speaking by bidding competitively in all auctions and achieving allocations commensurate with their secondary market share;
- to quote two-way prices on inter-dealer broker screens in selected stocks, for specified minimum sizes within specified maximum bid-offer spreads, and;
- to provide information to the DMO on market conditions, the GEMMs' positions and turnover;
- to provide closing prices of gilts to the DMO who collate the information and publish reference prices on the wire services and on its website on behalf of the GEMMs.

The privileges of GEMM status include:

- exclusive rights to competitive telephone bidding at gilt auctions and other operations, either for the GEMM's own account, or on behalf of clients;
- the right to an exclusive non-competitive auction allocation (1/2% per GEMM in conventionals, 10% in total in index-linked);
- the exclusive facility to trade as a counterparty of the DMO in any of its secondary market operations, including any transactions undertaken by the DMO for market management purposes;
- exclusive ability to strip gilts *(see Annex D);*
- an invitation to a quarterly consultation meeting with the DMO, allowing the GEMMs to advise on the stock(s) to be scheduled for auction in the following quarter, and to discuss other market-related issues;
- exclusive access to gilt Inter-Dealer Broker (IDB) screens.

Index-linked Gilt-edged Market Makers (IG GEMMs)

At end-December 2003, eleven of the sixteen recognised GEMMs were also recognised as Index-linked Gilt-edged Market Makers (IG GEMMs), where similar obligations and privileges apply to the index-linked sector of the gilts market. An IG GEMM does not have to be a conventional GEMM, although currently all of them are.

Gilts market conventions

Most gilts are quoted on a 'clean price'[11] basis, with the price typically being quoted per £100 nominal and to two decimal places[12]. Settlement is usually on the next business day (T+1), although trades can occur for forward settlement.

While coupon payments on individual gilts are usually made only twice a year, gilts can be traded on any business day. Whenever a gilt trades for settlement on a day that is not a coupon payment date, the valuation of the gilt will reflect the proximity of the next coupon payment. Accrued interest is paid to compensate the seller for the period since the last coupon payment date during which the seller has held the gilt but for which he receives no interest. Having only held the gilt for part of the coupon period the seller only receives a pro-rata share of the next coupon.

Since gilts are currently almost entirely registered investments[13], it is necessary to establish the identity of the recipients of each coupon payment ahead of the coupon date. Consequently, there is a period prior to each dividend date when a gilt is dealt without entitlement to that dividend (i.e. it is traded "ex-dividend"). For gilt trades settling on or before the gilt's ex-dividend date (which is seven business days before each coupon date for all gilts except 3½% War Loan, where it is ten business days), the buyer is entitled to the next coupon payment and the accrued interest is positive. Trades conducted in this period are said to be "cum-dividend". For trades settling after the ex-dividend date, the seller receives the next coupon payment and the accrued interest on the gilt is negative, reflecting the fact that the buyer of the gilt is entitled to a rebate from the seller. The full price of the gilt, which includes the accrued interest, is called the "dirty price". The daycount convention used for the calculation of accrued interest is actual/actual.

[11] A "clean" price is the price of a gilt which excludes accrued interest or rebate interest.
[12] Before 1 November 1998 gilts were priced and traded in £1/32nds.
[13] Entry of the name of the holder in a register confirms title.

Settlement and Treasury Bills

Settlement of gilt trading: CRESTCo (Euroclear)

CREST is the multi-currency, electronic settlement system for UK and Irish securities, providing secure and resilient facilities for investors to hold securities in dematerialised form and to transfer securities electronically in real time. Transfers are processed on the principle of delivery versus payment (DVP), without the need for certificates. The official stock register is updated simultaneously with movements of stock within CREST.

A gilt investor who holds stocks in CREST does not receive a physical certificate. Rather, direct CRESTCo members may access information on their holdings from the CREST system. Approximately 98% of the total value of gilts is held in dematerialised form within CREST. CRESTCo offers facilities for:

- settlement of securities and cash transfers;
- reconciliation of positions and transfers within CREST;
- overnight transfer of collateral – delivery by value (DBV) – to allow members to receive/issue stock against a secured overnight loan;
- stripping and reconstitution of gilts for GEMMs, the DMO and the Bank of England;
- a flexible membership and portfolio management structure;
- automatic transaction reporting to the London Stock Exchange and the Financial Services Authority;
- settlement banks[14] to extend credit to CREST members and manage their exposure; and
- efficient processing of stock lending and repo transactions.

[14] Those banks which provide payment facilities to CRESTCo members through CREST.

CRESTCo members include GEMMs and specialist financial institutions, broking intermediaries and custodians acting on behalf of institutional investors (such as insurance companies and pension funds). Members also include nominee companies, which allow indirect participation in CRESTCo for nominee account holders, and individuals.

CRESTCo is part of the Euroclear group, which, through Euroclear Bank, provides settlement services to 30 bond and 25 equity markets internationally.

Short-term debt instruments (Treasury bills)

Treasury bills are short-term, marketable instruments issued by the DMO. To date the DMO has issued Treasury bills with maturities of one, three and six-months but can also issue bills of up to one year maturity. Treasury bills do not pay coupons. They are issued at a discount to their nominal or face value. The stock of Treasury bills in issue is planned to rise by £3.3 billion to £18.3 billion in the 2003-04 financial year.

In September 2003 Treasury bills were dematerialised and are now cleared within CREST. Dematerialisation means that Treasury bills are now fungible with bills of the same maturity date. Treasury bills are eligible for inclusion in the main traded category of gilt, Delivery-by-Value (DBV), the Unstripped British Government (UBG) class, so they can be used as collateral for bilateral gilt repo transactions. Treasury bills are also eligible as collateral for the Bank of England's Open Market Operations and in RTGS[15] .

For more details see the money markets section of the DMO website at **www.dmo.gov.uk/cash/f1money.htm**

[15] The Real-time Gross Settlement payment system operated by the Bank of England.

Annex A. Gilts in issue at 31 December 2003

Gilts in Issue 31 December 2003 **(£mn nominal)**
Total amount in issue (inc IL uplift) £mn: **311,253**

Conventional Gilts	Redemption Date	Dividend Dates	Amount in Issue (£mn nom)	Amount held in stripped form at 02 January	Central Government Holdings (DMO & CRND) at 31 December 2003
Shorts: (maturity up to 7 years)					
5% Treasury 2004	07-Jun-04	7 Jun/Dec	7,504	102	465
6¾% Treasury 2004	26-Nov-04	26 May/Nov	6,597	-	477
9½% Conversion 2005	18-Apr-05	18 Apr/Oct	4,469	-	102
8½% Treasury 2005	07-Dec-05	7 Jun/Dec	10,486	69	313
7¾% Treasury 2006	08-Sep-06	8 Mar/Sep	3,955	-	439
7½% Treasury 2006	07-Dec-06	7 Jun/Dec	11,807	167	275
8½% Treasury 2007	16-Jul-07	16 Jan/Jul	4,638	-	370
7¼% Treasury 2007	07-Dec-07	7 Jun/Dec	11,103	146	249
5% Treasury 2008	07-Mar-08	7 Mar/Sep	14,221	9	157
5½% Treasury 2008/2012	10-Sep-08	10 Mar/Sep	1,026	-	182
4% Treasury 2009	07-Mar-09	7 Mar/Sep	13,250	1	6
5¾% Treasury 2009	07-Dec-09	7 Jun/Dec	8,937	84	357
6¼% Treasury 2010	25-Nov-10	25 May/Nov	4,958	-	477
Mediums: (maturity 7-15 years)					
9% Conversion 2011	12-Jul-11	12 Jan/Jul	5,396	-	205
7¾% Treasury 2012/2015	26-Jan-12	26 Jan/Jul	805	-	339
5% Treasury 2012	07-Mar-12	7 Mar/Sep	13,346	22	235
8% Treasury 2013	27-Sep-13	27 Mar/Sep	6,181	-	386
5% Treasury 2014	07-Sep-14	7 Mar/Sep	13,050	54	57
4¾% Treasury 2015	07-Sep-15	7 Mar/Sep	5,250	13	2
8% Treasury 2015	07-Dec-15	7 Jun/Dec	7,377	402	172
8¾% Treasury 2017	25-Aug-17	25 Feb/Aug	7,751	-	380
Longs: (maturity over 15 years)					
8% Treasury 2021	07-Jun-21	7 Jun/Dec	16,741	254	346
5% Treasury 2025	07-Mar-25	7 Mar/Sep	10,422	0	177
6% Treasury 2028	07-Dec-28	7 Jun/Dec	11,756	183	309
4¼% Treasury 2032	07-Jun-32	7 Jun/Dec	13,829	195	251
4¼% Treasury 2036	07-Mar-36	7 Mar/Sep	12,250	0	3

Index-linked Gilts	Redemption Date	Dividend Dates	Amount in Issue (£mn nom)	Nominal including inflation uplift	Central Government Holdings (DMO & CRND) at 31 December 2003
Index-linked Gilts					
4 3/8% I-L Treasury 2004	21-Oct-04	21 Apr/Oct	1,338	1,778	38
2% I-L Treasury 2006	19-Jul-06	19 Jan/Jul	2,037	5,312	37
2 1/2% I-L Treasury 2009	20-May-09	20 May/Nov	3,098	7,128	74
2 1/2% I-L Treasury 2011	23-Aug-11	23 Feb/Aug	4,342	10,554	70
2 1/2% I-L Treasury 2013	16-Aug-13	16 Feb/Aug	5,597	11,370	105
2 1/2% I-L Treasury 2016	26-Jul-16	26 Jan/Jul	6,055	13,443	169
2 1/2% I-L Treasury 2020	16-Apr-20	16 Apr/Oct	5,093	11,123	68
2 1/2% I-L Treasury 2024	17-Jul-24	17 Jan/Jul	5,751	10,670	112
4 1/8% I-L Treasury 2030	22-Jul-30	22 Jan/Jul	3,171	4,253	71
2% I-L Treasury 2035	26-Jan-35	26 Jan/Jul	3,175	3,314	1
Undated Gilts					
2 1/2% Treasury	Undated	1 Apr/Oct	493		22
3 1/2% War	Undated	1 Jun/Dec	1,939		30
"Rump" Gilts					
13 1/2% Treasury 2004/2008	26-Mar-04	26 Mar/Sep	96		26
10% Treasury 2004	18-May-04	18 May/Nov	20		6
9 1/2% Conversion 2004	25-Oct-04	25 Apr/Oct	307		158
10 1/2% Exchequer 2005	20-Sep-05	20 Mar/Sep	24		16
9 3/4% Conversion 2006	15-Nov-06	15 May/Nov	6		3
9% Treasury 2008	13-Oct-08	13 Apr/Oct	687		136
8% Treasury 2009	25-Sep-09	25 Mar/Sep	393		113
9% Treasury 2012	06-Aug-12	6 Feb/Aug	403		156
12% Exchequer 2013-2017	12-Dec-13	12 Jun/Dec	58		9
4% Consolidated	Undated	1 Feb/Aug	358		38
2 1/2% Consolidated	Undated	5 Jan/Apr/Jul/Oct	272		47
3 1/2% Conversion	Undated	1 Apr/Oct	90		73
3% Treasury	Undated	5 Apr/Oct	53		6
2 1/2% Annuities	Undated	5 Jan/Apr/Jul/Oct	3		0.4
2 3/4% Annuities	Undated	5 Jan/Apr/Jul/Oct	1		0.3

It is assumed that double-dated gilts (which have not been called) currently trading above par will be redeemed at the first maturity date.

Annex B. Gilt-edged Market Makers at 31 December 2003

ABN AMRO Bank NV
250 Bishopsgate
London EC2M 4AA

Barclays Capital**
5 The North Colonnade
Canary Wharf
London E14 4BB

Citigroup Global Markets Limited
Citigroup Centre
33 Canada Square
London E14 5LB

CS First Boston Limited**
One Cabot Square
London E14 4QJ

Deutsche Bank AG (London Branch)
Winchester House
1 Great Winchester Street
London EC2N 2DB

Dresdner Bank AG (London Branch)**
PO Box 18075
Riverbank House
2 Swan Lane
London EC4R 3UX

Goldman Sachs International Limited
Peterborough Court
133 Fleet Street
London EC4A 2BB

HSBC Bank PLC**
8 Canada Square
London E14 5HQ

JP Morgan Securities Limited
125 London Wall
London EC2Y 5AJ

Lehman Brothers International (Europe)**
25 Bank Street
Docklands
London E14 5LE

Merrill Lynch International**
Merrill Lynch Financial Centre
2 King Edward Street
London EC2M 1HQ

Morgan Stanley & Co. International Ltd**
20 Cabot Square
Canary Wharf
London E14 4QW

Royal Bank of Canada Europe Limited**
71 Queen Victoria Street
London EC4V 4DE

Royal Bank of Scotland**
135 Bishopsgate
London EC2M 3UR

UBS Limited**
1 Finsbury Avenue
London C2M 2PP

Winterflood Securities Limited**
The Atrium Builidng
Cannon Bridge
25 Dowgate Hill
London EC4R 2GA

*(**indicates additional IG GEMM status)*

ANNEX C. Taxation

Taxation

The taxation regime on gilts has been considerably simplified. The main features that apply to overseas investors are:

- **Overseas investors:** Overseas investors are in most cases exempt from any UK tax on gilts.
- **Overseas investors:** Gilts held on FOTRA (Free of Tax to Residents Abroad) terms, and the interest on them, are generally exempt from tax if they are held by persons who are not ordinarily resident in the UK. The precise terms depend on the prospectus under which the gilts were issued; but under the most recent version (post-1996), income on FOTRA gilts is exempt from tax if the holder is non-resident, unless the income is received as part of a trade conducted in the UK. In April 1998, all existing non-FOTRA gilts were made FOTRA gilts on post-1996 terms.

Annex D. Gilt strips

Gilt strips

Strips is the acronym for Separately Traded and Registered Interest and Principal Securities. "Stripping" a gilt refers to breaking it down into its individual cash flows which can be traded separately as zero-coupon gilts. A three year gilt will have seven individual cash flows: six (semi-annual) coupon payments and a principal payment. Gilts can also be reconstituted from all of the individual strips. Not all gilts are strippable *(see below)*. Official strip facilities have been available in the United States since 1985, and France since 1991. Official strip markets also now exist in Austria, Belgium, Canada, Germany, Italy, Japan, the Netherlands, South Africa and Spain. The strip market began in the UK on 8 December 1997.

At end-December 2003 there were 16 strippable gilts in two series with a total amount outstanding of £189.4 billion (accounting for 81.5% of the conventional gilt portfolio). However, only £1.8 billion (nominal) or 1.0% of strippable bonds were held in stripped form *(see Table 5)*. The 7 June/7 December series became strippable in 1997. The second series 7 March/7 September series followed in 2002.

All strippable gilts are currently conventional fixed coupon stocks. For some time the UK authorities have concentrated sales of conventional issues into strippable issues and the DMO intends that all issues of new conventional gilts will be strippable (sometimes with a delay after the first issue date).

Although anyone can trade or hold strips, only a Gilt-edged Market Maker (GEMM), the DMO or the Bank of England can strip (or reconstitute) a strippable gilt. GEMMs are obliged to make a market in strips, as they are in the underlying gilts.

The market in gilt strips has grown slowly since its inception. Factors that have contributed to this slow take-off have included the need for pension fund trustees to give the appropriate authority to fund managers to invest in strips and the inversion of the yield curve over much of the early years of the DMO's operations, which made strips *appear* more expensive relative to conventionals. Retail demand for strips has been hampered by the necessary tax treatment, whereby the securities are taxed each year on their capital gain or loss even though no income payment has been made. However, the ability to hold gilt strips within Individual Savings Accounts (ISAs) may reduce the tax disincentives to personal investment in strips.

More details about the gilt strips market can be found in the Bank of England paper "*The Official Gilt Strips Facility*" of October 1997 which is available on the DMO website at
www.dmo.gov.uk/gilts/public/technical/stripfalic.pdf

Table 5: Strippable stocks and amounts held in stripped form (end-December 2003)

Strippable stocks outstanding	Nominal amount in issue at end-Dec 2003 (£mn)	Nominal amount held in stripped form at end-Dec 2003 (£mn)	Percentage held in stripped form at end-Dec 2003 (%)
Gilt			
7 June / 7 December series			
5% Treasury Stock 2004	7,504	102	0.15
8½% Treasury Stock 2005	10,486	69	0.71
7½% Treasury Stock 2006	11,807	167	1.80
7¼% Treasury Stock 2007	11,103	146	1.35
5¾% Treasury Stock 2009	8,937	84	0.88
8% Treasury Stock 2015	7,377	402	6.43
8% Treasury Stock 2021	16,741	254	1.40
6% Treasury Stock 2028	11,756	183	1.68
4¼% Treasury Stock 2032	13,829	195	1.51
	107,635	1,688	1.57
7 March / 7 December series			
5% Treasury Stock 2008	14,221	9	0.06
4% Treasury Stock 2009	13,250	1	0.01
5% Treasury Stock 2012	13,346	22	0.16
5% Treasury Stock 2014	13,050	54	0.41
4¾% Treasury Stock 2015	5,250	13	0.25
5% Treasury Stock 2025	10,422	0	0.00
4¼% Treasury Stock 2036	12,250	0	0.00
	70,789	86	0.11
TOTAL	**189,424**	**1,787**	**0.94**

United Kingdom
Debt Management Office

Eastcheap Court
11 Philpot Lane
London EC3M 8UD

www.dmo.gov.uk