UK Government Cash Management:

The New Framework

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A New Cash Management Framework: Introduction

1. The Chancellor of the Exchequer's letter of 6th May 1997 to the Governor of the Bank of England set out details of the new monetary policy framework and the transfer of sterling government debt and cash management responsibilities from the Bank to the Treasury. The UK Debt Management Office (DMO), an Executive Agency of the Treasury, took over debt management responsibilities on 1 April 1998 and has also been working on a new framework for Exchequer cash management. The Finance Act 1998 gave the Treasury the power to create the Debt Management Account (DMA) through which the DMO will transact all its gilt and cash operations.

2. The Treasury published its outline proposals on 29 July 1997, with a response to consultation on 22 December 1997. The DMO published a progress report on 30th July 1998. (Copies of these papers are available from the DMO.) Throughout the process, the Treasury and the DMO have received valuable help and advice from the Bank of England as well as market participants. The Treasurers' Group of the Association for Payment Clearing Services has been especially helpful.

3. This paper gives the details of how the DMO and Treasury intend to operate the new cash management system. The new system will not commence prior to Q3 of 1999. Before then the DMO will publish an Operational Market Notice giving precise details of how it will conduct Treasury bill auctions and its daily operations with cash management counterparties. It will also publish a repo legal agreement and hope to sign up a number of counterparties active in the sterling money markets. Although the proposals outlined below are firm, the DMO would still welcome comment from market participants.

4. Any comments or questions should be made to Mike Ness, Cash Management Project Manager, UK Debt Management Office, Cheapside House, 138 Cheapside, London, EC2V 6BB; 0171 862 6522 (phone); 0171 862 6509 (fax). Expressions of interest in counterparty arrangements with the DMO should be made after the New Year to Ms Jo Whelan, address and fax number as above; 0171 862 6531 (phone).

Rationale and Ethos

5. The Chancellor decided to transfer Exchequer cash management responsibilities to the Treasury as part of the new monetary policy arrangements to clarify the roles of the Bank and the Treasury and to avoid any perception of conflicts of interest in market operations. Another benefit of this approach is that the management of the short- and long-term government borrowing programmes can be fully integrated.

6. Consistent with the rationale of this approach, the aim of the DMO will be to smooth the net daily cash flows that will occur across the private sector: central government divide at the Bank of England.[1] In essence, for cash management purposes, the DMO will operate as a stand-alone treasury function with responsibility for managing outstanding Exchequer sterling short term assets and liabilities whilst simultaneously working to minimise day-to-day net cash flows. The DMO's operations will differ from the Bank's current money market operations in that the DMO could be a net lender or borrower on any particular day and will operate at various points along the short-term yield curve. The intended result of the DMO's daily operations will be to neutralise changes in the Exchequer's aggregate cash position across the government's accounts at the Bank. The Bank of England's, and not the DMO's, operations will be aimed at steering the level of short-term interest rates for monetary policy purposes.

7. The Bank of England, acting as an agent of the Treasury, will continue to operate the Exchange Equalisation Account (EEA) through which the foreign currency transactions of central government take place. However, the net daily change in the EEA's sterling position will be taken into account in the DMO's operations in the sterling money market.

8. The DMO intends to work closely with other money market participants. In accordance with the rationale for the new cash management system, the DMO will

not take speculative positions on interest rate decisions by the Bank. The DMO has no contact with the Monetary Policy Committee (including the non-voting Treasury

[1] An alternative approach would have been to transfer the government's banking operations to the private sector banking system (as is done in some countries). However, the Treasury believed that this approach would not have been cost effective while raising fundamental questions about the relationship of government to the banking sector. Hence the current arrangements, whereby the Bank of England provides the main banking services to central government, will be unaffected under the new arrangements.

representative) with regard to interest rate decisions or its thinking. In addition, the DMO does not receive from the Treasury, the Office of National Statistics or other part of government advance notice of policy statements or data releases that affect the market's short-term interest rate expectations. The only exceptions are data and forecasts relating to the government's financing needs (or any policy announcement that could involve significant short-term cash flow implications). The DMO will not seek to act as a money market intermediary, or substitute for normal market mechanisms, with deliberately large simultaneous asset and liability positions. The DMO will take a conservative approach to credit risk, taking account of business needs.

9. The DMO's main objective will be to smooth Exchequer cashflows that are shown up by the forecasting process, first through the structured Treasury bill programme and then through daily market operations. Consistent with that objective, the DMO will operate to minimise the cost of borrowing or maximise the return from lending in the sterling money markets, being mindful of relative value on the sterling interest rate curve and the need to develop a constructive relationship with the DMO's money market counterparties.

10. In addition, the DMO and the Bank will work to avoid clashes in delivery of their respective objectives in the sterling money markets. Consequently, the DMO will not hold bill auctions or repo tenders at times when the Bank is conducting its money market operations (currently 9.45am and 2.30pm). The DMO will not enter into loan transactions of a maturity that could be perceived as competing with the Bank's structured daily repo operations. These are currently centred around a 14-day maturity.

Treasury Bill Issuance

11. <u>The Current Position</u>: Treasury bills are direct liabilities of the National Loans Funds (NLF) and the Treasury authorises their issue at auctions conducted by the Bank of England. Bill issues are used as a draining instrument by the Bank to influence the sterling money market shortage that is, in part, caused by the seasonal

flows across the Exchequer's accounts at the Bank. Hence, the size of the Treasury bill auction tends to increase when central government is spending more than it receives and vice versa. Also the bill stock may also rise to cater for gilt maturities and falls when gilts are issued.

12. Treasury bills are negotiable, non-fungible zero coupon instruments. They are sold by the Bank at weekly auctions held on Fridays. At present, three-month (91-day) bills are offered every week and have been occasionally supplemented by auctions of one- and six-month bills. The amount on offer is published a week in advance. Bidding at Treasury bill auctions is by telephone or paper on a competitive bid-price basis. Bidders do not have to be money market counterparties of the Bank but they need to have made pre-payment arrangements with the Bank. Settlement by successful bidders is on a day of their choosing the following week.

13. There is a secondary market in Treasury bills and they are used both as repo collateral in the Bank's money market operations and in the Real Time Gross Settlement system. However, there is not an established market maker system (unlike gilts) and their usefulness as a money market or investment instrument has been hampered to a degree by the variability in supply and the limited range of maturities regularly on offer. Although Treasury bills frequently trade at a premium to collateralised loans of the same maturity, the UK government has historically used them less than many other OECD governments as a regular borrowing instrument in the overall debt portfolio.

14. A New Framework for Structured Treasury Bill Issuance: In line with the new government accounting arrangements for debt and cash management, Treasury bills will in future be issued from, and be liabilities of, the Debt Management Account operated by the DMO as opposed to the National Loans Fund (NLF). This will not entail any change to the nature of the instrument. Treasury bills will continue to be direct obligations of Her Majesty's Government, with recourse to the NLF and Consolidated Fund, and will be paid on maturity on presentation at the Bank of England. Treasury bills will remain negotiable, bearer, non-fungible zero coupon instruments. However, the dematerialisation and fungibility of Treasury bills are enhancements that should be facilitated by the merger of the Central Moneymarkets Office into the Crest settlement system.

15. The monthly Central Government Net Cash Requirement (CGNCR) currently follows a fairly regular quarterly pattern with a generally favourable cashflow in the first month of each quarter followed by deterioration in the third month of the quarter. Significant net cash inflows are experienced in October and January (which tend to be periods of high Corporation Tax receipts) while government spending is particularly high in March. Rather than using a large stock of assets to cope with this seasonal pattern of cash flows, the Treasury believes that the smoothing of the seasonal cash position of the Exchequer can best be done by adjusting the stock of Treasury bills in issue at any one time. For instance, the Treasury bill stock would be run down in months of positive cashflows and increased in months of higher net expenditure by adjusting the amounts on offer at the weekly structured Treasury bill auctions. This approach minimises the gross level of the government's debt and the costs that have to be incurred by intermediation in the money markets.

16. Following consultation with market participants, and after reviewing the practices of other major sovereign issuers, the DMO believes that the current Treasury bill programme can be enhanced in a number of ways. (These changes follow the same principles of predictability and transparency that first the Bank, and subsequently the DMO, have applied to gilts issuance.) They are:

- a wider range of maturity of Treasury bill is planned for auction on a regular basis. The DMO initially envisages that 1-, 3-, 6- and 12-month bills will be issued, with the majority of issuance being in the 1- and 3-month areas to accommodate the seasonal cashflow pattern. (The issue of 12-month bills will be on a trial basis, due to their limited role in-year for cash flow management. The programme will be reviewed in the light of market demand and other demands on the debt portfolio.)

- a commitment from the DMO to a minimum Treasury bill stock to be in issue at any one time, irrespective of the state of the government's finances. This gives confidence to those market participants wishing to rollover investment in, or actively trade, Treasury bills that a relatively sizeable stock would always be in issue. This minimum is currently envisaged as £5 billion. (The current stock in issue is £1.3 billion.)

- a commitment to a minimum amount of bills to be available at the structured weekly Treasury bill auctions. This is envisaged as an absolute minimum of £250 million of bills per week, although this supply could be spread across two maturities of bill. This commitment is designed to reassure investors and traders that a sizeable amount of bills would always be available for sale each week. (The implicit minimum for a bill auction is currently £100 million).

- the DMO plan to preannounce a quarterly calendar for the maturities of bill which would be available in each week for the calendar quarter ahead on a regular pattern. Publication of the bill calendar would immediately follow the last structured Treasury bill auction of the previous calendar quarter at the latest. As now, the precise quantities of the bills on offer would be announced a week in advance. The preannouncement of a quarterly calendar will allow investors to plan their investment strategies while reducing any perception that the DMO was taking a position on short-term interest rate movements.

- subject to investor preference and integration into the cash management profiles, the DMO could establish 'benchmark' Treasury bill issues. Even though bills will remain non-fungible, liquidity could be enhanced by the DMO reopening a 12-month bill when it had matured into a 6-, 3-, and 1-month instrument. This would reduce investor choice in the secondary market for instruments of precise maturity days but should increase liquidity. If this path were followed, the exact maturity of the weekly bill auction could need to vary to coincide with the maturity date of the 'benchmark'. If this approach were not taken, bill auctions would be for regular maturity periods (1-month = 28 days; 3-months = 91 days; 6 months = 182 days; 12-months = 364 days). As now, these would be slightly adapted when maturities would otherwise fall on non-business days.

- structured bill auctions would settle on t+1. Hence, settlement for successful bidders at a Friday structured bill auction would be on the following Monday (or the next business day in the case of a national holiday). This differs from the current practice of allowing successful bidders to choose the day of settlement in the following week as the DMO will need greater certainty over the timing of its cash flows.

17. The other features of the Treasury bill programme that the DMO envisages would remain largely unchanged are:

- structured bill auctions will be held on Fridays (or the last business day of the week if a national holiday needs to be accommodated), with bidding closing by 12:30pm. The DMO will aim to publish the results by 1.10pm at the latest.

- auctions will be held on a competitive basis, <u>but bidding will take place in terms of percentage yield expressed to two decimal places</u>. Successful bidders will then pay the price for Treasury bills corresponding to the yields that they bid.

- bidding will be by telephone to the DMO for recognised cash management counterparties only (see below). Paper bids will be accepted by the DMO or the Bank. The DMO's counterparties would not be expected formally to underwrite Treasury bill auctions.

Precise details of bidding and settlement arrangements for bill auctions will be set out in the Operational Market Notice to be published by the DMO.

18. In addition to these changes to the bill auction programme, the Treasury will indicate each year in the Debt Management Report the broad level of the Treasury

bill stock that the DMO will be expected to maintain as part of the government's portfolio of liabilities. The level in issue may fluctuate considerably over the year in line with the seasonal pattern of government cash flows, consistent with the commitment to keep a minimum stock of £5 billion of bills in issue.

19. Earlier consultation papers raised the possibility of the Bank of England issuing its own bills as a draining mechanism for money market management. This option remains open. However, the Bank and DMO are exploring whether it would be possible and more appropriate if the DMO issued additional Treasury bills as an additional draining mechanism for the Bank. The advantage would be to keep the official bill programme unified in the sterling money markets rather than split liquidity across two separate instruments of equal credit worthiness. If proceeded with, the additional Treasury bills would form part of the DMO's structured auction programme. The Bank would publicly request that the DMO make a time deposit with it. An additional quantity of bills would then be added to the following week's auction. The deposit at the Bank would be remunerated at the weighted average yield of the relevant bill auction.

20. A previous consultation paper (December 1997) indicated that the Ways and Means overdraft facility at the Bank of England would be frozen at the time of the transition to the new cash management system. The outstanding balance would subsequently be repaid in accordance with the Maastricht Treaty (Articles 104 and 109e(3), the UK Protocol (Paragraph 11) and Council Regulation 3603/93). The means of repayment, and any consequences for the Government's financing requirement will be announced later.

21. <u>The Introduction of 'Cash Management Bills'</u>: In addition to the weekly structured bill auctions, the DMO envisages that it would introduce less regular 'cash management' bill auctions that could be held during the week. These bills would be exactly the same instruments as those sold at the structured auctions but would be for maturities of less than 28 days. They would be intended to meet temporary cashflow needs that could not be catered for through the structured bill auction process as conveniently, so allowing the DMO to fine tune the smoothing of the Exchequer's cashflow profile with greater precision.

22. The DMO would preannounce its intention to hold such auctions at the same time as its announcement of the size of the structured Treasury bill auctions. This announcement would give the day(s) in the following week for which a cash management bill auction was planned and the approximate maturity of the bills to be offered. The exact maturity of the bills and quantity to be offered would be announced on the morning of the auction. Bidding would be by telephone for recognised money market counterparties of the DMO only, and for same day settlement. Precise details of cash management bill auctions will be set out in the DMO's Operational Market Notice. The DMO will also retain the option to hold cash management bill auctions at short notice.

Daily Dealing Operations and Instruments

23. Dealing Methodology: Through a combination of structured and other tenders, and bilateral dealings for same day settlement, the DMO intends to neutralise the impact of the forecast net Exchequer cashflow across the government's accounts at the Bank. The DMO does not intend to publish a daily forecast of its cash needs. However, any use of its overnight standby facility with the settlement banks (see below)[2] would be identified by the Bank of England in its forecast of the money market shortage the following day. It will be for the DMO to unwind this shortage as part of its own dealings.

24. In addition to the structured and ad hoc bill auctions outlined above, the DMO intends to meet its daily cash transaction requirements through a combination of money market tenders and bilateral dealings with its cash management counterparties. DMO repo trades or outright sales could be for any maturity of instrument out to six months. DMO reverse repos or outright purchases could also be for any maturity of instrument out to six months other than the maturity bracket surrounding the Bank's money market operations (see paragraph 10 above). The DMO will aim to do the bulk of its dealing when the cash markets are most liquid but will also have to cope with changes to the Exchequer's cash forecast late in the dealing day.

25. Cash Management Tenders: On those days when the DMO needs to make a significant transaction of a particular maturity, it envisages holding a competitive tender. This would be either to buy instruments outright, to repo or to reverse repo acceptable collateral for same day settlement. On the day of a tender, the DMO would post on its screens the amount that it wished to transact and at what maturity at a set times in the morning (probably 8.45am and 12.00 noon – except on MPC decision days)[3]. The DMO's cash market counterparties would be free to bid competitively at that maturity of business. The DMO would then publish the results on its screens by a fixed time (9.00am and 12.15pm). The DMO would be under no obligation to accept any or all of the bids made. Unlike the Bank's typical daily

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[2] This facility will be put in place to ensure compliance with Article 104 of the Maastricht Treaty prohibiting central government borrowing from the national central bank. It will be a remunerated contingency arrangement that the DMO is negotiating with a number of settlement banks to prevent the DMA becoming overdrawn overnight at the Bank of England.

[3] The DMO would also reserve the right to call tenders at short notice in exceptional circumstances.

money market operations, the DMO's tenders could be either to lend or borrow, at various maturities and at varying rates.

26. Bilateral Dealing: In addition to structured tenders, the DMO intends to conduct the bulk of its remaining business through bilateral dealings with its cash management counterparties in both outright and repo transactions. The DMO will aim to develop a meaningful working relationship with its counterparties to foster the provision of liquidity at commercially competitive rates. Dealing could be either for same day or forward settlement.

27. Use of Money Brokers: In the initial stages of the cash management system's development, the DMO does not envisage dealing through money brokers. The DMO would, however, be interested in receiving an information-only service from interested parties prior to reviewing this decision.

28. Instruments for DMO Dealing: The DMO will be willing to deal in, or take as collateral, a wide range of high credit quality instruments. The focus of its dealings will be outright and repo transactions in UK government paper (gilts and gilt strips, Treasury bills and foreign currency instruments (repo only)). The Bank of England currently offers to purchase outright gilts nearing maturity as part of its management of the money market shortage. This practice will be integrated into the DMO's cash management operations as one way in which the DMO will smooth the large cashflow impact of gilt maturities. The DMO will be prepared to purchase near maturity gilts and strips from both Gilt-edged Market Makers and its money market counterparties when consistent with its cash management objectives. The Bank will retain the ability to deal in gilts as part of its monetary policy and balance sheet operations, as well as for clients.

29. The DMO will maintain a clear separation between its cash and debt management operational functions. Hence, the DMO will not create gilts purely for the purpose of meeting its needs for general collateral or DBV (Delivery-By-Value) repo. Gilts created by the DMO for primary issuance or acquired through secondary market dealing operations with the Gilt-edged Market Makers will not be used as collateral in gilt repo transactions. However, bills, gilts and gilt strips of less than six months' maturity acquired through outright dealing will be available as repo collateral for cash operations.

30. The DMO will not use its cash management operations to intervene in the specific gilt repo market to influence any ‘specials’ premia that may develop. (Although if, as a result of its general collateral repo operations, the DMO acquires gilts that come to command a repo premium it will be free to exercise any option of repoing the stock in question as specific collateral for a premium.) If the DMO were to create a stock for ‘special repo’ for gilt market management reasons, the cashflows would be unwound with the same counterparties, irrespective of the overall cash needs of the DMO over that period. Any such operation would be neutral for the DMO’s cash position.

31. In addition to UK government paper, the DMO will plan to take as collateral a range of other high credit quality instruments, subject to prudential limits, liquidity criteria and settlement arrangements. This will include selected eligible bank bills, major highest-rated European government euro debt instruments and sterling debt instruments issued by highest-rated supranational bodies.[4] This list of instruments will be periodically reviewed in the light of developments in creditworthiness and liquidity. In principle, the DMO could envisage taking other instruments of high credit quality and liquidity as collateral in its repo operations (eg. US Treasuries) if operationally useful and subject to custody arrangements being arranged. Highest-rated sterling commercial paper could also be considered if a liquid market develops.

32. Summary of securities to be used by the DMO to disburse cash in Exchequer Cash Management operations:

Purchases from the market for future resale (reverse repos) in;

	Basis of dealing
Gilts (DBV)[5]	Tenders & bilateral
Gilts (GC, Special)	bilateral
HMT bills	Tenders & bilateral
Other currency HMT debt	bilateral
Selected Eligible bank bills	bilateral
Highest-rated European Government debt (euro)	bilateral
Highest-rated Supranational £ paper	bilateral

Outright purchases of;

Gilts (< 6 months maturity)	Tenders & bilateral
HMT bills (< 6 months maturity)	Tenders & bilateral
Strips (< 6 months maturity)	Tenders & bilateral

[4] The DMO will regularly publish an indicative list of instruments that it will accept as collateral on its website.
[5] The Operational Market Notice will specify the specific categories and class type of all DBV that will be acceptable.

Selected Eligible bank bills
bilateral

33. The main instruments that the DMO will use to borrow short-term will be Treasury bills in the structured weekly auctions and ad hoc auctions of cash management bills. These options should mean that the DMO will not need to hold a large permanent stock of short-term assets ready to meet its immediate payment needs. However, there will be occasions when the DMO will need to raise short-term cash when it is holding a stock of short-term assets (eg. through previous outright purchases or reverse repo trades) and it will not be convenient to hold a cash management bill auction. On these occasions, the DMO will repo out those instruments that it owns as a result of cash management operations. When offering instruments for outright sale or repo, the DMO will use both tenders and bilateral dealing.

34. Summary of securities to be used by the DMO to raise cash in Exchequer Cash Management operations:

	Basis of dealing
Issue Treasury bills (28-364 days)	Structured auction
Issue Cash Management Treasury bills (<28 days)	Ad hoc auction
Sale to the market for future repurchase (repo) of;	
Gilts (DBV)	Tenders & bilateral
Gilts (GC, specials)	Tenders & bilateral
Strips	Tenders & bilateral
HMT bills	Tenders & bilateral
Outright sales of;	
HMT bills	bilateral

Other instruments for repo may be introduced on a bilateral basis at a later stage.

35. *Cash Loans:* The DMO may also seek to borrow on an unsecured basis from its counterparties on a bilateral basis. As indicated previously in the July 1998 progress report, the FSA have confirmed that they would apply a zero weighting on such borrowings under the EU Solvency Directive and the Basle Accord for the purpose of calculating capital ratios.

The Exchequer's Accounts

36. As indicated, the Exchequer's banking arrangements with the Bank of England will remain largely unchanged. Parliament has given the powers to the Treasury to establish a separate account linked to the National Loans Fund (NLF) through which all the debt and cash operations of the DMO will be transacted.[6] This will be known as the Debt Management Account (DMA) and will be audited independently by the National Audit Office. The DMA will always hold sufficient deposits with the NLF or the Bank of England to back any borrowing that it transacts with theThe Chief Executive of the DMO will be Accounting Officer for the new account.

37. As an adjunct to the management of the Exchequer's daily cash position independent from the Bank of England, a previous consultation paper (December 1997) indicated that the Ways and Means overdraft facility at the Bank of England would be frozen at the time of the transition (see also paragraph 20 above). The outstanding balance would subsequently be repaid. Alternative assets would be held by the Bank of England to back the sterling note issue. The DMO will then aim to keep a stable working balance with the Banking Department of the Bank of England. The target size of this balance is currently being assessed. Experience of the new system in operation could prompt this balance to be increased or reduced. The DMO will make known the target for this balance. Any changes would be infrequent.

38. During the transition of cash management operations, the Treasury has been working closely with other government departments to improve the accuracy of forecasts of the Exchequer's daily cash flow.

[6] Finance Act 1998, c.36.

End of Day Banking Arrangements

39. At present, the Ways & Means overdraft facility permits a large degree of discretion as to the timing of market borrowing by central government. Essentially, this means that the actual Exchequer daily cash flow outturn is catered for through the Bank's money market operations and its late lending arrangements with the settlement banks. As indicated above, the Ways and Means facility will cease to be used under the new system, and the existing structural balance subsequently repaid. New end-of-day arrangements will prevent the Exchequer from becoming overdrawn at the Bank when it suffers late and unexpected swings in the cash position that the DMO cannot rectify during the dealing day.

40. In designing solutions, the DMO and the Bank have had two aims: that imbalances in the Exchequer's accounts that arise late in the day should, as far as possible, be handled in a way that avoids disruption to the money markets; and that the settlement banks are not placed at a disadvantage through a failure of the Government to balance its cashflows. In the case of late swings against the Exchequer, the following facilities are being put in place.

41. First, the settlement banks are considering a system for lending any remaining surplus funds on their RTGS accounts at the Bank to the DMA on a *pro rata* basis, if the DMO needs to borrow at the end of the business day. These transfers will be remunerated. (In the event of a late swing in favour of the Exchequer, the Bank has agreed to include the amount in its final forecast and be prepared to offset the amount at a non-penal rate of interest in the settlement bank late repo facility, currently at 4.20pm).

42. Second, the DMO will have a standing target for the daily credit balance for the Exchequer's accounts at the Bank of England. At the close of the business day, the net positions of all the Exchequer's accounts held at the Bank are aggregated overnight. To avoid the DMA going overdrawn, the DMO's target credit balance will be sufficient to cover the vast majority of likely shortfalls that may become apparent after the aggregation process. If such a shortfall transpires, the DMA's credit balance at the Bank would be reduced. If the DMA balance is higher than the target it is likely that the settlement banks' RTGS balances are correspondingly below target. In either event, the overnight change in the Exchequer's credit balance away

from the target balance would be unwound in the following day's dealings by the DMO.

43. Third, there may then be very occasional instances when the Exchequer's credit balance is exhausted in the overnight 'sweep' of its accounts at the Bank. In order to be Maastricht compliant (if the UK were to join Stage 3), the Bank of England cannot lend overnight to make up the shortfall. As an alternative, a standby overdraft facility will be established in favour of the DMA with a syndicate of the core settlement banks. Any use of this facility by the DMO would be remunerated (at a rate to be agreed).

Counterparty Relationships and Selection

44. To facilitate the overall market operations mentioned earlier, the DMO will seek to deal with a wide range of counterparties and to develop an ongoing dealing relationship. The DMO will value counterparties with which it can transact on a fairly regular basis - for example, participating in the DMO's auctions for Treasury bills, its ad hoc tenders and in bilateral dealings with the DMO in a range of instruments. Counterparties will be regular participants in the markets in instruments in which they propose to deal with the DMO and are therefore likely to be regulated financial intermediaries. The DMO’s list of money market counterparties will not be published.

45. The features of a counterparty relationship with the DMO will be:

- The facility to bid by telephone at structured Treasury bill auctions;
- Access to the DMO’s ad hoc cash management Treasury bill auctions;
- Access to competitive repo and outright tenders;
- Ability to deal with the DMO on a bilateral basis;
- Consultations with the DMO on the state of the money markets and the direction of the DMO’s policies.

46. Counterparties will need to be able to respond quickly to tenders and will be expected to maintain direct dealing lines to the DMO. They will need to be able to settle transactions in accordance with the DMO’s practices. The DMO will take account of each counterparty’s credit standing in its dealings, in particular in relation to margining requirements. The DMO will contain its exposure to any one counterparty through applying its own prudential limits. Counterparties will be asked to sign the DMO's master repurchase agreement and any other relevant legal documentation. Further details of the arrangements for its dealings will be set out in the DMO’s Operational Notice and counterparties will be bound by its terms.

47. Counterparties will be expected to bid regularly and competitively at Treasury bill auctions and also at reverse repo tenders when the DMO is lending to the market. Whilst the DMO will not necessarily expect to be quoted two-way dealing rates, the DMO’s dealers will look to develop meaningful direct dealing relationships. Periodically, the DMO will review individual working relationships with each counterparty. The DMO will welcome market information as part of the general ongoing working relationship. Counterparties that specialise in Treasury bills will be encouraged to quote dealing rates in reasonable size on their screens. However, the DMO does not envisage instituting a formal market-maker system for Treasury bills.

Timing of the Transition to the New System

48. The July 1998 progress report previously stated that the DMO would not take over responsibility for cash management until the end of 1998 at the earliest, but indicated that transfer might occur by April 1999. This timetable is now unlikely to be feasible. The time taken for procuring, implementing and testing the deal-capture, risk management and accounting systems that will support the cash management function, and the inherent uncertainties in the project, mean that introduction could slip some months beyond April, possibly into Q3 of 1999. A definitive timetable will be given in due course.

49. Nevertheless, the DMO intends to publish its Operational Notice for cash management in first quarter of 1999 and will initiate discussions with interested counterparties in the interim. The DMO (and the Bank where relevant) will give the market notice of any changes to current arrangements well in advance.