

EXCHEQUER CASH MANAGEMENT IN THE UK



OPERATIONAL NOTICE

TREASURY BILL INFORMATION MEMORANDUM

Foreword

Exchequer cash management is an integral part of the work of the DMO alongside its debt management functions. This publication includes:

- **the Cash Management Operational Notice** which describes the overall structure of these operations and;
- **the Treasury bill Information Memorandum** which includes more detail about the conduct of weekly Treasury bill tenders and: a description of Treasury bills as a financial instrument.

These documents have been updated to reflect the dematerialisation of Treasury bills in September 2003.

This publication also includes at Appendix D a note describing the general structure of cash management in the UK and the DMO's approach to carrying out its cash management responsibilities.

This publication is available on the DMO website at www.dmo.gov.uk/cash/cashops110903.pdf and from the DMO.

Operational Notice for the DMO Exchequer Cash Management Operations – 11 September 2003

This Operational Notice sets out the arrangements for the DMO's Exchequer cash management operations. It outlines the typical cash management operations the DMO undertakes although these may vary from time to time. This Operational Notice replaces the version issued dated 21 September 2001.

It also includes, at Appendix A, the text of the Treasury bill Information Memorandum also published on 11 September 2003 covering the conduct of weekly Treasury bill tenders and changes to Treasury bills following the dematerialisation of money market instruments.

The Operational Notice and Treasury bill Information Memorandum will be revised as needs arise. Any questions on this notice should be raised to either Nick Fisher (020 7862 6518) or Chris Ryan (020 7862 6527).

Contents

	Page
Introduction	4
Weekly Treasury bill tenders	4
Ad hoc tenders	4
Bilateral dealing	7
DMO announcement pages	9
Cash Management counterparty selection	10
Appendices	
A) Treasury bill Information Memorandum	11
B) Telephone dealing arrangements	23
C) Dealing Room Voice Systems	24
D) Exchequer cash management by the DMO	25

Introduction

The DMO's main objective in carrying out its daily cash management operations is to offset, through its market operations, the expected net cash flow into or out of the National Loans Fund on every business day. It is to do this in a cost-effective way, taking account of risk. The DMO also aims to manage cash flows without influencing the level of short-term interest rates and to take account of the operational requirements of the Bank of England for implementing its monetary policy objectives; and to take account of its impact on the efficiency of the sterling money market.

The DMO conducts its cash management operations in accordance with the provisions contained in this Operational Notice, and it will act at all times in accordance with its published objectives and operate as required in order to achieve these objectives.

Weekly Treasury bill tenders

The conduct of weekly Treasury bill tenders is described in the Sterling Treasury Bills Information Memorandum of 11 September 2003, which is reproduced in full in Appendix A of this Operational Notice.

Ad Hoc Tenders

In addition to issuing Treasury bills by way of weekly tenders, the DMO may issue Treasury bills with maturities of up to approximately 28 days on an ad hoc basis. Treasury bills issued as a result of ad hoc tenders will be identical in every respect with those issued via weekly tenders and where possible will be additional "taps" of Treasury bills already in issue. There will, however, be some important distinctions in the bidding, settlement and administrative arrangements – see below.

The DMO may also conduct ad hoc repo or reverse repo tenders as part of its cash management operations. The collateral given and taken in any such operations is likely to be gilts or Treasury bills. In addition, there may also be ad hoc tenders for outright buying of gilts (including strips) with a residual maturity of less than 6 months. Broadly, the same structure in terms of announcement, bidding and settlement would be used in such operations as for ad hoc Treasury bill tenders.

Timetable

The DMO will usually announce the intention to hold (an) ad hoc tender(s) in the wire services announcement of the weekly Treasury bill tender results of the preceding week. That announcement would provide details of the type of tender(s), the day(s) in the following week on which the tender(s) will be held and a guide to the expected maturity and amount. The precise details of the maturity and amount will be announced on the morning of the tender(s). Up to two ad hoc tenders could be held per day, although it is not envisaged that this would be a regular occurrence. Ad hoc tenders will be for same day settlement in sterling, and tenders might be held on successive business days if necessary. The DMO envisages that the following timetables would be used for ad hoc tenders:

	Slot 1	Slot 2
Announcement & opening of tender	8.30am	10.00am
Close of tender	8.45am	10.15am
Aim to announce results shortly after	9.00am	10.30am
CHAPS payments in by	1.30pm	1.30pm
CREST movements by	close	close

The DMO does not intend to conduct ad hoc tenders in the second slot on gilt auction days or Monetary Policy Committee decision days.

Bidding

Bidding at ad hoc tenders will be by telephone only. Arrangements for telephone bidding are set out in Appendix B.

Bidding at all ad hoc tenders will be on a competitive bid yield basis. Bids must be for a minimum of £5 million nominal at each yield and in £1 million nominal multiples thereafter. Counterparties may submit no more than five bids per maturity on offer in each tender. The DMO reserves the right not to allot the total amount on offer, although it would consider this only in exceptional circumstances, and to reject and scale bids. The DMO aims to publish the tender results on its wire services pages within 15 minutes of the close of the tender.

Treasury bill ad hoc tenders

Ad hoc Treasury bill tenders are open to all DMO cash management counterparties and Treasury bill primary participants. Bids must be made by telephone only. Each bid submitted at Treasury bill ad hoc tenders must specify the maturity of bills being bid for, the nominal quantity being bid for together with the money market yield for each quantity expressed up to three decimal places.

Ad hoc repo or reverse repo tender

Ad hoc repo or reverse repo tenders are open to DMO cash management counterparties. Bids must be made by telephone only. The bidding procedure for such ad hoc tenders will be identical to ad hoc Treasury bill tenders, except that bids or offers submitted must be expressed to two decimal places and that the amount bid for or offered would be expressed on a sterling cash basis. As with bilateral transactions, variation and initial margining "haircut" arrangements will be applied to ad hoc repo and reverse repo tenders where necessary.

Ad hoc tender result

The DMO aims to release the result of an ad hoc tender around 15 minutes after the close of the offer. At the cut-off point (the highest accepted yield for a Treasury bill or repo tender and the lowest for a near maturity gilt or reverse repo tender), a scaling ratio will be calculated in the same way as for weekly Treasury bill tenders and applied to all bids (offers) at the highest (lowest) accepted yield.

The announcement of the result for each tender will contain details of the amount allocated / accepted, the average accepted yield, and the yield and the scaling factor at the cut off point (this would be the average weighted scaling for ad hoc Treasury bill tenders).

Settlement of ad hoc tenders

For those counterparties who are successful at any ad hoc tender, the DMO, in addition to exchanging written or electronic confirmations, will confirm by telephone the settlement and custody details shortly after the tender result is published. Settlement will be Delivery versus Payment via CREST for same day value in sterling. Near maturity gilt and reverse repo ad hoc tenders are settled through CREST or its equivalent.

Bilateral dealing

The DMO trades in a range of selected instruments on a bilateral basis with its cash management counterparties and scores, against its internal credit usage and counterparty limits, its exposures to any issue or counterparty.

Range of instruments

The range and type of instruments in which the DMO transacts in for cash management purposes are set out below. The DMO reserves the right to revise the range of instruments and any revised list would be published on the DMO's website www.dmo.gov.uk.

Repo and reverse repo

Instruments	Dealing basis
Gilts (delivery by value (DBV ¹) and General Collateral (GC) including strips)	Tenders & bilateral
HMT bills	Tenders & bilateral
Non-Sterling HMT paper	Bilateral
Selected Supranational £ and € paper	Bilateral
Selected European Government debt	Bilateral
Selected short-term debt ²	Bilateral
Selected Bank bills	Bilateral

The DMO can transact in repo and reverse repo with counterparties for maturities of up to 1 year. The DMO refers to the amount of a repo/reverse transaction in sterling cash terms as opposed to nominal stock terms (i.e. £10 million at the start leg of a repo will signify £10 million of cash not nominal of stock).

A right of substitution is not normally expected or given by the DMO. If substitution rights are given or taken, this will be confirmed at the point of trade. For all reverse repo transactions other than DBV, the DMO requires counterparties to identify the collateral being pledged in a timely manner.

The DMO marks to market its exposures to its repo counterparties and will call margin, if required, on a daily basis. Where initial margin ("a haircut") is to be calculated on a repo or a reverse repo transaction, the DMO follows the calculation methodology set out in the Gilt Repo Code of Best Practice produced by the Stock Lending & Repo Committee.

¹ The DMO intends to use and will only accept the UBG class of DBV.

² Debt instruments issued by high quality issuers, including supranational and foreign governments.

The DMO does not deliberately seek collateral that may be "special"³ or individual stocks with a view to their becoming "special". However, the DMO may decide to deal in specific stocks along with GC or DBV as part of its cash management operations.

Outright purchases and sales

Instruments	Dealing basis
Gilts (< 6 months to maturity)	Tenders & bilateral
Gilt strips (< 6 months to maturity)	Tenders & bilateral
HMT bills (<12 months to maturity)	Bilateral
Selected Certificates of Deposit £, \$, € and ¥ (< 12 months to maturity)	Bilateral
Selected Commercial Paper £, \$, € and ¥ (< 12 months to maturity)	Bilateral
Selected short-term debt ⁴ (< 12 months to maturity)	Bilateral

Other Dealing

The DMO may deal bilaterally on an unsecured cash basis. Contracts will be entered into by telephone. The "general terms and conditions for telephone dealing" set out in Appendix 2 shall apply in the case of contracts entered into by telephone.

The DMO may use short-term currency swaps, Forward Rate Agreements (FRAs) and interest rate futures to manage foreign currency and interest rate exposures. All foreign currency exposures would be hedged back into sterling.

Settlement

Unless specified otherwise, all bilateral transactions with the DMO are settled on the value date and in sterling. The DMO is prepared to transact in the instruments listed above provided settlement can take place in CREST or its equivalent, Clearstream or Euroclear, and according to the DMO's settlement requirements and timetable. For any enquiries regarding settlement please contact either David Cuthbert (020 7862 6542), Neil Corkill (020 7862 6565) or the DMO's settlement team (020 7862 6546).

³ Defined in the Gilt Repo Code of Best Practice produced by the Stock Lending & Repo Committee as "Securities which, for any reason, are sought after in the repo market, thereby enabling holders to earn incremental income (in excess of General Collateral) through lending them via a repo transaction."

⁴ Debt instruments issued by issuers, including supranational and foreign governments.

Standard Settlement Instructions for cash management transactions

Bankers: Bank of England. Sort Code 10-18-00. a/c 01206 / 22573410
 CREST: 00XBJ – Governor and Company of the Bank of England –DMA account
 CREST: 670IP – T-bill new issuance account

 CHAPS: 10-18-00
 SWIFT: DMOAGB2L
 Euroclear: Bank of England B-M a/c 22224
 Clearstream: Bank of England B-M a/c 87142

DMO announcement pages

Information	Reuters/Bridge/ADP	Telerate	Topic	Bloomberg
Cash Management Announcements	DMO/CASH 01	15700 to 15709	44660 to 44669	DMO9<GO>
Weekly Treasury bill tender Announcements and results	DMO/CASH 11	15710 to 15711	44670 to 44671	DMO9<GO>
Ad hoc tenders and results	DMO/CASH 16	15715 to 15716	44675 to 44676	DMO9<GO>
Treasury Bill Reference Prices	DMO/TBILL S01		44900	DMO9<GO>

Cash management counterparty selection

The DMO deals with a wide range of counterparties with whom it has an all round dealing relationship. The DMO values counterparties with whom it can transact on a fairly regular basis; for example, by their participation in weekly tenders for Treasury bills, ad hoc tenders and in bilateral dealings in a range of money market instruments.

Counterparties are regular participants in the markets in which they propose to deal with the DMO. Therefore they are expected to be regulated financial institutions or intermediaries. The DMO's list of counterparties is not published. The key features of a Cash Management counterparty relationship with the DMO are:

- Access to the DMO's Treasury bill and ad hoc tenders
- Access to the DMO's standing repo facility.
- The ability to deal with the DMO on a bilateral basis in a range of money market instruments.
- Consultations with the DMO on money market conditions and the DMO's policies.

Counterparties are expected to bid regularly at Treasury bill and any ad hoc tenders that may take place. The DMO's dealers seek to develop meaningful direct dealing relationship with each counterparty.

Once Cash Management counterparty status has been agreed, the DMO and the respective counterparty need to have performed the following actions before a trading relationship can begin:

- Completion of any relevant legal and other documentation⁵.
- Acceptance of the terms contained within this Operational Notice and the Sterling Treasury Bills Information Memorandum.
- Confirmation of the counterparty's regulatory status and details of its legal entity.
- Agreement of margining arrangements.
- Provision of Standard Settlement Instructions and lists of authorized signatories and contacts.
- Set up of a direct, dedicated telephone link to the DMO's dealing desk (see Appendix 3 for the specification).
- Completion of DMO's due diligence checks.

Expressions of interest in becoming a counterparty should be made in the first instance to Nick Fisher (020 7862 6518) or Chris Ryan (020 7862 6527).

⁵ The DMO's repo agreement (where the counterparty intends to enter into repo or reverse repo transactions with the DMO) and or ISDA documentation and also a letter confirming the counterparties' agreement to adhere to this and subsequent versions of the Operational Notice.

Appendix A:

INFORMATION MEMORANDUM STERLING TREASURY BILLS:

Introduction

The UK Debt Management Office (DMO) continues to regard sterling Treasury bills as an important constituent in its Exchequer cash management operations and an intrinsic component in the UK Government's stock of marketable debt instruments, alongside gilts. HM Treasury's remit to the DMO for 2003-04 includes plans for a £3.3 billion increase in the stock of Treasury bills over the financial year (to £18.3 billion).

This Information Memorandum sets out the main features of Treasury bills as a financial instrument, how they can be bought, traded and settled and through whom. The arrangements set out in this Memorandum will be effective from the Treasury bill tender to be held on Friday, 12 September 2003.

This Memorandum is to be read alongside the DMO's revised Cash Management Operational Notice dated 11 September 2003 (this Memorandum forms Appendix A of the Operational Notice) The combined publication can be found on the DMO website www.dmo.gov.uk (and is available on request from the DMO).

The Government's Treasury bill programme is continuously kept under review. If interested parties have any comments or suggestions on the programme, or wish to express an interest in becoming a Treasury bill primary participant (see Annex 1) or would like more information on Treasury bills more generally, see Annex 2 for DMO contact/information details.

Dematerialisation

It is intended that from 15 September 2003 the DMO will issue Treasury bills in dematerialised form. All outstanding Treasury bills issued in physical form will be dematerialised over the weekend of 27-28 September 2003 and migrated into CREST with effect from Monday, 29 September.

Dematerialisation will mean that Treasury bills will become fungible with previously issued Treasury bills of the same maturity. As Treasury bills will be eligible for inclusion in the main traded class of gilt DBV⁶ they will be able to be used as collateral for bilateral gilt repo transactions. Treasury bills will remain eligible as collateral for the Bank of England's Open Market Operations and in RTGS⁷.

⁶ CREST Delivery by Value functionality enables CREST members to give and receive packages of securities as collateral. The main traded gilt DBV class is UBG (Unstripped British Government Stock).

⁷ The Real-Time Gross Settlement payment system operated by the Bank of England.

1. Description of the instrument

- 1.1. Treasury bills are sterling denominated unconditional obligations of the UK Government with recourse to the National Loans Fund and the Consolidated Fund. They are issued from, and are liabilities of, the Debt Management Account. Treasury bills are zero-coupon eligible debt securities⁸.
- 1.2. In credit risk terms Treasury bills have the same standing as gilt-edged securities ("gilts")⁹. They qualify as zero risk-weighted instruments for the purposes of determining capital adequacy under the 1988 Basel Capital Accord.
- 1.3. Treasury bills can be used as collateral in the Bank of England's Open Market Operations and in RTGS and are included in the main traded class of gilt DBV for repo transactions.
- 1.4. Treasury bills can be issued with a minimum of 1 day and a maximum maturity of 364 days. However they are typically issued at tenders in maturities of 1 month (approximately 28 days), 3 months (approximately 91 days), 6 months (approximately 182 days) although they could be issued with a maturity of 12 months (up to 364 days) too.
- 1.5. Treasury bills can be held in the following central securities depositories – CREST and Euroclear (see section 3).
- 1.6. Treasury bills will be fungible with bills of the same maturity date. The DMO plans to continue to issue bills with one, three and six months to maturity. The reference point for these bills will be the maturity date. Once a maturity date is established by the issue of bills, later issues of bills with the same maturity date will be treated as a further issue of the original bills for that date.

⁸ The term "eligible debt security" is the term used in the Uncertificated Securities (Amendment) (Eligible Debt Securities) Regulations 2003 to refer to those non-material securities, which may be issued into CREST, creating rights and obligations which (so far as practicable) correspond to those in relation to paper, negotiable money market instruments.

⁹ Gilts and Treasury bills are both unconditional liabilities of the UK Government, which are AAA rated by Standard & Poor's and Fitch IBCA, and Aaa by Moody's.

Tender Pricing

1.7. Treasury bills are issued at tenders (see below) on a money market yield basis, with the quotation of yield being up to three decimal places. They will be settled according to the following price/yield formula:

$$P = \frac{N}{\left(1 + \frac{y \times n}{36500}\right)}$$

where: P = Settlement proceeds in pounds
 N = Nominal value in pounds
 y = Yield, quoted as a percentage to three decimal places
 n = Number of calendar days from the settlement date to the maturity date

The settlement proceeds P will be rounded to the nearest penny for each transaction (0.5 pence is rounded up).

CREST Reference Prices

1.8. At the end of each business day CREST reference prices for UK Treasury Bills will be published by the DMO on its wire services pages (see page 10). The prices will also appear on a daily basis on the DMO website at www.dmo.gov.uk/cash/tbills/tbillhtm. The prices will be based on a money market yield to maturity calculation priced around the London Inter Bank Offer Rate (LIBOR) adjusted to take into account the credit quality of Treasury Bills.

Reference rates applicable to pricing Treasury bills

Treasury Bills	Time to maturity		
	0-1 month	1-3 months	3-6 months
Reference rate	1 week LIBOR	1 month LIBOR	3 month LIBOR

1.9. Reference prices in CREST will provide an indicative price for CREST valuation purposes and be used for the purpose of valuation of collateral transfers. The reference prices are not intended to represent market prices at which the securities could be traded and do not constitute an invitation or offer to buy or sell securities.

2. Treasury bill tenders

- 2.1. Treasury bills are issued at weekly tenders, held by the DMO on the last business day of each week (i.e. usually on Fridays) for settlement the following business day. The DMO announces the size of the following week's tender and the maturity of bills on offer at the preceding week's tender. These announcements are made on the DMO's wire service pages¹⁰.
- 2.2. The DMO may also issue Treasury bills to assist the Bank of England in its management of the sterling money markets. If requested by the Bank, the DMO would consider adding an additional amount of bills to a tender and in which case it would identify, in its usual announcements, any amount being issued for the Bank.

Participation

- 2.3. Direct bidding by telephone in Treasury bill tenders is open to the following:
 - DMO cash management counterparties – who may make bids on existing direct dealing telephone lines.
 - Treasury bill primary participants – (see Annex 1).
 - A limited range of wholesale market participants who have established a telephone bidding facility¹¹ with the DMO.
- 2.4. Primary participants have indicated that, subject to their own due diligence controls, they are willing to bid at tenders on behalf of other parties.
- 2.5. Eligible bidders may bid at tenders in their own name and/or on behalf of clients; it will be the responsibility of the client and the eligible participant to agree bilaterally the payment and custody arrangements for any Treasury bill holdings acquired in a tender.

¹⁰ Reuters/Bridge/ADP, DMO/CASH11, Telerate, 15710 to 15711, Topic 44670 to 44671, Bloomberg, DMO9<GO>.

¹¹ In accordance with the arrangements set out under "Cash management counterparty selection" in the Operational Notice. When arranging for a telephone bidding facility, allowance should be made for the timescale involved in setting up such arrangements.

Bidding at Treasury bill tenders

2.6. The key features of the Treasury bill tender process are:

- Tenders are held on a competitive bid yield basis.
- All bids must specify the maturity of bills being bid for, and must be made on a percentage money market yield basis¹². Bids may be made up to three decimal places, and must include the nominal amount bid for at each yield.
- Bids must be for a minimum of £500,000 nominal of bills. Above this minimum, bids must be made in multiples of £50,000. There is no limit to the number of bids that may be submitted by any one tenderer.
- All bids must be received by 11.00 am (London time) on the day of the tender.

Processing of bids

2.7. On receipt of bids from eligible participants the DMO will:

- rank bids for each maturity on offer by yield. Bills will then be allotted to those bids that are at, or below, the yield deemed by the DMO to be the highest accepted yield. Bids at the highest accepted yield may only receive a proportion of the nominal amount of bills bid for;
- reserve the right not to allot the total amount of bills on offer, to cancel any tender and not allot any bills (although it would consider this only in exceptional circumstances), and to reject and scale bids. At the cut-off point a scaling ratio will be calculated and applied to bids at the highest accepted yield. The scaling ratio will be rounded down to the nearest 0.01% with the residual retained by the DMO and held in its official portfolio of collateral available for cash management purposes;
- publish the results of the tender on its wire services pages and on its web site www.dmo.gov.uk as soon after 11.00 am (London time) as possible¹³. The results will set out the amounts applied for and allotted respectively at each maturity, the lowest, average and highest accepted yields, the scaling ratio at the highest accepted yield together with the residual amount retained by the DMO¹⁴;

¹² See the section on pricing for the settlement convention the DMO uses for these purposes.

¹³ The results of the 52 tenders held in 2002-03 were made available on the DMO's wire service pages on average within 10 minutes of the close of the tender.

¹⁴ The amounts allotted to bidders and the DMO will be rounded to the nearest £0.01m

- announce, at the same time, the amounts on offer at each maturity at the next tender, together with an outline of any ad hoc tenders to be held in the following week.

Historic Treasury bill tender results appear on the DMO's website at www.dmo.gov.uk/cash/results/f2tend.htm.

Maturity of bills issued

- 2.8. Bills issued at tenders currently mature on the first business day of the week, four weeks, thirteen weeks, twenty six weeks respectively following the issue date, which will be the first business day of the week following the tender.
- 2.9. If Treasury bills are due to be issued or to settle in weeks including bank holidays, the exact maturity of the bills at issue will be adjusted to ensure repayment on the first business day of the relevant week.

Announcements of future tenders

- 2.10. Following the final tender at the end of each calendar quarter, the DMO will issue a notice outlining the maturities of Treasury bills available in each week of the following quarter.

3. Settlement arrangements

3.1. The main features of the settlement arrangements relating to Treasury bills are:

Settlement

- Successful tenderers will be contacted by the DMO following the publication of the results of the tender to which their allotments relate. The DMO will confirm the nominal amount of Treasury bills allotted, the purchase consideration bearing in mind the accepted bids and the purchasers' settlement instructions.
- An exchange of confirmations will follow. Treasury bill allocations resulting from tenders will be settled on the first business day of the following week; this will also be the issue date of the Treasury bills purchased.
- Settlement of the Treasury bill allocations are made by means of *Delivery versus Payment* (DVP) in CREST on the settlement date¹⁵.
- Treasury bills may be held in CREST in multiples of 1p and may be transferred in multiples thereof in secondary trading.
- Transactions in Treasury bills can also be settled across Euroclear.

Failure to settle

3.2. The DMO reserves the right to claim compensation from any tenderer in the event that payment is not received on the settlement date for whatever reason.

¹⁵Unless in any particular case the DMO agrees a different method of settlement.

Registration

- 3.3. Treasury bills will be held in the CREST system, which will constitute the central register of ownership for Treasury bills. Legal title will be evidenced by the entry of a given number of units against a holder's name in the relevant CREST record. This record will constitute the "Operator register of eligible debt securities" to be maintained by CREST.¹⁶
- 3.4. It is also possible to hold Treasury bills in Euroclear by means of its participation in CREST.

4. Withholding tax

- 4.1. All payments to holders of Treasury bills will be made without withholding or deduction for or on account of any taxes of whatever nature imposed or levied by or on behalf of the United Kingdom or by any political sub-division of or taxing authority in the United Kingdom unless required by law.

5. Treasury bill primary participants

- 5.1. Annex 1 contains a list of banks that have agreed, subject to their own due diligence, to bid at Treasury bill tenders on behalf of investors; they will also provide secondary dealing levels for Treasury bills.
- 5.2. All participants at Treasury bill tenders must be registered financial institutions, regulated by the FSA and subject to its rules and guidance in their activities.

¹⁶The *Uncertificated Securities Regulations 2001*, as amended, provide that the "Operator register of eligible debt securities" shall be prima facie evidence, and in Scotland sufficient evidence unless the contrary can be shown, of any matters which are directed or authorised to be inserted in the register by the Regulations

6. Provision of information to Inland Revenue for exchange with other tax authorities

- 6.1. On 3 June 2003, the Council of the European Union adopted a new directive regarding the taxation of savings income (the "Directive"). The Directive is scheduled to be applied by Member States from 1 January 2005 provided that certain non-EU countries adopt similar measures from the same date. Under the Directive each Member State will be required to provide to the tax authorities of another Member State details of payment of interest or other similar income paid by a person within its jurisdiction to an individual resident in that other Member State; however, Austria, Belgium and Luxembourg may instead apply a withholding system for a transitional period in relation to such payments, deducting tax at rates rising over time to 35%. The transitional period is to commence on the date from which the Directive is to be applied by Member States and to terminate at the end of the first fiscal year following agreement by certain non-EU countries to the exchange of information relating to such payments.
- 6.2. Section 199 of *Finance Act 2003* was enacted to enable the United Kingdom Government to satisfy its obligations under the Directive. Section 199 gives the Treasury power to make regulations dealing with matters arising from European Union legislation relating to the taxation of savings income. Section 199 provides that regulations made under the section may require "paying agents" to obtain, verify, record and then provide to the Inland Revenue, information about identities and place of residence of the persons to whom payments of savings income are made. Regulations made under section 199 will describe classes of persons who may be treated as paying agents and these may include public offices and government departments.

Annex 1:

Treasury bill primary participants (at 11 September 2003)²¹

The primary participants listed below are banks that have agreed, subject to their own due diligence, to bid at Treasury bill tenders on behalf of investors; they will also provide secondary dealing levels for Treasury bills.

Barclays Bank plc	020 7773 9650
Cater Allen International Ltd	020 7756 4500
Citigroup Global Markets Ltd	020 7986 9435
Credit Lyonnais SA	020 7782 0106
Deutsche Bank plc	020 7545 2090
HBOS Treasury Services Ltd	020 7374 0484
JP Morgan Securities Ltd	020 7779 3180
Lehman Brothers International (Europe)	020 7260 2337
The Royal Bank of Scotland plc	020 7256 6623
UBS Ltd	020 7567 2801

¹⁷ The DMO will update this list as necessary – a current version will appear on its website www.dmo.gov.uk.

Annex 2: Contacts/information

Cash dealing unit – participation/dealing issues

020 7862 6518

020 7862 6527

Settlements team – settlement and custody issues

020 7862 6542

Risk management unit – legal/compliance issues

020 7862 6523

Press/media issues

020 7862 6532

Further information on the Treasury bill programme can be accessed on the DMO website www.dmo.gov.uk (in the money markets pages) and in the DMO's Quarterly Reviews published each January, April, July and October (and which are also available on the DMO web-site in the publications pages).

The DMO also publishes information on its Treasury bill and money markets activities on the wire services – for details see the table on page 10.

Appendix B

General terms and conditions for telephone dealing

- Telephone deals with the DMO are irrevocable.
- Telephone calls to the DMO's dealing desk and settlements desk will be tape-recorded.
- The DMO's record of a deal will prevail in the event of any dispute or misunderstanding.
- The counterparty will be wholly responsible for ensuring that it has complied fully with all applicable anti-money laundering legislation and regulations in all transactions and its business relationship with the DMO.

Ad hoc tender terms and conditions for telephone bidding

- The terms and conditions of issue are set out in the DMO's cash management / Treasury bill tender announcement.
- Telephone applications must be for or of a minimum of £5 million nominal and must be made in multiples of £1 million nominal thereafter.
- A maximum of five bids (or offers) per maturity on offer (or advised) at each tender may be submitted by any one counterparty.
- Bids (or offers) must be received by the latest time specified as such in the DMO's cash management announcement.
- Each bid (or offer) must specify: the name of the bidder, the maturity being bid for (or offered), the yield of each bid (or offer) and the quantity of each bid (or offer). Separate bids (or offers) must be made for each maturity.

Appendix C

Dealing Room Voice Systems

The DMO's dealing room voice system is an IPC DK2000 digital voice switch. This system as currently configured supports Fig.1 (Ring In / Loop Out) and Fig. 2 (Ring In / Ring Out) analogue line interfaces. Other standard analogue line interfaces can be accommodated by arrangement if required.

Counterparties will need to order a private voice circuit between their own and the DMO's dealing rooms, with themselves as the "A" end and the DMO as the "B" end. Counterparties are free to select the carrier of their choice subject to suitable presentation at the DMO's site. The DMO currently has telecommunications presentation from COLT Telecommunications and BT.

The technical contact at the DMO for any enquiries relating to voice communications is Graham Fletcher (Tel. 020 7862 6574, e-mail graham.fletcher@dmo.gsi.gov.uk).

Appendix D: Exchequer cash management by the DMO

The DMO's cash management objective

The UK Debt Management Office (DMO)'s main strategic objective in carrying out its cash management role is to "offset, through its market operations, the expected outturn cash flow into or out of the National Loans Fund (NLF), on every business day; and in a cost effective manner with due regard for credit risk management".

The structure of Government cash management

The DMO's operations are part of a wider Government structure for managing Exchequer cash flows. Government cash flows, whether expenditure, revenue, interest payments or borrowing are based around two central funds: the Consolidated Fund and the National Loans Fund. Government revenue from taxation and other sources is collected daily into the Consolidated Fund. Payments out of the Consolidated Fund to finance government spending are authorised by Parliament and almost all this spending is channelled through accounts held by Government Departments at the Office of HM Paymaster General, which in turn banks at the Bank of England. The NLF is the fund that formally borrows money for the Government and for example funds via the Public Works Loan Board (PWLB) lending to local authorities. UK government bonds – gilts – are liabilities of the NLF.

An arrangement of accounts, known as the Exchequer Pyramid, ensures that any cash balances which remain in government accounts at the Bank of England at the end of every business day are channelled into the main central government accounts, thereby minimising the government's cash borrowing needs. If the Consolidated Fund has a surplus, this is automatically transferred to the NLF to reduce its need to borrow. Equally, a deficit in the Consolidated Fund is automatically financed by a transfer from the NLF.

The DMO's cash management task

It is the DMO's task to undertake market borrowing or lending during each business day to balance the remaining position on the NLF after the operation of the Exchequer Pyramid described above. To do this the DMO needs to have reliable forecasts of each day's significant cash flows into and out of central government, and up-to-date monitoring of actual cash flows as they occur. Responsibility for forecasting and monitoring central government cash flows lies with HM Treasury.

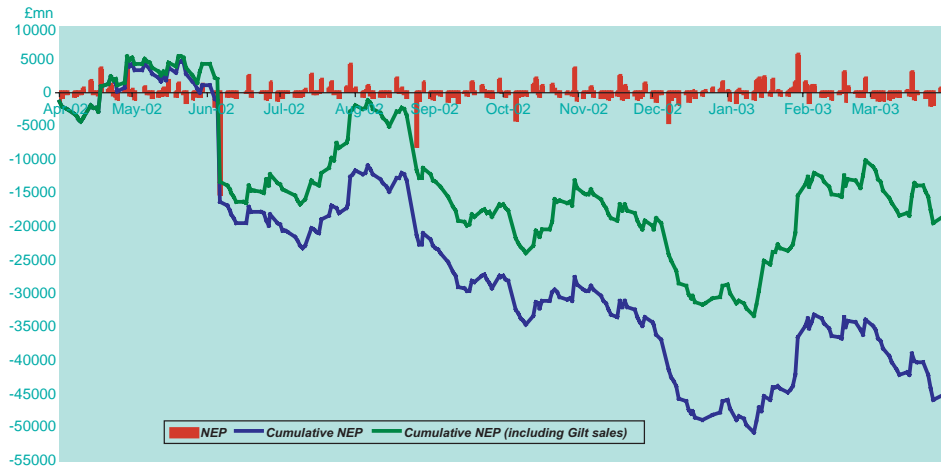
Over the course of a year the Exchequer's cash flow usually has a fairly regular monthly pattern associated with the pattern of tax receipts or expenditure cycles. The pattern of the cumulative CGNCRs in 2001-02 and 2002-03 is shown in the chart below. The major change was in the level of the central government cash requirement, which was significantly further in deficit in 2002-03.

Cumulative CGNCRs 2001-02 and 2002-03



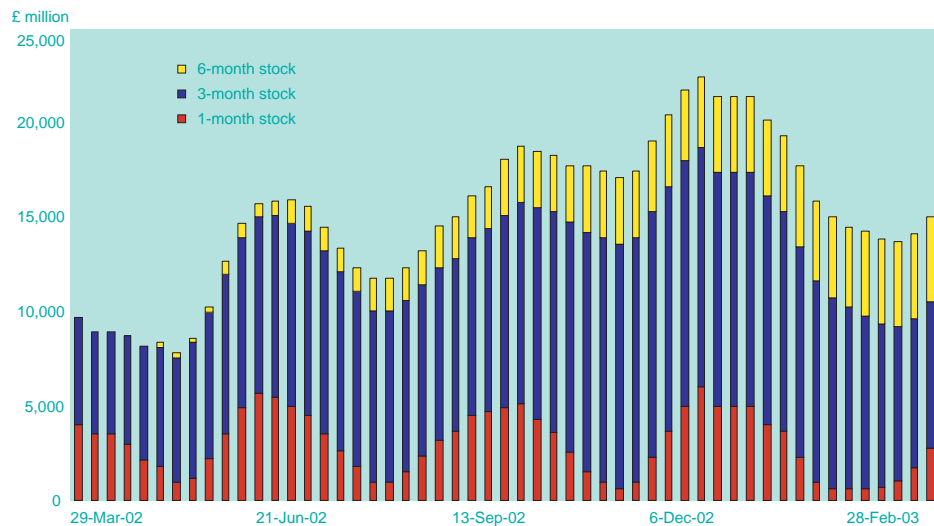
The chart below shows the scale of cash flows on a daily basis in 2002-03. The net exchequer position tracked here on a daily and cumulative basis is essentially the CGNCR less gilt redemptions.

Daily and cumulative Exchequer cash flows 2002-03



The increase in the deficit in 2002-03 required a general increase in the stock of Treasury bills which began 2002-03 at £9.7 billion and ended the financial year at £15.0 billion. However, the stock peaked at some £22 billion in late December 2002. Six month Treasury bills were introduced for the first time in May 2002.

Treasury bill stocks 2002-03



Cash flow smoothing

Within the longer-term pattern there is considerable uncertainty as to flows on any one day, associated largely with the unpredictability of the precise timing and size of some tax and expenditure flows. The DMO's approach has been to manage these flows primarily through bilateral dealing in a range of money market instruments and by the issuance of Treasury bills. In the case of the latter the DMO's remit envisages a run down of the stock of bills in months of positive cash flow (i.e. surplus) and an increase in months of higher net expenditure (deficit).

Some rough smoothing of the Exchequer's prospective cash flow variation is possible through term lending and borrowing. But the daily variation in the forecast of Exchequer flows means that there is also a need to fine tune cash flows on a daily basis. Apart from the weekly issue of Treasury bills most of the DMO's dealing is done using secured money market instruments to borrow from, or lend to, wholesale money market participants.

The DMO's approach

The DMO seeks to manage cash flows without influencing the level of short-term interest rates. The DMO also takes account of the operational requirements of the Bank of England for implementing its monetary policy objectives, and its impact on the sterling money market.

An important part of the DMO's approach is therefore to seek to ensure that its actions do not distort market or trading patterns. In its bilateral dealings with the market the DMO is a price-taker and its remit is to balance the Exchequer cash flows cost-effectively. This means that while the DMO takes account of market levels in seeking to find a cost-effective way of smoothing the Exchequer cash flows, it does not run the cash management operation with a profit target and would not seek to influence rates to its advantage.

Interaction with UK monetary policy

The DMO has no contact with the Monetary Policy Committee (including the non-voting Treasury representative) with regard to interest rate decisions or its thinking. The current framework for Exchequer cash management was developed by HM Treasury and the DMO in discussion with the Bank of England to avoid clashes in the delivery of the DMO's and the Bank's objectives in the money market. In particular, the DMO will not hold weekly bill tenders or ad hoc tenders at times when the Bank of England is conducting its money market operations (currently 9.45am and 2.30pm). The DMO does not intend to conduct ad hoc tenders in the second slot (10.00am) on Monetary Policy Committee decision days. Neither will the DMO hold reverse repo ad hoc tenders of a maturity that could be perceived as competing with the Bank's structured daily repo operations.

The DMO may also issue Treasury bills to assist the Bank of England in its management of the sterling money markets. If so requested by the Bank the DMO may add an additional amount of bills to a tender. If the DMO were to do this it would identify, in its usual announcements, any amounts being issued for the Bank.

Relations with other external bodies

The DMO does not receive from the Treasury, the Office for National Statistics or other parts of government advance notice of policy statements or data releases that will 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.

End of day and contingency arrangements

On occasion, sizeable unanticipated cash inflows and outflows may occur too late in the day for their impact to be smoothed by bilateral dealing in the money markets. To take account of this, arrangements have been put in place with the Bank of England and settlement banks to cope with late changes to the forecast without disadvantage to the market.

In circumstances where there is an Exchequer cash surplus at 4.05pm, the surplus is taken into the Bank of England's Settlement Bank late repo facility (without the borrowing banks having to pay a penal rate of interest on the amount). An Exchequer cash deficit can be offset by bilateral borrowing from a number of settlement banks through a Special End of Day Transfer Arrangement (SEDTA).

For the rare circumstances where unanticipated changes to the forecast are not fully accommodated in the usual end of day arrangements, and to provide for changes arising from the overnight sweeping of accounts flowing into the NLF, the DMO holds a balance of £200 million at the Bank of England, as a further source of operational flexibility. HM Treasury also has in hand a programme to improve both the forecasting and monitoring of the daily cash flows.

The current structure has replaced the previous arrangements through which late changes were reflected in the size of the Government's Ways and Means Account at the Bank of England¹⁸. Since the assumption of Exchequer cash management responsibility by the DMO the size of the Ways and Means account has been held at £13.4 billion.

The DMO has in place plans to ensure business continuity in the event that its office is not available for use. In the event that the DMO has to invoke these it plans to post a notice on its web site (www.dmo.gov.uk) notifying its market counterparties of the event and of further information relevant to the continued operation of the DMO's business.

¹⁸ The Ways and Means Account is the Government's overdraft with the Bank of England and is held by the Bank as an asset to back the note issue.

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The United Kingdom
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