

# SETTING UP A DEBT OFFICE

The experience of the United Kingdom and issues arising

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# Setting up a Debt Office

- ◆ Background to the UK Debt Management Office (DMO)
- ◆ Relationship with Finance Ministry (HM Treasury) and Central Bank (Bank of England)
- ◆ Objectives and targets
- ◆ Governance and Risk Management
- ◆ Resources

# UK DMO: Headlines

- ◆ Established in April 1998 - an Agency of HM Treasury
- ◆ Corollary of interest rate setting responsibilities for the Bank of England announced in May 1997
- ◆ With the aim“...to minimise the Government’s debt financing costs over the long term, taking account of risk, and manage the aggregate cash needs of the Exchequer in the most cost-effective way, while being consistent with monetary policy objectives.”

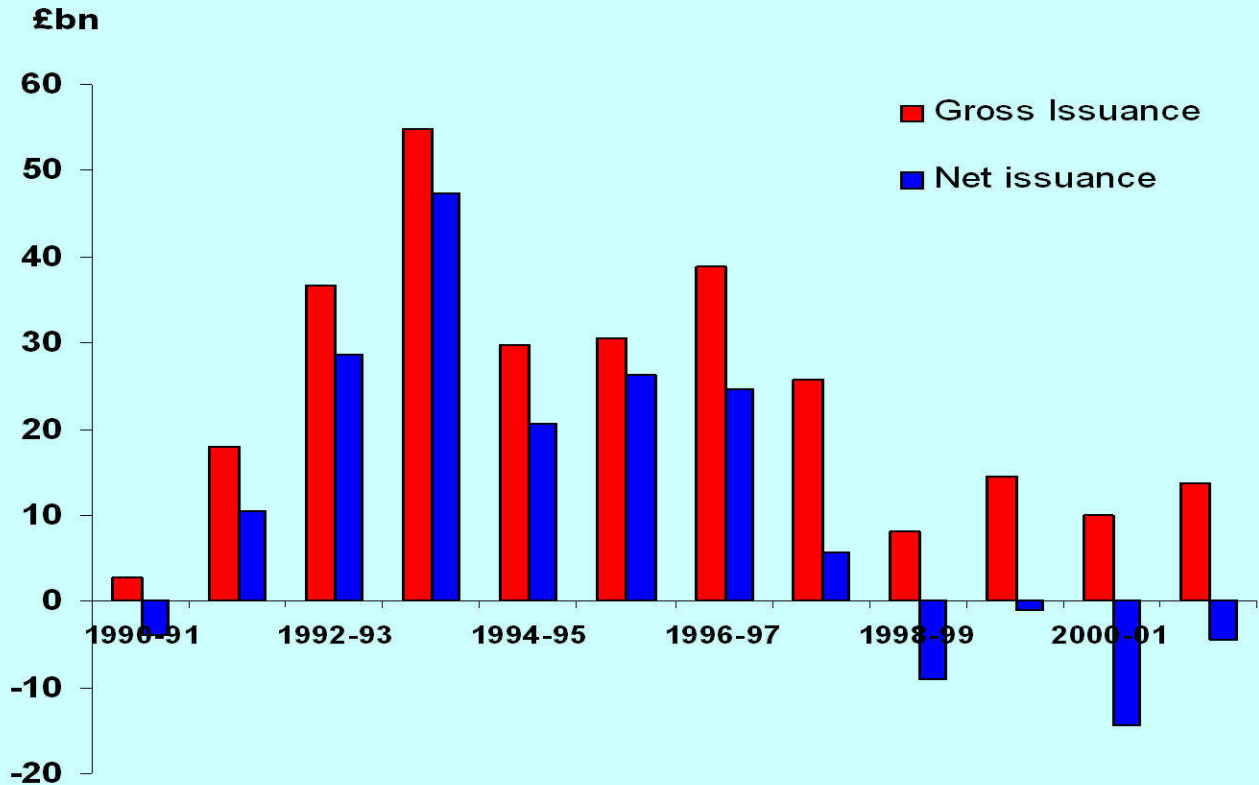
# DMO's Functions

- ◆ The Government's debt manager
  - issuing gilts (and Treasury Bills), managing the gilts market
- ◆ The Government's cash manager
  - balancing daily the net cash flow into/from Government
  - issuing Treasury bills; borrowing and lending (mainly secured) in the money markets; using a range of money market instruments (mainly repo)
- ◆ The Government's (short term) asset manager
  - managing of cash surpluses (inc from 3G licences)

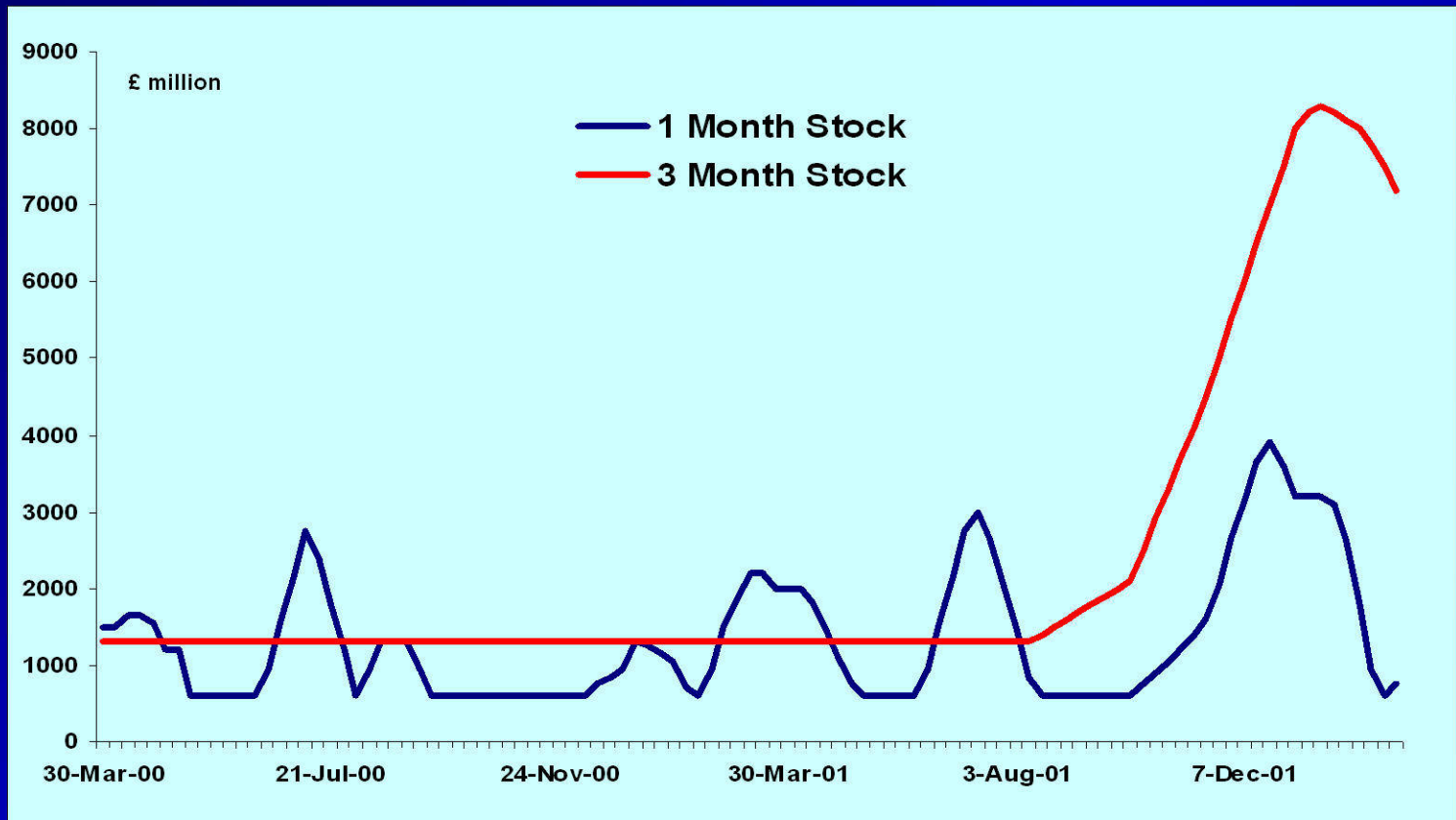
# DMO: Balance Sheet Indicators

- ◆ Gilt Portfolio (market value, end Dec 01)
  - Conventionals £ 230.7 bn
  - Index Linked £ 72.1 bn
  - Held by DMO £ 6.7 bn
  - Modified duration (total) 7.79 years
- ◆ Short term assets and liabilities (end Dec 01)
  - Treasury Bills in Issue £11.2 bn
  - other short-term liabilities (mainly repo) £ 5.2 bn
  - short-term assets £7.0 bn

# UK: Gross and Net Gilt Issuance

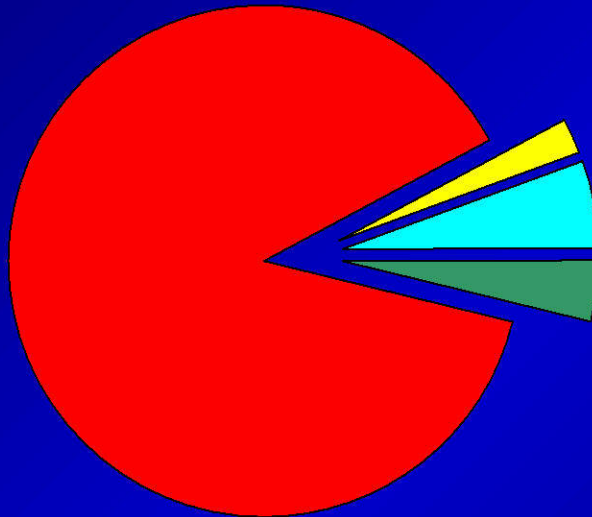


# UK: Treasury Bill Stock, 2000-01



# Cash Management Activity

Total Turnover 2000-01  
£ 357.5 bn



- Deposits £ 13.6 bn
- Repo £ 316.5 bn
- Securities £ 8.2 bn
- T Bill Issuance £ 19.6 bn

# Relationship with Central Bank

## ◆ Key principles

- separate debt and monetary policy (separate dealing functions; no inside information or policy discussions)
- [NB in UK, only a weak link between financing policies and monetary conditions; and monetary supply growth and inflation]
- separate domestic debt (DMO) and overseas reserves (Bank) management

## ◆ Bank provides services

- settlement agent and banker, gilt registrar

- assists in end-of-day balancing processes

# Relationship with Ministry of Finance (HM Treasury)

## ◆ Key Principles

- Ministers set objectives and targets
- DMO needs managerial and operational independence - for market credibility and to create centre of expertise
- DMO advises on its remit and portfolio objectives; but HM Treasury integrates with wider economic advice (on fiscal and balance sheet policies)

# Roles and Responsibilities

- ◆ Legally part of HM Treasury
- ◆ Clear division of responsibilities and roles - in Framework Document
- ◆ Ministers set policy framework
  - set annual remit
  - approve Business Plan and targets
- ◆ Chief Exec is responsible to Parliament for both administrative expenditure (£8 mn in 2001-02) and DMA (turnover c. £ 500 bn)

# Objectives and Targets

## ◆ 10 Strategic Objectives

- Advising on and meeting both debt and cash remit
- High quality service to market
- Efficiency and cost-effectiveness

## ◆ 10 Annual Targets

- Full compliance with remit
- Service to market and public
- Operational efficiency

# Formal Performance Benchmark or Duration Objective

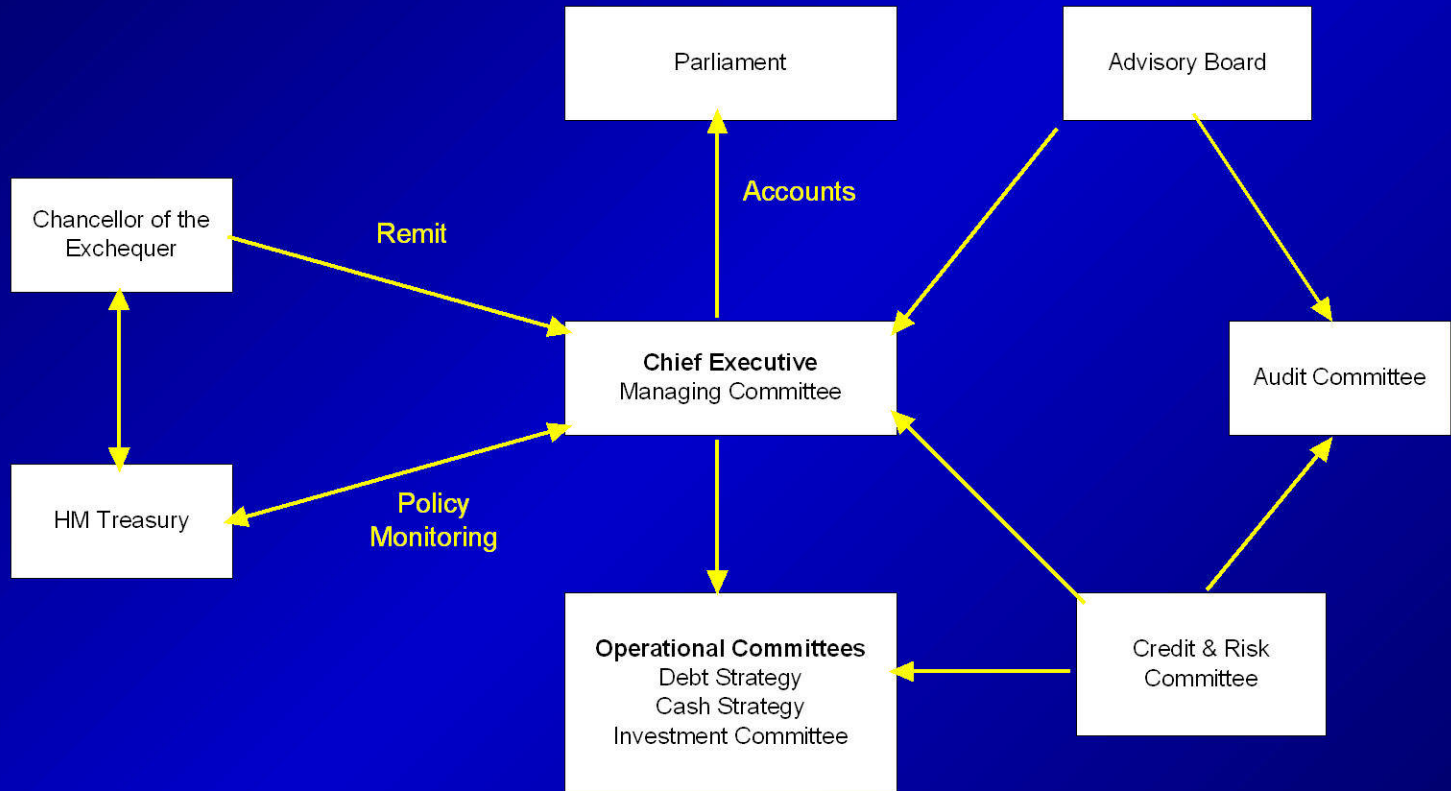
- ◆ Concern to avoid opportunistic behaviour
- ◆ Benchmark not independent of DMO's actions
- ◆ Status as part of HM Treasury risks adding to market uncertainty and damaging DMO's credibility
- ◆ Setting the target is not straightforward

# DMO Governance





# Governance: Internal



# Risk Assessment

## ◆ Main risks

- 'strategic' - policy, people, IT, perceptions
- operational - fraud, error, settlement
- credit
- market - but no 'profit' objective

## ◆ Impact: financial, reputational, political

## ◆ Mitigation strategies

- financial and operational controls
- business continuity plan

# Internal Control Structure

## ◆ Audit Committee

- independent chairman
- advice on risk assessment and internal control

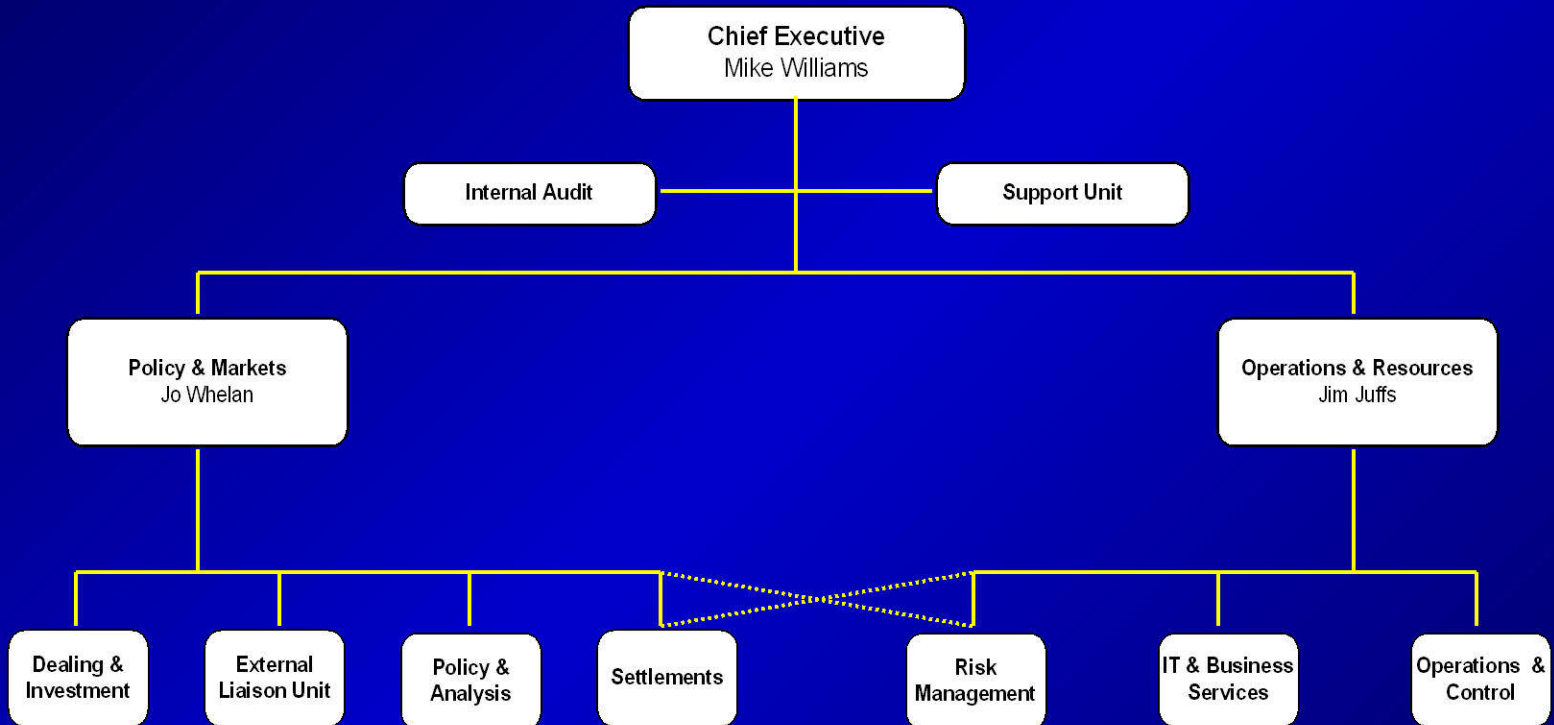
## ◆ Credit and Risk Committee

- risk appetite
- limit approvals and control

## ◆ Risk Management Unit

- analytical capability
- control advice and monitoring

# DMO: Functional Structure



# Resources: Strengths

- ◆ Agency status allows managerial independence
- ◆ Able to design own pay system
- ◆ Recruited staff externally and internally
  - 55 staff, over half from private sector
- ◆ Target professional skills
  - centre of expertise
  - skills available for others in Government
  - inc for HMT in wider balance sheet management

# Resources: Constraints

- ◆ Staff are still civil servants, subject to wider pay and other policies
- ◆ Budget part of HM Treasury's, subject to public expenditure control system
- ◆ No mechanism to trade-off extra admin expenditure against debt interest savings

# Some Lessons

- ◆ Establish respective roles and responsibilities - and publish them
- ◆ Agree the rules with Ministry of Finance
  - the scope for managerial freedom, especially on pay and budget
  - NB competence is not cheap
  - avoid Parliamentary or legislative constraints that inhibit flexibility
- ◆ Benefit from others' experience!