Proposals for Reforms to the Debt Management Office's Financing Remit

Submission to HM Treasury

October 2025

The Gower Initiative for Modern Money Studies

1. Introduction

1.1 This paper sets out proposals for changes to the Debt Management Office's (DMO) financing remit. It places these proposals in the context of the government's decisions on gilt and Treasury bill issuance, as outlined in the Debt Management Report 2025–26, and considers both qualitative and quantitative approaches to improving operational efficiency.

1.2 Each year, the government determines the structure of the financing remit in line with the Debt Management Objective[1]. The proposals in this paper align with this objective and broader policy aims, including the monetary policy objectives outlined in Section 11 of the Bank of England Act 1998.

1.3 The proposals developed in this paper take account of the Treasury's full funding rule[2] and the Chancellor's view of fiscal pressures within the existing fiscal rules, including reliance on Office for Budget Responsibility (OBR) forecasts.

1.4 Recent episodes, such as the 2022 mini-budget and current debates about fiscal sustainability, show that major policy shifts increase fundamental uncertainty. In response, UK sovereign bond investors tend to favour shorter maturities. This reflects a general preference for shorter durations in fixed-interest investments during periods of change, not concerns about solvency or policy quality[3]. The proposals that follow are designed to accommodate this behaviour.

1.5 The proposals are presented as enhancements to the DMO's operating framework that lower costs for the Exchequer without tax increases or spending cuts, thereby improving value for money.

1.6 The proposals assess the costs and risks of debt issuance by maturity and instrument type, guided by investor demand as revealed in current bids and broader participation. They also consider practical factors, including the need for greater flexibility in issuance operations during the year. On this basis, the following diagnostics identify key inefficiencies in the current framework.

2. Diagnostics

2.1 The current DMO framework ("Annex B")[4] is built around an annually fixed issuance schedule agreed through stakeholder consultations. This ensures predictability but introduces rigidity, making it difficult to adjust issuance in response to market volatility or changing demand.

2.2 At the January 2025[5] consultation meetings, participants reported declining demand from the defined benefit pension sector at longer maturities, supporting a shift from long conventional issuance towards more short- and medium-dated gilts. Yet reliance on these stated preferences risks misalignment with revealed preferences in the market, as shown by yield variations and price movements. When issuance does not match real-time demand, costs rise, highlighting the schedule's inability to respond dynamically.

2.3 The same consultations recommended reducing or maintaining the share of index-linked gilts, reflecting weaker pension fund demand, while noting strong appetite for Treasury bills and scope to expand the programme[6]. However, the fixed issuance schedule prevents timely adjustments, such as shifting towards bills when long-maturity bids are weak. It thus constrains the DMO's ability to issue in line with current market appetite. This inflexibility carries a significant cost; as analysis demonstrates[7],

[1] (HM Treasury 2025a, 6, §2.3)
[2] (HM Treasury 2025a, 8, §2.13)
[3] Informed market participants are well aware that default is impossible under current legislation. (Berkeley et al. 2025, 871–72)
[4] (HM Treasury 2025a, 31, Annex B)
[5] (HM Treasury 2025a, 31, B.6)
[6] (HM Treasury 2025a, 31–32, B.7-8)
[7] See Appendix B

a greater reliance on issuing Treasury bills over the past year would have produced a better interest payment outcome for the Exchequer than the fixed issuance schedule the DMO followed.

2.4 On 20 May 2025, the syndication of the 5⅜% Treasury Gilt 2056[8] sold £4 billion nominal at a yield more than 1.5% above the rate achievable through issuance at the lowest risk premium aligned with Bank of England inflation expectations[9], imposing a significant additional cost to the public purse for the next 30 years. This suboptimal outcome stemmed from the framework's heavy emphasis on refinancing, liquidity, and execution risks, which led to issuance into weak market demand. Despite the attractive high coupon and a broad investor base that included retail participants, bids remained limited and notably subdued. A more flexible strategy, attuned to real-time market appetite, could have mitigated these avoidable costs.

2.5 Chart B.1[10] shows nominal spot yields rising by around 100 basis points across maturities up to February 2025. By the summer, 30-year yields had exceeded 5.7% amid concerns about fiscal sustainability, before easing to about 5.48% by late September[11]. This volatility illustrates the need for a more responsive issuance mechanism, one that can swiftly recalibrate to shifting market conditions without being constrained by institutional rigidities.

2.6 A prime example of such constraints lies in the enduring role of Gilt-edged Market Makers (GEMMs), who retain privileges justified initially on the basis that they support government borrowing operations. These privileges, such as exclusive access to primary auctions and performance-based allocations, were designed to ensure liquidity and distribution, but are now structurally incompatible with the institutional role of a sovereign issuer operating in a monetary framework of ample settlement balances[12]. The closure of the Approved Group's admission to primary issues in 2020, without a permanent replacement, has further limited access to gilts and bills, narrowing the pool of potential participants.

2.7 Restricted access has particularly affected retail investors. Activity in gilts and Treasury bills remains significantly lower than in FTSE 100 or FTSE 250 shares, in part because retail investors lack access to real-time quotes and almost all limit order functionality. This reduces both discovery and liquidity. By contrast, the secondary market for UK equities, where retail platforms are directly connected to the London Stock Exchange, provides instant execution and a full range of order types.

2.8 Although market yields are an important data point, they should not be treated as accurate forecasts of inflation or as definitive verdicts on fiscal policy. Yields reflect portfolio choices made under uncertainty, not foresight. In a system with ample settlement balances remunerated at Bank Rate and guaranteed by HM Treasury, sovereign bond investors are essentially yield-focused portfolio managers. Their aggregate alternative is limited to holding settlement balances or deposits at, or close to, Bank Rate. This structure gives the DMO leverage to issue on terms more favourable to the Exchequer.

2.9 Episodes such as the 2022 mini-budget and recent concerns over 10- and 30-year yields illustrate how fiscal policy changes increase fundamental uncertainty. An increase in uncertainty triggers a mechanical shift in investor demand towards shorter maturities—a duration shift. Regardless of a policy's justification, cost, or explanation, any departure from the status quo alters the duration demanded in predictable ways that a rigid issuance framework struggles to accommodate.

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[8] Source: DMO Syndication Results https://www.dmo.gov.uk/data/datareport?reportCode=D10A
[9] See Appendix B
[10] (HM Treasury 2025a, 33)
[11] See Appendix B Chart 1
[12] "The current arrangements raise questions about the economic efficiency of these operations, given the involvement of financial intermediaries (the primary dealers, mainly commercial and investment banks), which profit from handling issuance transactions and market-making for the wider financial sector." (Berkeley et al. 2025, 876)

2.10 These duration shifts are often misinterpreted as a verdict on government policy, which some commentators have termed a “moron premium.” In practice, the UK sovereign bond market neither approves nor disapproves of government fiscal policy; rather, adjustments in gilt yields reflect the interaction between issuance strategy and prevailing portfolio preferences. When issuance aligns with demand, yields remain stable; when it does not, volatility rises, not because investors are rejecting the government’s approach, but because the demanded duration has shifted.

2.11 Failure to respond to these duration preferences has political consequences. Yield volatility created by issuing into weak demand is often seized upon in public debate as evidence of market disapproval. This misconception of market disapproval can generate significant pressure on the government to dilute or abandon its political mandate, thereby reducing the effectiveness of fiscal policy and subordinating democratic choices to a misinterpretation of routine market behaviour.

2.12 Countering this dynamic requires operational flexibility, not simply communications. By adopting a flexible issuance strategy that responds to real-time market signals, the DMO can stabilise yields, lower borrowing costs, and increase fiscal space. These measures are not narrow, technical adjustments, but essential steps to defuse the “confidence” narrative and preserve the political space for the government to implement its agenda.

2.13 Finally, punctuated auctions and syndications are often shaped by intermediaries’ balance sheet limits rather than genuine end-investor demand, which can drive up costs[13].

2.14 The diagnostic examples presented in this section, while varied, point to a single conclusion: the current debt management framework embeds significant and avoidable costs and risks. The rigidity of the issuance calendar, the suboptimal outcomes of specific syndications, and the tendency for market volatility to be misinterpreted as political judgment are not isolated issues but symptoms of an outdated operational paradigm. To address these symptoms effectively, it is necessary to examine the institutional assumptions that produce them. The following section, therefore, moves from practical diagnostics to a critique of the foundational principles underlying the DMO’s financing remit.

3. Foundational Rationale

3.1. UK debt management operates within a framework that conceptualises government as a borrower competing with the private sector for scarce savings. This legacy view, inherited from an era of fixed exchange rates, defines the central task of debt management as “securing financing” rather than managing the composition of sterling assets in circulation. From this assumption emerged institutional arrangements designed to project confidence and prevent perceived “funding failures”. The creation of a privileged group of Gilt-edged Market Makers (GEMMs) to underwrite auctions, alongside a rigid, pre-announced issuance schedule, reflected the belief that continuous market access depended on maintaining investor confidence in the government’s creditworthiness.

3.2. That framework, while coherent under systems such as Bretton Woods or the Exchange Rate Mechanism, is inconsistent with the operational structure of the UK’s modern monetary regime. As the sovereign issuer of sterling, operating a fully floating exchange rate, the government is not subject to a financing constraint prior to spending[14]. The operational sequence is the inverse of conventional doctrine: government expenditure credits sterling deposits to the banking system, while taxation

[13] ‘That’s something we are very focused on because each time we go to the market with an offering, we are effectively leveraging off the balance sheet capacity of the primary dealers,’ said Stheeman. (Khadbai 2024)

[14] We conclude, therefore, that it is the expenditure that causes a matching, future tax liability and there is no “intertemporal budget constraint,” as is commonly proposed in the orthodox view (Berkeley et al. 2025, 862)

debits them, and debt issuance alters their composition[15]. By accounting identity, the government's financial deficit equals the non-government's financial surplus[16]. Therefore, liquidity generated by fiscal operations accumulates within the private sector, and the government's policy challenge lies not in raising money but in managing the distribution of sterling-denominated assets in order to optimise macroeconomic outcomes.

3.3. Debt management is thus a portfolio management function: it determines how the non-government sector holds safe sterling assets and how the Bank of England's policy rate is transmitted through those assets. The government is not a supplicant in the market but the monopoly supplier of risk-free sterling securities that investors rely upon[17]. What is often described as "market confidence" is, in practice, the mechanical interaction between issuance strategy and investors' preferred durations.

3.4 Although auctions are often presented as mechanisms for "price discovery," this characterisation no longer applies within the UK's administered-rate framework. The Bank of England's Monetary Policy Committee (MPC) determines the base price of sterling through the Bank Rate, which anchors all risk-free yields. Because the Bank's policy reaction function is to set that price within a floating exchange rate regime, debt management's use of a pre-announced issuance schedule places it in futile competition with market forces that have already discounted all available information. The market no longer "discovers" price, but preferred *duration*: how investors allocate sterling liquidity across maturities. Auctions, therefore, perform a portfolio-distribution role, not a pricing one. Treating them as funding operations obscures the fact that the MPC administers price and sustains the illusion of market activity as a process of "price discovery."

3.5 Recognising auctions as portfolio-distribution operations removes any rationale for maintaining exclusive dealer privileges or rigid issuance calendars. The GEMM system no longer functions as a safeguard but as an anachronistic constraint that limits market access and increases costs. Likewise, a fixed, supply-driven auction schedule is a relic of a funding-risk paradigm, hindering rather than supporting effective duration discovery. A modern, demand-led approach would allow the DMO to respond directly to market preferences, reduce costs, and improve efficiency and policy coherence with the Bank of England.

3.6 Within this framework, the DMO functions as the government's sovereign portfolio manager, coordinating the allocation of settlement balances and government securities. It is responsible for managing maturities and costs across the existing stock of sterling assets created through fiscal operations. The DMO's purpose is therefore not to raise funds, but to maintain cost-effectiveness in support of monetary and fiscal policy objectives.

3.7 Inflation is primarily anchored by the prices the government pays for goods, services, and labour[18]. As one of the largest purchasers, government procurement sets price benchmarks that influence pricing in the private sector. This perspective contrasts with the mainstream framework that inflation is managed through monetary aggregates or the composition of public debt. In practice, debt composition is secondary: inflation control is pursued through the Bank of England's adjustments to the overnight Bank Rate, while gilt and bill issuance is calibrated to that anchor. The effectiveness of

[15] "HM Treasury requires the Bank of England to advance public deposits by virtue of the 1866 Act" (Berkeley et al. 2025, 873)
[16] Across the total economy (UK and the rest of the world), the total sources of funds must equal the total uses of funds, and every financial asset transaction must have a counterpart liability transaction. (Office of National Statistics 2024, 67)
[17] Under the current "floor regime," where there is excess liquidity in the wholesale money market, the issuance of government debt instead serves mainly to support secure store-of-value and source-of-collateral functions for the private sector. (Berkeley et al. 2025, 872)
[18] The state sets the terms of exchange for its currency with the prices it pays when it spends, and not per se by the quantity of currency that it spends. (Mosler 2023, 90)

this approach, given its known limitations, remains open to question[19]. What is clear is that disciplined procurement and a fiscal stance aligned with the economy's productive capacity would offer a more direct and durable method of anchoring inflation.

4. Assessing Debt Management Risks

4.1 The guiding principle of cost minimisation is to issue debt at maturities for which investors demand the lowest risk premium. While Annex B.14[20] qualifies this as applying only "when all else is equal," under the UK's sterling monetary framework and freely floating exchange rate, that condition is always satisfied. These risks are structurally absorbed by the banking system's permanent holdings of sterling deposits and settlement balances, which government net spending augments and banks must maintain as a consequence of the system's design. Since the only aggregate alternative to gilts and Treasury bills is sterling deposits remunerated at or near the Bank Rate, cost management becomes the DMO's central task, and the Annex B[21] risk categories should be understood in this light:

Interest Rate Risk

4.2 Annex B.24 and section 2.6 describe interest rate risk as the exposure that arises when new debt is issued. In practice, yields on UK government securities move closely with the Bank Rate, responding to actual or anticipated decisions of the MPC. Since the DMO operates within that framework, its role is not to counter policy changes but to align issuance with them. The component of market pricing that debt management can influence is, therefore, limited to the risk premium, the element that reflects investor preference rather than the underlying opportunity cost.

4.3 A flexible issuance strategy minimises this premium by targeting maturities where investor demand naturally lowers yields. These decisions would be guided by the Bank of England's inflation outlook and the implied trajectory for Bank Rate. When the expected path of Bank Rate is downward, banks tend to exchange settlement balances for longer-maturity gilts to preserve income, while depositors prefer shorter maturities. This produces a Dual Bid effect[22] that strengthens demand in that area of the curve. By adjusting issuance to these preferences rather than following fixed schedules, the DMO can issue at lower yields and limit interest rate exposure, aligning debt operations with monetary conditions in real time.

Refinancing Risk

4.4 Annex B.25 emphasises minimising near-term refinancing risk and avoiding redemption concentrations through a range of maturities. Under the UK's closed sterling system, however, the nature of this risk changes fundamentally. The sterling liabilities held as settlement balances at the Bank of England cannot be withdrawn from the system; they can only be transferred between accounts. When gilts or Treasury bills are redeemed, the proceeds move from public deposit accounts to settlement balances elsewhere on the Bank's balance sheet, and vice versa. In aggregate, capital cannot exit sterling financing, so the issue becomes one of price rather than availability. The only aggregate alternative to holding government securities is to hold sterling deposits, either with commercial banks or at the Bank of England.

4.5 This structure effectively removes the possibility of a "buyers' strike." Since sterling holders cannot exit the system, gilt and Treasury bill yields are anchored by the Bank Rate applied to settlement

[19] Parikh (2025) outlines structural shifts like fixed-rate debt dominance, service sector growth, and intangible asset investments that weaken and delay monetary policy transmission in advanced economies, reminding us that interest rates are a 'blunt tool' for guiding prices amid long and variable lags.
[20] (HM Treasury 2025a, 35)
[21] (HM Treasury 2025a, 39, B.24-28)
[22] See Appendix A

balances. The Bank of England's administration of the rate and associated balance sheet facilities provides a direct policy lever that determines the relative attractiveness of government debt. Because the policy on settlement balances can be adjusted further, as discussed in recent policy proposals[23,24] and demonstrated during the Covid-19 period[25], aggregate demand for government debt becomes determined by the Bank's monetary policy framework rather than by market sentiment.

4.6 The DMO can therefore use Treasury bills as a flexible buffer to manage the gilt maturity profile. Because yield-seeking investors have no aggregate alternative to sterling assets, persistent demand across the maturity curve is assured. A demand-driven Treasury bill facility, rather than fixed weekly auctions, would allow the DMO to seamlessly absorb short-term financing fluctuations, while providing market participants with a safe, interest-bearing asset and reducing overall costs for the Exchequer.

4.7 The advantage of this flexible buffer is most evident during periods of large redemptions. Index-linked instruments, for example, can generate substantial cash outflows: the July 2024 redemption of the 2½% Index-linked Treasury Stock 2024 required payments of around £20 billion above its nominal value. Such concentrated outflows place strain on a rigid auction schedule, but a demand-responsive Treasury bill facility is specifically designed to absorb these fiscal pressures, maintaining liquidity and stability across the debt portfolio.

Inflation Risk

4.8 Annex B.26 proposes balancing index-linked and conventional gilts to manage inflation risk. In practice, however, index-linked issuance can amplify inflationary pressures. The UK's substantial stock of index-linked debt — about 20% of the gilt portfolio, compared with 5–10% in other G7 countries[26] — ties government interest and redemption costs directly to the Retail Prices Index (RPI). This linkage does not address the supply issues that drive price rises; instead, it institutionalises their effects by transmitting them into higher indexed payments and valuations[27].

4.9 The amplification arises through the compounding mechanism of the dirty price. Both the coupon and the principal are adjusted for inflation, meaning that each uplift increases not only current interest but also the future redemption value. These cumulative adjustments raise market valuations and collateral requirements across the financial system. As RPI rises, the revaluation of index-linked gilts boosts both interest payments and the capital value of the instruments used as security in repo and derivative markets, creating a feedback loop that can compound inflationary episodes.

4.10 Index-linked gilts also have distributional effects. During inflationary periods, holders of index-linked gilts are protected from the real-income losses that burden the wider economy, with the associated costs of protection imposed on the Exchequer. Therefore, HM Treasury should consider a strategic pause in new index-linked gilt issuance to avoid reinforcing inflation, limit regressive transfers, and refocus DMO operations on supporting price stability. Although some investors regard index-linked instruments as essential hedges, their broader effects, including higher fiscal costs, amplified inflation dynamics, and regressive distributional impacts, outweigh these benefits.

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[23] "The technical solution is to introduce a system of tiered interest rates on a bank's reserves balance." (Tucker 2022, §7.5)

[24] (Regulation (EU) 2023/1679 of the European Central Bank of 25 August 2023 Amending Regulation (EU) 2021/378 on the Application of Minimum Reserve Requirements (ECB/2021/1) (ECB/2023/21) 2023)

[25] (HM Treasury 2020)

[26] According to the DMO's end-of-year data for March 2025, index-linked gilts account for 23.1% of the total gilt portfolio (£631.5 billion out of £2,735.6 billion) (HM Treasury 2025b, 54, Table 21). TIPS account for 5.5% of Total Treasury Securities Outstanding in the USA (US Treasury 2025).

[27] "Of course a shortage means that the desired products don't exist. More money just raises prices. When that in turn causes the government to further increase the money available an inflationary spiral has been created. The institutionalisation of this process is called indexing" (Mosler 2013, 70–71)

Liquidity Risk

4.11 Annex B.27 emphasises the need for a deep and liquid market to guarantee sustainable access under all conditions. In practice, however, market access is structurally assured: the only aggregate alternative to gilts and Treasury bills is sterling deposits remunerated at or near the Bank Rate. Liquidity risk is therefore best managed by aligning issuance with investor preferences, such as through a permanent open auction mechanism. This approach supports smoother borrowing by harnessing captive demand, rather than by adhering to rigid issuance timetables. While some argue that fixed schedules promote stability, genuine stability is better achieved through flexibility that reflects actual market dynamics.

Execution Risk

4.12 Annex B.28 defines execution risk as the possibility that the DMO cannot sell debt in the planned volume or must do so at a significant discount. Rigid reliance on auctions and syndications, constrained by intermediary balance sheet limits, can heighten this risk. By shifting toward secondary-market dealings, perpetual competitive bids can be secured, and issuance can be aligned with real-time demand. Although cancelling an auction or syndication issue because bids are unacceptable would be politically untenable, adjusting issuance dynamically along the yield curve remains operationally straightforward. This approach improves efficiency, avoids execution failures, and lowers long-term costs for the Exchequer.

5. Solutions and Benefits

Open Issue System: A Dynamic, Demand-Driven Issuance Framework

5.1 To overcome the limitations of the current auction- and syndication-based issuance framework, this section proposes an Open Issue System (OIS), a dynamic, demand-driven approach to gilt and Treasury bill issuance. Under the OIS, all existing issues remain continuously available for reopening. The Debt Management Office (DMO) would create and issue bills and gilts in response to market demand, matching open bids in the secondary market rather than through pre-scheduled auctions or occasional syndications.

5.2 The OIS operates within a sterling monetary framework characterised by ample settlement balances. When government spending exceeds tax receipts, the resulting increase in Bank of England settlement balances prompts their holders to seek higher returns, generating sustained demand for Treasury bills and gilts as the only aggregate option. Because HM Treasury pursues a free-floating exchange rate, sterling holders cannot exit the system in aggregate, and therefore, proceeds from secondary market sales are recycled domestically. When spent, they raise tax revenues and reduce the need for net issuance; when saved, they re-enter the market as bids for government securities.

5.3 Integrating issuance with the secondary market allows the DMO to respond dynamically to genuine demand signals across maturities. This structure ensures consistently strong demand, enabling issuance on favourable terms, minimising yield volatility, and improving operational efficiency compared with fixed schedules.

5.4 Under the OIS, the DMO would supply Treasury bills and gilts continuously in response to market demand, issuing only when bids represent value for money for the Exchequer relative to its base cost of funds and the path of interest rates consistent with the Bank of England’s expected path of inflation.

If advertised prices fall short of this threshold, the DMO would defer issuance until market conditions improve[28].

5.5 Treasury bills should form the foundation of the system, providing a short-term outlet for excess sterling balances. The DMO would meet demand at maturities where value criteria are satisfied and postpone issuance when duration shifts favour overnight holdings, avoiding forced sales and ensuring cost-effective debt placement. The DMO's proven capacity to manage £5.9 trillion in trading turnover during 2024-2025[29] demonstrates its readiness to implement the OIS's demand-driven, high-volume Treasury bill issuance.

5.6 For gilts, issuance under the OIS functions as a short-to-long maturity swap guided by market bids. When investors bid for longer tenors, yields on those instruments fall, enabling the DMO to issue selectively where demand is strongest and prices are favourable relative to Treasury Bills. Gilt issuance thus substitutes for, rather than adds to, bill issuance. In a declining Bank Rate environment, this interaction is likely to activate the Dual Bid Mechanism, further lowering yields and improving the Exchequer's outcomes.

5.7 The existing cash management process, including weekly balancing against short-term funding targets, should be discontinued. In an environment with ample settlement balances remunerated at Bank rate and continuously available Treasury bills and gilts, such balancing provides no operational benefit and creates unnecessary churn. Under the OIS, cash management becomes a byproduct of market interaction: settlement balances fluctuate automatically in response to spending, taxation, and securities issuance.

5.8 Accordingly, HM Treasury should review and update the Key Performance Indicators (KPIs) used to assess the DMO's funding operations. Metrics designed for a scarcity-based framework, such as daily cash neutrality or fixed auction completion, should be replaced with measures that reflect cost efficiency, responsiveness to demand, and contribution to overall market stability.

Benefits of the Open Issue System

5.9 The OIS lowers borrowing costs by removing the DMO's obligation to sell fixed volumes of debt on predetermined dates. Instead of issuing into weak demand and accepting higher yields, as occurred with the 2056 syndication, the DMO can defer issuance until favourable bids emerge. Debt is therefore issued only when market conditions offer value for money for the Exchequer, ensuring borrowing occurs at the lowest attainable risk premium along the yield curve. This shifts the DMO's market position from being a price taker on a fixed quantity of securities to being a price maker on a (transitively) floating quantity, aligning policy more coherently with the stated objective of minimising costs for the Exchequer.

5.10 Continuous, demand-driven issuance replaces the disruptive cadence of periodic auctions and syndications. The DMO can respond to shifts in investor duration preferences in real-time, smoothing movements across maturities and preventing volatility that might otherwise be misinterpreted as a

[28] Deferring issuance implies relaxing the DMO's current weekly-average cash neutrality objective. This could result in the DMA balance diverging from target and more regular use of the Ways and Means II account. As explained by Butler and Clews (1997, 57, §6) the use of a positive buffer balance is operationally identical to an overdraft facility and therefore the stigmatisation of the W&Ms can be questioned. Regardless of which account is affected, however, the cash neutrality objective is operationally redundant in a monetary framework which pays interest on settlement balances. The recommended policy change can be seen as an operationally neutral, pragmatic adaptation to monetary policy which has evolved substantially since the DMO was established.

[29] (Debt Management Office 2025a, 9)

loss of confidence in government policy. Demand-driven issuance stabilises the yield curve and strengthens the credibility of both fiscal and monetary policy signals.

5.11 The OIS optimises borrowing costs across the entire debt portfolio, avoiding the narrow focus of single-issue auction premiums. This narrow metric ignores the lowest available premium on any given day and fails to account for the secondary market demand suppressed by the auction process itself.

5.12 The OIS reinforces the Bank of England's operational framework by working within the yield structure shaped by its inflation outlook and the implied trajectory for Bank Rate. By issuing according to prevailing market demand, the DMO supports monetary stability and avoids the inflationary feedback effects of index-linked issuance. Efficient maturity management ensures that debt operations complement, rather than complicate, the Bank's control of short-term interest rates.

5.13 Lower borrowing costs and more stable yields increase fiscal space, enabling the government to pursue its policy agenda without immediate pressure for tax hikes or spending cuts. The OIS, therefore, positions debt management as an active tool for macroeconomic stability, improving efficiency and resilience within public finances.

Implementation Considerations

5.14 The proposals in this submission are designed as the next logical evolution of the DMO's operational framework, building upon its recent innovations. The introduction of 'Programmatic Gilt Tenders' in 2025-26[30] is a welcome step, providing the DMO with greater flexibility to issue off-the-run gilts in response to market conditions. The OIS extends this principle of flexibility across the full range of issuance, moving from periodic, pre-announced tenders to a continuous, market-driven model that will further enhance efficiency and deliver better value for money.

5.15 Implementing the OIS will require updating DMO operational protocols to enable broader market participation. Enhancements should include real-time market monitoring, integration with retail investment platforms, and systems capable of supporting continuous issuance.

5.16 To improve price discovery and accessibility, the DMO should consider adopting a fully electronic order book, such as the Stock Exchange Electronic Trading Service (SETS), to enable gilts and Treasury bills to trade through wider electronic broker networks with real-time quotes and limit-order functionality, similar to the UK equities market.

5.17 Under the OIS, the exclusive privileges currently granted to Gilt-edged Market Makers (GEMMs) would be phased out. They would continue to serve as key market makers in the secondary market while participating in issuance on equal terms with banks, institutions, and retail investors. This more open structure would broaden participation, retain liquidity without subsidy, and align the gilt market's transparency and competitiveness with other major UK capital markets.

5.18 Transitioning to the OIS would modernise debt management operations, integrating them more closely with contemporary market infrastructure. By embedding issuance within the existing financial ecosystem, the DMO can operate with greater efficiency and responsiveness, reinforcing policy credibility and enabling the government to sustain its objectives even under changing market conditions.

5.19 The proposals outlined in this submission are designed to be implemented within the existing statutory framework. No legislative changes are required. The necessary adjustments to the Debt Management Office's financing remit can be achieved through administrative direction from HM Treasury, drawing on existing statutory authority. Operationally, the proposals would require an

[30] (Debt Management Office 2025b, 5, §2.19 et seq.)

enhancement of the DMO's capacity for real-time market analysis, but they do not necessitate new functions or powers.

5.20 These proposals demonstrate that genuine market confidence arises from operational competence and cost efficiency, not from adherence to rigid conventions or fiscal restraint. By aligning issuance with market demand, the DMO can prevent volatility in 10- and 30-year yields from being misinterpreted as a constraint on fiscal policy, enabling any government to pursue its economic objectives effectively. The Exchequer holds enduring authority to determine issuance terms, and the OIS provides a coherent framework for exercising that authority in a more cost-effective and transparent manner.

5.21 We would welcome the opportunity to discuss these proposals further with HM Treasury.

Appendix A: Technical Descriptions

This appendix provides background on the operational mechanisms underpinning the UK's sterling monetary framework and their significance for debt management. It outlines the institutional relationships and accounting structures that support the analysis in the main text, explaining how government fiscal operations interact with the banking system, the behaviour of settlement balances, and the dynamics of gilt and Treasury bill issuance.

The Captive Sterling Holders Mechanism

A.1.1 This section explains why participants in the UK sterling system, principally banks and financial institutions, are described as "captive". Under the UK's floating exchange rate regime, there is no mechanism for currency conversion: the Bank of England does not redeem sterling for foreign currency, gold, or any other asset. It allows only currency exchange, where its sterling liabilities change hands between participants. As a result, all sterling-denominated balances remain within the Bank's balance sheet framework, forming a closed loop by design.

A.1.2 Settlement balances are sterling deposits held by approved commercial banks in accounts at the Bank of England, used to settle interbank payments. These balances are liabilities of the Bank and can only be transferred between accounts within its Real-Time Gross Settlement (RTGS) system. Even when sterling is exchanged for foreign currency, the transaction involves a transfer of balances from the seller's bank to the buyer's bank, transitively within the RTGS system; the total stock of sterling settlement balances is unchanged. In aggregate, banks must collectively hold these balances, which earn the Bank Rate.

A.1.3 Government fiscal operations interact directly with this closed-loop structure. When the government spends, sterling is transferred from its public deposit accounts at the Bank of England to commercial banks' settlement accounts. When taxes are collected, sterling moves in the opposite direction, from banks' settlement accounts back to the government's accounts. When expenditure exceeds receipts, banks are left with higher aggregate settlement balances, and vice versa.

A.1.4 Banks and their depositors typically seek higher returns than those available on settlement balances or commercial deposits. The Debt Management Office (DMO) provides the only aggregate alternative by exchanging these balances for Treasury bills or gilts, which pay fixed interest. These transactions return settlement balances to public deposit accounts at the Bank of England, closing the loop while allowing non-government participants to hold interest-bearing sterling assets instead of balances at or near the Bank Rate.

A.1.5 Bank of England operations, particularly asset purchases under quantitative easing, have ensured a sustained surplus of settlement balances beyond the DMO's issuance needs. This structural excess guarantees persistent demand for Treasury bills and gilts. When issuance aligns with market maturity preferences, prices rise and yields fall, reflecting the captive position of sterling holders within the monetary system.

Ample Settlement Balances

A.2.1 This section explains how "ample" settlement balances, created through the Bank of England's monetary operations, ensure strong and steady demand for government debt. Ample balances arise when commercial banks hold significantly more funds in their accounts at the Bank of England than are needed for payments or regulatory purposes. The main driver of this condition is the Bank's policy of quantitative easing (QE), under which it purchases assets such as government gilts from private sector holders and credits the settlement accounts of commercial banks with the corresponding sterling payments. These transactions increase the total quantity of settlement balances in the system, leaving banks as a group with more than they require for day-to-day operations.

A.2.2 Because these surplus balances earn only the Bank Rate[31], banks seek higher returns by investing in other sterling assets, including Treasury bills and gilts. This portfolio adjustment creates a continuous and predictable source of demand for government securities. When the DMO issues debt that matches prevailing market maturity preferences, these ample balances are readily exchanged for new instruments, supporting stable market absorption and reducing borrowing costs for the Exchequer.

A.2.3 A similar structure for managing liquidity could apply under an alternative monetary framework where interest on reserves is withdrawn. In such a system, Treasury bills would naturally become the primary sterling safe asset for short-term investment. Their yield would establish the effective floor for overnight interest rates, as banks would prefer to hold T-bills rather than non-interest-bearing balances. The ceiling of this interest rate corridor would be the Bank Rate, made effective through the Bank of England's Short-Term Repo Facility, which provides a lending backstop to the banking system.

A.2.4 This alternative arrangement offers significant operational and fiscal simplification. Since HM Treasury already compensates the Bank of England for interest paid on reserves via the Asset Purchase Facility indemnity, having the DMO issue Treasury bills to absorb excess settlement balances directly would simply remove the Bank as an intermediary in this fiscal transfer[32]. Such an adjustment would streamline the public sector balance sheet, mitigate the perceived fiscal cost of Quantitative Tightening, and create a path for the Debt Management Account to absorb and eliminate the Asset Purchase Facility.

A.2.5 If further incentive were needed, the Bank of England could require that settlement accounts close at a zero balance daily. This operational change would further reinforce the role of Treasury bills and gilts as the primary instruments for commercial banks to manage their liquid assets.

The Dual Bid Mechanism

A.3.1 This section explains the Dual Bid Mechanism, a feature of the UK's closed sterling settlement system in which both banks and their depositors compete for UK government debt. The mechanism arises when policy changes or shifts in economic expectations alter the durations demanded by different investor groups. Banks and the wider fixed-interest investor community then respond differently along the maturity spectrum, creating overlapping demand for similar maturities of gilts and Treasury bills.

A.3.2 When the Bank of England's interest rate is expected to fall, banks seek to protect income by exchanging settlement balances held in their Bank of England accounts for slightly longer-maturity gilts or Treasury bills that offer fixed returns above the anticipated lower Bank Rate. At the same time, changes in government policy can create wider uncertainty, prompting pension funds, insurers, and other fixed-interest investors to shorten the duration of their holdings and seek more liquid, short-term instruments.

A.3.3 Because all payments by depositors and investors are cleared using banks' settlement balances, both banks and the broader investor base may end up bidding for gilts and Treasury bills using the same underlying pool of sterling funds. This overlapping activity produces a Dual Bid effect, where banks and investors compete for securities at the same maturities. By aligning issuance with this temporary concentration of demand, the DMO can issue at lower yields and reduced cost to the Exchequer. The mechanism illustrates how flexible, demand-responsive issuance can exploit these duration shifts within the sterling system to achieve cost-effective results.

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[31] Credited and compounded once every 'maintenance period' which runs from one MPC decision date to the next - every 42 days or so. (Bank of England 2025, 5)

[32] If such a tidying up process affects the 'fiscal rules' parameters, then that would suggest those rules are defective in construction and should be revisited.

Debt Management Dynamics: Price-Taker vs. Price-Maker

A.4.1 This section explains the dynamics of debt issuance under two contrasting approaches: the price-taker model and the price-maker model. In the conventional price-taker approach, a fixed maturity and volume of debt, such as gilts or Treasury bills, is announced in advance and auctioned on a set date. The issuer must accept whatever price the market offers at that moment to meet the pre-determined quantity target, even when market conditions indicate limited appetite for that maturity.

A.4.2 In the price-maker model, sometimes referred to as a price-led framework, the issuer focuses on achieving a target price rather than a fixed volume. Both the maturity and the amount issued can vary to secure cost-effective terms. The DMO sets a minimum acceptable price (or, equivalently, a maximum yield) and proceeds with issuance only if market bids meet or exceed that threshold. If bids fall short, issuance can be deferred or redirected toward maturities showing stronger demand.

A.4.3 Operating as a price-maker links debt management more closely with prevailing monetary conditions. Yields can be benchmarked against the Bank Rate or the Bank of England's forward guidance so that issuance reflects, rather than disrupts, the broader rate environment. When bids are insufficient, funding can instead be maintained through higher balances in commercial banks' settlement accounts at the Bank of England. These balances are remunerated at the Bank Rate, providing a clear trade-off between market-based funding and the predictable cost of settlement balances.

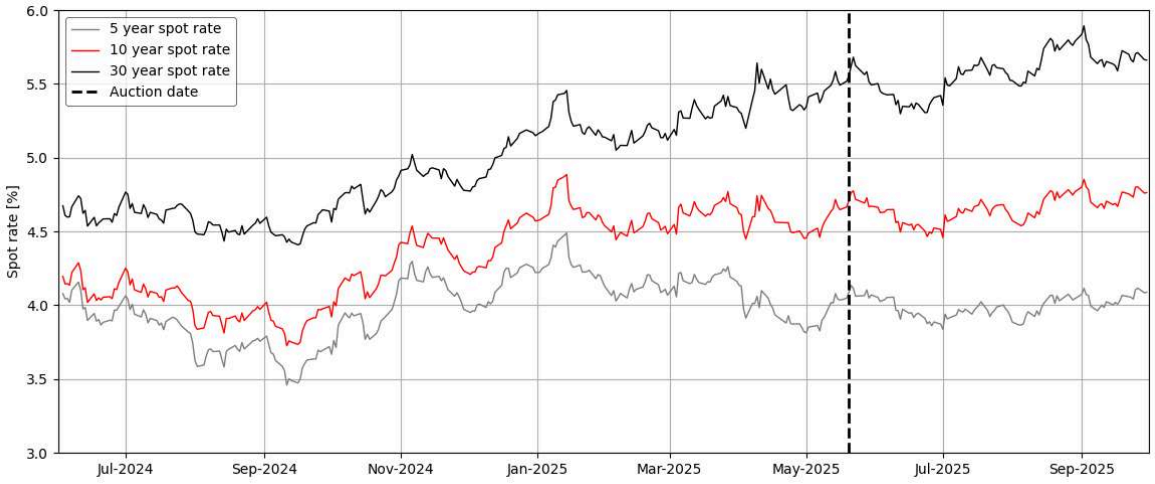
Appendix B: Data Analysis

Interest Cost for 20 May 2025 Gilt issue

B.1.1 The average projected Bank Rate over the next five years (from May 2025) using the OBR's March 2025 forecast is 3.84% (4.0% for 2025-26 and 3.8% for 2026 through to 2030). The yield differential is 5.375% - 3.84% = 1.535%. On a £4 billion nominal amount, this results in an additional cost of £61.4 million per annum.

Yield Charts

Chart 1 - Benchmark Spot Rates April 2024 to October 2025



B.2.1 Charts 2 and 3 illustrate the close relationship between the Bank Rate and the yield on one-month Treasury bills at weekly tender. The correlation coefficient of 0.989 indicates an almost one-to-one co-variation, implying that Treasury bill yields are effectively determined by the Monetary Policy Committee rather than by market forces. On average, one-month bill yields have been about 12 basis points below Bank Rate, as shown in Chart 3. The data cover the period from 2010 to 2025, corresponding to the era of ample central bank settlement balances.

Chart 2 - 1 Month Bill vs Bank Rate 2010 to 2025

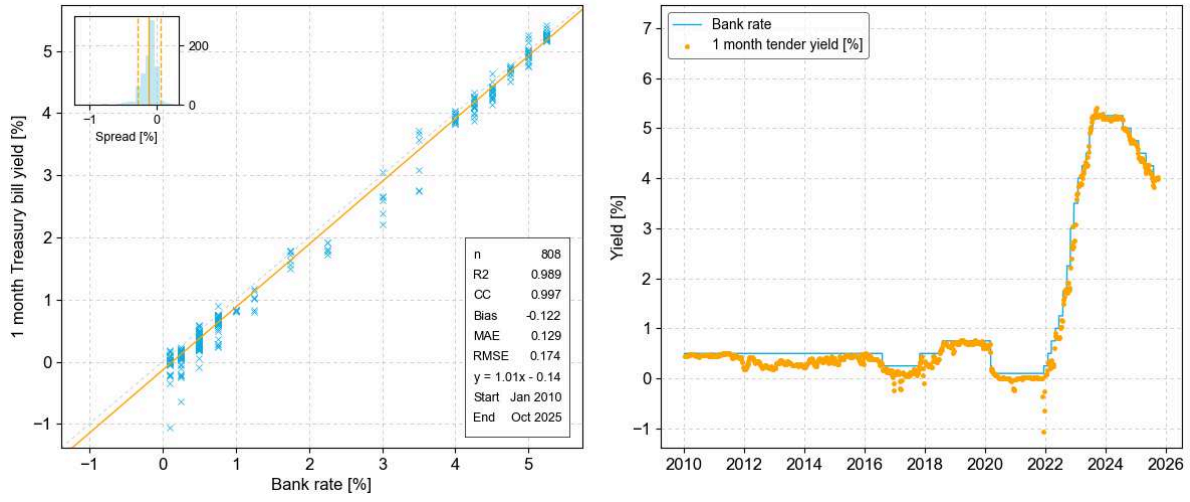
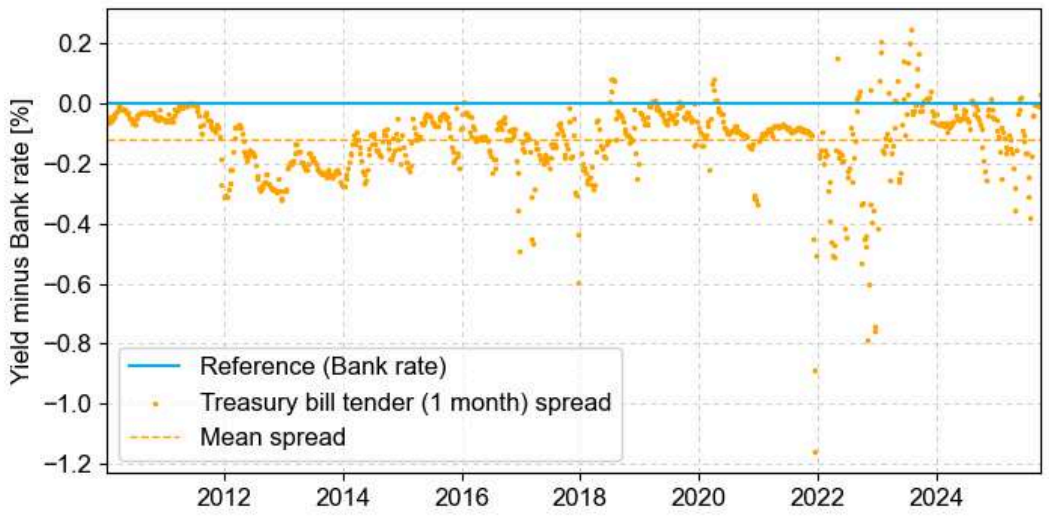


Chart 3 - 1 Month Bill spread over Bank Rate 2010 to 2025



Gilt Interest paid vs Treasury Bill alternative

B.3.1 This section compares the interest costs incurred up to 6 October 2025 on gilts issued since the start of FY 2024 and on or before 8 September 2025—the issue date of the last one-month Treasury bill maturing within the period—with a counterfactual in which the same funds had instead been invested continuously in one-month Treasury bills.

B.3.2 Gilt costs are calculated using accrued coupon payments and amortisation of the issue discount or premium, assuming a constant redemption yield equal to that observed at auction. Equivalent Treasury bill costs are derived from the yields reported at the weekly tender over the same dates. To ensure the comparison favours gilts as much as possible, the Treasury bill scenario compounds all discounts as savings, assuming full reinvestment with no leakages into expenditure.

B.3.3 By contrast, gilt interest payments are more likely to generate such leakages, as coupon income can re-enter spending flows and thereby return to the Exchequer through taxation. For that reason, not all gilt interest would in practice be re-saved into further gilt purchases. In addition, no amortisation has been applied to gilt issues where accrued interest is effectively rolled up until redemption.

B.3.4 Results are shown in Chart 4 and summarised in Table 1. The analysis provides a broad indication of how the duration-shift strategy performs. Gilts with maturities exceeding about 14 years result in a higher cost to the Exchequer than a Treasury bill alternative, while shorter-dated gilts deliver outcomes broadly comparable to, or marginally more favourable than, Treasury bills.

Chart 4 - Percentage change in costs for gilts auctioned between April 2024 and October 2025 relative to a Treasury bill comparator.

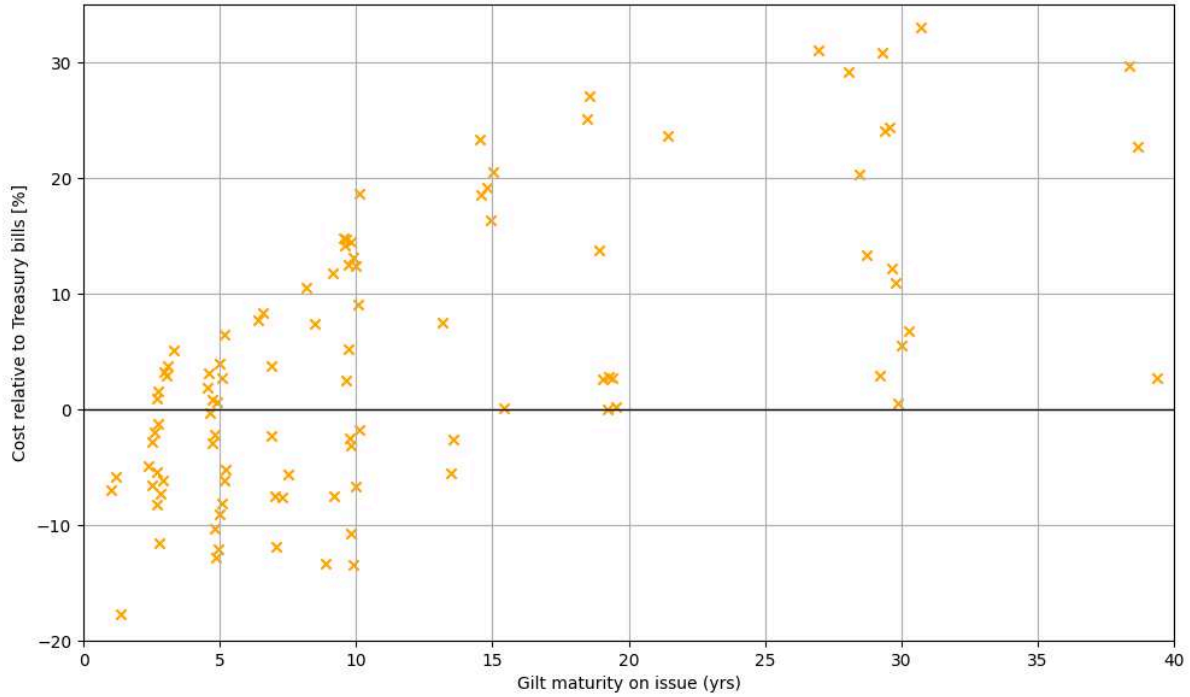


Table 1 - Percentage of auction outcomes which are advantageous compared with a Treasury bill alternative.

Minimum maturity (yrs)	**0**	**1**	**2**	**3**	**5**	**10**	**15**	**20**	**25**	**30**
Number of auctions	101	100	98	85	72	38	28	18	17	6
% exhibiting advantage over T bill	38	37	36	29	26	8	0	0	0	0

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