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# UK Debt Management Office Roundtable

NOVEMBER 2024



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# Agility and reliability in turbulence and transition

The UK's borrowing need over the next year has increased materially, creating a challenge and opportunity for the new CEO of the Debt Management Office to calibrate the best funding channels to deliver cost-effective financing. To discuss how it plans to manage this, together with the changing dynamics of the Gilt market, innovation and risks, *GlobalCapital* convened a roundtable with the DMO, market makers and investors to explore and interrogate these areas.



**GlobalCapital:** Jessica, I'm going to start with you. The Budget has been delivered and the UK has a much increased borrowing requirement. But the UK is not the only sovereign to be doing more. How will the Debt Management Office manage this increased borrowing requirement?

**Jessica Pulay, UK DMO:** First, it is worth reminding ourselves of our initial remit, which was published at the Spring Budget earlier this year. Our original financing programme for this financial year set out total Gilt sales of roughly £265bn. It was then increased, as always happens in April, following the publication of the previous year's cash outturn, so that meant a remit of £277bn.

We decided, as we have for many years in a context where we have elevated financing programmes, to implement a broadly balanced programme across the different maturities of conventional Gilts but with a particular focus on issuing in the short and medium-dated sectors, which for us means one to

seven years in shorts and seven to 15 years in mediums.

We took this approach for several reasons. First, an initial expectation, based on market feedback at the time, that institutional demand for long-dated Gilts was potentially not as strong than in the previous financial year. We also wanted to focus issuance on the most liquid sectors of the market where it's also possible for us to raise more cash for a specific supply event.

Then there were practical considerations around the operational calendar. For example, we were able to schedule somewhat larger-sized auctions in those short and medium maturities than in longs, given the relatively lower supply of risk DV01 to the market for a certain size of transaction at those tenors.

Then at the Autumn Budget, our financing requirement was increased by £22.2bn to a total of £299.9bn, which was broadly in line with market expectations. We decided to implement this via £19.2bn in higher Gilt sales across all maturities and types of Gilt, alongside a £3bn

increase in the sale of Treasury bills for debt management purposes.

It's important to note that we also issue T-bills for cash management purposes and they represent an important instrument in our cash management operations.

Interestingly, over the course of this financial year, we have seen that long-dated demand has actually proven stronger than initially anticipated. There have been a few reasons for this. We have observed that it has manifested itself in a stronger performance at auctions of long-dated conventional Gilts relative to other maturities with an average cover ratio which is higher, but also the average tail is also lower than relevant maturities in short and medium. So the average tail since April has been 0.4 basis points; this is the differential between the average accepted yield and the highest accepted yield.

There has also been very good take-up of our post-auction option facility (PAOF) in long-dated Gilts. This is a facility whereby successful bidders are allowed to purchase an additional 25% of the Gilt that

## Roundtable participants



<b>David Parkinson,</b> head of sterling rates sales, Santander	<b>Ed Russell,</b> head of flow rates trading, Europe, RBC Capital Markets	<b>James Bucknall,</b> head of sterling rates trading, NatWest Markets	<b>Carina Lindberg,</b> head of sterling rates trading, Nomura	<b>Jessica Pulay,</b> chief executive officer, UK Debt Management Office	<b>Megum Muhic,</b> vice-president — rates strategist, RBC Capital Markets	<b>Scott Creed,</b> managing director, head of prudential liquidity management, Lloyds Banking Group	Moderator: <b>Toby Fildes,</b> managing director, GlobalCapital
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they were allotted at the auction at the average accepted price for conventionals or the clearing or strike price for index-linked Gilts. We have seen a significantly higher take-up of PAOF for longs relative to shorts and mediums: over 20% of the auction proceeds.

The final context here is that our long-dated syndicated transactions, have also met with very good subscription. So the average planned size of long syndications was £4.5bn in cash terms. There was a new 15-year Gilt, which was launched in September, and that achieved a size of £8bn; that reflected obviously a sizeable order book but also importantly the quality of the order book and the breadth of the order book, all of which were extremely welcome.

So taking into account all of these factors, we tweaked the maturity structure very modestly at the Autumn Budget. While we increased shorts and mediums as well as inflation-linked (index-linked) Gilts, which reflects our intention to maintain a diversified programme of issuance, we also increased the long proportion modestly.

But it's important to note that we increased it reflecting the PAOF take-up. Auction sizes had decreased because of the PAOF take-up and, separately, we also only had a very small amount in our syndication programme left for long-dated syndications, so that

needed to be rebuilt. Consequently, part of the long proportion was just rebuilding what had already been achieved.

Just to finish, it is worth emphasising that the Gilt market has continued to operate within historical parameters. Obviously we have seen periods of volatility but the Gilt market has been able to respond to these. And so we are on track with our financing programme for this financial year, including post-Budget as well.

**GlobalCapital: David, focusing on maturities, what's behind that slightly better support of the long-end than perhaps was expected?**

**David Parkinson, Santander:** There are a few things behind that but before I get to it, I think what we've seen this year is that the Gilt market has benefited from the strengths of the DMO in terms of this balance between predictability and flexibility. So, in terms of predictability, because people know what's coming when, perhaps a little bit better than they do in a lot of other markets, it means their set-up for auctions and syndications is usually really smooth, whether that's active managers, systematic accounts, or the Street. And we've seen that in the smooth delivery of the auctions.

In terms of flexibility, the unallocated portion, the fact

that the syndication bonds aren't identified at the start of the year, and then making a virtue out of necessity with the autumn remit of dates, means that the DMO can respond to changes in patterns of demand as it goes along.

On the long-end, I think there's been a variety of things. The market has looked at the amount of supply we're getting over the next few years and realised that the bulk of that is not coming in the long-end so it's actually quite a safe place to be. That's one thing. I think the insurers, who we all expected to be big sellers of longs and linkers over the course of the year with the bulk annuity market taking off, have if anything been buyers rather than sellers, so that's helped the long-end.

Then through the lens of some of the international investors, the UK looks like quite an attractive place for political stability. So we've seen some waves of overseas buying, which has specifically targeted the long-end predicated on that argument.

**GlobalCapital: Turning to our investor on this — does any of that ring true for you?**

**Scott Creed, Lloyds Banking Group:** All of it does. I'd say that the long-end has been supported by a lot of cross-market money and money that maybe doesn't necessarily continue to invest in

Gilts in all market conditions, such as a widening of credit spreads. David alluded to the bulk annuity flow that could leave on that move between sovereign and dollar IG corporate spreads, so some of the long-end flow is a little bit more flighty and more cross-market and could leave the Gilt market in a credit spread widening.

**GlobalCapital:** Any further comments from our banks? James?

**James Bucknall, NatWest**

**Markets:** We've certainly observed higher correlations between Gilt yields and global fixed income.

For a long period, the Gilt market was, for international investors in particular, a market which they were perhaps a little reticent to get involved in given that, at least in the long-end of the curve, the presence of the pension fund community and LDI funds in particular, were often seen as price insensitive and so impacting valuations. Gilts just didn't look as attractive in a global context. I think they are now attractive in a global context and we are seeing the demand reflect that.

As already mentioned, that does come with risks around the extent to which those positions are less sticky and, in the event of any fiscal or political uncertainty, might exit. But generally I think you could argue that the Gilt market is in a healthier spot now.

**Carina Lindberg, Nomura:** I

would echo what the others around the table have said. Part of it is the absolute level of yields as well. We definitely see the 5% level attracting domestic and international support, even in the face of higher yields in other countries. Given that we had such a sustained period of lower long-end forwards in the UK, those with maybe a two-year or three-year horizon on interest rates think it is an attractive part of the curve to own and to hold on an outright basis, so that's where a lot of the flows we have seen have come from.

I agree that the European insurance demand for Gilts that we saw really materialise on asset swaps at the start of the year has waned, especially as we see asset swap markets move in European countries. I do think the domestic base is relatively consistent for now. I certainly recognise that the dollar



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*David Parkinson, Santander*

corporate spreads are the key factor that may continue to drive that. But as new deals are written, there is still, at these asset swap levels, demand to hold a certain portion of those Gilts, so I don't see a mass exodus of those positions. Yet, in future there is potential for less support than we're seeing now.

**Ed Russell, RBC Capital**

**Markets:** I think 12 to 18 months ago we had the double whammy of an LDI community that was actively deleveraging following the mini budget in September 2022 and insurers actively selling, switching out of Gilts into other assets. Both factors have waned significantly, so the flow effect is supportive for the long-end now and that certainly fits the flows that we've seen as well.

**GlobalCapital:** We've touched on a few things there that we could probably go into in a bit more detail later. For now, I'm interested to get your thoughts around the role of syndications. It does look like syndications are going to be doing the heavy lifting, certainly since the budget. The first quarter of next year looks particularly busy with potentially three deals between January and March, I think. Value for money is of course paramount but so too is the ability to access markets and do so confidently. Are those two mutually possible together? Does something have to give?

**Parkinson, Santander:** I don't think so. And I'd say a few things on that. First of all, the DMO is always showing itself eager to listen to the market and when we had the

quarterly consultation, the period over which those three syndications will take place, was stretched out a bit which I think is helpful. I think you need to look at the maturity of the syndications that we're getting, it's all in that 10-year to 25-year part of the curve so nothing longer than that.

In DV01 terms, if you look at syndications for the next quarter, they don't look remotely out of the norm over the last four or five years. So, yes, there's a clustering of three events in the space of a couple of months but in DV01 terms it's nothing unusual at all.

And then I guess the very fact that you've chosen to do the syndications in the 10-year to 25-year part of the curve, you're targeting the part of the curve where there's demand. The last thing I'd say about it is that we've seen with the '34s and '40s syndications more overseas investor appetite for the kind of maturities that the DMO is targeting next quarter.

**Lindberg, Nomura:** That's a great point. You may have three syndications but they're three very different investor bases. If you think about who will be the end-user, you're not cannibalising the appetite from one investor base to another by those three different syndications that will be issued next quarter.

And the DV01 point is a very good one as well in terms of the efficiency of the cash raised versus the DV01 released. It doesn't feel like the market should have any difficulty digesting these syndications and actually sometimes the increased frequency of these

events improves the liquidity of the market because they are seen by a variety of investors as entry points or as focal points for activity, so having a few more of these larger events with lower DV01s could actually benefit the day-to-day market interaction.

**Creed, Lloyds:** I would favour the smoother functioning of the Gilt market over ‘value for money.’ Ultimately the value for money will disappear if the smooth functioning of the market doesn’t continue. So a poor syndication or a poor auction is going to diminish value for money on an ongoing basis, rather than just always looking for value for money from a direct primary issuance perspective.

**Bucknall, NatWest:** I think it’s really difficult to define accurately what value for money actually means. And I think it could be a little bit short-sighted to focus on short-term yield movements. Ultimately the syndication process is extremely well understood by the investor community and that didn’t happen overnight. There’s been a huge amount of work by primarily the DMO, but the GEMM community as well, to foster that. And because, as you’ve said, it’s well understood, that reduces the term premium in the market which ultimately is the cost of funding for the government.

So I’m very much in favour of shifting the focus away from the short-term yield movements to the broad understanding and the smoothness of the process.

**Russell, RBC:** I agree with those points. I think I’d flip the question around and say this is really the syndication programme doing

its job. The syndications are the tools that the DMO can use to react more quickly or flexibly to requirements that might come up or market conditions that might change. The alternative is obviously quite significant, changing the auction schedule or the skew of issuance in the auction programme which I don’t think the market would have enjoyed much either.

**Pulay, DMO:** I completely echo the point about the need to have smooth and efficient market functioning for all products and distribution types, including syndications. I think one important point to note is that in the DMO’s remit revision, which was published in October, we didn’t add any new auctions. So the number of auctions remains constant at 77 throughout this fiscal year and obviously we’ve done a very large proportion of those already.

On syndications, we replaced a medium auction with a medium syndication and then we added, instead of that medium auction, a long auction. We undertook four syndications in the first half of this financial year; it is of the utmost importance to us that not only are they of sufficient size to meet our financing requirement but that they also represent value for money for the taxpayer. And I think it’s fair to say that we have done some very successful transactions this year. We are seeing very good breadth of demand from different investors in our syndications.

So at the Autumn Budget we rebuilt this long syndication pot which was essential for us to be able to launch a long syndication of a meaningful size in the next quarter. And two index-linked Gilts are upcoming, one in the very near

term and then we plan another one in the first quarter. As people round the table have observed, the other two syndications of conventionals will attract a diverse group of investors and will also meet the government’s financing needs.

**GlobalCapital:** Just sticking to the topic of syndications, what advantages do they give you? Is it the visibility of the investor base that you quite like as well?

**Pulay, DMO:** They give us a number of advantages. First, the ability to access the market in size at a given supply event. And as noted earlier, these supply events are welcome more generally for the market. But I think direct access to the institutional investor community is also important. And we continue to work very closely with our market stakeholders in designing this programme to ensure that the structure best meets the needs of investors.

**GlobalCapital:** Scott, do you have a preference?

**Creed, Lloyds:** I probably favour slightly fewer events in general. I think there’s probably room to upsize some of these events to reduce the calendar. The balance at the moment is probably the right one.

**GlobalCapital:** We have talked a little bit about the international investor base, but let’s go into it in a bit more depth. Should we expect it to grow from its current base? Carina?

**Lindberg, Nomura:** It’s a very open-ended question. If you look at the growth of issuance over the past few years, especially that focus on shorts and mediums, as Jessica alluded to — at the start of this fiscal year and remit — part of that has been to attract, and has attracted, the international investor base. We continue to see very strong support in those sectors from the international community.

I think this year, specifically, we’ve obviously had growth, most notably through SPIRE repackaging transactions in the European insurance investor base, who have probably been less active in purchasing UK Gilts or linkers since or before the LDI crisis. They

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*Scott Creed, Lloyds Banking Group*



have been a very strong investor base and supporter of Gilts and linkers this year. For this growth to be sustained, especially as we approach a new year, there will need to be more cash allocated.

In terms of growth elsewhere, it will continue to be from cross-market trades as valuations in other countries on a cross-market basis look more or less attractive. However, I think it's difficult given current levels versus the start of the year to see growth in that area right now. But I don't think we've precluded seeing growth in the future given market volatility in general.

**Russell, RBC:** There's been very strong sponsorship, especially in the short end as you might imagine with central bank and official money. There was a latent expectation of that since Brexit Britain was somehow off limits, but you certainly don't see that in the data. We'd argue it's quite the opposite.

At the longer end, as Carina mentioned, we've had large movements in relative asset swap spreads, and credit spreads have moved significantly as well across most regions. The cross-currency basis has been very volatile recently as well, which is a big factor for overseas investors when they're looking at bonds of different flavours.

All of those factors mean that maybe it's a little bit more of a relative valuation story at the moment, but the overall level of sponsorship and support remains very high.

**Parkinson, Santander:** The only thing I'd add is to echo Ed's point about the official institution demand for Gilts. One of the things that people often underestimate is how sticky at least half of the overseas investment in Gilts is. The reserve manager holding of Gilts has survived the GFC, Brexit, Covid, and the Truss mini-budget. It's actually some of the stickiest money in the Gilt market.

**GlobalCapital:** *Jessica, do you have a number in mind, a percentage in mind, between domestic and international holders of Gilts?*

**Pulay, DMO:** We don't have a specific view as to what the right

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*Jessica Pulay, UK Debt Management Office*



composition of Gilt holdings should be and we're very keen to sustain a diverse investor base for many reasons, not least to protect against any sudden shifts in demand.

We have seen strong buying from international investors, but this is a trend which has been taking place over a number of years now. More recently, August 2024 data produced by Bankstats show net cumulative inflows in this fiscal year to date, i.e. since the beginning of April, to total over £27bn. In terms of the overall stock of debt, as tracked by our Office for National Statistics, international investors accounted for around about 30% of the outstanding portfolio as of June 2024.

As has been noted, typically international investors such as official institutions are most likely to focus on the shorter maturities; the feedback that we have received from market participants suggests that these overseas asset allocators are increasingly seeing the UK as a good investment.

It is also important to note, in the context of this discussion, that international investors encompass many different categories. For example, as well as official institutions such as central banks, and global asset managers, a significant proportion of this category consists of pooled LDI funds which might be domiciled abroad and therefore some caution is needed when you are looking at these statistics. Some of these investors perhaps wouldn't typically be defined as true overseas investors.

In terms of how things have changed, you have had a broad range of opinions already around the table, but I do think it's also

perhaps important to underscore the importance of the role of sterling and its continued, and even increased, role as a reserve currency over the past couple of decades. Sterling, and by extension Gilts, now account for 5% to 6% of global reserves, according to IMF COFER data, and up to 8% of major global bond indices. Sterling's role as a reserve currency is very welcome from the DMO's perspective.

**GlobalCapital:** *The LDI crisis was two years ago and is receding in the memory. But has the market plumbing changed enough since then so that we don't have another such crisis again?*

**Russell, RBC:** It's very rare you get the same thing happen twice in a row, in my experience it's usually something slightly different. It's difficult to say that there will never be another crisis. However, there's been an awful lot of work done to address the challenges that were experienced during that particular period. I've mentioned it already but there has been a significant deleveraging process by the LDI funds that were particularly involved in that scenario, part of which was voluntary and part of which has been brought in by regulation.

We know that the Bank of England has announced a repo lender of last resort facility which I think will, once up and running, significantly help with this particular flavour of issue as well. I expect the banks and the dealers have done a lot of work themselves in terms of looking at their balance sheet, looking at the composition of the repo lending book and how their operational processes work to try

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Ed Russell, RBC Capital Markets



and avoid having a similar set of issues occur all at the same time.

It’s hard to say that we’ll never experience any kind of problem, but I think that, overall, the market has done a good job of looking at the set of specific issues that occurred then.

**Bucknall, NatWest:** If you take risk completely out of a market, then it ceases to be a market. And if you’ve got risk in a market, then you’ll have tail risks and all those tail risks are going to look like crises. So there’s always a risk of a crisis in a market.

I think the work that has been done particularly around exchange of collateral and the reduction in leverage for the LDI funds means that I’d agree it’s unlikely that we’ll get another LDI crisis. But I don’t think any amount of changing the plumbing is going to protect the Gilt market or indeed any bond market from a reckless approach to fiscal management from a government. That’s probably the bigger risk.

**Parkinson, Santander:** I would highlight changes under three categories. The first is regulatory. Pension funds now have a requirement to have 250bp of collateral available at all times. Secondly, I think attitudes and risk appetite have changed as well. So 250bp might be the standard, but it’s not uncommon for pension funds to have 600bp of collateral available.

Then thirdly there has been innovation on the buy side, working with investment banks so that LDI is much more likely now to have a corporate bond repo, corporate

bond CSAs, credit collateralised Gilt repo and things like that. And as Ed mentioned, the Bank of England is doing its part, working on a new facility as well. So in terms of a repeat of what we had before, the market is in a much better place. But let’s not have the trigger anymore, let’s hope the lessons are learnt by government.

**Pulay, DMO:** I would say the market is in a very different situation relative to a couple of years ago. As has been noted, leverage ratios have fallen significantly and the LDI buffers have increased compared with a couple of years ago. Of course, one can never be completely certain of anything in the future but certainly these important parameters are in a different place.

And there have also been some other developments, for example from the Bank of England as well as the Pensions Regulator. Earlier this year the Bank of England Financial Policy Committee (FPC) commented that there had been continued progress with the implementation of the resilience standards for these funds, as had been recommended. This is encouraging. The government has also accepted the FPC’s recommendation that the Pension Regulator’s remit should take financial stability considerations into account.

So, as ever, we continue our market monitoring through intelligence gathering, through speaking to our GEMMs and also consulting investors in order that we understand developments in both the primary and secondary markets, which could be relevant to

the DMO and particularly to our operations.

**GlobalCapital:** Now we’ve got a new chief executive of the DMO, how can we expect to see the approach evolving over the coming months and years as a result of the change at the top?

**Pulay, DMO:** It’s obviously a huge privilege for me to have taken over from Robert Stheeman after so many years. I think one of the most important things in this transition has been to demonstrate the DMO’s ongoing commitment to the same predictable, transparent, open approach that we’ve always taken, particularly with respect to engagement with the market, but also to the way that we structure our operations.

I believe that this reassures market stakeholders about the reliability and credibility of not only the DMO but also its approach to the Gilt market.

In terms of our overall objective, the debt management objective, this has not changed. This is to minimise over the long term the cost of meeting the government’s financing needs, taking into account risk, based on the well-established principles which underpin the debt management framework. So again, predictability, transparency and so on.

We also have to assume that the government is going to continue to borrow in a sustainable way over the long term. We are a permanent borrower, if you like, and so that means we have to take decisions with a long-term focus. It also means that as an issuer we need to retain access to the market in all market conditions. Those are very important principles.

It really is an honour to have this position, to work with the talented and experienced teams that we have at the DMO with specialist skills across a range of different areas. This helps to ensure that, no matter what the circumstances, I believe we can build on the successful track record which the DMO has established since its inception more than 25 years ago.

**GlobalCapital:** Let’s move on to the next question. So what do our GEMMs think of workings and architecture around the Gilt market? Do they recommend any aspects of other primary

## dealerships that they could perhaps bring in? How could it be improved?

**Parkinson, Santander:** We'll see but I think the consensus round the table is that things are working pretty well. I doubt if many people are going to be calling for massive wholesale structural changes. There's always going to be preferences in one corner or another for tweaks here and there, bigger operations and fewer operations, more syndications, less syndications. But the basic architecture works pretty well.

One thing that people talk about when they look at some of the other markets is the period for which the post-auction option operates. There are arguments for and against a change in that. But for me, and others might have a different view, the current set-up is delivering the DMO's programme and delivering funding for the government very smoothly and efficiently. We as GEMMs are choosing to operate in that market so we can't have too many objections about the way it works.

**Russell, RBC:** I agree with David. One of the useful things about the way that the DMO operates is that we get a quarterly opportunity to provide this feedback. We know that it gets listened to and there's always the opportunity to have that discussion bilaterally as well, which is welcome.

There's always room to tweak and optimise and adapt to market conditions as they change, which may happen, but at the moment I think we're in a pretty good place.

Yes, you could talk about the number of auctions versus the size. Some people talk about what the optimum benchmark size for a new issue is and the frequency with which we issue new lines rather than reopening of existing ones.

Those are healthy discussions because there is, generally speaking, quite a wide variety of views across the dealer community and certainly across the investor base about what the best structure and set-up would be. Where a clear consensus emerges, the DMO is typically open to hearing it and to acting on it. From previous experience, and where there is no clear consensus, often the best thing to do is just stay where you are.

**Lindberg, Nomura:** I'd echo those points. Predictability and reliability are stalwarts of the DMO and Jessica has embodied that for her whole career there and she and her team do a wonderful job with that.

I agree with your point that actually different parts of the market and different individuals within those parts of the market will have their preferences and actually some will say that this predictability and reliability can come at the expense of flexibility. But actually, that is a positive in the sense that market wishes can evolve very quickly and dramatically and going back and forth with these changes would not be supportive for the issuance programme.

By utilising syndications, that is the point that offers some flexibility and offers the ability to adapt to changing demand dynamics and needs of issuers over the course of the year. They are also important in balancing different objectives, the cash efficiency argument, and the ability to raise the amount needed for the government in the least market impactful way.

So there are a lot of different and competing needs that Jessica and her team face at the moment. And, yes, a lot of work should go into things like the post-auction option facility. I would be in favour of it being extended, but I understand the risks around that and therefore work should go into that, such as thinking about what are the benefits for the government of relaxing something that is clearly a benefit to the buyers of the auctions but not necessarily a clear benefit to the issuer itself. That's the sort of debate that is valid as well.

**Bucknall, NatWest:** I would agree with all those points. The GEMM system works very well. It ensures

that the regular auctions are taken down without any fuss. And as a result of the transparency and the openness, the overall value for money for the taxpayer is increased as costs are reduced.

The DMO has recently shown an increased openness to things like tenders where individual market-makers or a group of market-makers might identify an opportunity for the DMO to save more money by issuing more expensive bonds. The challenge there, and I think it's something that the market still needs to address, is that banks will generally operate a zero-tolerance approach to communications with other banks. So it is increasingly difficult for the market to form a consensus on tenders.

There's the potential for that to be explored because the tenders do form a really valuable part of the market from a market-maker's perspective.

**Pulay, DMO:** Let me perhaps come in on this point. We did want to retain at the Autumn Budget a proportion of so-called unallocated issuance which had not previously been allocated to any particular maturity, type of Gilt or distribution method. Specifically to meet demand for particular bonds, in September, for example, we launched a consultation, following which we issued a tender for a 2026 maturity which had been much in demand from the market. Even this week, we launched a consultation for a reopening of that bond and we will tomorrow be tendering that bond as well.

**GlobalCapital:** How should we expect the linker portion of issuance to evolve?

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*James Bucknall, NatWest Markets*



**Bucknall, NatWest:** From a linker issuance perspective it's been a wild ride over the last 10 years or so. As a proportion of total issuance, in nominal terms, we got up to something like 22%-23%. But in the period after Brexit, in DV01 terms, linker issuance accounted for over 50% of the risk that the market was taking down, predominantly by pension funds.

After that, the Office for Budget Responsibility highlighted that the fiscal risks associated with high levels of inflation-linked Gilt issuance started to come down, but it was the RPI reform consultation which almost forced the market's hand or the DMO's hand to issue fewer linkers. So the proportion has dropped quite considerably to 10%-12% of notional issuance. Interesting that as a result of the level of yields, the risk proportion has dropped to around 20% from 50%.

As to where it goes from here, the linker portion of the Gilt market remains a very important feature of the market. The demand isn't as strong as it was over the last maybe 10 to 15 years but it's still very strong in a global context. Pension funds still want to buy inflation-linked assets and inflation-linked Gilts and the proportion is just about right now.

**Lindberg, Nomura:** There's been a clear move to focus marginal issuance increases potentially more in the short to medium parts of the curve, which has arguably a more diverse investor base.

What's very positive to see is that there are no real scars left from the Truss mini-budget and LDI crisis in terms of both domestic and international support for

linkers. Often it's a fixed amount of linkers that seems to be in demand. The question will be, in periods where demand might re-emerge, how can the DMO react within a year? That's where a syndication is fantastic because either a longer duration bond can be issued or the syndication can be increased in size. That allows the flexibility around the proportion to be adapted quite a bit quicker.

In terms of how we see that evolving, I think we have seen growth in other investors in UK linkers, but I echo James's point — the domestic support remains very robust and that will persist.

**GlobalCapital:** Do you expect the switch from RPI to CPI to affect that at all?

**Lindberg, Nomura:** What the ONS is able to do and what they intend to do around the calculation methodology of RPI is a very well-flagged switch. The market has somewhat priced in that reform to take place over that period, 2030 to 2031. As for how the market responds, investors have had several years to come to terms with this switch.

**Russell, RBC:** I agree. I think the certainty on that point is the helpful thing. We spent a long time with a lack of certainty and years of not really knowing which way it was going to go. Given that we can now be almost certain that we are going to have this reform in 2030, and obviously everything forward of then is already a CPIH flow by definition, that is very helpful for the market.

**Parkinson, Santander:** On the wider point about how index-linked

issuance will develop, one of the things we've seen is that pension funds' hedging ratios are very mature now. But now that they have immunised that macro risk, they're paying much more attention to their micro risks, so the DMO is very diligently helping them with that by filling in gaps on the linker curve. And I see that next quarter we've got a new seasonality line being opened up, which — I don't know for certain, but I suspect — is part of that same strategy.

**Pulay, DMO:** You may not all remember this, but the UK was the first issuer of index-linked bonds in the world in 1981. This class of instruments has become a mainstream product for us. It is widely traded, including on a cross-market basis. So the larger share of linkers that we have in our portfolio reflects — and it is a somewhat larger share than certain other comparable countries — the unique structure of the pension fund industry here where these funds have had particularly strong demand for index-linked Gilts to match their liabilities.

It is important, though, to note that to determine the proportion of index-linked Gilts that we issue every year, we analyse the relative cost-effectiveness of linkers in comparison with equivalent maturity conventional Gilts, under a range of different scenarios. And we look at breakeven inflation rates and see how they're evolving.

It's also important to note that having issued linkers, we have been able to generate quite significant cost savings over time for the UK taxpayer. At the DMO we've conducted some analysis that the government generated direct savings for all those index-linked Gilts issued since 1981 but have now matured. The sums were significant: in 2023 terms, £158bn for those linkers that have matured.

**GlobalCapital:** Moving from linkers to green Gilts, which are well and truly established now. Is there scope to evolve issuance and adopt new structures of issuance, for example sustainability-linked bonds? There are a couple of other sovereigns out there that are looking at it and may even press the button going into January. Jessica, starting with you?



**Pulay:** First of all, we haven't ruled out any product at this point, but we have no current plans to issue a new product. Any new instrument would need to satisfy our criteria of achieving value for money for the taxpayer, enjoying strong and sustained demand over the long term, and also being consistent with the government's wider fiscal objectives.

I would highlight that green Gilts are now an established product in our debt management portfolio and I have been particularly pleased to see this. The green Gilt programme has just celebrated its third anniversary. We issued our first green Gilt in 2021: a 2033 maturity which we launched slightly longer than 10 years to roll down the curve and become a 10-year benchmark. This was followed by a 2053 maturity. We have now raised funds of approximately £43bn via green Gilts to date.

Moreover, green Gilts have been fully integrated into the debt management programme via our auction schedule. This was very much an objective of the green Gilt programme when we set out on that journey over three years ago, largely because we wanted to ensure that green Gilts would enjoy the same or similar characteristics in terms of liquidity to our standard Gilts.

We have a green Gilt programme this year of £10bn. We have issued more than £6.8bn so far. We auction them on a regular basis and, to the extent possible, we want to continue to build up the size of the existing lines to encourage liquidity in this sector.

**GlobalCapital:** Is there ever any discussion around looking at perhaps what another sovereign might do, let's say Germany or Denmark, and any alternative structures that they use?

**Pulay, DMO:** When we embarked on the programme, we did obviously take a careful look at what peer issuers were doing in the market. We decided to adopt the approach we did largely because we felt it would meet the investor appetite for liquidity — a recurrent theme we had in our outreach to the investment community — and also ensure distribution to the widest possible investor universe.

*"We believe that the stability of our issuance strategy gives the market certainty including during uncertain times."*

*Jessica Pulay, UK Debt Management Office*



It's important to note that our green Gilts have attracted new investors into the Gilt market who had not previously purchased Gilts.

We also introduced a few innovative features into our green Gilt programme. For instance, alongside our institutional green Gilts, our sister institution National Savings & Investments launched a retail green savings bond through their network. We also incorporated a new expenditure category for biodiversity into our programme, which has been replicated subsequently.

Importantly, we also committed to report on the social co-benefits in addition to the environmental impact of funds raised under the programme. We report regularly on our programme; there's an allocation report every year and we publish an impact report every two years. All of these publications are available on the DMO's website.

**GlobalCapital:** Scott, is there as much demand from where you sit as there was two, three years ago?

**Creed, Lloyds:** It's a good question. I think there will be ongoing demand around the globe for ESG and specifically green sovereign issuance. There is a structural ongoing need for investors to access ESG-type issuance. And I think what the DMO has done over the last three years has been successful.

It's a balance between building up current green Gilts to enhance liquidity. It's then the balance between continuing to build those up and issuing new on-market bonds at some point to make more of a curve in green Gilts. As Jessica

alluded to, the 2033s were issued post-Covid at zero interest rates.

**GlobalCapital:** Do you think investors such as yourselves would like to see a bit more choice around the actual product of ESG?

**Creed, Lloyds:** It depends on the investor type. At the moment one specific type of ESG sovereign issuance is sufficient. Then, as the world evolves over the next few years, it might be for the DMO to continue to branch out.

**Parkinson, Santander:** I've been around long enough to remember a time before the DMO existed. Back when the Bank of England was running things, there were all kinds of different structures: convertible bonds, partly-paid Gilts, things like this. I think the DMO has very much taken the view during the last 25 years that any cost savings by tapping little pots of demand that those kinds of bonds might appeal to would be offset by having a strategy of building deep liquid benchmarks and that would deliver better value for the taxpayer overall.

I think one of the nice things about the green Gilt programme, although it's got its own carve-out within the remit, is that the bonds themselves are vanilla structures. So the green Gilt programme doesn't move the market back to those days of weird and wonderful structures. I'm not an expert on SLBs but I think typically they have features such as coupon step-up structures and things like that. I'm sure it won't be ruled out but to me that would be quite a big decision for the DMO to move away from the vanilla-bond liquid benchmark strategy.

There's plenty of mileage left in the programme. When they were first announced, the DMO promised to build a curve. We've got two bonds now and I'm sure that in the next two or three years there'll be other bonds added to that to build something that looks much more like a green curve.

**GlobalCapital:** We've got a couple more questions. What scope is there for further technological innovation in the Gilt market, such as digi-Gilts?

**Bucknall, NatWest:** The Economic Secretary announced only this week a pilot in this space, so it's clear that there is going to be a future for this in some form. It's also clear that there are some potentially significant benefits for the market. I think for me as a market-maker, I'm keen to look at the risks around these emerging technologies and not get too swept up in the hype cycle that you often see.

One of the features that has been put forward was around instantaneous settlement and the benefits around reducing back-office scale as a result. I think that it can be the case in complex systems like the Gilt market or indeed any fixed income market that certain features provide a certain amount of anti-fragility which actually cushions from shocks.

As an example, if the deposit sector was completely on a distributed ledger, then bank runs might become instantaneous and that's probably not going to be a good thing. There might be controls in place to stop that, but you can see it as a risk. Things happening too fast is often not a good thing and there is some

evidence from the LDI crisis where certain frictions in the settlement system actually generated some resilience to the market and protected asset managers in a lot of cases.

I'm excited about the potential but also keen to think through the risks because there will be risks to these new technologies.

**GlobalCapital:** It's going to require the DMO to work on this, it's going to require the GEMMs to work on it, it's also going to require the investor base to have to move as well. So what are your thoughts?

**Creed, Lloyds:** There is definitely room for it. The world is moving in this direction. We, as a bank, alongside other banks, have worked on a technological Regulated Liability Network, which is innovation within the payments space towards using DLT (distributed ledger technology). There are also a number of innovations going on in the margining space. It does have clear benefits in terms of instantaneous safe settlement and essentially making a much more efficient marketplace from a payments infrastructure perspective.

**Pulay, DMO:** The chancellor announced at the Mansion House dinner speech a few weeks ago that the government intends to launch a pilot digital Gilt instrument, or DIGIT, using DLT. The economic secretary to the Treasury elaborated on this in a written ministerial statement. The objective is to raise money for the UK that tests potential uses of DLT in the debt issuance process.

It is a pilot experimental issuance which will take place in the digital securities sandbox, which was launched this autumn. It will not affect the existing approach to issuing Gilts via the existing debt management programme. The government values the critical role that current infrastructure providers have in supporting the Treasury and the DMO's debt management objectives and these are going to be unchanged by this pilot exercise.

The digital securities sandbox opened for applications in September through which firms can use DLT to create a trade to administer securities while being supervised by the Bank of England and the Financial Conduct Authority. It allows participants to experiment with DLT-based infrastructure in a controlled and monitored setting. This ensures that potential risks can be managed while innovation can be fostered.

We at the DMO are looking forward to engaging with stakeholders, alongside our colleagues in HM Treasury, throughout the design of the pilot in the new year, but it really is important to stress that this is taking place outside our regular Gilt and T-bill programmes.

**GlobalCapital:** The last official question — what contingency plans does the UK DMO have in the event of another severe event that triggers another Covid-style vast increase in borrowing?

**Pulay, DMO:** I mentioned earlier that it's very important for the DMO to be able to maintain access to capital markets in all conditions and at a cost which represents value for money for the UK taxpayer. Our response to an extraordinary exogenous event would largely be dependent on the circumstances in which we and the market found ourselves at the time.

In exceptional circumstances, which we saw during the Covid period, we would potentially look to make operational changes and this would most likely necessitate a larger number of operations. But in deciding that, we would need to liaise closely with our primary dealers to understand demand and market feedback. We would need to schedule operations carefully, as we did during the Covid period.

*"It works well to align the incentives of the primary dealers and the issuer because everybody knows that it's a repeated game"*

**Ed Russell, RBC Capital Markets**



What has never changed, including during the Covid period, is our adherence to the debt management objective, which is long-term cost minimisation. This has served us very well over the years.

We believe that the stability of our issuance strategy gives the market certainty including during uncertain times. It's fair to say that the DMO has successfully navigated turbulent market conditions including large financing requirements and periods of volatility. We have a track record of successfully delivering the remit regardless of circumstances and that's a testament to our people, our longstanding experience, as well as the adaptability and the support of our market stakeholders.

**GlobalCapital:** Markets seem fatigued by all the crises in recent years. Is there a sense in the market, therefore, that what we need is a year or two with no crises so that we can just almost get rid of that fatigue? Are markets, not just Gilts, vulnerable more than ever to this?

**Parkinson, Santander:** I think there's an important distinction to be made between a UK-specific event and a global event. Covid was global, the mini-budget crisis was UK-specific. I'd much rather have neither of those, but I think a UK-specific one would be more of a challenge.

That said, Covid wasn't just a fire drill, it was a live-fire exercise and I think the market and its institutions and participants came through it in really good order. Almost from the start the market adapted to working from home and the other challenges of that period without the supply programme being interrupted, without investment programmes being interrupted. Things worked really well and from there on, the banks adapted and just got better and better at it.

So, yes, we can hope for no big catastrophic events — that would be nice — but I think the fact that we've had a few should actually give some confidence in how adaptable the market is.

**Russell, RBC:** It's a strength of the primary dealer model really. It works well to align the incentives of the primary dealers and the issuer

*"... when things do go wrong, you've got a panel of banks who are long-term committed to the market to provide the resilience"*

*James Bucknall, NatWest Markets*



because everybody knows that it's a repeated game, and you're going to carry on interacting with each other and carry on working together. You just find the best way to get through it, whatever the situation is.

Covid was obviously challenging for everybody, but we found a way. The DMO managed to perform a successful syndication in the midst of the LDI crisis.

One of the things that probably is on our minds a little bit, and which the global regulators are also examining, is where the risks currently sit in financial markets and in what kind of institutions. For instance, the risks that sit in the so-called shadow banking system or the slightly less regulated areas of markets are being examined for what that means for future episodes.

**Lindberg, Nomura:** Crises are almost impossible to avoid, especially the correlation of the different bond markets with central-bank price action and activities, either raising or lowering rates, as well as the investor base having a much more global focus.

Historically, you had a very domestic-focused LDI-driven investor base. There is now greater activity of both domestic and international investors looking at Gilts on a cross-market basis, which means that trouble in another bond market can lead to volatility in another.

So far, there has been no UK-specific crises this year. But there has been what could be deemed crises or sharp volatility events in other markets, and the UK bond market has navigated that very well, as has the primary

dealership set-up. So we can have a lot of confidence around the fact that we've had a global crisis, we've had a domestic crisis, and actually the regulated institutions are now in a much better place to navigate future crises.

Shadow banking or shadow leverage is a really important risk. It was important in 2020, in 2022, and continues to be. In addition, the cross-asset focus, which can lead to contagion, also needs to be examined. Overall, though, I'm very happy to see how the UK market participants have navigated these so far.

**Bucknall, NatWest:** I completely agree with all of that. I've already said how I believe the primary dealer model offers value for money through the smooth workings of the market. But even if it didn't, it, at the very least, provides an insurance policy such that when things do go wrong, you've got a panel of banks who are long-term committed to the market to provide the resilience.

**Creed, Lloyds:** 100% agree with everything. Banks are very well capitalised, very liquid and very well risk-managed now. The next crisis is more likely to come from within the shadow banking sector.

The scale of the next crisis is probably twofold. Is it idiosyncratic — how are our peer countries being impacted? And what is the central bank intervention like? We've seen intervention from the Central Bank over the last three or four big events. We're now obviously going through a period of QT. What is the appetite for more intervention during the next crisis? GC