

# Treasury Committee

## Oral evidence: [Debt Management Office Annual Report and Accounts 2013-14](#), HC 761

Wednesday 29 October 2014

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Members present: Mr Andrew Tyrie (Chair); Steve Baker, Mark Garnier, Jesse Norman, Alok Sharma, John Thurso.

### Questions 1-84

*Witnesses:* **Robert Stheeman**, Chief Executive, Debt Management Office, **Jo Whelan**, Deputy Chief Executive and Co-Head of Policy and Markets, Debt Management Office, and **Jim Juffs**, Chief Operating Officer, Debt Management Office, gave evidence.

**Q1 Chair:** Good afternoon, Mr Stheeman, and welcome, Jo Whelan and Jim Juffs. Didn't you come last time without any women or did you have women then?

**Robert Stheeman:** Last time I appeared with my DMO colleagues, you saw exactly the same colleagues as we do here. The last time I came in front of the Committee was in your inquiry into QE and I came with Paul Fisher.

**Q2 Chair:** That is quite right. We have been keeping a close eye on anything you say, of course, Mr Stheeman, and in an interview in March it was reported that you had said that, while only the Bank can decide when to start selling its QE stockpile, the best approach would be just to let some of the gilts mature without reinvesting the proceeds. Is that still your view?

**Robert Stheeman:** I am not sure I phrased it exactly in those terms. It was suggested that I said that. What I certainly felt was that—

**Chair:** I will not hammer away but, anyway, it is pretty close?

**Robert Stheeman:** Pretty close. Quite objectively, that view, which is one that I hold, echoes the view that the Bank itself and MPC members have stated publicly, namely that bank rate is their preferred initial instrument in terms of any monetary policy tightening. That obviously does not preclude sales of the gilts they have accumulated through QE, but initially their focus, they have said clearly to the market and to the whole world, is bank rate.

**Q3 Chair:** You and they will have different objectives when there are two major players selling into the market. That is correct, isn't it? You are going to be, as you always are, trying to get the best value and they are going to be thinking about the effect this has on monetary policy, which is no concern of yours, at least not directly.

**Robert Stheeman:** Yes.

**Chair:** Therefore, it is highly likely that at times they are going to want to offload stock that will be inconvenient for you.

**Robert Stheeman:** It may not necessarily be inconvenient as long as their operations do not clash with ours but, again, the Bank has been quite explicit and said that they want to co-ordinate the sales. They want to make any possible sales occur in a programmatic fashion and they have been explicit on that. Perhaps I can just make one comment in relation to this. Clearly, at the beginning of each year when we are given our remit, we set out in advance how much we intend to borrow and we describe what we intend to borrow. We pull that into a few major categories: short, medium, long, conventional gilts and inflationary gilts. The whole market knows a year in advance approximately what we are going to issue and how we are going to issue. That is the way debt management is conducted. When the Bank comes, potentially, to selling any QE, their approach is a different one. Their time horizon is potentially also going to be a different one.

**Chair:** Shorter.

**Robert Stheeman:** Shorter.

**Chair:** Much shorter.

**Robert Stheeman:** Potentially much shorter.

**Chair:** Just to make clear for people watching this, yes.

**Robert Stheeman:** Absolutely. That is quite legitimate from the perspective of monetary policy implementation, but I do not necessarily believe that they would have an obvious interest in selling rather a lot of gilts in a relatively short time to significantly affect the level of yields in a very dramatic fashion.

**Q4 Chair:** That sentence began with "I do not necessarily believe", but circumstances may change and you might find yourself being forced to believe that is what is going on.

**Robert Stheeman:** Possibly. When you say "circumstances may change", it probably is worth thinking what sort of circumstances those might be. The Bank itself, by its own description, has described QE as unconventional monetary policy easing. Presumably, the flipside of that, selling any gilts, would be unconventional monetary policy tightening. I am not an expert on monetary policy and it is not for me to comment in any detail on what the Bank should or should not do. I would just say, as an observation, I find it quite hard to imagine a world in which the Bank would want to engage in such unconventional monetary policy tightening unless we were faced with rampant inflation or whatever reason that the Bank thinks this is absolutely necessary to tighten monetary policy conditions to such an extent that it would potentially cause a very sharp move up in yields.

Where am I coming out on this? I think that when the Bank decides that it wants to sell any gilts, it will do exactly as it has said.

**Q5 Chair:** You are painting this rather extreme view of this very sharp rise. Between where we are now and then there is a spectrum of possibilities, which are going to make your life more difficult.

**Robert Stheeman:** They may do.

**Chair:** They could do. Perhaps I should ask you directly. What mechanisms are in place for thinking through how to mitigate those problems?

**Robert Stheeman:** It goes back to the point that the Bank will presumably—if it does not want to do this rather dramatic scenario that I have deliberately described—if it wants to see yields rise in a moderate and orderly fashion, do exactly what we do with debt management policy, which is to draw up a programme of sales and ensure the gilts are sold—

**Q6 Chair:** Have you discussed this with the MPC or with the Bank?

**Robert Stheeman:** We have talked in very general terms. Over the years, since QE has been initiated, we have talked to the Bank about the possibility of that, but the notion of programmatic sales is clearly one, and you can see that from what the Bank has said in public, that they have bought into. They see the value of that. The Bank understands that they have a vested interest in working with the market so as not to have this disruptive effect. The scenario I have been trying to paint is to try to describe why the Bank, in my view, is unlikely to do anything other than proceed pretty cautiously unless we have this extreme scenario.

**Q7 Chair:** What I am trying to get you to talk about is not a moment at which things become very disrupted. I am trying to probe you on what arrangements are already being considered or should be considered to be put in place to deal with those circumstances short of that, which are quite likely. It sounds as if there has not been much discussion about that or, if there has been discussion, it is certainly well short of thinking through a hypothetical programme or a hypothetical set of principles that should be followed in order to try to mitigate the risk of disruption of the market. Am I right?

**Robert Stheeman:** We have discussed at a high level exactly what you have just said, a hypothetical scenario, but the last time that happened was, I think it is probably fair to say, several years ago. It is my firm belief that the Bank, for obvious reasons, is most likely and would want to talk to us in private, when that moment that the MPC deems it necessary, about the operational implications and what would be the best way to go about doing this. You have to understand that each time it thinks about this it will be operating in a different market environment to the one that might have thought existed two or three or four years ago, for instance. I would also make another point that, in theory, the Bank would be tightening monetary policy in a modest way—not in the dramatic way that I hinted at earlier, but in a modest way—presumably when we have significant growth in the economy, which should, in theory, also mean that the borrowing requirement of

Government itself should decline from the very high levels that we have seen in recent years.

**Q8 Chair:** You are not giving Parliament the sort of reassurance that perhaps some will feel we need. You are saying, “Well, don’t worry, there will be some growth and, don’t worry, they are already aware of these problems and, don’t worry, they will see that it would be crazy to shake the market to its foundations by offloading heaps of QE just at the moment when you are also trying to offload some stuff and yields are rising.” I am trying to discuss a scenario that seems quite likely, which is that they are just going to be wanting to use some reversal of QE as part of monetary policy and that that, to some degree, is going to get in the way of what you are doing. I am asking you, do you have something in place as a set of arrangements already for thinking about how to handle that state of affairs? What are those arrangements? If you are not able to tell me, might it not be a good idea to have a discussion with the Bank about it and come back to us?

**Robert Stheeman:** We can certainly do that and obviously we will, as we have done, continue to have ongoing discussions. By necessity, those discussions will have to take place in light of prevailing market conditions at the time. I suppose what I am saying is for us to have, together with the Bank, a hard and fast set of rules as to how they might want to go about doing this, to design those rules without knowing what market conditions would be like at the time is pretty hard. That is why the discussions that we have had so far, because they have not been that close to doing this, have been of perhaps a more general nature. I have no doubt that when we get closer they will, by necessity, have to become more specific.

**Q9 Chair:** They are operationally independent with respect to QE—aren’t they?—by virtue of memorandums of understanding but they could be withdrawn. Has any work been done at all in the DMO towards thinking, “Well, if they were to get in our way or if we were to find our job made materially much more difficult we might—after all we are an executive agency of the Treasury—go to the Chancellor and say, ‘Will you review the MoUs’”.

**Robert Stheeman:** That option always exists for us in extremis if we felt it was necessary. You are absolutely right; we are part of the Treasury and one of our mandates from the Treasury is to ensure that we keep Treasury colleagues fully informed about market conditions at all times. If we felt that certain things, as a result of actions by the authorities, by the Bank or anyone else, were potentially so disruptive to market conditions I can assure you we would speak to the Treasury about that and to Ministers if necessary.

**Q10 Chair:** I would like to look at the flipside to the benefit of your being part of the Treasury and just check out whether your own operational autonomy is at a sufficiently developed level. There was a framework document between the DMO and the Treasury published in 2005.

**Robert Stheeman:** Yes.

**Q11 Chair:** That is a decade ago. It sounds as if it is something that might need a bit of brushing up. Has that been examined?

**Robert Stheeman:** We have not talked about it in any great detail recently. You are absolutely right. This followed a review in 2004. The DMO was set up in 1998 and was given an original framework document. In 2005, it was decided to go through that and to check that everything was as it should be. The framework document is a relatively high-level document. It covers many things. An agent is always quite keen at times to be as independent as possible, but I am both realistic and also acknowledging of the fact that ultimately it is the Treasury's debt that we manage and I both accept and respect that.

I think it is very important that certain aspects of our independence are well supported by the framework document and that is indeed the case. Those aspects mean that, yes, we will always discuss with Treasury colleagues the advice that we think the Treasury should be receiving, but we always have the possibility—I have mentioned this to the Committee before—if necessary, of escalating any issues directly to Ministers if we felt it was important that they got a view directly and explicitly from the DMO that they were not necessarily getting or were getting an alternative view from the Treasury.

**Q12 Chair:** What would you do if you did not get any change out of the Chancellor?

**Robert Stheeman:** We are part of the Treasury. We are civil servants and it is the Chancellor to whom we are accountable. Ultimately, I serve the Government of the day.

**Q13 Chair:** Do you, like a senior civil servant, ask for an instruction?

**Robert Stheeman:** If there was a question of value for money, that indeed is an option that is open to me as an accounting officer. That absolutely exists. I am very conscious that our independence is one within a framework where we are there to serve the Government of the day. We do not enjoy the sort of statutory independence that the Bank itself enjoys.

**Q14 Chair:** In the time that you have been at the DMO have you encountered any political interference of any type?

**Robert Stheeman:** Political interest is probably how I would describe it.

**Q15 Chair:** That itself is a very interesting remark. I think you had better develop that a little.

**Robert Stheeman:** I can give two examples because I think the word “interest” is an appropriate one. The first is related to an event that has happened within the last 12 months. You would probably be aware that we have issued an Islamic bond. That was a ministerial initiative. That was not a proposal that came from us or would come naturally from the DMO, which has focused this year on selling £127 billion in gilts. In relative terms, the Islamic bond was a very small transaction.

**Q16 Chair:** Is it not the case that you had already looked at this earlier and decided you were not very keen on it, and a new Minister appeared and he was very keen on it?

**Robert Stheeman:** Indeed, and I think that is entirely legitimate. Again, we serve the Government of the day and it was our role to try and facilitate that. I suppose that is what I

mean by political interest. An Islamic bond is not an obvious thing for us to have pursued without that political initiative behind us.

**Q17 Chair:** But you did not feel that that in any way conflicted with your value for money—

**Robert Stheeman:** We looked, as did Treasury colleagues, very closely at the issue of value for money, but, in the end, it was decided, also by the Permanent Secretary of the Treasury, that the wider value for money benefits of sukuk, Islamic bond issuance outweighed the potential costs. I tip my hat here to Ministers because I would note that the actual price of the transaction, when it was finally done, was effectively exactly flat to the cost that we pay for gilts in five years. That is pretty impressive and I do not believe I am revealing something that I should not, but Ministers had been confident that that might indeed be the case. They were proven right.

**Q18 Chair:** The other episode?

**Robert Stheeman:** The other episode is the most recent one. It is not directly one that we have been involved in, which is the renminbi bond that the Bank of England, as the reserves manager of the Government, has done. Again, to me, those sorts of transactions where you see issuance done for reasons other than pure debt management—very valid and legitimate reasons but not reasons that we would have done—that is what I mean with political interest.

May I pick up one point that you mentioned on the independence question? We do have it firmly enshrined in the framework document, but one area where I do feel it is extremely important that we have a level of independence is for us to be able to manage operationally the DMO and our own affairs. That means managing the operations as we see fit. It means, for instance, that we have full control over our internal policies, over HR, but also, critically, over something such as the audit function. I just mention that because there is always within central Government a constant push towards centralising some of these functions that, in some cases, are viewed as central services. In some cases, I would argue that they are integral to the business that we do.

We are an operational entity that has to deal with very significant amounts of money, and for me to be able to have the assurances that I need that those operations are carried out correctly, I need to have the control framework in place and have certain functions such as risk, compliance, audit, an HR function that allows me to hire people as necessary, without necessarily always having to follow central guidance. That is a very important part for us.

**Q19 Chair:** Have you been put under pressure to follow centralisation?

**Robert Stheeman:** Occasionally, yes.

**Chair:** You have resisted it?

**Robert Stheeman:** We have resisted it.

**Chair:** Is that at official level of ministerial level?

**Robert Stheeman:** That is official level.

**Q20 Chair:** The document you have protects you adequately from that pressure?

**Robert Stheeman:** So far it has.

**Chair:** It might be appropriate if you put down on a piece of paper how, in your view, that document might better be strengthened in order to give you the protection that you think you need on that, together with a further explanation on why the centralisation approach will not work.

**Q21 Steve Baker:** When I look at the review of activities it is a great reminder that this will be the seventh year that you have had to raise over £140 billion. Since the policy is not your fault, thank you for what you have done. I feel sure we would have been in much worse trouble without you. What pressures is it creating for the DMO that you are now in this new form of normal?

**Robert Stheeman:** It is a very reasonable question and I think the most obvious one is perhaps the one I have just hinted at a moment ago, namely, most of all operational pressures. The market has been remarkably resilient. I am very careful now what I say about the market because I do not have any guarantee that it will remain that way in the future, but the market has worked with us and I would go so far as to say perhaps better than I could have hoped. The first few years I was in the DMO, we were borrowing £30 billion, £40 million, £50 billion. Then, as you know, we jumped in 2008-09 from about £60 billion to over £140 billion; the following year, £227 billion. It seems to be almost the norm now, that we are doing more than £100 billion annual gilt remits every year.

The consequence of that is we have to hold many more auctions. The consequence of that is not just on the auction front but the cash management function, which is not often seen, has played a much greater role in an ever more difficult and, at times, illiquid money market. It has put a not-inconsiderable strain on the operational side of the office, which my colleague Jim Juffs runs, but also on staff who have to not just run the operations but sometimes transact the operations, colleagues who have to the run the whole of the auction programme. We have had to try and automate processes as much as possible and we have, to a certain extent, over the years been successful in doing that. Immediately pre-crisis, we used to have all auctions conducted through telephone bidding. Fortunately for us, we were able to implement, just before the crisis hit and the borrowing requirement rose, an electronic bidding system. That has made it much more straightforward; also better for the market, quicker for the market, for us to be able to get this thing done.

**Q22 Steve Baker:** Thank you. I would not want to spend very much time on this particular point but that automated bidding system was that developed in-house or was it brought in from somewhere else?

**Robert Stheeman:** It is a platform that is developed—and we use it—from Bloomberg.

**Q23 Steve Baker:** I was hoping to find a Government software development success story, but evidently not. I believe the strategy for the programme is written by Ms Whelan, is that right?

**Jo Whelan:** No, it is very much a joint effort.

**Q24 Steve Baker:** I understand you have previously come from the Bank of England where you were doing reserves management. Could you just explain how you have seen strategy change and how has your Bank of England experience informed the strategy it has formed?

**Jo Whelan:** The Bank of England experience is quite a long time ago now and it was, in terms of managing the asset management side of the reserves, so that just gave me some live experience of what it is like operating in the market as an investor, which is helpful, but it is not particularly relevant to the strategy that we have on the debt management side.

**Q25 Steve Baker:** I will try to tease out why I am asking that. Why do you think it is then that the market has been so supportive of the degree of issuance?

**Robert Stheeman:** In my opinion, the nature of the market has changed fundamentally. I have been at the DMO now for nearly 12 years. When I joined the entire gilt portfolio was worth approximately £300 billion. It is now £1.4 trillion. It is a much bigger market. It is deeper than it was. It is more liquid than it used to be. Perversely one of the benefits—and I put that in inverted commas—of greater issuance has meant that we have been able to provide liquidity ourselves and liquidity events to the market in parts of the curve where previously, when we had much smaller borrowing requirements, we were not. For instance, there were a number of years in the first part of this century when we did not issue anything less than 15 years maturity. That meant that there was very little market liquidity at the short end of the market. Without liquidity, you do not have the ability to access the market regularly. In a very strange, almost perverse way, greater issuance has led to a better functioning market. That is just one aspect. That is not the only thing that has done it. We also, I think it is very fair to say, have more market makers than we used to. Market makers are key to what we do.

**Q26 Steve Baker:** With that in mind, what is the role of the Bank of England as a market maker?

**Robert Stheeman:** The Bank of England is not a market maker of gilts.

**Steve Baker:** In the sense that the Bank bought so many bonds.

**Robert Stheeman:** The Bank of England absolutely during QE played a fundamental role. We were on one side of the market; the Bank was on the other side. It is very reasonable to say that their presence in the market at that time enabled an equilibrium in terms of buying and selling some of the bigger picture in the market to establish itself, which otherwise might not have been there.

**Q27 Steve Baker:** What I am driving at is Andy Haldane famously came before the Committee and said that the Bank had deliberately blown the biggest bond market bubble in

history. The Governor, when he was last before the Committee—and I was on it—he said that we still had extraordinary if not emergency monetary policy. What I am wondering is the extent to which the market is behaving as it is precisely because the market has expectations that the central bank would step in if necessary. Do you think there is an argument for that?

**Jo Whelan:** I am not sure. Looking back over the longer term and thinking about the strategy, there has been a very big increase in the amount of interest in holding the asset, so we have had a lot of increase from overseas holders, and that is reflecting the fact that developing countries reserves have gone up enormously and they have been looking for reserve assets to hold, so a large proportion of that has gone into gilts. We have also seen a big weight of flow from the pensions industry. Those factors are very much at play and the Bank is obviously a large part of the market at the moment, but it is just part of a very diverse pool of interest.

**Q28 Steve Baker:** Do you think the market could become saturated?

**Robert Stheeman:** In terms of Government issuance?

**Steve Baker:** Yes.

**Robert Stheeman:** Government issuance is, to a certain extent, what keeps the market going. Jo made a very valid point, which is that the Bank of England is clearly, through the APF, the biggest single participant now in the gilt market and has been for a number of years. But of course as long as QE has been on hold, as it has, for the last two years now, in relative terms that has begun to decline slightly because of course our issuance has continued. Without predicting where APF holdings will go from here, it is not unreasonable to imagine that over time their importance will decline as our issuance continues.

**Q29 Steve Baker:** So QE is only one aspect of the programme of monetary activism that is being pursued. To what extent are the other aspects of monetary activism, like funding for lending, relevant to your work?

**Jo Whelan:** We do provide a service to support the funding for lending—

**Steve Baker:** I was thinking not—forgive me for interrupting you—operationally but in terms of market conditions.

**Jo Whelan:** I do not think that that is an enormous factor from our point of view. It is an indirect factor in the sense that it is going towards trying to improve the economic wellbeing of the country as a whole, which in turn will affect the amount that we need to finance. But all of the mechanisms, provided that they respect the good functioning of the market, should allow the rates that we can borrow to move smoothly to whatever the appropriate level is for the wellbeing of the economy as a whole.

**Q30 Steve Baker:** What do you expect will be the effects of reducing issuance on the market? You talked earlier about issuance creating liquidity. Obviously, we would like to reduce the degree of issuance. How would you expect liquidity to change in response to that?

**Robert Stheeman:** That is a very good question. The challenge for us in the DMO will be to design a gilt remit that then focuses on, for instance, key liquidity points in the market.

At the moment, we have the luxury—if that is the right word—of being able to issue completely across the curve, all the way out, up to and including 55 years. Already this year, this current year's gilt remit is £127 billion. That is a very large amount of money, but it is also £100 billion less than what we were doing five years ago at the height of the crisis. That was £227 billion then. Already this year, in the advice that we had to provide to the Treasury, we made it clear that we wanted to focus on key liquidity points, for instance, in building up deep liquid benchmarks in five years, 10 years, 30 years, 50 or 55 years across the board, rather than trying to fill every single spot along the yield curve. Those sorts of choices we are going to have to make in a declining borrowing environment much more. We are going to have to say what is necessary for us in terms of our issuance strategy to ensure the longer term health of the gilt market, which is critical to us being able to borrow for Government.

**Q31 Steve Baker:** What do you see as the great threats to liquidity in your operations?

**Robert Stheeman:** I have said this before, and I will repeat it because I do think it is an issue. Liquidity is about having willing buyers and willing sellers on a regular basis and ideally in all market conditions. That willingness depends, in the model that we operate, on having a market making or we call it a gilt-edge market making model having so-called primary dealers. The primary dealers, the banks, the investment banks, are facing challenges of their own and one of the concerns that I have had is around regulation. Not because I have any sense that regulation is not a good thing, but I am constantly mindful of what I would call the potential unintended consequences of certain regulation if that impacts on market liquidity.

Having said that, Government bonds, in my opinion, are likely to be the last part of, for instance, fixed income markets to suffer from the potential consequences that impact liquidity through regulation, and we have seen that. Liquidity in the market has not been so far negatively affected, but I have previously sent to the Committee a note on certain aspects of regulation, which have given us cause, in some cases, for concern because we are very mindful that we need to have willing market makers. We need to have banks that are willing to make two-way prices to us, as the issuer, and to the investor base, at all times, in order for that market to function. If regulation hampers their ability to do that then that is a concern, and that is something we have spoken to the Treasury about regularly. I have said that before to the Committee.

**Q32 Steve Baker:** Thank you. Just finally from me, how has recent low inflation affected your work?

**Robert Stheeman:** It has enabled us, through no merit of our own, to issue gilts at historically very low levels. You may be aware that at the moment the entire gilt yield curve is below 3% across all maturities. Yesterday, we issued the longest bond that we have in our portfolio, which is a 2068 nominal conventional bond at a yield just below 3%. That is not something that I would have predicted. I am more than happy to say that. That is a consequence of both low inflation and of course monetary policy easing, and it affects globally the world.

**Q33 Alok Sharma:** In the first six months of this fiscal year, we have had an extra borrowing of just over £5 billion. Can you just tell us how this is affecting your work in terms of selling gilts? Also the Treasury's view is that some of the shortfall be made up in terms of income tax receipts at the beginning of the year when people do their year-end returns. Do you have a discussion around that in terms of the ongoing amount that you then have to raise month by month?

**Robert Stheeman:** Certainly we have discussions around that and also about the future, clearly in private, about what the Treasury thinks we may or may not have to borrow. But it is important perhaps to say one thing: we borrow cash and we fund the so-called Central Government Net Cash Requirement, the CGNCR. That figure is given to us and it is what underpins our remit at the time of the Budget. It will be revised only in normal circumstances twice a year: one, when the outturn of the previous year is made known in April, and the other time is at the time of the autumn statement. Any changes that will occur to our borrowing remit flow from those points in time. In other words, what we have borrowed has not changed and our borrowing plans have not changed at all as a result of some of the fiscal developments you describe.

**Q34 Alok Sharma:** What do you expect following the autumn statement?

**Robert Stheeman:** That is obviously something I discuss closely with my colleagues, but the CGNCR is a number that ultimately now comes from the Office for Budget Responsibility.

**Q35 Alok Sharma:** But as part of your planning process clearly you are thinking about this. It is not as if there is the autumn statement and suddenly this figure pops up. This must be an ongoing process.

**Robert Stheeman:** It is ongoing, but there are so many things that go into the cash number. What you have been referring to particularly is effectively the fiscal developments, but sometimes that cash number can be affected by all sorts of things. In the past, you have seen asset sales or asset purchases, which have affected that number, so our focus is—I would not like to say we do not have a focus on the fiscal position, of course we do. It is always the big thing in the background. But we are very wary, given where we sit, about reading too much into the numbers that are made public in terms of fiscal developments because they do not often correlate with how the CGNCR turns out to be.

**Q36 Alok Sharma:** You talk about the fiscal position. What are people in the market telling you about that and how it is turning out? Are you hearing any concerns?

**Robert Stheeman:** Not in significant terms of gilts or gilt market developments, which is the key issue for us. Some analysts, these are mostly GEMM analysts, have suggested—I have seen it said that if anything yields should move higher—but I remember a lot of analysts, a lot of people—and I regretfully include myself—probably felt at the beginning of this year, and said at the beginning of this year, that they would have expected yields to begin to rise. They have not. But everybody was wrong and a lot of people who are paid better than I am were wrong, too.

**Q37 Alok Sharma:** We are six months away from a general election and last time there was a hung parliament, in 2010, it looked as if there would be a period of underperformance in the bond market. How much does the political uncertainty affect your work in terms of planning, particularly for the future?

**Robert Stheeman:** Probably not that much. We have to borrow regardless, whichever Government is in place. The CGNCR has to be funded and one of the roles of the DMO is to ensure that Government is funded every single day. I mentioned the cash management function earlier. The bigger picture of course in the long term it will affect us, but where it can become an issue is if political developments lead to market volatility. That is obviously something you always have an eye on. We cannot do very much about it.

**Q38 Alok Sharma:** No, of course. What are your market contacts telling you about the impact of another potential hung parliament?

**Robert Stheeman:** At this stage, quite genuinely not many people seem to have focused on it. If I may put it this way: the time horizon of the market, the ability to focus on anything beyond a few days, is sometimes rather limited.

**Q39 Alok Sharma:** You said that the market is very deep, it is very liquid. In 2008 or 2009, you were able to raise £227 billion. What is your view that if there was a Government, of whatever political persuasion, which suddenly decided that they wanted to turn the taps on, and were coming to you and asking you to borrow significantly beyond 140—whatever the figure we are now doing—what could the markets take? Let us say whoever happens to be Chancellor comes along and says, “Let us go from 140 to 240, 250”.

**Robert Stheeman:** I can only base that view on past, because it depends entirely on what market conditions. By market conditions I do not just mean yields. It means what I spoke about a moment ago when I talked about the health of the market, willing GEMMs, profitable banks who are willing to take risk positions in what we do. All that is a fundamental part of it. I am not trying to duck the question, but it is now long ago that I can perhaps just mention one small anecdote. I recall back in the days of early 2008 when we had started the financial year with a borrowing requirement that year of approximately just under £60 billion; it was £58.5 billion for the 2007-08 financial year. In early 2008, I sat down with Jo and another colleague, Joanne Perez, because the Treasury indicated to us that we may have to borrow as much as £80 billion. This was at the time of Northern Rock. Indeed, we had to. It was announced at the 2008 Budget that our remit for 2008-09 was going to be £80 billion. Jo may not recall but I remember discussing exactly this question: how much could the market take? At that time, just to show how little I knew, I was of the firm opinion that we could not issue more than £100 billion. That year we ended up issuing £146 billion, and in the next year we had £227 billion. All I am saying is that my view probably is not always that great.

**Q40 Alok Sharma:** Could I just turn very briefly to Scotland? The Committee had a very interesting discussion yesterday about tax implications of further Scottish devolution, but the UK Government has announced that from 2015 Scotland is going to be able to borrow on its own account. Have you had discussions with the Scottish authorities about how they might undertake that borrowing? Before the vote on independence, Moody's were basically saying Scotland would have a lower credit rating than the rest of the UK, so can you give us

some sort of commentary around how it might work and whether you have been involved in any of those discussions?

**Robert Stheeman:** We have not been involved directly nor have we been approached. Of course, our role is to fund the entire UK, which means the United Kingdom central Government, and nobody has discussed so far with us the potential funding-

**Q41 Alok Sharma:** Just to be clear, you have had no discussions with the Westminster Government but no one from—

**Robert Stheeman:** That is correct.

**Q42 Alok Sharma:** No one from the Scottish Government has been in touch with you either?

**Robert Stheeman:** They have not.

**Q43 Alok Sharma:** Would you then expect that there would be a separate body set up in Scotland to do this fundraising and how would you interact with it?

**Robert Stheeman:** The honest answer is I do not know. It is entirely within the Scottish Government's power if they want to set up an office of that nature to do so. It is also equally possible that they may want to suggest that we play a role in that, too. Ultimately, UK Ministers will have to decide whether or not we would do that. But they could easily set up a separate office. They may find that, for whatever reason, desirable to do so.

**Q44 Alok Sharma:** If they were to approach you and the DMO was going to do this fundraising, how do you think a Scottish bond would price in comparison to gilts?

**Robert Stheeman:** You are probably aware there was a consultation that the UK Government, which suggested in terms of the responses that Scottish bonds might have to yield I think it was anything between 30 and 120 basis points, so up to 1.2% more. As recently as the beginning of this month the private sector, Oxford Economics Consultancy, talked about Scottish bonds potentially having to yield 1% more. That will depend on all sorts of things. It will depend on infamous liquidity. It will also depend on the maturity that they might want to choose. They will have to do something that arguably the gilt market already has, which is to build up a track record and one that would be convincing enough for investors. They will also presumably have to get some kind of a rating from the credit rating agencies. All these things would potentially—

**Q45 Alok Sharma:** So do you not find it astonishing that this is something that has been announced—it is live from 2015, some months to go—and no one in either the Westminster Government or from the Scottish Government has been in touch with the DMO to discuss how this might work? Did you not find that amazing?

**Robert Stheeman:** There are lots of things that are quite astonishing and amazing when it comes to Government. I would just say that the amounts under the current proposed rule, the existing rules, they can raise are relatively small—I think between £200 million or

£300 million—for capital investment purposes a year. That is a very small amount in terms of the sort of issuance that we look at annually.

**Alok Sharma:** I thought it was over £2 billion.

**Robert Stheeman:** I think £2.2 billion is the total amount that they needed to raise rather than the annual amount.

**Q46 John Thurso:** Can I just ask a very quick follow up to that question? When you were talking about the yield gap, was that in the circumstance of an independent Scotland or of the actual bonds. A lot of the work that was done was work that was assuming that Scotland was independent and looking for its debt whereas what the 2012 Act enacted was the right for a specific amount of borrowing, much along the lines of any local authority might.

**Robert Stheeman:** Absolutely. I do not want to put a figure on it but even if this was the Scottish Government within the United Kingdom raising money there would be some kind of premium.

**Q47 John Thurso:** Would you expect it to be roughly similar to what local authorities do in their borrowing?

**Robert Stheeman:** Yes.

**John Thurso:** It would be broadly equal to?

**Robert Stheeman:** Logically, it should be because the status of the Scottish Government should not be massively different.

**Q48 John Thurso:** Do you handle all local government borrowing, or do they do some on their own?

**Robert Stheeman:** They can if they choose do some on their own.

**John Thurso:** Some do that?

**Robert Stheeman:** All we do is handle the borrowing that is channelled through the Public Works Loan Board.

**Q49 John Thurso:** That would be quite normal if they went and did their own thing?

**Robert Stheeman:** It would.

**John Thurso:** Thank you very much.

**Chair:** That was very helpful clarification. Jesse has one very quick supplementary.

**Q50 Jesse Norman:** You said they have to have a track record, and unlike some aspects of the gilt market, they do not have any and there would be no existing gilts to be

priced off. The issuance is neither here nor there. £200 million is hardly anything so there will be no liquidity in the bonds, all of which would be pushing yields up and therefore spreads up.

**Robert Stheeman:** Their yields, their spreads.

**Jesse Norman:** Yes.

**Robert Stheeman:** Absolutely. Presumably, they would use the gilt market as the benchmark, the curve over which they price, which would show very clearly and unambiguously what the cost of that process would be compared to borrowing through the National Loans Trust.

**Q51 Jesse Norman:** How much would you require to generate what you would consider proper liquidity in the market and therefore proper pricing? What would the total amount of gilts have to be before you got that?

**Robert Stheeman:** The question behind that is what constitutes a liquid gilt, to which I would say that if you look at what we issue, most individual gilts now we aim to build up to as much as £20-30 billion-plus. The market would probably not regard a gilt that is less than £10 billion as being very liquid.

**Q52 Mark Garnier:** Can I just pull a few threads together you have been talking about recently? You mentioned a little bit earlier—I think it was 2006, 2007—that the funding requirement was £58.5 billion. The following year it was £80 billion. You also mentioned it was £127 billion this year but, I think your words were, people with a higher pay grade than yourself have been getting it completely wrong in terms of the expectation of the yield; yield is much lower than perhaps some people were expecting. What is the conventional wisdom when you have markets is when you have substantial flow of stock, whatever it happens to be, you tend to get a driving down of the price and yet what you are suggesting is something completely the opposite. What is it that is driving gilt prices to go up despite this increasing amount of stock coming through?

**Robert Stheeman:** It is a very good question and perhaps if I can just underline your point. If you look at the average yield of issuance—and we have some numbers that I can probably find on that—the average yield of issuance has, in general, been on a declining path for nearly 15 years now. That decline was at its most marked just when our issuance started to increase dramatically, which is completely counterintuitive. The reason for that is that you would expect normally that supply, and a significant increase in supply, would push prices down and yields up, but of course that ignores the demand side of the equation. The conclusion you can draw from that is that the biggest single factor determining bond yields, in any major developed government bond market, is monetary policy. Of course the big decline in yields that I just referred to occurred around 2008-09, 2009-10. If I can just throw some numbers at you: for instance, 2007-08, the year you mentioned, the average yield at issuance was something like 4.6%. At 2012-13, when the market had more than doubled in size, and our borrowing requirement had tripled, the average yield insurance was 2.66%. What has affected that? The biggest single factor in terms of the cost of our borrowing going forward will be monetary policy expectations.

**Mark Garnier:** Conventional or unconventional?

**Robert Stheeman:** Whatever—both of them together. Not just in the UK but also elsewhere. It is noticeable that our yields have gone down, but they have also gone down across the entire developed world. In particular, at the moment, the eurozone is looking at extraordinarily low yields: 10-year yields in Germany are well below 1% at the moment. This is a global phenomenon.

**Q53 Mark Garnier:** It is, but equally so you have to have a huge amount of confidence. People like PIMCO have to have an enormous amount of confidence in the Government that they are going to start repaying their stuff at some point in the future. Certainly if you look specifically at the UK, it could be down to monetary policy but it also could be down to the fact that there is a huge amount of money that now has the confidence that the UK Government policy is right, and that the Government can repay its debts. As we know, the Government debt market is going to increase to £1.8 trillion, possibly £1.9 trillion, by 2018-19. That is a huge amount of issuance coming through. Add to that the fact that you have £375 billion of quantitative easing, which at some point is going to have to come out of the system, whether it is just allowed to mature or you guys get involved by trading out of it. Then obviously you have the maturities coming through. Your £127 billion this year, about a fifth of that is going to be repaying maturing short gilts, I suspect. This is a guess. So your issuance demand over the next few years is absolutely gigantic and yet the market seems to be perfectly happy with that and confident in what the Government is doing.

**Robert Stheeman:** For the moment, and I am not trying to either suggest that I am worried or suggest that you should get worried, but there is clearly no guarantee at all that the market will continue to deliver both the low level of yields and the sort of pricing that we have seen for our debt ad infinitum in the future. There is absolutely no guarantee. You are right, if I may just say, to mention redemptions. It is something that we are very conscious of. It is worth pointing out that in the financial year 2019-20, we already know now, even without any fiscal forecast that far, that redemptions mean that we are going to be borrowing more than £90 billion that year, just in redemptions. That means we are going to be in business for a little longer.

**Q54 Mark Garnier:** The interesting thing is the Debt Management Report found that short gilts are the most cost-effective way of raising money but your issuing shorts has gone down from 30% in 2012-13 to 25% this year. Is that reflecting the fact that you are trying to manage out these redemptions to be much further and much smoother in the future?

**Robert Stheeman:** Yes. That is exactly right. We have a cost minimisation objective, which logically would suggest that we should borrow as much as possible in the shorter maturities because we have, at the moment, a very steep positive yield curve. It is cheaper to borrow short than it is to borrow long. For many years that was obviously not the case, but once the crisis started the shape of the yield curve changed dramatically. You are right to mention that. With 27% in the current plans in terms of shorts this year, we were doing something like 33%, 34% a few years ago. But it has been recognised, certainly with us and absolutely with colleagues in the Treasury, that the redemption issue and the refinancing issue is a potentially major issue.

Ultimately, good debt management is about balancing costs and risk. That is a judgment to a certain extent. But in the advice that colleagues provide to the Treasury, we try to do that. So we do not stick everything into the short end, we think it is much healthier, both in

terms of management refinancing risk and also the market, to try to spread that out. You may be aware that we have perhaps the advantage that the UK has the longest average maturity in its debt portfolio of any country in the world, and by a wide margin.

**Q55 Mark Garnier:** Thereby, by inference, making our Government debt, certainly from the Government's point of view, the most predictable borrower in terms of the cost of borrowing of all Governments.

**Robert Stheeman:** That depends, I suppose. The cost is defined more likely by monetary policy, but what it does do is that it helps spread or mitigate refinancing risk more than perhaps it would be otherwise. That is something that in the crisis has become a real issue, certainly also for certain other countries. Refinancing risk is something that all sovereign debt managers have to be very mindful of, and they have been forced to become very mindful of it.

If I can just mention the US Government, which enjoys the world's largest most liquid deepest market, at the height of the crisis it had an average maturity in its portfolio of approximately five years, or just under five years. So considerably different.

**Mark Garnier:** What is our average maturity?

**Robert Stheeman:** It is effectively taking all the gilts that we have in our case and just saying what is their maturity. Is it 5, 10—

**Mark Garnier:** What is it now?

**Robert Stheeman:** Sorry, with us it is 15 years, almost exactly 15 years. That does not make us three times better than the US and it does not mean the refinancing risk is mitigated by three times. What it does mean is that perhaps for the gilt market, which does not enjoy this status that the US Treasury market has, which I was just describing, which is not the world's market reserve currency—sterling is not the world's reserve currency—it is perhaps very important for us to consider things such as average maturity because it enables us just to mitigate risk a little bit in that area.

**Q56 Mark Garnier:** Can I just have a look at some of the slightly more esoteric or exotic bonds that we do? Index-linked gilts, they are also found to be generally cost-effective and relative when you look at maturity to conventional gilts. But again this is something that seems to be happening less and less. I think sales are going to be both long and short gilts. Presumably index-linked with inflation down at 1.7% or something now they are again quite attractive, are they not, in terms of being a borrower?

**Robert Stheeman:** That is absolutely right. It is true that they decline somewhat, but in percentage terms what we are doing this year is, in terms of index-linked gilts, it is just over 24%, I believe. In terms of the portfolio itself, it is over 25% in terms of index-linked gilts. What I would say is, yes, it looks very cost-effective in terms of so-called real yields but of course conventional gilts are equally cost-effective on an inflation basis. If you think about it, in real terms, yes, we may be paying for 10-year conventional gilts, at the moment it is about 2.21% to 2% but also for 10-year inflationary gilts it looks on paper nice if we are issuing these at a negative real yield, but in both cases the so-called breakeven implies that it is cheap funding either way, if that makes sense.

**Q57 Mark Garnier:** On the long dated ones, we talked about the 55-year gilts and those seem to be quite successful, so there seems to be an appetite for that and you will continue to meet that appetite as it goes on, which is encouraging. Looking at the even longer dated, the irredeemables, do you have any thoughts about what you would do? I think it is 8 you have at the moment, obviously War Loan is a big one, but if I remember from my days as a blue button on the gilt market, the Consols 2.5 and Daltons and all the rest of it. Do you have any plans as to do anything with those or shall we just carry on trundling on with those?

**Robert Stheeman:** If we had any plans I could not say it in public before the Committee for obvious reasons because—

**Chair:** It was a good try though.

**Robert Stheeman:** But I would like to assure you we keep that under very close review and we talk to the Treasury—

**Q58 Mark Garnier:** But it is a political decision?

**Robert Stheeman:** Absolutely. It is a political decision and just to give you a sense of the sorts of issues that would have to be considered, they are, for instance, how large are these issues? Are they worthwhile keeping? You mentioned the fact the War Loan is significantly larger than the others. It is a perfectly reasonable question for a Government to ask what percentage or what part of its portfolio does it feel it might want to have, for instance, in perpetual or irredeemable debt. But those are issues we discuss very actively with that. Of course when yields are very low those discussions intensify.

**Q59 Mark Garnier:** Just one last question about the final exotic one, we have spoken about Islamic bonds and Scottish bonds, but renminbi bonds? It is a couple of questions to do that and I will package them together. First, this is a Bank of England thing, rather than a Debt Management Office thing, I understand. The first part of the question is, what part did you play in the construction of the issuance? Second, as I understand it with these renminbi bonds, these are not being issued or it is not being issued to pay for a specific UK financing project or whatever it is. Can you ever see a time when the UK would issue non-sterling bonds in order to pay for sterling financing?

**Robert Stheeman:** You are absolutely right; this is something that has been done by the Bank and by the Treasury and we have not been part of that. I have obviously been aware of it and spoken to people about that.

The current policy is to fund the domestic deficit, to fund the UK borrowing requirements in sterling and through sterling. I personally believe that that is a very healthy policy because foreign currency issuance—and this now includes renminbi—by the UK Government is done exclusively to finance the reserves; in other words, to generate foreign currency exposure.

One of the things, in my personal opinion, that the crisis of the last few years has highlighted has been the fact that exposure to foreign currency debt by Governments, unhedged exposure in particular, is not always a very positive thing. The policy that the UK has had there, which it has had certainly for many years, and also under completely different Governments, has stood us in very good stead. It is one that is followed by one or two other

countries: Canada is an example. But not trying to finance the annual borrowing requirement through any other currency than sterling, in my personal opinion, is an extremely sensible and prudent policy.

**Q60 Steve Baker:** You answered some questions about the sukuk earlier, so I only have a couple of things to ask you about. In particular, you have said that interestingly it is not proven easy to find sufficient assets either for bigger size or for a programme of issuance. Where do we stand on finding assets to underwrite a bigger programme of sukuk?

**Robert Stheeman:** At the moment, the Treasury has no current plans to do any further issuance, but on the point that you have just mentioned, that is absolutely right. One of the reasons why the size of the £200 million issue was only £200 million, which was probably the bare minimum that we would have felt, and Ministers would have felt, was adequate either to make the symbolic statement that sukuk was or to have something of an asset for those investors that wanted to have it. One of the key factors of that was there was simply not enough. Government does not own very many tangible and also what have to be determined as so-called Sharia or Islamic-compliant assets.

**Q61 Steve Baker:** Could you just flesh out what is a Sharia-compliant asset that might underlie such an—

**Robert Stheeman:** A Sharia-compliant asset is one that is deemed as such by a so-called Islamic scholar, and I have to be a bit careful because my knowledge of Sharia law is very limited. But it means that the underlying asset can only be used for certain things and in a certain way. A Ministry of Defence asset would not be suitable for that. So those sorts of thing. Then when you start looking within central Government for hard, tangible assets, there are not that many that lend themselves to this sort of structure.

**Q62 Steve Baker:** What I am driving at is this: on the one hand, the sukuk is driving towards assets, which in the sense are moral, tangible productive assets that are adding value to people's lives, to slightly caricature the qualifications. We cannot find the productive assets to underwrite the sukuk but on the other hand, on page 22, your report says, "Ongoing structural demand was perceived from the UK pension and insurance industries for long-dated and index-linked gilts." So it seems to me on the one hand we cannot find the productive assets to underwrite the sukuk, but on the other private pension funds are being drawn into investing increasingly in instruments that are ultimately backed by the power to tax. Does it concern you that we are ending up with private pension funds in the UK dependent on the power to tax rather than on productive activity? Should I ask the Chancellor?

**Robert Stheeman:** Probably yes, and I happily confess I have not given that a huge amount of thought.

**Jo Whelan:** They are slightly different situations. When we are trying to structure the sukuk we were using a particular type of structure—ijarah structure—and in that context there are certain types of assets that you have to use; office buildings, for example, that are not doing non-compliant things. There is a limited number of those, but that does not mean that Government, as a whole, has no productive assets or indirectly has access to productive assets through other means, but just for that particular structure it was not suitable to use anything else.

**Q63 Steve Baker:** Since I have the floor, if I may, just finally: this issue of timed horizons of bond traders, there was a slight, if I may say so, giggle around the room when we mentioned time horizons of bond traders of a few days. You have also talked about monetary policy expectations. Is not one of the biggest risks now to the Government's programme of financing that a member of the Monetary Policy Committee will drop the ball on setting people's interest rate expectations? Is that not now one of the biggest risks you face?

**Robert Stheeman:** When you say "drop the ball" meaning that—

**Steve Baker:** If Mark Carney was caught saying something that was not in line with the Bank of England, would that not represent one of your bigger risks, that a member of the Monetary Policy Committee accidentally shifted market expectations?

**Robert Stheeman:** Comments that surprise the market, whether they come from members of the MPC, also from Ministers, also from politicians, always have the ability to move markets and very quickly and potentially, depending on what the comment is, quite dramatically. In some cases that might even be by design, I do not know, you would have to ask the person making the comment. I would be more concerned if those comments suggested a shift from not just what market expectations were but from what the people who made them intended them to be.

**Q64 Chair:** Mr Stheeman, was the DMO consulted about the Chancellor's pension reforms?

**Robert Stheeman:** We knew in advance about what was being proposed and we spoke to colleagues in the Treasury about that, yes.

**Q65 Chair:** And offered advice on the effect that that might have on the gilt market?  
**Robert Stheeman:** We did indeed.

**Q66 Chair:** What proportion of the gilt markets are being funded out of pensions?  
**Robert Stheeman:** It is a significant proportion. It is not as large as it once was but it is still significant, so approximately 26% of the entire gilt portfolio is held by the pension industry, which I describe as pension funds and also life insurance companies. They used to dominate, but ever since we started increasing our issuance in the shorter maturities then other investors would come in. But they are very significant. They are a critical part of what we do.

**Q67 Chair:** The decline in the DB schemes, what effect will that have?  
**Robert Stheeman:** It is incredibly hard to say. The point is that there is a very significant number of DB schemes, which are mature now and that hold significant assets. I think the latest so-called Purple Book suggested that the assets held by such schemes in existence are close to £1.2 trillion, so a huge amount. Part of that is still, I would say, unhedged, and what has supported our market especially at the long end has been demand from the pension fund industry in terms of trying to de-risk some of these schemes, where they

have these existing liabilities, and that has supported for many years the gilt market in the long end. The reforms that have been proposed, in my view, may over time have an effect on demand for those gilts, but I personally believe that that effect will be gradual. Market reaction to the pension reforms, when they were announced in July, would suggest that the market was quite sanguine about the effect of those reforms.

In my opinion, you will see over time—but you were likely to see this in any case—as those schemes mature, as they also become shorter in their average life, the corresponding demand coming from that sector will start to shorten as well. This is perhaps linked to what we were talking about earlier when I mentioned the average maturity. The UK is quite unique in its issuance that we issue so much long-dated bonds over time, personally I believe that you will see demand gradually shorten. We already have. But when I say “gradually” it means that instead of us constantly being able to issue 40 or 50 years, because that is where we see the greatest demand, it might be 30 to 40 years. It will be a very gradual process. I do not see a significant impact in the short or even in the medium term as a result of this.

**Q68 Chair:** The replacement that is coming from overseas demand, sovereign wealth funds and central banks, I suppose, does that have any implications for the way you perceive the demand for the market?

**Robert Stheeman:** Yes, it does because, in general, demand from overseas investors, and you mentioned sovereign wealth funds, what we refer to as official institutions, reserves, reserve managers, central banks, that demand traditionally is focused more on the short rather than the long end. I would say much more on the short than the long end. So of course they have supported our short-end issuance over the last few years, in particular, also our medium, 10-year issuance as well.

**Q69 Chair:** While we benefit from the 15-year maturity we are missing a trick by not having a lot of the short end to supply this demand?

**Robert Stheeman:** We are still supplying pretty hefty amounts—

**Chair:** A third, you were saying a moment ago.

**Robert Stheeman:** —into this market. I indicated earlier, I do think perhaps in a few years’ time in the happy event that we have less to borrow we will have to make some choices about where we want to focus that issuance.

**Q70 John Thurso:** Can I ask a few questions about the administrative side of the DMO? Let us start with your annual report and the statement of objectives, many of which were commendably achieved, but one or two of which were not achieved. One of which was the DMO, and I am quoting from it, “Failed to ensure factual accuracy in the publication of all market sensitive data and to make announcements in a timely manner”. There are a total of seven errors in the financial year comprising five website errors and two errors in the published material. Did this have any material effect on the financial market?

**Robert Stheeman:** No, it did not.

**Q71 John Thurso:** I notice that last year DMO also failed to meet this objective with a total of 13 errors. Why does this continue to be a problem?

**Robert Stheeman:** It is important to see these things in context. When I first joined, we used to have as an objective a tolerance of no more than 10 errors a year. We decided to scrap that because we felt that to try to achieve zero errors was a more desirable outcome ultimately. But I mentioned the context. It is worth noting that our website holds over 2 million, what I would call, separate data points and we conduct approximately 5,000 separate updates of the website during the year. That human error will occasionally occur and creep in, it seems to me—I do not want to suggest that I am accepting this and this is a good thing—very hard to avoid in its entirety.

**Q72 John Thurso:** On balance, what you are saying is it is better to have a zero target.

**Robert Stheeman:** Absolutely.

**John Thurso:** This would have been within the old tolerances and it is relatively small, but you are still going to try for zero?

**Robert Stheeman:** Yes. I completely agree, and also you made a fair point, which is to ask at the beginning, was there any market impact? To me that is the absolute key. I can state that in none of these was there a market impact.

**Q73 John Thurso:** One other question on that: another performance target was to ensure the maximum time taken to issue the results of gilt auctions does not exceed 15 minutes and you successfully met this target. But the average release time was slower compared to last year, 4.4 minutes versus four minutes. Does this upward trend indicate a statistical blip, a worrying trend or an irrelevant anomaly?

**Robert Stheeman:** I would like to think the latter. Perhaps a little bit of, I hope, useful context. Assuming everything runs smoothly during an auction we have the results of that auction ourselves within about 30 seconds, even less. We then choose to run a number of tests to ensure complete accuracy, just to make sure that everything is exactly as it should be. The market knows this. The primary dealers who just bid at the auction know that and they, to some extent, expect that and, I would venture, are very grateful to us for doing that because occasionally market makers make errors.

You may have heard in terms of financial market terminology of the fat finger syndrome. They may occasionally—because this is now an electronic market—bid in a way that they did not intend to. We try, if we can, although we are under no obligation at all to do so, to try and take that into account where possible. It is not always possible but we try to mitigate for that. The reason why I mentioned that is that the longest publication time of any auction result this year, and it may be listed in there, was one of approximately 13 minutes. The fact that it took so long, it could have been an error on our side—I do not believe I am revealing something that I should not—it was to a certain extent due to a combination of factors, one of which was an error by one of the bidding banks. We believe that it is in the market's interest, that means our interest but also the interest of the banks and ultimately the investors, to rather wait a few minutes, make sure that we have complete accuracy, that we are not rushing things out, and we just get it right. That to me is of critical importance, rather than trying to aim for some fantastic statistic, which I can then tell you about afterwards.

**Q74 John Thurso:** That is a very interesting piece of background because it tells us that if it has suddenly dropped down to three minutes we should be worried that you were not necessarily doing the right checks. So it is quite an important thing to put in context.

**Robert Stheeman:** It is, and I would say that if you look at a couple of other major sovereign bond markets—the German market and the US market in particular—they do not allow for the sort of checks and, if necessary, changes that we make.

I have said previously we are very cognisant of the fact that the UK is not the world's biggest market. We rely on general market goodwill—also from the primary dealers but from the investor community—and we need to work with the market. Not just to say, “If you have made a mistake, tough.” There is a benefit ultimately for the UK Government to be extracted by allowing a certain element of tolerance to creep into that process.

**Q75 John Thurso:** Can I turn to the staffing? One of the things that is noticeable from both last year's accounts and this year's accounts, is a relatively high reliance on interim contracts as opposed to permanent staff, between 25% and 33%, something like that. Is that something that we should be concerned about or you should be concerned about? Is it an indication that you cannot get staff? Or is there a practical reason why you choose to do it this way?

**Robert Stheeman:** The honest answer is a little bit of a mixture of both. There is a practical reason and that is to do with the composition of staff in the DMO. As you probably know, we are just a little bit over 100 people. In terms of the staff that we have and the nature of what we do, we are very heavily IT orientated. So the biggest single area in the office is IT and IT staff. Nearly 40% of the entire staffing in the office is somehow related in one way or another to IT. It is in the nature of the IT market, especially the skills that we need, which tend to be specific IT-related financial sector skills, that a lot of these people work only on a contract basis. So there is that aspect.

**Q76 John Thurso:** Would they typically come in to do work for you and then leave and be replaced by other people according to the need?

**Robert Stheeman:** Yes.

**Q77 John Thurso:** So this is not a bunch of people who are permanently on an interim contract?

**Robert Stheeman:** No, but having said that, we also experience a certain amount of turnover within the permanent staff. Again, this is reflective of the IT market. So we will lose, and we do lose, probably more IT people than I would like. Just to answer your first question: we do feel challenged, I think it is fair to say, on our ability to get our staff because we have to compete for skills with the private sector. More than 90%, I think the figure since 2010 is 96% of all staff recruited in the DMO come from the private sector. The sorts of skills that we seek are not normally found in the civil service.

**Q78 John Thurso:** You pre-empted what was going to be my next question. Is being regarded as part of the civil service a problem in that you cannot compete for the skills necessary given the City over the last year, 18 months has been rehiring at quite a big rate?

**Robert Stheeman:** It has become a problem. That is the area in which we have seen the highest turnover. It would not be correct for me to over-dramatise that, but is it a problem? It gives Jim, in his area, a significant headache. We cannot compete. It is not just IT. It is also what I call the other specialist functions, such as risk, compliance. Again the sorts of skills that we seek are, to a large extent, non-existent in the standard civil service. A few years ago, we saw within one year 100% turnover in our risk and compliance area. That was the operational risk area. That was not something we were comfortable with.

**Q79 John Thurso:** If one looks at the vast sums of money that are entrusted to the DMO, their management are raising, is it not an extraordinary false economy to impose upon you pay rates that may mean that all of the best people in the game are not available to you? Or many of them?

**Robert Stheeman:** I am probably not the most objective person to answer that question. To give you a subjective answer, yes, it probably is.

**Q80 John Thurso:** Would it be a good idea for policy makers, perhaps even a recommendation from this Committee—if the Chairman saw fit—that those responsible should look at this and weigh the risks of not having the right people against the broader policy of a pay restraint in the public sector?

**Robert Stheeman:** The way you phrased it is a very reasonable way of looking at it because, just to put it in perspective, the gross cost of running the DMO on an annual basis is a little over £20 million. You need to weigh that against a borrowing requirement this year of £127 billion and, perhaps more significantly, transacted flows through our cash management desk of close to £3 trillion a year. All I would say is we cannot afford to make false economies because we cannot afford to have errors in those areas. I am not saying we would be error free if we could hire whoever we can, but we need to be very careful. The pressures that we have had in this area have increased. In fairness, I will also say that I have had conversations with the Permanent Secretary of the Treasury in this area and he has encouraged me, where necessary, to do what I can to adjust certain things if that is absolutely what is needed for us to remain operational. That is a specific measure that does not really address the wider issue that you have addressed.

I do think that there is an issue there. Clearly, I am coming from one perspective, but I am trying to see also the bigger picture. I am aware of public sector pay constraints and all of that sort of thing, but the hard truth is we compete for talent and we lose real talent to the private sector on a far too regular basis.

**Q81 John Thurso:** It sounds to me very much like something that you have as a red risk in your red risk register, with not a lot of mitigation between the risk at the beginning and the end because there is not a lot you can do.

**Robert Stheeman:** Our risk register, and we do have one, is obviously confidential, but I am going to reveal one thing. We have high up there in deep red exactly what you have just mentioned.

**John Thurso:** Thank you very much.

**Q82 Chair:** Very interesting. It would be helpful perhaps if you could give a bit more thought to the issue that John has just been exploring, particularly with respect to the relationship between overall pay levels and value for money, and the relationship between that and variations in turnover. I have one more question I want to raise but before I go any further: Mr Juffs, do you have anything at all you would like to say to us this afternoon because you have been remarkably reticent?

**Jim Juffs:** I have heard the evidence given by my colleagues, Robert and Jo, and they have given a great account of our performance over the course of year. I would emphasise Robert's points about the operational nature of the entity and the fact that we have to be operational on each and every business day, and that requires skills, it requires systems and it requires investment in systems. That is not a type of business that is very frequently found in Whitehall, so we have a very specific set of circumstances and we need to be able to deliver continuously on that basis.

**Q83 Chair:** Back to the survey for a moment. I have never known a survey that says, "Yes, please, we are paid exactly the right amount or paid too much," so I am not surprised by the answers on that. But there is one area that did surprise me. "My work gives me a sense of personal accomplishment: 88%." "I am interested in my work: 100%." I think there are very few organisations that could claim that, but I do note that only 32% of staff decided to reply to this survey so you hand-picked them, did you, Mr Stheeman?

**Robert Stheeman:** I promise you I did not hand pick them, but I would say you are quite right to notice the low sample size. I was as pleased as we might perhaps be by the overall message. It does come with a little bit of a health warning. The one good thing is that this is now an annual thing, the staff survey, which happens across Government. We are in the process of having our current staff survey, which ends at the end of this week. I am told that the response rate is now over 50% so I would like to think that whatever comes out, whether it is good or bad, is more representative perhaps than a staff survey where you only have 32%.

As a serious point, why was the response rate so low? I imagine that perhaps part of it is a mixture of what I would call survey or consultation fatigue, but also many people, because they come from the private sector, they just think, "Oh gosh, this is something the Government wants to do." It is not mandatory to fill it out.

**Q84 Chair:** When you supply this information I know that you do not have pay bands or grades, and you do not want to reveal individual pay of staff beyond the top end, but it might be helpful if we could have some more information on pay than is provided in the annual report.

**Robert Stheeman:** You would like us to publish—

**Chair:** By level.

**Robert Stheeman:** By level?

**Chair:** Yes, So we can get a feel for roughly what your staff are paid.

**Robert Stheeman:** Would it help if I were to send a note to the Committee perhaps because we appoint to certain pay points.

**Chair:** Yes, that is exactly what we would like.

**Robert Stheeman:** Good.

**Chair:** Thank you very much for coming to give evidence to us this afternoon. It has been very informative as ever, and occasionally entertaining. We look forward to hearing about how you got rid of the next few hundred billion when you come to see us next time. Thank you very much indeed.