RetailBook

Explaining

Treasury Bills

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What are treasury bills?

UK Treasury Bills (T-Bills) are short-term debt instruments issued by the UK government.

They are often used to generate returns on surplus cash given they are virtually risk free and have short maturities, typically 1, 3 and 6 months. At maturity, investors can choose to reinvest or withdraw their funds.

How do T-Bills deliver a return?

T-Bills are zero-coupon securities, issued at a discount to the 'par value' which is paid to investors at maturity. T-Bills do not make coupon payments and it is the closure of this discount creates a 'yield to maturity' .

For example, purchasing a £100 6-month T-Bill for £98 yields a £2 return upon maturity. This is typically expressed as an 'annualised yield' as this helps compare T=Bills to other investment alternatives. Annualised yield:

$$= \left(\frac{\text{Par value} - \text{Purchase price}}{\text{Purchase price}}\right) \times \left(\frac{\text{Days in a year}}{\text{Days to maturity}}\right)$$

$$= \left(\frac{100 - 98}{98}\right) \times \left(\frac{365}{182}\right) = 4.1\%$$

What is the risk profile of T-Bills?

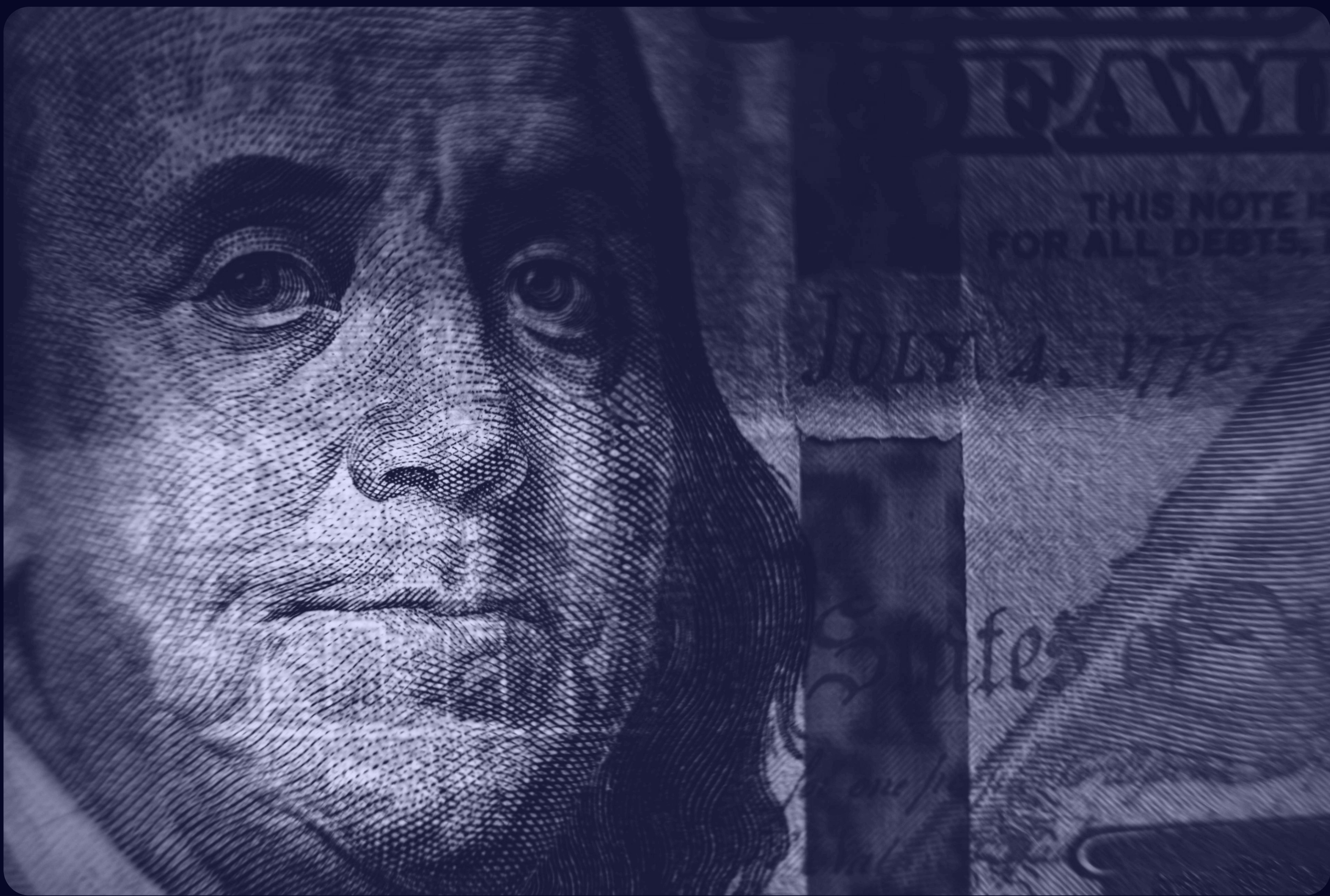
T-Bills are issued by the UK government, making them one of the lowest risk investments available. The UK government has never defaulted on its debt and enjoys a high credit rating.

Whilst T-Bills are a buy to hold product and cannot be sold in the secondary market, short maturities also provide quick access to funds which reduces liquidity and interest rate risk.

Can T-Bills be held in a SIPP or ISA?

As government issued securities, T-Bills can be held in an ISA or SIPP which shields the income generated from tax.

Otherwise, their classification as 'deeply discounted securities' means that gains from T-Bills are taxed as income, rather than capital gains. Consequently, gains from UKTBs can be offset against a personal tax allowance.



How do T-Bills differ from Gilts?

The UK government issues gilts to satisfy longer-term borrowing needs, whereas T-Bills are short-term debt instruments.

A gilt guarantees to pay both a regular cash payment, called the coupon, in addition to the return of the original investment, known as the principal, at maturity.

Whilst the credit risk of gilts and T-Bills is similar as both are backed by the UK government, gilts exhibit higher levels of interest rate risk and greater volatility due to longer maturities. Capital gains from gilts are tax-free but coupons are taxed as income. Like T-Bills, gilts are tax free if held inside an ISA.

How are T-Bills issued?

T-Bills are issued through weekly auctions conducted by the UK Debt Management Office (DMO). Retail investors typically do not participate directly in these auctions but can access T-Bills through their existing investment platform, broker or wealth manager who places demand on their behalf.

The DMO publishes the minimum accepted yield after each auction, which reflects market demand and interest rate expectations.

Conclusion

UK Treasury Bills offer a secure, liquid, and straightforward investment option for retail investors. T-Bills are particularly useful as a cash management tool given their predictability, short maturities and low risk profile.

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Risk Warning

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