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Commonwealth Debt Management Review
C/- Department of the Treasury,
Langton Crescent
PARKES ACT 2600

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Dear Sir or Madam:

RE : REVIEW OF THE COMMONWEALTH GOVERNMENT SECURITIES MARKET – DISCUSSION PAPER OCTOBER 2002

Please find by way of this cover letter and the attached document a submission for consideration by the Debt Management Review Team and the Reference Committee ("the Committee") in response to the above referenced discussion paper.

No doubt the Committee has and will receive by way of submission from various parties, vigorous arguments based on detailed research, modelling and forecasting as to the need for the Commonwealth Government, to maintain, in one form or another, a liquid market in Commonwealth Government Securities (CGS), despite the potential that may exist to eliminate the CGS market by 2005-06 as identified in the discussion paper.

I do not wish, nor presume, to add to nor argue with the important information that such submissions deliver to the Committee for its deliberation, other than to address two issues.

Firstly, I believe that a rational assessment will conclude that the nub of the arguments in support of maintaining a CGS really translate into the maintenance of a pricing benchmark at the "risk free" level from which other credit prices can "bootstrap". Notably with the exuberant development, creativity and flexibility of both physical and derivative financial markets, the physical existence of CGS as an investment security should be "all but" replaceable by the combination of alternate physical and synthetic securities and derivative contracts. The one element that remains problematic in such an approach is the "risk free" price setting function that CGS fulfil.

Secondly, the discussion paper identifies that significant governance and other public policy issues would be raised should a liquid CGS market be maintained and the Commonwealth find itself in a position to accumulate substantial financial assets.

One area identified in the discussion paper for the potential use of the funds generated by the maintenance of the CGS program is the funding of the Commonwealth Government's unfunded superannuation liabilities. Notably this opportunity has a certain level of appeal as it would potentially address a significant inter-generational cross-subsidy that currently exists in the form of these unfunded liabilities - in simple terms, the superannuation obligations being created by the current generation will need to be funded by future generations if the liability remains unfunded now, further, the population dynamics of an ageing population structure may amplify the undesirable economic and social impacts that may arise from such an unfunded position. On the surface of it, there is clear public benefit in considering the use of a continued liquid CGS market to unwind this inter-generational burden. However, such a program of itself would create significant governance issues, significant potential market risk, and more importantly still leaves future generations burdened with the economic cost of the continued existence of significant outstanding Commonwealth Government Debt, which will need to be serviced and repaid, albeit this burden may be less than would otherwise arise.

At the same time as considering this alternative, the Government and the Parliament through both Senate and House of Representative Committees, and the various activities of relevant Government Departments (not the least of which includes the 2002-03 Budget Paper No. 5 – Intergenerational Report 2002-03), has been seeking to address another significant inter-generational burden – namely the provision for and funding of aged pension and aged health care needs of a rapidly ageing Australian population. Like the unfunded Commonwealth Government superannuation liabilities, these issues, represent a significant potential inter-generational burden, the extent of which is still emerging, but is potentially far more wide reaching and far more significant than the Commonwealth Government's unfunded superannuation liabilities, in the manner in which it will affect both future Commonwealth Governments, and the Australian Community in general.

Key to addressing this is the existence of a robust superannuation system, but significant expert analysis has suggested that the current superannuation system (albeit amongst the world's best) will be insufficient to meet the future demands of an ageing Australian population. At the same time, one of the largest sources of private investment wealth in this country – the homeowner equity in Australian homes – remains untapped and mostly inaccessible as a liquid financial resource in addressing the current and expanding future health and welfare needs of a dramatically ageing Australian population. As recently as 27 November 2002, The Myer Foundation released "2020 A Vision for Age Care in Australia" which is based on extensive research including a detailed report by the highly respected Dr Vince Fitzgerald, co-chairman of the Allen Consulting Group, and highlights this growing need, and the potential for accessing the homeowner equity in private homes as an important and equitable alternative to enhancing the financial resources applied to addressing these dramatically increasing future needs.

A tangible solution to aid in addressing this issue exists today – but currently this solution remains untapped. Additionally in utilising this solution the Commonwealth Government could create a new CGS market, in limited issuance form, achieving a supply of real benchmark pricing information at the "risk free" level, from which the remainder of the financial debt markets can "bootstrap", while at the same time avoiding the build-up of expansive Commonwealth Government Debt (in fact the interest servicing and principal repayment of the debt created could be entirely self funded).

What is this solution ?

Third Son Financial Services is a private financial consultancy which has developed The Home Exchange Program ("HOMEX"), specifically to provide a policy option to Governments to achieve increased short term flexibility and benefits with respect to aged pension and aged care funding, through a mechanism that has neutral impact (in net present value terms) on the Government's fiscal position, and utilising the existent infrastructure of Governments and major financial institutions. Additionally HOMEX, involves the issuance by the Commonwealth Government of new CGS in limited volume, which could act as a pricing benchmark at the "risk free" level, but at the same time, under HOMEX, the interest servicing and principal repayment of such CGS can be fully self-funded from within the HOMEX program

HOMEX, is essentially a Home Equity conversion program whose design and financial engineering is such as to extract and deliver to older Australians, significantly greater benefits than those otherwise available through such programs, and at a neutral cost (in net present value terms) to the Government's fiscal position, with the added benefit of creating a new CGS "risk free" pricing benchmark.

The attached document, "The Home Exchange Program – HOMEX – **Program Overview Document**", is a high level overview document outlining issues related to aged pension and implied health care costs and the impacts of a retiring "baby boomer" generation, and the benefits delivered by, and core structural design impacts of HOMEX in relation to these issues.

A further and highly detailed document titled "The Home Exchange Program – HOMEX – **Program Design Document**" is also available (subject to confidentiality agreements being entered into) and provides detailed design of HOMEX including the structural design of each element and "The HOMEX Financial Model" – a detailed financial model on which the specific benefits, funding mechanisms and modelling, budgetary effects, etc. of HOMEX have been developed, <u>including the expected term and nature of the CGS issued under HOMEX</u>.

I am the principal of Third Son Financial Services, and have had senior experience in major financial institutions in Australia over the last 13 years, including periods as Country Treasurer Citibank Australia, Head of Investments and Superannuation ANZ Funds Management, and Head of Treasury and Financial Products, Investec Bank (Australia) Limited. I am pleased provide the Committee with this submission, and look forward to your response.

Sincerely,

Peter M. Binetter

Director
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