TAG Asset Consulting Group Pty Ltd
ACN: 097 703 047 trading as

ATCHISON
CONSULTANTS

6 December 2002

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

Dear Sirs,

Commonwealth Debt Management Review

We appreciate the opportunity which has been provided for stakeholders to make submissions to the Commonwealth Debt Management Review. Our submission is focused on one aspect of Chapter 5: Options Available to the Commonwealth – Option 3: Maintain the Commonwealth Government Securities market and fund the Commonwealth Government's unfunded superannuation liabilities.

As an active participant in discussion of this issue, we have had an article published in the Australian Financial Review which we now provide as the key element of our submission – Appendix A. The article addresses the second of the questions raised in the discussion paper regarding option 3.

Option 3 Question 2 – "whether funding the unfunded superannuation liability through a superannuation fund is a good way of dealing with the governance issues associated with substantial Government asset holdings"

The article considers this issue from the current governance of the superannuation funds for the Commonwealth Government civilian and defence personnel.

We have also attached, at Appendix B, a schematic of a superannuation investment policy framework which we would advocate would form the basis of the management of the assets of a superannuation fund in the public or the private sector. At the present time, the Trustee Directors of the Commonwealth Government superannuation funds are not able to fulfill the full extent of the role envisaged in the framework provided.

Level 6, 140 Queen Street
Melbourne,VIC 3000
Phone: 03 8604 4731
Fax: 03 9642 8886
Mobile: 0425 754 731
e-mail: ken@austind.com.au

Option 3 Question 1 – "governance arrangements for a hypothecated asset fund that stakeholders suggest would insulate investment decisions from direct Government control"

Adoption of the investment policy framework and securitising the obligation of the Commonwealth could permit the governance arrangements being established, which would be insulated from direct Government intervention.

We have addressed, very briefly, each of the other questions under Option 3. Our comments are brief as we believe the critical questions have been raised in Appendices A and B, and need to be considered before addressing in detail the remaining questions.

Option 3 Question 3 – "the appropriate limits on holdings of any single instrument if the Government were to invest in debt securities"

The Commonwealth Government funds currently have an exposure of in excess of 80% to an obligation of the Commonwealth which has the characteristics of debt securities, with terms related to the variables impacting on the unfunded liabilities, including changes in salary conditions of personnel. This exposure is excessive in a portfolio structure.

Option 3 Question 4 – "the appropriate limits for equity holdings in any one company if the Government were to invest in equities"

Prudential limits would be appropriate for the level of equity in any one company. It is not desirable that Trustee Directors become in control of companies. The level of equity holdings which represents control, as set out in the Corporations Law, would provide an absolute limit.

Option 3 Question 5 – "the likelihood of Government investment distorting asset prices"

We have estimated the investment universe in Australia in all assets to be of the order of $3000 billion. As a nation, we understand that the net overseas liabilities are in excess of $320 billion and rising, due to a continuing balance of payment deficit. We do not envisage that superannuation fund assets, which currently total $550 billion and which will be increased by $80 billion if full funding of liabilities were to occur, would distort the capital market in Australia. It would only occur temporarily if the investment program were instituted in one year, which we would not advocate.

Option 3 Question 6 – "the impact of restricting Government investment to foreign securities"

The issue of international capital flows is beyond our area of research on this review at this stage.

Option 3 Question 7 – "the increased uncertainty for fiscal policy arising from variations in investment returns"

We have commenced development of models which will demonstrate that the impact on fiscal policy on an accruals basis is significantly reduced when full funding is in place. The variability in investment returns might be expected to be greater than interest rates. However, the unfunded status is the equivalent of a geared investment portfolio and the impact of gearing is to increase the volatility of investment returns over time more significantly than an ungeared portfolio. The consequences we have estimated are that the volatility arising from a diversified multi-asset investment portfolio weighted to growth assets would be 10% - 15%, whilst the geared equivalent would have a volatility of well in excess of 30%. The consequences are that the fiscal volatility is greatly increased on an accruals basis from an unfunded liability compared with a fully funded status.

Our submission and commentary is brief. We believe that the issues we raise are a significant contribution to the review, as we have a perspective which we are not aware that other stakeholders have considered.

None of the issues are commercial in confidence. We would appreciate acknowledgement of our analysis, where appropriate.

Should you have any requirements, please do not hesitate to contact us on 03 8604 4731.

Yours sincerely,

Ken Atchison,
Managing Director.

Att