6 December 2002

Commonwealth Debt Management Review
C/o Department of Treasury
Langton Crescent
PARKES ACT 2600

By Email: debtreview@treasury.gov.au

Dear Sir/Madam

This letter provides comments on the "Review of the Commonwealth Government Securities Market" Discussion Paper dated October 2002.

AXA believes that the proposal to eliminate the Commonwealth Government Securities (CGS) market may have detrimental effects on consumers of the life insurance and wealth management industries.

Government debt is the core of any low risk investment strategy and is an important asset class for retirees and those approaching retirement, as well as for insurers who provide financial guarantees to their customers. As the Australian population ages, demand for low risk investments, investment guarantees and annuities will increase. Elimination of the CGS market may result in fewer investment choices, higher cost and a lower level of guarantee to the consumer.

Several examples follow:

1. **Restricted Investment Options**

   As consumers of financial services products age, their superannuation and savings are expected to shift from growth assets such as equities to lower risk assets such as bonds and cash. Retirees may expect to have a large proportion of their portfolio in such lower risk assets.

   Government bonds are one of the lowest risk asset classes. Eliminating these securities could have an adverse effect on low risk investment strategies. Retirees will be forced to invest in more volatile assets with a lower level of security.

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2. **Provision of Guarantees**

Life insurers provide long-term investment guarantees to consumers of superannuation, savings and annuity products. Life insurers invest a significant proportion of these assets in government bonds in order to minimise the risk of not meeting these guarantees and match the cashflow of these liabilities with a high degree of certainty. The absence of a government bond market would:

(a) require insurers to seek riskier assets to replace the government bonds, increasing capital requirements; and

(b) increase the volatility of the corporate bond market (due to the lack of a risk-free yield curve in which corporate yields are based). This could further increase capital requirements.

The consequences of this increase in capital requirements would include potential higher charges to consumers, a lower level of guarantees offered, and the complete withdrawal from the market of some types of guarantees. This would result in reduced consumer choice.

3. **Provision of CPI - Linked Benefits**

Life insurers offer life-time annuities and income protection insurance that include guaranteed benefits indexed to the Consumer Price Index (CPI). To mitigate the risks associated with these guarantees, life insurers purchase CPI-linked bonds. A large proportion of the CPI-linked bond market would be eliminated under the proposal. Insurers offering such benefits would be subject to greater risk. This may result in some insurers withdrawing these benefits or offering them at increased cost to the consumer again resulting in reduced consumer choice.

AXA believes that Treasury should retain the CGS market on the grounds that eliminating the CGS market would have a negative impact on consumers. Consumers seeking lower risk investment or savings options, or products with guarantees or protection against CPI increases, would face less choice and higher prices.

Thank you for your consideration of our comments.

Yours faithfully,

RMSher

Richard Shermon
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