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

Dear Sirs

RE REVIEW OF THE COMMONWEALTH GOVERNMENT SECURITIES MARKET

The Catholic Superannuation Fund is a major Australian superannuation fund covering approximately 30,000 members and $1.1 billion in assets. The Fund has long held a substantial investment in fixed interest assets, including Commonwealth Government bonds.

The Fund has a number of major concerns with the potential elimination of the Commonwealth Government bond market with regard to both the level of risk and potential returns for our investment portfolio. These concerns are:

1. a reduction in the investment options open to the Fund;
2. an increase in risk of the Fund's investment portfolio;
3. the requirement for the Fund to increase its holdings of bonds issued by foreign governments if it is to try to keep the risk of our investment portfolio around current levels;
4. increased uncertainty in the domestic economy, the risk of higher financing costs for Australian business and a consequent fall in domestic equity returns;
5. the possibility that the defining of a goal to eliminate the debt may override the commitment to a budget balance over the cycle leading to fiscal policy being more contractionary than might otherwise be the case, with a consequent risk of lower economic growth and lower equity returns;
6. the possibility that, if the bond market is eliminated, the degrees of freedom of future governments to, say, counter an economic downturn could be unduly constrained leading to a slower macroeconomic response, lower growth and lower equity returns than might otherwise be the case; and
7. the risk that if the economy was to lose the risk free anchor provided by the Commonwealth bond yield curve, the economy could become more exposed to bank credit, particularly via the swap curve. This would make it significantly more vulnerable to banking crises such as in 1990-91, again potentially increasing the risk and lowering the return from equity investment.

In view of these concerns the Fund is strongly of the view that the interests of its members would be best served by the maintenance of a liquid, risk free yield curve in Australia. However, having cognisance of the Commonwealth's desire to utilise the proceeds of future asset sales to pay down a substantial portion of its debt, the Fund would like to suggest that consideration be given to the creation of a joint Commonwealth - State securities market.

We do not believe that a return to the situation where the Commonwealth issued securities on the behalf of the States, as raised in the discussion paper, would be a politically tenable one. However, we do believe that the discussion paper has seriously under addressed the key role that State securities could play in a future where the volume of Commonwealth Government securities on issue could be substantially below what it is today. On the other hand, if structured appropriately, a combined Commonwealth – State securities market would maintain all of the scale, credit and liquidity required to provide Australia with the liquid, risk free yield curve that it needs.

The type of structure that we envisage is one where the Commonwealth and the States agree to bring their coupons and maturity dates into line. Further, in order to make these securities as homogeneous as possible, it would be highly desirable that the Commonwealth provide a degree of credit enhancement to the States provided a broad set of agreed budgetary parameters as adhered to.

In effect, this would see the Commonwealth providing a conditional guarantee to State debt. We would envisage that such a guarantee not be on an issue by issue basis, but be of the issuers themselves for as long as they abided by the agreed set of fiscal parameters. In effect this would mean that, should the guarantee be withdrawn, it would be withdrawn on all outstanding issues and not just new ones.

This would not entail any substantial lessening of the powers of market discipline on the States as the costs of falling out of the Commonwealth guaranteed umbrella would be very considerable. Further, States whose finances were verging towards the parameter levels would rapidly find their debt falling out of favour with the market.

In effect, for States who behave in a fiscally responsible manner, their debt would trade virtually as if they were Commonwealth bonds. Conversely, States that threatened to stray outside of the agreed parameters would pay a substantial price.

Further detail of each of these points and a discussion of other issues raised in the discussion paper are included in our more detailed response that follows.

Your sincerely

Dan Sexton
Chairman

REVIEW OF THE COMMONWEALTH GOVERNMENT SECURITIES MARKET

Prepared by

CATHOLIC SUPERANNUATION FUND

5 December 2002

Introduction

The Catholic Superannuation Fund (CSF) was established in 1971 for the benefit of employees of Catholic schools and other organisations. The Fund primarily covers teachers in Victoria, Tasmania and the Northern Territory. It currently has approximately 30,000 members and its assets exceed $1.1 billion.

The Fund has a detailed set of investment objectives which relate both to performance and risk. In order to fulfil these objectives the Fund utilises a wide range of investments. Australian fixed interest assets have long been a major component of the Fund's investment portfolio. As of 30 June 2002 around 22% of the Fund's investments were in Australian fixed interest.

These domestic fixed interest assets are included in the portfolio in order to provide a stable investment option, with a medium return and low risk, in large part to offset the volatility of higher return but higher risk equity investments.

As a consequence, the Fund has a vital interest in issues surrounding, not only the Commonwealth securities market, but also with the wider future and growth of the Australian economy.

The Fund is alarmed at the proposal to eliminate the Commonwealth securities market and believes that such action would clearly be against the interests of its members, unless an alternative liquid, risk free yield curve was to be substituted for it.

Given the Commonwealth's desire to utilise the proceeds of future asset sales to pay down a substantial portion of its debt, the Fund would like to suggest that consideration be given to the creation of a joint Commonwealth - State securities market to fill the gap now solely filled by CGS.

We do not believe that a return to the situation where the Commonwealth issued securities on the behalf of the States, as raised in the discussion paper, to be a politically tenable one. However, we do believe that the discussion paper has seriously under addressed the key role that State securities could play in a future where the volume of Commonwealth Government securities on issue could be substantially below what it is today.

On the other hand, if structured appropriately, a combined Commonwealth – State securities market would maintain all of the scale, credit and liquidity characteristics required to provide Australia with the liquid, risk free yield curve that it needs.

The type of structure that we envisage is one where the Commonwealth and the States agree to bring their coupons and maturity dates into line. Further, in order to make these securities as homogeneous as possible, it would be highly desirable for the Commonwealth to provide a degree of credit enhancement to the States provided a broad set of agreed budgetary parameters as adhered to. In effect, this would see the Commonwealth providing a conditional guarantee to State debt.

That guarantee would not apply to securities until maturity but to all securities issued by each State up until and unless that State breached the agreed budgetary parameters. This would not entail any substantial lessening of the powers of market discipline on the States as the costs of falling out of the Commonwealth guaranteed umbrella would be very considerable. Further, States whose finances were verging towards the parameter levels would rapidly find their debt falling out of favour with the market.

In effect, for States who behave in a fiscally responsible manner, their debt would trade virtually as if they were Commonwealth bonds. Conversely, States that threatened to stray outside of the agreed parameters would pay a substantial price.

In the absence of such a domestic, liquid, risk free yield curve, the Fund believes that it would have no alternative but to significantly increase its holdings of fixed interest securities issued by foreign governments.

While not strictly an investment issue, the Fund believes that its members would prefer their fixed interest investments be used to finance investment by the Australian Government than investment or consumption by foreign governments.

CSF's Investment Concerns if the Commonwealth Bond Market was to be be eliminated

1. A reduction in the investment options available to the Fund

There is a very substantial body of research that demonstrates that the wider the range of assets with different characteristics that are in the investment universe, the more able the investor is to diversify risk and to maximise return for a given level of risk.

Bonds issued by central governments play a vital role in this mix of assets, providing a pure risk free asset with medium return characteristics. The loss of such an asset would have a significant impact on the overall ability of the Fund to manage its risk and to provide its members with the range of differing risk portfolios that they want.

Of the various assets that could be used as substitutes for Commonwealth Government bonds, none are what the fund would consider to be perfect substitutes. The closest substitute would be bonds issued by other major OECD Governments. If need be this is where the Fund would most likely redirect the bulk of the money it has invested in Commonwealth bonds should they cease to exist.

However, running yields on foreign bonds are on average significantly less than those in Australia. While part of this loss in yield can be made up by currency hedging the holdings, the complications of currency hedging are such that the Fund does not consider such bonds to be a perfect substitute for Commonwealth bonds.

The other domestic alternatives are State Government bonds, corporate bonds or swaps. The Fund does not consider either corporate bonds or swaps to be in any way adequate substitutes for Commonwealth debt.

Australian corporate bonds are illiquid at best and impossible to sell at worst. In addition they carry a credit risk clearly vastly different from that of Commonwealth debt and in no way can they be considered a substitute.

Swaps are administratively complex, of variable liquidity, and carry a credit risk. In addition to these factors the Fund is concerned at the susceptibility of the swap market to any emergence of general market concerns as to bank credit. Without the Commonwealth debt market to anchor the swap curve, the Fund is very concerned at the potential for a severe blow out in swap rates, marked illiquidity in the market and a sharp widening in dealing spreads when the inevitable repeat occurs of the domestic banking near-crisis of 1990-91. In such circumstances they could hardly be considered adequate investment substitutes for risk free Commonwealth bonds.

2. An increase in risk of the Fund's investment portfolio

It is self evident that the removal of a liquid risk free asset from the Fund's investment portfolio would result in an increase in risk of the portfolio, all other things being the same.

With there being no fully satisfactory domestic alternative, the fund's options in order to keep its previous risk profile would be to increase either or both of the domestic cash and international fixed income weightings. In each case there would most likely be some reduction in the overall performance of the fund.

In other words, the direct impact of the removal of domestic risk free bonds as an investment choice would be to either increase the risk of the Fund's portfolio or to reduce its return.

3. The requirement for the Fund to increase its holdings of bonds issued by foreign governments if it is to try to keep the risk of our investment portfolio around current levels

As suggested above, an almost inevitable consequence of the removal of Commonwealth bonds as an investment option would be an increase in the Fund's holdings of bonds issued by other governments.

In addition to the return and currency management issues that might flow from such a decision, the Fund is concerned at how members, the public and politicians might react to Australian superannuation funds having potentially 50% or more of their assets invested offshore.

The realties of politics are such that this could result in pressure to either invest in unsuitable and riskier domestic fixed income alternatives or to curtail other areas of international investment, most particularly equities.

The Fund would be very concerned if either was to be the case.

4. Increased uncertainty in the domestic economy, the risk of higher financing costs for Australian business and a consequent fall in domestic equity returns

Returns from equity investment is the major driver of the overall performance of Australian superannuation funds. As a consequence, anything that potentially harms equity returns is of concern to Australian superannuation funds.

CSF has no doubt that the removal of the stabilising function performed by having a liquid risk free yield curve would increase the general level of uncertainty in the Australian economy and make it more vulnerable to economic shocks.

While some might argue that removing the remaining Commonwealth debt would free up more funds for corporate issuers, we believe that, with Commonwealth debt already having been reduced to very low levels, there would little or no additional demand for corporate securities should Commonwealth debt be removed entirely.

Rather, we have very little doubt that, if there was no domestic liquid risk free yield curve, the overall yield level of corporate debt would be higher. In other words medium to longer term debt would be more expensive than otherwise for corporate issuers.

The likely combination of greater uncertainty, a more volatile and potentially vulnerable economy and a higher cost of term debt to Australian corporates would almost certainly see lower equity returns than would otherwise be the case.

5. The possibility that the defining of a goal to eliminate the debt may override the commitment to a budget balance over the cycle leading to fiscal policy being more contractionary than might otherwise be the case, with a consequent risk of lower economic growth and lower equity returns

We note that the Commonwealth's net debt now stands at around $60 billion. With a commitment to maintaining a Budget balance on average over the cycle, all other things being the same, that debt would remain at $60 billion at the same stage of the next economic cycle.

In other words, under the Government's stated fiscal policy there would be no reduction in debt on average from around current levels, except by the application of the proceeds of asset sales.

We note that, after the various other expenditures that would be required, even the full sale of Telstra would see the Commonwealth's debt less than halved.

If a goal of total elimination of debt was to be announced, it would appear that this could only be achieved by running Budget *surpluses*, on average, over the cycle.

CSF would not support such a policy. Indeed, we believe that it would be a policy fraught with economic risk, with fiscal policy adopting a significantly contractionary rather than neutral stance over the cycle.

Such a contractionary bias would certainly see the economy grow more slowly than otherwise, inevitably leading to lower domestic equity returns than wouldotherwise be the case.

6. The possibility that, if the bond market is eliminated, the degrees of freedom of future governments to, say, counter an economic downturn could be unduly constrained leading to a slower macroeconomic response, lower growth and lower equity returns than might otherwise be the case.

Should an objective of debt elimination be enshrined as a central tenet of fiscal policy, it would make it significantly more politically difficult than would otherwise be the case for the Commonwealth to run a substantial Budget deficit to counter the next major economic downturn. While we would all like to believe that the business cycle can be conquered, the reality is that we will face major downturns in the future.

Should our next major downturn be of a similar order to that in 1990-91 sensible economic policy would prescribe the running of substantial deficits of several percent of GDP and well beyond the scope of running down Commonwealth reserves with the Reserve Bank.

Any delay in the adoption of appropriate fiscal policy in these circumstances and the severity and length of the downturn is very likely to be greater than would otherwise be the case.

The adoption of a zero Commonwealth debt policy would effectively be a return to a pre-Keynesian world, at least for a period until the policy is eventually abandoned. The length of that period could impose severe costs on the economy and on equity returns.

7. The risk that, if the economy was to lose the risk free anchor provided by the Commonwealth bond yield curve, the economy could become more exposed to bank credit, particularly via the swap curve. This would make it significantly more vulnerable to banking crises such as in 1990-91, again potentially increasing the risk and lowering the return from equity

We have made this point in passing above, but we would like to emphasise just how important we believe a liquid, risk free yield curve is to the overall stability of the financial system and hence to our members' retirement savings.

Our financial system is already very heavily dependent on the fortunes of just four banks. Elimination of the Commonwealth securities market and greater reliance on the swap market would further entrench the economy's sensitivity to these banks.

Inevitably this would make the economy significantly more vulnerable to banking crises such as that in 1990-91. Such an increase in systemic risk is clearly against the interests of the economy as a whole and of investors in particular.

Responses to questions and issues raised in the Discussion Paper

Pricing other financial products

The Government would appreciate views from stakeholders on:

- ***whether CGS is used extensively as the primary benchmark for pricing the debt securities of other issuers;***

The Fund's experience is that the risk free Commonwealth yield curve is used almost exclusively as the benchmark for the pricing of other debt securities.

Moreover, from the Fund's experience the majority of domestic equity managers use the CGS market as a measure of the risk free rate in their valuation process.

- ***whether the interest rate swap curve is used widely for pricing debt securities. If not, are there obstacles to using the swap curve in the future? and***

The Fund's experience is that the swap curve currently plays little or no role in the pricing of mainstream fixed interest securities. Regarding the future, with the swap curve itself containing significant credit exposure and with there being major practical difficulties in creating a swap futures market, CSF regards it as unlikely that the swap curve would be a practicable benchmark for the pricing of most securities.

- ***what other options are available for pricing debt securities? How effective are they?***

In the opinion of CSF, the domestic securities market needs a liquid risk free yield curve if it is to operate efficiently and maintain the confidence of fixed income investors. In our discussion earlier in this submission we have outlined one possible solution that would achieve this using a combination of State and Commonwealth securities with common coupon and maturity characteristics and a measure of credit enhancement.

Referencing other financial products

The Government would appreciate views from stakeholders on:

- ***whether the yield on CGS is commonly used as a reference benchmark for comparing the yields on other debt securities; and***

As indicated above, in the Fund's experience the CGS yield curve is virtually the only set of yields used in comparing the yields of other debt securities.

- ***whether any major obstacle hampers the interest rate swap curve or some other benchmark being used as a reference benchmark.***

Again as indicated above, any benchmark set of yields requires a degree of credit, homogeneity and liquidity that would be difficult to replicate. In particular the interest rate futures market plays a vital role in enhancing the liquidity of the market and in reducing market spreads and hence transaction costs. It is very difficult to imagine a successful swap based futures market. Conversely an acceptable solution to us would appear to be the Commonwealth/State hybrid we have discussed previously.

Managing financial risk

The Government would appreciate views from stakeholders on:

- ***whether there is scope for the Treasury bond futures market to be replaced by a futures market based on alternative instruments. What could hamper an alternative futures market from developing?***

From our experience, very few futures instruments are successful, even when there is a deep underlying market, for example the $A. We are very sceptical as to whether a futures market based on, say, interest rate swaps would be successful.

On the other hand, changes to the specifications of an existing contract have been successful in the past and we do believe that the existing bond contracts could still be successful if based partly on commonwealth securities and partly on commonwealth guaranteed State securities.

- ***whether the interest rate swap market is sufficiently liquid at maturities longer than five years to facilitate interest rate risk management;***

As stated earlier, we do not see the swap market as being a suitable alternative for liquid, risk free debt whatever the maturity.

- ***whether the viability of the interest rate swap market would be affected significantly by winding down the CGS market; and***

In our experience the swap market is priced off the CGS curve. Remove the CGS curve and there would clearly be a greater degree of uncertainty as to where the swap curve should be. This uncertainty would be reflected in wider spreads, higher transactions costs and a less efficient market.

- ***if alternate risk management tools were not available, what would be the likely impact of this on the cost of capital for corporate bond issuers?***

In our assessment, if there was no CGS market and no deeply liquid interest rate futures market, investors such as ourselves would feel less confident as to the Australian corporate bond market. As a consequence, we would expect that the cost of domestic term debt for Australian corporates would rise significantly.

Providing a long-term investment vehicle

The Government would appreciate views from stakeholders on:

- ***the significance of CGS as a long-term investment vehicle, particularly for institutional investors such as superannuation funds and life offices;***

In our view there are two aspects to this question: the actuality of investing in CGS and the option to do so. Both are important and both have a value to us as investors. We currently have a significant investment in CGS, primarily as a means of offsetting part of the risk and volatility associated with equity investment. We also hold significant amounts of State and corporate debt.

While we regard State debt as a fairly good substitute for CGS, as recent events in the US have amply demonstrated, the diversification benefits of corporate debt are somewhat less compelling.

Just as important to us as the actual holding of CGS is the option to hold such securities. In times of rising uncertainty and risk, “assets of last resort” have a significant value and, in our view, help to act as a bulwark against more sever losses in general market confidence.

- ***whether there is currently an unmet demand for CGS within the superannuation sector; and***

Clearly there are many holders of CGS other than superannuation funds. Equally clearly, should super funds want to increase their holdings they are in a position to bid up prices to levels which would encourage other existing holders to sell.

However, this is just a snapshot view at a single point in time. In different economic circumstances, even those similar to those in the US over recent months, the demand by super funds for CGS could be expected to be significantly greater than is the case today.

- ***the potential to develop alternative long-term investment instruments.***

As we have said previously, our demand as investors is for liquid, risk free assets. CGS perfectly fill this role. We have previously outlined a proposal whereby State securities could be added to this pool of securities to compensate for any future reduction in CGS supply. We cannot envisage circumstances where either corporate bonds or swaps could fulfil this role.

Implementing monetary policy

The Government would appreciate views from stakeholders on the declining importance of CGS in the operation of monetary policy.

We have no view on this issue.

Providing a safe haven in times of financial volatility

The Government would appreciate views from stakeholders on:

- ***the importance of the CGS market in providing a safe haven during periods of financial instability;***

We have already indicated that we regard the mere existence of liquid risk free securities as very important to the overall range of investment options open to Australian superannuation funds. This is particularly so in times of crisis, when the liquidity of other fixed income alternatives can be severely impaired and when their margins and dealing spreads can widen enormously.

Recent events in the US Government and corporate bond markets amply bear this out, with the yields of Government bonds falling, while those on corporate issues have risen, in some cases very sharply so.

We have also seen such events in our own market, for example during the Asian economic crisis in 1998. In one specific example, yields on the Australian paper issued by the Korean Development Bank went from 50 basis points over bond to more than 1000 basis points over bond, all without virtually a single transaction actually occurring.

- ***what evidence there is of the role of CGS as a safe haven? and***

See above.

- ***what possible alternative safe havens exist and how appropriate they are?***

The major alternatives are cash or foreign bonds. In extremis cash itself might not be as safe as CGS given the inevitable exposure to bank credit. Foreign bonds of themselves do provide a good risk free alternative, except for the requirement to currency hedge, which again requires a credit exposure.

Attracting foreign capital inflow

The Government would appreciate views from stakeholders on:

- ***whether the absence of a CGS market would affect Australia's attractiveness to foreign investors; and***

We have no view on this issue.

- ***how important global bond indices are for foreign investment in Australia.***

Our perception is that Australia is not really on the map of foreign fixed income investors, except for the occasional opportunistic play. We are already such a small part of the indices as to be a market that can be safely ignored most of the time.

Promoting Australia as a global financial centre

The Government would appreciate views from stakeholders on:

- ***whether the CGS market plays a significant role in promoting Australia as a global financial centre; and***

We have no view on this issue.

whether the absence of a CGS market would affect transaction costs and Australia's attractions as a centre for global financial services.

We are strongly of the view that dealing spreads for virtually all other fixed interest securities would widen in the absence of the CGS market, thereby increasing transaction costs and that liquidity of the market would also be significantly affected.

Appropriate size of the Commonwealth Government Securities market

The Government would appreciate views from stakeholders on the appropriate size of the CGS market in the event that the market is to be maintained.

We note that the size of the CGS market has ranged from below $40 billion in the late 1980s to over 80 billion in the mid 1990s. We did not note any particular loss of liquidity or unsatisfied demand within this range. Clearly as the market reduces there must be some loss of liquidity, but it is a matter of judgement as to when this becomes a material factor. Our assessment would be that somewhere in the range of $30 to 40 billion, the market would start to note liquidity impacts and that below $30 billion, these would be of sufficient magnitude as to question whether the market was still fulfilling its liquid, risk free role.

Options available to the Commonwealth

Option 1: Wind down the Commonwealth Government Securities market

The Government would appreciate views from stakeholders on:

- ***potential implications of winding down the CGS market;***
- ***the likely impact on the cost of capital;***
- ***the most appropriate approach and timeframe to implement a decision to wind down the market, if this decision is made; and***
- ***the likely re-entry costs (in the form of additional borrowing costs) if the Commonwealth withdraws from the market.***

We have provided what comments we have on these issues above and do not have anything additional to add.

Option 2: Consolidate Commonwealth and State government debt markets

The Government would appreciate views from stakeholders on:

- ***whether there is merit in reconsidering the idea of consolidating Commonwealth, State and Territory government debt into one market; and***

- ***whether this option would assist with the transition to reducing the supply of Government debt.***

We are strongly of the view that the area of somehow homogenising Commonwealth and State debt is the best market solution to the overall issues posed in the discussion paper.

However, in our assessment a consolidation effectively returning us to the era before the advent of State Borrowing Authorities would be politically untenable to the States and would remove the disciplines of the market from them.

In both the covering letter to this submission and in our introduction, we have offered an alternative means by which Commonwealth and State debt could be brought together without the States losing their autonomy or the ultimate discipline of the markets.

We realise that this solution is not plain vanilla, but if the Europeans could agree on the Maastricht treaty, then hopefully we would be able to reach a mutually beneficial agreement amongst ourselves.

Option 3: Maintain the Commonwealth Government Securities market and fund the Commonwealth's unfunded superannuation liabilities

The Government would appreciate views from stakeholders on:

- ***governance arrangements for a hypothecated asset fund that stakeholders suggest would insulate investment decisions from direct Government control;***

- ***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 appropriate limits on holdings of any single instrument if the Government were to invest in debt securities;***

- ***the appropriate limits for equity holdings in any one company if the Government were to invest in equities;***

- ***the likelihood of Government investment distorting asset prices;***

- ***the impact of restricting Government investment to foreign securities; and***

- ***the increased uncertainty for fiscal policy arising from variations in investment returns.***

CSF does not regard it as appropriate for the Commonwealth to have a large hypothecated asset portfolio outside of its superannuation obligations. The governance issues associated with such a portfolio are simply too great to countenance.

However, we can see no such governance issues arising out of a partial funding of the Commonwealth's unfunded super liabilities if it so decides.

CSF does not have a strong view either way as to whether partially funding superannuation is a desirable goal, given the Commonwealth's ultimate taxing powers. We do, however, note that there are significant intergenerational issues regarding these liabilities.

Should the government decide to partly fund its liabilities, we do not see any great problems for markets arising out of the addition of another large asset pool, provided the investment guidelines for the portfolio are in line with general market practice. In particular, there should be no externally imposed obligations on the extent of foreign investment and so on.

Finally, while we recognise the problems for the public accounts of the interest payments for the debt on one side and an uncertain offsetting gain from the investment portfolio on the other, we do not see these problems as being insurmountable.

In our view the Government decides its own accounting policies anyway, and should be able to come up with a solution to this issue. Two suggestions that we would have would be:

1. construct a situation where the interest liability on the debt ultimately resides in the superannuation funds themselves. For example the Commonwealth issues the debt on behalf of the funds and charges them interest equal to that paid by the Commonwealth on the securities, in a manner similar to that which applied when the Commonwealth issued bonds on behalf of the States.

2. take the performance of the investment portfolio on to the Budget, but on an amortised basis over, say, ten years. Obviously there would be significant transition issues associated with this.

Of these options, we believe that the first would be preferable.