Investment & Financial Services Association Ltd
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16 December 2002

Mr Blair Commley
Commonwealth Debt Management Review
c/- Department of the Treasury
Langton Crescent
PARKES ACT 2600

Dear Blair

The Investment and Financial Services Association appreciates the opportunity to make a submission the Commonwealth Debt Management Review.

Our submission deals with the issues from a funds management and life insurance industry perspective. The submission is more general than our joint submission with the CGS Steering Group which was lodged last week. The joint submission deals with the questions raised in the Treasury Discussion Paper.

We look forward to participating in the future consultation process undertaken by the Review.

Yours sincerely

Richard Gilbert
Chief Executive Officer

REVIEW OF COMMONWEALTH GOVERNMENT SECURITIES MARKET

INVESTMENT & FINANCIAL SERVICES ASSOCIATION (IFSA) SUBMISSION
TO THE
TREASURY

DECEMBER 2002

INVESTMENT & FINANCIAL SERVICES ASSOCIATION

IFSA is a not for profit national peak body representing the wholesale and retail investment management, superannuation and life insurance industries. IFSA has over 100 members who invest approximately $640 billion dollars on behalf of over 9 million Australians.

IFSA's mission is to play a significant role in the development of the social, economic and regulatory framework in which our members operate, thereby assisting members to serve their customers better.

IFSA works to achieve its mission by encouraging ethical and equitable behaviour by its members through the development of industry standards; contributing to the development of simple and efficient regulatory regimes; creating competitive markets; and contributing to a strong national economy by encouraging savings.

IFSA plays a pivotal role in the formulation of public policy on the regulation of the financial services industry. To this end, IFSA liaises extensively with parliamentarians, ministers and Government officials on proposals and strategies to enhance policy for the benefit of consumers and market participants.

Executive Summary

The open and transparent manner in which the Government is conducting its review into the Commonwealth Government Securities (CGS) market is welcomed by IFSA. Our members are major stakeholders in the outcome and we therefore welcome the opportunity to lodge a submission on the matter.

IFSA considers that the Government bond market serves important functions in the structure of the Australian economy. Therefore a liquid CGS market is vital to the efficient operation of the domestic financial market. Given the importance of funds management, superannuation and insurance companies to the stability and growth of financial markets it is essential that these sectors be permitted to produce the best outcomes for their respective clients.

The CGS market is used extensively by the financial sector as a benchmark for other instruments. Given the risk-free and transparent nature of these bonds, other types of instruments are imperfect substitutes. The CGS functions are enhanced by a strong futures market, which facilitates reliable price discovery. All these unique features contribute towards lower borrowing costs and efficient risk management for investors.

The CGS market facilitates the efficient matching of liabilities with assets over the long term, an attribute particularly important in both superannuation and insurance portfolios. If the CGS market were removed it would mean that institutions would need to contend with greater mismatches between liabilities and assets. In turn, this impacts on credit rating implications.

The use of corporate bonds, swaps or US Treasuries as substitutes to CGS produces a less than ideal trading situation for financial markets participants.

Corporate bonds are a heterogeneous product as risk varies from one company to the next and across sectors. This idiosyncratic risk evolves through changes in the price of a bond due to the unique circumstances of the firm or sector, and is not passed onto the market. This can affect the individual firm’s credit rating and requires market participants to invest in a considerable amount of research to monitor these changes.

Within the swap market there remains a lack of liquidity beyond the five year mark thus making it impossible for use as a benchmark for longer-term investments of the kind generally required by superannuation and life insurance companies. It should also be noted that replacing bonds as the main instrument for benchmarking and as a liquid asset for adjusting portfolios will introduce both accounting and administrative complexities due to the non-investable nature of swaps.

In order to mitigate exchange risk, 10 year US treasury bonds paid semi-annually will require each stream of income to be hedged. This would represent an unnecessary cost to business. It would require entering into swaps agreement with commercial banks as the counterparty, thereby introducing counterparty risk and removing the risk free status of US treasury bonds.

IFSA supports the Treasury papers option 3 as an alternative to removing the CGS market and relying on the possibility that future instruments will take the place of Government bonds. This could be achieved either though allowing unfunded superannuation liabilities to be privatised or maintaining an assets portfolio managed by either the funds industry or at the RBA to achieve the objectives of the fund.

The CGS market performs a vital role in the efficient management of superannuation assets. It is possible that various alternative products could fill many of the diverse roles currently served by CGS market. However, these will be less efficient and involve additional expense for fund managers. These increased costs will ultimately impact on the returns for superannuation beneficiaries. For example, through the cost of hedging and lack of market power to force down price as well as unfair withholding tax regimes (eg Japan and Switzerland).

If Australia is to maintain an internationally competitive financial market as well as a strong domestic market the Government must maintain a viable and efficient bond market. A strategy that maintains the CGS market and manages future obligations of the Australian Government should be the next step in maintaining the Government’s responsible fiscal policy.

IFSA recommends that the Government retains the CGS market via funding the Commonwealth unfunded superannuation liabilities.

Review of Government Securities Market
INTRODUCTION

The Federal Government policy has been to improve and develop the foundations of Australia's economic growth through the maintenance of fiscal surpluses and asset sales in order to continue with its privatisation agenda and retire debt. The trend towards reducing debt has made it necessary for the Government to consider the consequences for financial markets of removing the CGS market.

In response to concerns from the private sector the Government released a discussion paper in October 2002 called *Review of the Commonwealth Government Securities Market* to consider the various options if gross debt is continually reduced to the point where it is totally eliminated. The Review raises a number of fundamental points that need detailed examination in order to determine which conditions will give rise to the best outcomes for Australia's financial markets and economic growth. Some of the key questions include:

- What options exist in terms of a substitute to risk-free bonds? Which of the said options can most fully support a diverse range of portfolios?

- What is the importance of the CGS market in times of financial instability?

- Is the provision of a low-risk long-term investment vehicle unique to the CGS market or can alternatives be found?

- What are the consequences for the cost of capital if the Government removes its bonds from the market?

- Are there compensating benefits to economic management from the disappearance of deficit financing opportunities?

The above questions are important when considering the consequences for the financial community, superannuation beneficiaries and for the Federal Government of removing the bond market. IFSA considers that the issues regarding Telstra and future fiscal surpluses should be separated from the discussion regarding the future of the Government bond market. There are several options currently available that allow the Government to maintain a bond portfolio, notwithstanding the possible sale of Telstra or future fiscal policy.

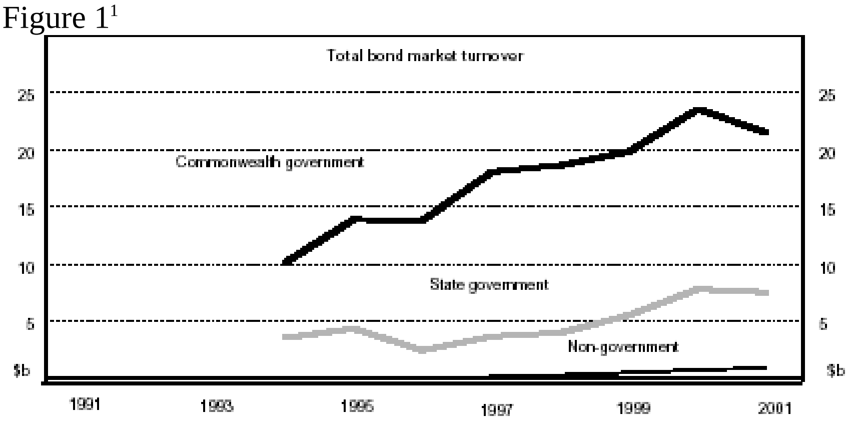
Previous governments have taken the decision not to fund superannuation liabilities but to pay them as the need arises, through increases in revenue, taxes or debt. To finance such activities before they fall due would require a dedicated pool of funds to be available in advance of the liability accruing. This solution is currently in place in a number of Australian states and would not represent a radical change in Federal Government policy. Moreover, it is complimentary to the policy of ensuring that Commonwealth finances are sustainable.

Given that the bond market is a necessary and positive force that has helped to develop the private financial sector, IFSA recommends an approach that maintains and develops the Government bond market while reducing net debt to zero.

This change to the Government's financial position has already occurred with gross Commonwealth government debt declining more slowly than net debt. This reflects an accumulation of financial assets being held by the government.

The significant reduction in the size of the CGS market is already of concern to market participants. Over the period 1995/96 to 2000/01 the size of the bond market has declined by approximately $60 billion. As such, liquidity and turnover has also declined (see figure 1). A liquid market can be defined as a market in which trades are immediate and large trades have no impact on the bid-ask spreads or current and subsequent prices.

Figure 1[1]



Although the size of the Government bond market that is necessary to maintain liquidity is important, it should not however be our sole

1 Malcom Edey and Luci Ellis, BIS Paper No 12 "*Implications of declining government debt for financial markets and monetary operations in Australia*", pg 29.

focus. Rather, the effect of closing the Government bond market on the development of Australia's capital market and the broader economy should be the central issue.

It may be difficult to address some of these issues, given the difficulties of accounting for the effects of innovation in the event that products that act as a proxy or substitute for the CGS market are developed. However, new markets will not act as a replica for all the functions performed by the CGS market and therefore concern is expressed for potential efficiency losses.

Even though the Government may not require a bond market to achieve funding requirements it could still choose to maintain a CGS market by either paying out the superannuation entitlements of public servants who have retired or resigned (this being IFSA's preferred option) or accumulating a private sector asset portfolio. This outcome would benefit the Government by preserving its ability to access low cost funding while simultaneously meeting demand for liquid and safe securities without removing the infrastructure which may be needed in the future.

Background

Growth in the investment management industry has increased considerably over the last ten years, due mainly to Australia's retirement income policy, to become a significant and dynamic part of the financial services sector. Given the current importance and future potential of the investment funds industry to the Australian economy, it is essential that the Government takes account of the implications on the industry when developing economic policy.

Key Facts:

- In September 2002, assets of managed funds in Australia totalled $A640 billion. The volume of funds under management has increased by a factor of close to three over the 1990s and has roughly doubled over the last five years.

- Average annual growth rates of between 10 and 20 per cent are expected for the industry over the next ten to fifteen years. Average annual growth of 10 per cent would see funds under management in Australia at around $A2.3 trillion (US$1.2 trillion) in 2015[2].

- Superannuation funds accounted for around 70 per cent of the Australian financial market in 2002. Unit trusts make up a further 25 per cent. The market shares of both have increased substantially over the last ten years.

- There are up to 100 investment management specialists operating in the Australian market. These include entities associated with both large and small domestic financial institutions as well as some of the world's largest global asset managers.

- Investment managers are expecting significant growth in revenues, customers and profits over the near term. Employment growth within the industry is also expected to be strong.

The importance of the investment management industry to the Australian economy partly stems from changes to superannuation entitlements put in place in 1992. As a result superannuation assets increased from approximately 20 per cent to around 70 per cent as a share of GDP.

2 Reserve Bank of Australia, March 2000.

This potential for growth has also been recognised by international management firms and is a key driver of global industry participants seeking to establish and build investment management operations in the Australian market.

Assets of Managed Funds

(June 2002 - A$ billion)

	Total	Cross-invested	Consolidated
Superannuation funds	360	63	297
Life Insurance Offices	199	25	713
• of which superannuation	(118)	-	-
Public unit trusts	154	22	131
Other	43	-	43
Total	757	112	645

Source: Australian Bureau of Statistics August 2002

Growth in the total of assets under management has been substantial in recent years, most notably because of the introduction of a broad-based compulsory superannuation scheme[3] but also because of investment earnings. The increase in net contributions and the certainty associated with these inflows has underpinned asset growth and development in market infrastructure.

The importance of investment management funds to Australians is demonstrated by the degree of coverage that superannuation funds have in the workplace. With around 90 per cent of the workforce - up from 40 per cent in the mid 1980s - now making compulsory superannuation payments, almost all Australians have a direct interest in ensuring the best outcome from this Review. If in future years the Government expects Australians to provide for their own retirement through superannuation, the returns gained will have a major influence on the success of the program.

CGS market and Funds Management

Funds Managers and life insurance companies are two of the largest investors in the CGS market. As at September 2002, the ABS data reflects that the funds management and life insurance companies hold approximately $16 billion of CGS. Superannuation accounts

3 Over the 1990s, the minimum rate of employer contribution was increased from 3 to 7 per cent. The rate was increased from 7 to 8 per cent in July 2000 and again to 9 per cent from July 2002.

for over $11 billion which reflects the importance of the CGS market to superannuation beneficiaries.

Overview of the Government bond market

> "Government securities are often considered substitutes for cash, and thus are universally seen as safe havens into which investors can escape during periods of heightened risk. The infrastructure supporting government securities markets – the legal and regulatory framework, trade execution arrangements, clearing and settlement systems, repurchase and derivatives markets, and risk management procedures – enhances the development of non-government securities markets[4]".

There are several key characteristics that distinguish the CGS market from the private securities market. They include:

- minimal credit risk
- high liquidity with a broad range of maturities
- well developed infrastructure (such as repurchase and futures markets)5.

The Government bond market fills an important function in the structure of the Australian economy and is therefore vital to the efficient operation of the domestic financial market. The CGS market is for all practical purposes risk-free, liquid and has a broad range of maturities thereby fulfilling the primary benchmark role. The price transparent nature of the CGS market assists in the efficient pricing of other debt instruments.

A risk-free asset

Government bonds are considered free from default risk given the ability of the Government to finance its debt obligations through increased revenue. It is this attribute that makes CGS a benchmark for risk-free interest rates and therefore unique in the financial market. A lack of default risk and a steady supply of Government bonds has resulted in an efficient, liquid, twenty-four hour secondary market. However, efficiency in this market has recently deteriorated as the size of the CGS market has diminished.

The less efficient CGS market is mainly due to falling liquidity brought about by the smaller number of Government bonds on issue. This falling liquidity is apparent in both the physicals and SFE derivatives markets. Overnight dealing, once a large volume

4 BIS Paper No 5, 2001 p 3

5 IMF "*International Capital Markets: Developments, Prospects and Key Issues*" The Changing Structure of the Major Government securities markets: Implications for Private Financial Markets and Key Policy Issues, Chapter IV p 83.

phenomenon, has almost ceased. Daytime trading has become less efficient as a result. The diminishing liquidity has already impacted negatively on the fundamental functions of the CGS market. Any further erosion of the market is likely to mean that CGS will cease to be an integral part of the financial economy.

In addition, some Government securities such as indexed bonds are free from inflation risk. As such, these securities provide less risk than holding money to maturity.

> "Markets use (central) government debt to calculate prices of other debt and derivate instruments. Such benchmarking is considered to be important for the development of a corporate bond market[6]".

The default-free nature of CGS means that yields on these securities represent the risk-free rate of return. Consequently, the risk-free rate of return is used to analyse the expected interest rate and inflation rates as well as forecast rates of economic growth. The performance of corporate bonds cannot be reliably compared to those of the CGS market, as the risk free nature of CGS allows participants to separate changes in risk. The changes in yield curves permits the disaggregation of risk into changes in credit risk and the risk-free rate. The yield that other assets must provide relative to the risk-free rate is measured by the extra yield offered above that of the CGS market.

Furthermore, a position taken in a corporate debt investment bond is frequently hedged in the CGS market. The willingness to take on corporate debt is influenced by the ability to hedge term/duration risk by using CGS or bond futures. If the CGS market did not exist then its market-making properties would not occur using other types of futures markets. This link between hedging CGS and the liquidity of other markets should be viewed as a cost of dismantling the Government bond market.

A large and liquid CGS market provides the foundation for efficient repurchase and futures markets. The active repurchase market permits market participants to borrow securities and finance their positions while the futures markets permits the trading of securities for future delivery. The CGS market therefore also acts as a reference and hedging benchmark for other fixed-income securities and non-fixed-income securities.

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6 Paul Mylonas et al, "*New Issues in Public Debt Management: Government Surpluses in Several OECD Countries, the Common Currency In Europe and Rapidly Rising Debt in Japan*", The role and uses of government debt in financial markets, Chapter 2 p 5.

Another unique feature of the CGS market is the broad range of maturities that currently make up the CGS yield curve. The risk-free aspect of Government bonds allows for other types of risk to be easily added as a premium to the price of other bond issues, especially at longer maturities.

The risk-free nature of Government bonds allows a yield curve to be developed which is consistent across a broad range of maturities. As the yield curve efficiently reflects the market's views of a risk-free rate of return, then the price is only slightly affected by issue-specific differences in liquidity, supply and demand. Broad ranges of maturities are supplied and are generally more extensive than those provided by other forms of debt such as corporate bonds and interest rates swaps. The amount of liquidity experienced on the physical CGS market, repurchase and derivates markets ensure that cash flows of equal value are traded at the same price[7].

The long-dated maturities of government bonds allows a portfolio manager to buy a risk-free security that extends further into the future than is currently offered on other debt markets. This permits portfolio managers to reduce their refinancing costs and therefore stabilises the cost of borrowing while reducing refinancing risk.

Liquidity

The liquidity and efficiency properties of the CGS market are also important. Government bonds are a benchmark through which other financial assets are priced due mainly to the quality of the information contained within the price of the bond itself. Information available about bond prices is easily accessed and verified, thus highlighting the advantage of government bonds over corporate bonds in terms of setting a risk-free rate and in their use as a benchmark.

The depth of the bond market also plays an important role in reducing the transaction costs of interacting in the market place. This depth adds to the liquidity of the market and therefore reduces the bid-offer spread. A low bid-offer spread enhances the ability of the market to aggregate the information of individual investors into prices[8].

A highly liquid market will produce CGS prices that are close to the market view of what a risk-free asset should cost. As well as

7 Michael J. Fleming, "*Financial Market Implications of the Federal Debt Paydown*", US Treasure Market as a Benchmark and Reserve Asset, p 5.
8 Gravelle, T (1999): "*Liquidity of the Government of Canada securities market: stylized facts and some market microstructure comparisons to the United States Treasury market*", Introduction and Motivation, Bank of Canada, Working Paper no 99-11.

the quality of the information embedded in the price of a bond, liquidity can also affect how quickly information is shared across the market. If these properties are not found in a substitute market, asymmetric and poor quality information will reduce the pricing efficiency of the financial market. This is particularly the case in relation to hedging activities where the benchmark will be less reliable. The lack of liquidity leads to higher bid-offer spreads, which in turn makes the information contained in the price less reliable. Currently, no substitute market can match the pricing efficiency of the CGS market.

By their very nature, Government bonds are the most public of debt contracts. Unlike the borrowings from syndicated banks or those obtained directly from central banks and institutions, bonds generate information for third parties who are not directly involved in the transaction.

Infrastructure

The effectiveness of the CGS market as a benchmark and hedging instrument can be evaluated through comparing its liquid and well-developed repurchase and futures markets to that of other instruments. To be an effective instrument for hedging, Government bond prices must be highly correlated with those in other markets. As shown in the Treasury discussion paper issued by the Government, bonds are highly correlated with other yields.

The ability to borrow money at low cost is important when considering a hedging instrument. Given the low transaction costs of entering the CGS market, large amounts of Government bonds can be bought and sold. Without the depth of the Government bond market, it is debatable whether the current quantity of derivatives transactions could be maintained.

Government bond issues tend to be a homogenous product given that there is only one issuer. Other features such as payment dates and issuance frequencies are usually identical across issues.

Other financial instruments priced using the Government bond market include derivatives, swaps, other assets and future classes of credit. In some cases the CGS market is the only means through which investors can achieve the desired level of risk-return combinations for their portfolios. These types of risk-free long-term securities are especially important to insurance companies and investment funds where there is no genuine substitute available. Should the CGS market be removed, this would mean that institutions would need to contend with greater mismatches between liabilities and assets. This would introduce credit rating implications and ultimately increase cost and administration for fund managers and life insurance companies.

Safe Haven

> "Since the summer, global financial markets have been characterised by heightened uncertainty with investors shunning equities and fleeing to government bonds[9]".

Aside from their benchmarking and hedging roles Government securities fill another important function in the financial sector by acting as a safe haven. That is, CGS act as near monies during periods of instability. This means that over short periods, CGS contain very little market risk and are therefore important as a store of value. Removing government securities may ultimately increase systemic risk to the financial system.

The removal of a safe haven mechanism will reduce the ability of the economy to adjust to external shocks such as the Asian financial crisis and September 11. It could ultimately produce an economy with a higher degree of risk, especially during periods of instability.

There is currently no satisfactory safe haven alternative and it is unlikely that a suitable alternative market would develop in the future. To remove the CGS market from the Australian financial system would put unnecessary strain on the economy during periods of instability and remove an important piece of infrastructure from the Australian market.

The Cost of Re-Opening the Bond Market in Times of Fiscal Deficit

Market liquidity has many dimensions and depends upon the volume and design of the relevant asset. Government bond markets have advantages in this regard as, typically, government security issues are large compared with other bond issues. There is some evidence that larger issue sizes tend to be accompanied by somewhat narrower bid-ask spreads[10].

The amount of liquidity in the CGS market benefits the Government by making it the lowest cost borrower in the market. The risk-free nature of Government bonds contributes to the Govvernment's access to lowest cost debt. However credit

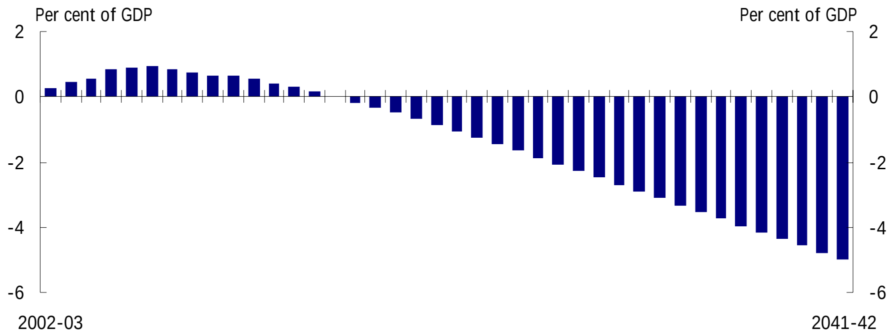
9 Organisation for Economic Co-Operation and Development (OECD), "*Financial Market Trends No. 83 Highlights of Recent Trends in Financial Markets*", November 2002 p 7.
10 Paul Mylonas et al, "*New Issues in Public Debt Management: Government Surpluses in Several OECD Countries, the Common Currency in Europe and Rapidly Rising Debt in Japan"*, Figure 2, p .30

considerations are not the only influence on spreads between different securities and instruments. If the Government were to remove the CGS market from the Australian financial system and an alternative risk-free asset was developed, the Government would not be able to borrow at the lowest market rate in the future. That is, market participants would require a premium to re-enter a market which has been previously removed.

IFSA acknowledges that current Budget forecasts are predicting surpluses to continue into the near future. On present indications, Government debt will be able to retired by around 2005. However, some commentators question the ability to achieve this outcome:

> "If current trends continue, Commonwealth Government spending could rise significantly over the next 40 years. Assuming that revenue remains around the current share of GDP, rising levels of spending would push the Budget into deficit. The gap between spending and revenue could grow to 5 per cent of GDP by 2042 which amounts to $87 billion in today's dollars[11]".

An Emerging Gap Between Revenue and Spending over the next 40 years[12]



11 Budget Overview 2002/03, "*Intergenerational Report: Examining the outlook for future budgets*" p 4.
12 Ibid

Long-term budget pressures notwithstanding, it is possible that the Government's short term projections are inaccurate. Offsetting effects such as lower growth, higher than forecast spending or lower than forecast revenue will see smaller than expected surpluses or result in the budget sliding into deficit.

Given the tragic incidents of September 11 last year, Bali and the effects of the drought which is currently gripping most of the nation, it would not be difficult to imagine an unexpected increase in Government expenditure at reduction in tax receipts. Large increases in government expenditure make it difficult to maintain a surplus even when economic growth is strong.

Given the government's policy is to balance the budget over the cycle, and the eventual payment of debt, it will become necessary for the government to borrow during periods of cyclical downturn.

> "The government debt ratio can decline even when the government is not deliberately reducing debt. Any government that keeps its budget in balance on average over the course of the business cycle will eventually eliminate its debt, if only during the stronger phases of the business cycle. Provided growth in nominal GDP is positive in the long run, the long-run average government debt ratio will asymptote to zero from whatever is its starting point. It will then oscillate around zero. Therefore, a government that tries to maintain fiscal balance on a cyclically adjusted basis will eventually find itself accumulating net assets during cyclical upturns, but seeking to issue debt during downturns. Unless some efforts are made to sustain a continued positive gross debt position, such a government would be forced to re-establish a market for government debt in every cyclical downturn. This is likely to be difficult at the very time investor confidence is weak[13]".

The Government, through the payback of debt and elimination of the CGS market, will need to borrow money to cover its future expenditure. As the CGS market is currently liquid Government bonds are traded at a premium relative to private sector debt. This premium is produced by issuing into a liquid market which reduces the cost to government of borrowing.

13 Malcolm Edey and Luci Ellis, "*Implications of declining government debt for financial markets and monetary operations in Australia*" Development in government debt, BIS papers No 12 p 27.

Financial institutions including fund managers would not participate in occasional Government bond issuances at such low yields as was previously the case due to lower market liquidity. It is of course evident that the government could find buyers for its securities. However these purchasers are likely to reflect a buy and hold stance and the securities would not be used as a means to process flows. However, fund managers may use the securities to process flows if the Government offered a higher yield on the bonds to induce buyers to purchase them in a less liquid market.

This premium in a less liquid market fails to materialise, as the price changes in the bond are greater for a trade of equal size. A greater degree of volatility makes trading more uncertain both on the physical market and the derivatives markets (to the extent a derivatives market would exist). The development of a futures market may take time and therefore the risk management role that the CGS market currently performs may not necessary be reinstated immediately.

A fully functioning and liquid bond market permits the government to borrow large sums of money at low cost when required. Given the likelihood that in the future the Government would need to borrow again, the higher cost of such transactions need to be taken into account before any decision on the future of CGS market is made.

It is necessary to consider the costs associated with a loss of infrastructure for the Government and the financial sector.

Promoting Australia as a Global Financial Centre

The financial community acknowledges the Federal Government's initiative to develop Australia as a global financial centre. However, we query the effect that removing the CGS market would have on this policy goal. Deregulating Australia's financial system is seen as a major contributor to the development of equities, foreign exchange and derivates markets. The abolition of the CGS market would undermine these highly developed structures.

Foreign direct investment into Australia has always been an important factor in helping to develop our financial system. To this end, foreign investors hold approximately 30 per cent of government bonds on issue. The closure of this market may see Australia overlooked by non-resident institutional investors.

If non-resident investors exit Australia's capital market, regional headquarters that have been set up and developed by international firms will move overseas, as Australia becomes less relevant to their investment portfolios.

Other countries have set up their own government bond markets in order to stabilise their financial markets and compete for international funds. Foreign governments have undertaken this course of action without a requirement for funds as these governments are currently running surpluses.

> "For all of these reasons, some market participants question whether financial markets as currently configured can function efficiently without government securities. Indeed, several governments with a history of fiscal surpluses, including those of Hong Kong SAR, Norway and Singapore, have resorted to over funding by issuing debt even when the funds are not needed. The policy authorities in such cases apparently deem the social benefits of government securities markets to be more than sufficient to offset the costs of issuing unneeded debt[14]".

Foreign governments are developing domestic bonds market for a number of reasons. These include aims to assist in the development of other markets such as corporate or swap markets as well as the public good benefits provided by government bonds.

Given the significance placed on the government bond market by other countries, it would appear that the Treasury discussion paper has underestimated its importance in Australia. IFSA submits that the innate nature of Government bonds provides market and economic stability.

The Importance of the Government Bond Market to Fund Managers and Superannuation Industry

IFSA submits that the Treasury discussion paper does not give sufficient weight to the importance of the CGS market to the funds management and superannuation industry.

> "At the end of the March quarter 2001-02, superannuation funds reported total assets of around $500 billion, with CGS accounting for less the 5 per cent of these assets. The very small contribution of CGS to total assets suggests CGS may not be a crucial

14 BIS Paper No 5, 2001 p 3.

> instrument in the investment strategy of the superannuation sector at the moment[15]".

This analysis overlooks the fact that, as a single issuer, CGS are held to a greater extent that any other issuer in Australia. Superannuation funds greatest risk exposure to a single entity is the Federal Government. Since 1995 bond issuance by the Federal Government has fallen while the quantity of assets under the control of superannuation funds has risen.

The importance of the CGS market to the superannuation industry is demonstrated by the results of a survey recently conducted by IFSA (Appendix 1). Key questions centred around the suitability of various substitutes to the CGS market. The survey results indicate that many of the alternatives may be somewhat effective substitutes for CGS in some respects. However, the alternatives are not considered to be suitable substitutes in respect to all functions performed by the CGS market. In particular, all alternatives were considered to be poorly effective instruments for long-term debt management or as a safe haven investment. The reasons for these views are indicated in the following section.

According to the results of the IFSA survey, corporate bonds were seen as inefficient substitutes for Government bonds in respect to almost all of it current functions. Interest rate swaps and US treasury bonds performed marginally better although they were still considered to be less efficient than the current CGS market.

When asked about possible or future alternatives for a safe haven, IFSA members responded unequivocally – there is no alternative. Matching liabilities with assets for both the superannuation and insurance sectors is of vital importance. This is perhaps why 80 per cent of respondents believe that their ability to do this would be impaired if Government bonds were removed from the Australian market place. Given these results, it must be stated that the CGS market does play an important role in relation to the efficient management of superannuation funds and insurance portfolios.

The CGS market is also important for superannuation funds because there are currently no substitutes for the long-term, low-risk debt securities. With this in mind, the long-term and risk-free nature of the CGS market is unique and fund managers do not see a suitable alternative becoming available in the future. In fact, rating agencies encourage insurance and superannuation companies to invest in long-term securities (predominantly offered though the

15 Discussion Paper, "*Review of the Commonwealth Government Securities Market*", Role of the Commonwealth Government Securities Market Chapter 3, p 51.

CGS market) if they have long-term liabilities. The lack of long-term assets is considered an important failure of the private securities market by long-term investors. This lack of a suitable long-term investment asset means that superannuation companies will need to manage the growing "gap risk" caused by the mismatch of their assets and their liabilities. If is not well managed, this gap could cause serious stability issues for the domestic market.

The long-dated corporate bond market is presently seen as inadequate to fill the roles of the CGS market. This stems from the fact that the supply of other long-dated maturities would not be sufficient if Government bonds are removed from the market. The superannuation industry also requires any long-term bond to be risk-free or "low-risk" in order to appeal to an aging population. This is required in order to fulfil the asset allocation preferences for clients who become more risk adverse as retirement age grows nearer. This trend towards portfolios including risk-free assets will continue as Australia's population ages, as highlighted by the Government's recent Intergenerational Report.

IFSA's members underwrite annuities that are substantially underpinned by CGS. The Government explicitly gives these products a social security preference by way of assets test exemption as well as special RBL arrangements. These products are such that the investment risk is with the life insurance company as opposed to the retiree. Government bonds allow the life insurance company to offer a product which has a guaranteed income stream.

If the Government were to, either overnight or over a period of time, redeem its CGS portfolio, the following problems would be experienced:

- diminished opportunities for retirees to purchase guaranteed products
- lower levels of competition for these products as fewer providers would be able to offer these sorts of products
- increased costs in offering such products as they would need to be backed by higher risk assets as well as hedging overlays.

Fund managers also require in their portfolios an asset that is liquid so that during periods of inflows and outflows the manager can transact quickly and efficiently in securities with tight pricing spreads. These low bid/offer spreads protects the interests of other unit holders from fluctuations in unit pricing caused by the decisions of some unit holders to redeem their investments. As such, the CGS market is integral to ensuring investor confidence in the liquidity of the managed investment market and the pricing mechanism for applications and redemptions.

Liquidity is also important to fund managers because of legal obligations set out under the Corporations Act 2001. Under the law, in order for a fund to be a liquid offering it must be composed of at least 80 per cent of liquid assets. The CGS market is an important part of meeting this obligation. Currently other investment vehicles such as corporate bonds are sufficiently liquid to perform this legal requirement. However they often induce a higher bid-offer spread in the corporate market. This characteristic of corporate bonds, if they were to be traded actively as a mechanism to provide the necessary or required liquidity for unit holder,s would result in the dilution of returns for investors.

Alternative Benchmarks

Advocates for winding back the CGS market inevitably consider that the market will produce new instruments that can effectively replace the risk-free, liquid nature of the CGS market.

An important question is whether private substitutes exist, or can be created, for pricing and quoting private debt instruments and hedging interest and private financial risk in a manner that is as efficient as the current CGS market. Obviously, market participants will incur transitional costs in transferring to alternative markets. However the degree and nature of the permanent cost increases that arise from the removal of the CGS market need to be evaluated closely. Issues include the lack of a credible substitute for the safe haven properties of the CGS and the reduction in efficiencies for other important roles performed by the CGS market.

Corporate bond market

In contrast to the CGS market, which has steadily become smaller over the last few years, the corporate bond market has grown remarkably. This success has led some to believe that such a market could in fact act as a substitute for the CGS market. This would entail using corporate bonds as a benchmark to price other corporate issues, as well as serving as the foundation for a derivatives market.

While the growth in the issuance of corporate bonds is undeniable, what is of interest is that only a portion of this debt is AAA rated or high quality debt. The majority of corporate issuance are A-rated. If corporate bonds are to act as a substitute for government debt then it would have to rely on companies with a high rating. Due to the lack of appropriately rated corporate bonds, it is unlikely that a corporate market will be able to replace the decline in the number of Government bonds issued.

Currently, the corporate bond market does not provide the level of depth and liquidity as compared to that of the CGS market. As well as the shortcomings previously noted, the corporate bond market does not provide the necessary range of maturities to form a reliable yield curve.

> “Government debt securities are usually issued into a limited number of maturities (or benchmark lines). For example, the Commonwealth Government currently has 11 benchmark Treasury bonds with an average of around $5 billion on issue in each line. The concentration of

> issuance into a limited number of benchmark lines promotes market liquidity".
>
> "Benchmark lines of government debt securities are usually spread over a wide range of maturities. The Commonwealth's 11 benchmark lines are distributed reasonably evenly from less than one year to 13 years to maturity".[16]

The above statements indicate Treasury's view as to why the CGS market works so efficiently. The CGS market is consistently liquid and diverse, thereby making it far superior to the corporate bond market.

> "Corporate bond maturity is concentrated at the shorter end of the yield curve. Over half the bonds on issue have a maturity of less than 3 years. Only 11 bonds, accounting for 9 per cent of outstandings, have a maturity greater than 6 years[17]".

This compares to the corporate bonds issuance where an average amount outstanding in any particular security is around $300 million with approximately 260 benchmark lines. The corporate bond market not only lacks the depth of the CGS market but also the depth to act as a benchmark in it own right.

> "Ideally, the issuer(s) of such securities would regularly offer a wide range of maturities in large homogeneous chunks that facilitate turnover[18]".

However, corporate bonds are heterogeneous given the varying risk across companies and sectors. This idiosyncratic risk evolves through changes in the price of a bond due to the unique circumstances of the firm or sector and is not passed onto the market. This can affect the individual firm's credit rating and as such, it takes a considerable amount of investment in research to monitor those changes. Although this type of risk can be almost eliminated through diversification of portfolios, it still represents an additional cost to fund managers which ultimately impacts on investment returns.

This heterogeneity allows for a yield curve to be formed over short-dated maturities. However, over the longer term the yield curve

16 Discussion Paper, "*Review of the Commonwealth Government Securities Market*", Role of the Commonwealth Government Securities Market, Chapter 3, p 32

17 Reserve Bank of Australia Bulletin, "*Corporate Bond Yields in Australia*", June 2001 p 6.

18 Albert M. Wojnilower, "*Life Without Treasury Securities*" Corporate Bond Insurance, Business Economics October 2000 p 12.

breaks down. The corporate bond yield curve will explicitly reflect a differing credit risk as the yield curve moves further away from the present. This degree of heterogeneity makes it almost impossible to develop a range of liquid hedging instruments that utilise the corporate bond market as a benchmark. Corporate bonds are not a perfect substitute for each other.

It would be extremely difficult for corporate bonds to act as a safe haven in periods of financial stress given that the volatility of corporate bonds is generally highly correlated with that of the economy at large.

Swaps market

Fundamentally, an interest rate swap is an agreement by two parties to swap a fixed-interest-rate loan for a floating loan or to exchange one stream of income for another stream. Interest rate swaps are traded on over-the-counter (OTC) markets and used by institutions and corporations to manage their interest rate risk. The diverse nature of these swaps makes it difficult to hedge against risks associated with swaps and this may aggravate liquidity problems. Swaps, unlike Government securities, are not risk-free as they involve a small degree of credit risk.

The interest rate swap market in Australia has grown rapidly in recent years with turnover exceeding $1000 billion dollars. This growth does not, however, make the interest rate swap market a suitable substitute for the CGS market. There remains a lack of liquidity beyond the five year mark thus making it impossible for use as a benchmark for longer-term investments of the kind generally required by superannuation and life insurance companies.

The risk of default from the counterparty in the longer term means that the yield curve for the swaps market is steeper. This represents an increase in costs over that of the GCS market for institutions using capital markets.

> "The transitional issue is that the swaps market is insufficiently commoditised to hedge the various risks that have historically been hedged in the treasury market. This is partly a result of the broader difficulty in creating traded futures and options markets in non-government securities because private credit risks are heterogeneous[19]".

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19 Garry J. Schinasi et al, "*Financial Implication of the Shrinking Supply of US Treasury Securities*", How Might the Ability to Hedge Interest-Rate Risk be Affected, International Monetary Fund March 2001 p 26.

If this is the case for the US market, which has the most highly developed and liquid market in the world, it would seem that Australia's capital markets would have immense difficulty in succeeding where the American market has not.

Interest rate swaps are bilateral agreements and are therefore not traded in the same manner as Government bonds. This raises concerns about the possible liquidity of the market and whether it could ever become as liquid as the CGS market. As a consequence this may increase the cost of "insurance" due mainly to the increased cost of adding and removing hedges. The extent to which this arises as a problem will, however, depend on how commoditised the swap market becomes. There is currently no futures market for swaps.

> "Exchanges are trying to capitalise on the fact that the OTC swap market continues to face some of the limitations associated with decentralised and customised marketplaces. In such markets, participants tend to maintain a large number of bilateral counterparty relationships since each new transaction involves the writing of an additional contract with a dealer. Moreover, time and administrative costs tend to complicate the transfer (or "assignment" in market terminology) of contracts from one counterparty to another For example, although swaps can be transferred to any mutually acceptable counterparty, both original counterparties must first agree on a new one before the transfer can proceed, which involves some inconvenience[20]".

It should be noted that replacing bonds as the main instrument for benchmarking and as a liquid asset for adjusting portfolios will introduce both accounting and administrative complexities due to the non-investable nature of swaps. The number of transactions increases as time goes by, leaving the fund with numerous contracts and counterparties. While there is a place for swaps in portfolio management, they are not a replacement or substitute for government bonds.

A large, liquid and developed pool of Government Bonds provides the market a safe haven from financial instability. During periods of instability and the default of counterparties, the swap markets liquidity can come under serious duress.

20 BIS quarter review March 2002 Part 4 p 38

The four major banks trading various instruments dominate the swap market in Australia. This structure may constitute a market that it is less transparent and efficient than what is currently available through the CGS market.

US dollar or other denominated treasuries

Another proposed alternative to CGS is to use international capital markets as a benchmark and safe haven instrument. Using foreign currencies as a risk-free alternative to the CGS can only be achieved if this transaction is undertaken with a currency swap given the introduction of an exchange rate risk. This additional transaction increases the cost of investing in risk-free bonds and therefore reduces the effective yield.

In order to mitigate exchange rate risk, 10 year US treasury bonds paid semi-annually will require each income stream to be hedged. This represents an unnecessary cost to business and an increase in administration. It would require entering into a swaps agreement with commercial banks as the counterparty thereby introducing counterparty risk and thereby removing the risk-free status of US treasury bonds. This is not a suitable alternative to the CGS market, which offers Australian denominated risk-free assets.

What is perhaps more important is the fact that the price of bonds and the yield curve reflect current and future economic conditions as well as inflation and interest rate expectations. Removing the CGS market would have implications for the role of bonds in performing this function in the Australian market.

Public Superannuation Liabilities

The Federal Government currently has an outstanding debt of approximately $84 billion dollars of unfunded superannuation. This represents a stream of annual payments that must be funded from annual receipts. If the Government is to retire its outstanding debt it is necessary to include such liabilities in public finances so as to inform the public of the Government's true debt obligations.

Privatising unfunded superannuation liabilities through implementing choice of fund

The privatisation of the Government's superannuation liability would negate the need for a dedicated pool of assets to be set up at arm's length in order to fund the public superannuation liabilities. It would not require the development of special governance procedures or Government resources to be allocated to scrutinising such a fund. This policy is also consistent with the Government's position of providing superannuation choice for consumers.

Currently there are a substantial number of public servants who have either retired or resigned from the public sector and have preserved their Commonwealth benefits. Therefore the issuance of debt to fund superannuation liabilities must take into account the "backlog liabilities" that have accrued in the past and have not been funded, as well as liabilities that continue to accrue.

To discard this debt the Government would simply:

- calculate the actuarial value in present dollar terms of these benefits for each beneficiary
- communicate with these individuals offering them with an option to take a lump sum
- requiring individuals to roll over their lump sum into the private sector superannuation market. It would continue to have preservation, RBL and superannuation tax characteristics

This option could then be used to continue to fund the ongoing liabilities for those who retiree or resign in the future. If considered appropriate, this option could be in addition to developing a dedicated pool of assets for those public servants who do not wish to privatise their Commonwealth superannuation entitlements.

Creation of a dedicated pool of assets

The policy of past and present Governments has been to fund superannuation liabilities as they fall due. As such, a dedicated pool of assets or reserves to pay off future liabilities does not exist. Given the Government's strong track record for paying national debt, it is now important to debate and consider ways in which total national liabilities can be properly managed. The current situation has led to debt management in Australia becoming a real issue. The funding of superannuation liabilities is one option for maintaining a CGS market.

One of the primary reasons as to why governments have chosen not to fund such liabilities on an ongoing basis is their capacity to raise revenue through increased taxes. Through the maintenance of operating cash surpluses and the sale of assets, net public debt will continue to fall. Falling net debt allows the Government to make decisions about whether or not it is necessary or prudent to remove the CGS market.

As stated previously in this submission, there are direct and tangible benefits for Government in retaining debt in the marketplace. Combined with the transitional and permanent costs involved with removing the CGS market, the Government must consider alternative measures. Maintaining a minimum level of gross debt will eliminate the costs of re-establishing the CGS market in the future when an aging population and health costs increase expenditure and net debt. Given the issues raised in the Treasury Intergenerational Report, this option will be more sustainable than relying on the ability to increase taxation revenue in the future.

Funding superannuation liabilities provides the Government an opportunity to manage those liabilities before they fall due. This means that with operating surpluses or debt the government can choose its expected rate of return simply by investing in different types or degrees of risk associated with assets.

Risk, Governance and Investment Objectives

If the Government continues to reduce its debt, savings are delivered to the public via reduced interest payments. However, an investment in Government bonds will have a negative effect on the financial markets. An alternative would be to invest in assets which have the potential to provide a return greater than the interest payments on the debt used to finance their acquisition. Over the long term, investing in a diversified portfolio could provide a return that is higher than the rate at which those assets were funded, as has historically been the case.

Once the decision to invest in growth assets has been made, the Government must decide the amount of risk exposure it will take on in terms of investing in different assets. Any funds raised by CGS in excess of those required for the Budget must be considered in light of the degree of risk exposure and the policy objectives of the Government. This would be achieved within an appropriate governance regime.

Governance arrangements are necessary to ensure that the fund is appropriately administered in accordance with necessary checks and balances. Governance procedures would require that any funds be at arms length from the Government as an assurance that they were used only for their stated objectives. Any set of procedures should minimise the chance of such a fund being used to achieve short-term goals and for purposes not originally intended.

Once the objective of the fund is stated, issues of governance become relatively easier to devise. Trustees would comprise an independent board which has responsibility for the establishment and management of the fund. Strict rules would govern various issues including the manner in which funds may be withdrawn, and annual monitoring and reporting requirements.

Alternatively, portfolio immunisation could be achieved by outsourcing the management and responsibilities to an independent agency, eg the RBA or new agency. Although the RBA already holds fixed income investments, the government in its discussion paper stated:

> "While this facility is appropriate for short-term management, it is not considered appropriate to require the RBA to perform the role of funds manager on behalf of the Government for a large and ongoing portfolio of financial assets[21]".

However no explanation or reason was given for the above stance. A portfolio run by the RBA, or other agency, would be independent of the government and thus could not be influenced to achieve objectives that were not set out originally. Funds management could also be managed in a similar way to the management of current contributions to Commonwealth Government superannuation schemes. This fund could be overseen by the Australian Office of Financial Management (AOFM) or another agency, and would serve as the point of contact for the client (namely the Australian government).

21 Discussion Paper, "*Review of the Commonwealth Government Securities Market*", Options available to the Commonwealth Chapter 2 p 75.

State Government approach to Superannuation

In most cases State Government superannuation liabilities represent the largest unfunded liabilities. Some jurisdictions have made payments to fund these liabilities before they fall due (see table below)

Table 1[22]

Jurisdiction	**To Fully Fund Annual Accruing Liabilities**	**To Fully Fund Backlog Liabilities**
Commonwealth	No, on emerging basis	No, on emerging basis
NSW	Yes, by year 2020	Yes, by year 2045
Victoria	Yes	Yes, by year 2047
SA	Yes	Yes, by 2025
Qld	Yes, now	Yes, now
WA	Yes by 1998-1999	No, on emerging basis
Tas	No	No, but one-off payment
NT	No, on emerging basis	No, on emerging basis
ACT	Yes, not yet decided how	Yes, not yet decided how

Jurisdictions such as NSW, WA and Victoria have made one-off payments towards their superannuation liabilities. The Victorian government provided $855 million in 1998-99 as part of a number of payments that are expected to reduce the future cost of superannuation liabilities of the state. By reducing the net liabilities through these one-off payments, the States will be provided with an interest income that can then be used to both offset the emerging funding requirements and improve the operating result.

Successive Queensland Governments have implemented a policy of continually accumulating asset reserves in order to meet assessed superannuation liabilities. Western Australia has set up an external superannuation fund that is independent of the public sector.

22 A report from Banker Trust and KPMG, "*Unfunded Superannuation, Accrual Accounting and Public Sector Liabilities*" Status of Superannuation Liabilities Across Jurisdictions, chapter 5 p 17.

Conclusion

The Government's current fiscal situation has put it in a position that requires it to consult with stakeholders on the effects that removing the CGS from the market will have on the Australian economy.

If the Government continues to produce surpluses and maintains its policy of privatisation in order to reduce its debt, then the effects of a diminished and less efficient bond market will begin to seriously affect the financial sector. Already preliminary impacts have been felt in the CGS market in the form of falling liquidity.

The removal of Government bonds from the market result in Australia's financial system utilising a less efficient, less liquid and less transparent substitute. This is not to say that alternatives would not arise, however these alternatives would be inferior in all aspects than the current risk-free, liquid and stable government bonds.

The roles any substitutes would need to perform would include:

- minimal credit risk
- high liquidity with a broad range of maturities
- well-developed infrastructure (such as repurchase and futures markets)

At presently, no Government has deliberately eliminated its securities due to a zero debt policy. In fact, many governments are building assets portfolios for future liabilities and maintaining their current markets. Still other governments are taking on debt and deliberately trying to build a stable government bond market.

Should the Government abolish the CGS market Australian business will be reliant upon corporate bonds, US treasuries and swap markets to perform the CGS tasks, all of which are too underdeveloped in Australia to perform as adequate substitutes. The absence of the CGS market will create higher risk in the economy leading to debt issues paying higher yields to attract capital.

The Government does have alternatives which permits Australia to retain the CGS market while adhering to a policy of zero net debt. One such option is to fund the currently unfunded superannuation liabilities, which are projected to force the Government into a fiscal deficit requiring the re-opening of the Government debt market. IFSA submits that in order to achieve this goal:

- the CGS market should be retained;

- retired or former public servants can have the option of rolling over their current Commonwealth entitlements to the private sector superannuation industry;
- in conjunction or addition, an appropriately governed investment pool could be maintained at arm's length to the Government. As stated above, this approach has been tested by other governments and is prudent in terms of long-term fiscal responsibilities.

The Federal Government can avoid the consequences of removing the CGS market simply by maintaining gross debt in a manner consistent with overseas experience. In IFSA's opinion, removing the bond market must be avoided.

Appendix 1
Questionnaire on the Possible Elimination of the Market for Commonwealth Government Securities

A review by Treasury is currently taking place into the Commonwealth Government Securities (CGS) market. Because of the fall in government debt and the possible sale of Telstra all government debt may be eliminated over the next few years. There therefore may soon be no CGS market in Australia. The following questionaire seeks information on the importance of the CGS market to your business and the effect that eliminating the CGS market would have.

Please tick the appropriate response.

Number of Respondents: 15

1. Do you currently maintain a portfolio of Commonwealth Government Securities?

    Yes 100% No 0%

2. The Government is considering the abolition of this market because it wishes to remove all public sector debt. Do you believe the government should eliminate the sale of CGS?

    Yes 20% No 80%

3. How important to your business is the CGS market (including derivates) for each of these uses?
   Please use the following scale in answering this question.

    1 Very important
    2 Somewhat important
    3 Not important

Importance to Your Business

	Very	Somewhat	Not at all
Pricing private debt securities	80.0%	0.0%	20.0%
Quoting yields on private securities	53.3%	26.7%	20.0%
Managing interest rate risk	80.0%	0.0%	20.0%
Long-term debt management	73.3%	13.3%	13.3%
As a safe haven instrument	73.3%	20.0%	6.7%

Other uses:

- Liquidity and cash flow management – CGS are the most liquid fixed interest rate assets.
- Also underpins some member's assets allocation processes – providing the starting point for discussions.
- Also used as risk rebalancing item/method in product decisions for insurance.

4. How effective would the corporate bond market be as an alternative to the CGS market?

Please use the following scale in answering this question.

1 Very effective
2 Somewhat effective
3 Not at all effective

Effectiveness of Corporate Bond Market as an Alternative

	Very Effective	Somewhat Effective	Not at all Effective
Pricing private debt securities	13.3%	53.3%	33.3%
Quoting yields on private securities	13.3%	53.3%	33.3%
Managing interest rate risk	13.3%	20.0%	66.7%
Long-term debt management	6.7%	33.3%	60.0%
As a safe haven instrument	6.7%	20.0%	73.3%

5. How effective would the interest rate swap market be as an alternative to the following functions currently performed by the CGS market?
Please use the following scale in answering this question.

1 Very effective
2 Somewhat effective
3 Not at all effective

Effectiveness of Interest Rate Swap Market as an Alternative

	Very Effective	Somewhat Effective	Not at all Effective
Pricing private de securities	15.4%	84.6%	0.0%
Quoting yields on priva securities	7.7%	80.0%	0.0%
Managing interest rate ris	15.4%	53.3%	20.0%
Long-term de management	7.7%	33.3%	46.7%
As a safe haven instrume	7.7%	13.3%	66.7%

6. How effective would U.S. Treasury bonds be as an alternative to Australian CGS?
Please use the following scale in answering this question.

1 Very effective
2 Somewhat effective
3 Not at all effective

Effectiveness of U.S. Treasury Bonds Market as an Alternative

	Very Effective	Somewhat Effective	Not at all Effective
Pricing private debt securities	7.1%	35.7%	57.1%
Quoting yields on private securities	14.3%	26.7%	53.3%
Managing interest rate risk	14.3%	53.3%	26.7%
Long-term debt management	14.3%	53.3%	26.7%
As a safe haven instrument	35.7%	53.3%	6.7%

7. In considering the elimination of Australian CGS in your view are there alternative safe havens available now or which could be developed in the future that could provide equivalent security?

   Yes 21.4%
   No 78.6%

   If 'yes' please specify:
   - Nothing could adequately replace CGS.
   - There are alternatives but these would be more cumbersome and administratively difficult to manage and would involve extra risk a therefore a nightmare when managing large portfolios.

8. What effect would the removal of the CGS market have on the arrangement of your portfolio to match liabilities and assets?

It would make it more difficult	80%
There would be no change	20%
It would be less difficult	0%