

UK DMO Consultation on issuance of ultra-long gilt instruments

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United Kingdom **Debt Management Office**



Launch of the UK DMO consultation at PBR 2004

At PBR 2004 the Chancellor of the Exchequer asked the DMO to consult on the possible introduction of:

- ultra-long (circa 50-year) conventional and index-linked gilts;
- ultra-long (circa 50-year conventional and index-linked annuity-type gilts.



Background to the consultation

Continuous monitoring of market developments and dialogue with investors;

⇒ Informal talks with pension industry participants:

- Asset managers;
- Trustees;
- Consultants, actuaries.

⇒ Gauging the size and nature of investors' demand for gilts going forward.



Background to the consultation

Distribution of gilt holdings at end Q2 2004 (£ millions)

Insurance companies and pension funds	216,292
Overseas	64,511
Other financial institutions	32,091
Households,	27,911
Local authorities and public corporations	3,002
Building societies	600
Banks*	-7,022
TOTAL	337,385

* Repo positions

Source: ONS



Background to the consultation

Stakeholders suggested different areas where there may exist no or insufficient supply of high-quality bonds:

- Index-linked bonds;
- Bonds with long and ultra-long maturities (e.g. 50 years);
- Bonds with alternative cash flow structure (fixed-term annuities);
- Index-linked bonds with limited price indexation (LPI bonds);
- 'Longevity bonds'.

⇒ Should HMG supply such instruments to meet demand?



HM Government's debt management policy objective

“to minimise over the long-term the costs of meeting the Government's financing needs, taking into account risk, whilst ensuring that debt management policy is consistent with the aims of monetary policy”



HM Government's (wholesale) debt management strategy

- Pursuing an issuance policy that is open, transparent and predictable;
- Issuing gilts that achieve a benchmark premium;
- Adjusting the maturity and nature of the Government's debt portfolio by means of the maturity and composition of debt issuance and other operations;
- Developing a liquid and efficient gilts market.



HM Government's (wholesale) debt management strategy

The maturity and composition of debt issuance is determined taking into account:

- The investors' demand for gilts;
- The Government's own appetite for risk;
- The shape of the yield curve.



Focus of the consultation on ultra-long gilts

Instruments:

- Gilts with ultra-long maturities;
- Gilts in fixed-term annuity format;
- Conventional and/or index-linked.



Focus of the consultation on ultra-long gilts

Questions:

- Potential demand for new instruments in 2005/06 (and beyond);
- Issuance procedure;
- Instrument design;
- Timing for introduction of new instruments;
- Potential advantages/disadvantages with issuance of new instruments;
- Market making responsibilities.



Next steps

- Deadline for responses to DMO consultation was 21 January 2005;
- HMT / DMO currently assessing business case;
- Any decision to proceed with issuance of ultra-long gilts would be announced in Budget 2005/06 and incorporated in DMO remit for 2005/06.
- Summary of responses to the consultation to be published on the DMO website (www.dmo.gov.uk)



Longevity bonds?

Not a focus of the ongoing consultation:

⇒ Issuance of longevity bonds would raise policy issues (outright transfer of longevity risk onto the Government's balance sheet) that extend beyond a strict interpretation of debt management considerations.

But HMT keeps an open mind:

HMT / DMO may revisit the issue at a later stage.

⇒ HMT / DMO interested in monitoring market developments and in views on potential demand for longevity bonds.

