Remit Flexibility
A Debt Management Office Consultation Document

A response by

The National Association of Pension Funds
October 2006

This response is from the National Association of Pension Funds (NAPF). The NAPF is the leading voice of workplace pension provision in the UK. Some 10 million working people are currently in NAPF Member schemes, while around 5 million pensioners are receiving valuable retirement income from such schemes. NAPF Member schemes hold assets of some £750bn, and account for over one sixth of investment in the UK stock market.

The NAPF welcomes the opportunity to comment on the flexibility of the DMO's remit.

Questions

1. *The introduction of limited remit flexibility was designed to allow the DMO to increase its ability to respond to substantial changes in market conditions and patterns of demand throughout the current financial year. Do you think that those objectives have been met?*

Yes, the NAPF believes that flexibility has met its objectives. On the other hand, market conditions have been stable. The test of flexibility will be during times of market turbulence.

2. *Do you think that the introduction of limited remit flexibility has been a positive development?*

Yes, issuance should have been concentrated even more in long term maturities and in index-linked, in order to take advantage of the inverted curve and low yield. The degree of flexibility needs to be still greater.

3. *If you answered no, could you say why?*

4. *Could you indicate whether you think that the amount of supplementary issuance (£10bn) has been a) about right, b) too much or c) too little*

Could you say why?

(c) too little. More flexibility could have achieved greater issuance of index-linked and longer maturities. There is clear demand for this as can be seen from the persistent inversion of the yield curve. Structural and regulatory change have both increased the demand of pension funds for long maturities. The context is that at end-2004 (latest available data) pension funds held £20.8 billion of maturities over 15 years; this was 23.8% of their total gilts holdings. Index-linked debt accounted for 52.9% of gilts holdings. So these two categories accounted for more than 75% of total gilts holdings of pension funds. Over time, the regulatory need for pension funds to increase their holdings of long-dated and indexed gilts should slow, and holdings will reach a sustainable level. In 'normal' years, the current level of flexibility (16% of total issuance) may be too high. But for the time being, the NAPF believes that more flexibility is needed.

5. *The introduction of the remit flexibility meant that a proportion of the allocation of the Government's gilt sales plans was not known at the beginning of this financial year. Do you think that this has impacted adversely on your perception of a predictable and transparent issuance regime?*

If yes, could you say how?

No, the limited degree of flexibility has not impacted significantly on the perceived predictability or transparency of the issuance regime

6. *Do you think that announcing the quarterly auction calendars a month earlier than before has produced benefits for the market?*

Could you expand on your opinion, and are you in favour of continuing this innovation in 2007-08?

Yes. The NAPF believes that the earlier announcement of a quarter's gilt sales has increased the transparency of the market and has allowed GEMMS and end investors to position their books with a long lead time prior to the start of the auctions. The NAPF favours the continuance of this recent innovation.

7. *Did you understand the basis on which the DMO has made the allocations of supplementary issuance in the first three quarters of this financial year?*

Yes

8. *Do you think that the DMO has provided clear explanations of its decisions to allocate the supplementary issuance in the first three quarters of the financial year?*

Yes

9. *If you answered no to question 7 or 8, could you indicate in what ways the DMO might have acted to provide clearer explanations of its decisions to allocate the supplementary issuance.*

10. *Do you think that the new remit commitment to regular issuance of conventionals at key maturities (5- and 10- year) combined with regular* *issuance of at long maturities (both conventional and index-linked) has been beneficial for the market?*

Could you expand on your opinion, and are you in favour of continuing this innovation in 2007-08?

Yes. At end-2004, pension funds held more than £67 billion of long maturities and index-linked gilts. Structural and regulatory factors will imply a continuing desire for some years yet to boost weightings of these instruments within portfolios. So the NAPF believes it important that there is a commitment to issue in these areas of the market. The hump of redemptions that will occur in short maturity gilts in 2007 and 2008 also argues for a commitment to supply this area of the market. And the increasing prevalence of derivatives requires a liquid 10-year maturity to be available to the market for hedging purposes on a consistent basis.

11. *Has the introduction of the remit commitment to regular pattern of issuance impacted positively on your perception of a predictable and transparent issuance regime?*

Yes

12. *The limited remit flexibility was intended to be a temporary change in response to difficult market conditions at the beginning of this year. Do you think that there is a case for the remit flexibility to be carried forward into 2007-08 or beyond?*

Yes

13. *If you answered yes to question 12, please say why.*

It is not possible to predict the onset of market turbulence, so the NAPF believes it is important to preserve an element of market flexibility.

14. *Should any future element of flexibility be implemented in the same way as in 2006-07?*

Different from 2006-07

15. *If you answered "different from 2006-07" in question 14, could you say in what ways you think it should be different?*

The NAPF feels that insufficient weight has been given to pension fund views, as expressed at the quarterly meetings with the DMO. Taking Q4 2006 issuance as an example, there has only been one issue with maturity over 30 years. This is despite a seasonal tendency for yields on maturities over 30 years to fall in Q4, due to funds and trustees tending to manage their liabilities in the final quarter of the calendar year. Maturing shorter-dated bonds should be replaced with gilts of maturity 30 years and over.

16. *Do you think the quarterly consultation meetings are the best forum for discussing the implementation of remit flexibility?*

Yes

17. *If you answered no to question 16 could you say how you would prefer to see consultation with the market handled?*

The NAPF believes that there could be more use made of email consultations, additional to the regular quarterly meetings.

18. *If you have you any other comments on the impact of these changes on the delivery of the remit in 2006-07, could you please elaborate on them?*

There has been discussion of a swap programme which arguably might help investors to match long-term liabilities without moving gilt indices. The DMO should consult on this. Another idea is to issue future dated index-linked annuities which could be bought by defined contribution pensioners in order to ensure that they have a future index-linked asset stream from their intended retirement date.