United Kingdom
Debt
Management
Office

UNITED KINGDOM

DEBT MANAGEMENT OFFICE

Super-long and Perpetual Gilts:

A Consultation Document

25 May 2012

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Introduction

1. In March 2012, the Government announced that it would consult on the case for issuance of gilts with maturities significantly longer than those currently in issue (in excess of 50 years, herein referred to as “super-long” gilts) and/or perpetual gilts.

2. The Government is consulting to build an evidence base to consider whether or not to issue super-long and/or perpetual gilts. Before undertaking issuance, the Government would need to be satisfied that doing so would be consistent with achieving its debt management objective, minimising the Government’s costs of financing over the long term, taking into account risk.

3. In that context, the decision as to whether the Government will issue super-long and/or perpetual gilts will be driven by an analysis of the value for money of issuance for the Exchequer and how such issuance would contribute to the overall balance between cost and risk in debt management. This analysis will be informed by considerations on the depth and sustainability of investor demand for such instruments and the potential impact of issuance on the long-term functioning of the gilt market.

4. Responses to this consultation paper should be sent by **close of business on 17 August 2012 to:**

James Knight
UK Debt Management Office
Eastcheap Court
11 Philpot Lane
London EC3M 8UD
E-mail: policy@dmo.gsi.gov.uk

5. Respondents are requested to submit responses to the consultation in writing[1]. Market participants may request a meeting with the UK Debt Management Office (DMO) following the submission of their written response to follow up any points raised or to discuss the matter more generally.

[1] Please note that the DMO is subject to the provisions of the Freedom of Information Act 2000 and consequently information disclosed by us in response to requests for information under the Act could enter the public domain. If you are providing information that is commercially sensitive please mark it as such and we will endeavour not to disclose it to the extent that such non-disclosure is permissible under the Act.

1. Background and Rationale for Consultation

6. The Government's debt management objective is*: "to minimise, over the long term, the costs of meeting the Government's financing needs, taking into account risk, while ensuring that debt management policy is consistent with the aims of monetary policy."*

7. The Debt and Reserves Management Report 2012-13 set out that, in the light of evidence of ongoing strong demand for long maturity gilts and against a backdrop of historically low long-term interest rates, the DMO would consult on the case for issuance of gilts with maturities significantly longer than those currently in issue (i.e. in excess of 50 years) and/or perpetual gilts.

8. This consultation seeks to inform an assessment of whether issuance of such instruments would represent value for money for the Exchequer and how such issuance would contribute to the overall balance between cost and risk in debt management.

9. The Government currently issues conventional gilts and index-linked gilts with maturities up to around 50 years. In 2011-12, the average maturity of gilt issuance was 17.48 years. For conventional issuance, gilts are defined by maturity sector as short (1-7 years), medium (7-15 years) and long (over 15 years). No specific definition by maturity is made for issuance of index-linked gilts. In addition to these formal definitions, conventional and index-linked bonds with maturities of around 35 to 50 years are typically referred to as ultra-long gilts.

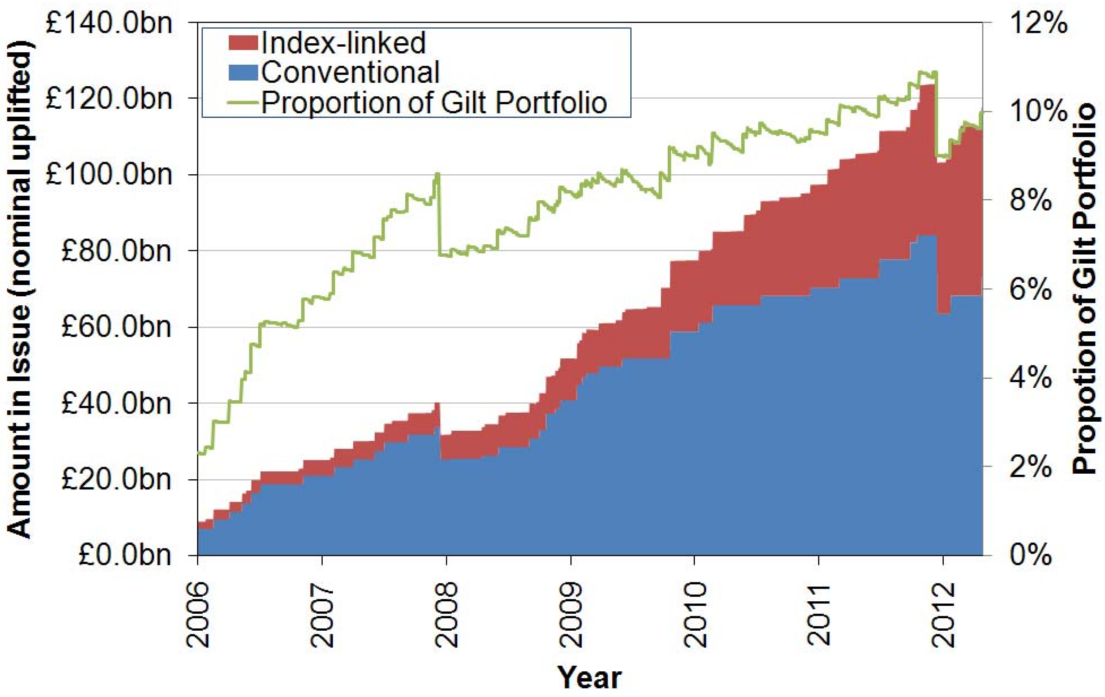
10. In this consultation, the DMO is seeking market feedback on potential issuance of:

- **super-long gilts**: conventional and index-linked gilts with maturities in excess of 50 years, potentially significantly so; and

- **perpetual gilts**: gilts with no fixed final maturity date.

11. Issuance of ultra-long gilts has been a relatively recent innovation[2], introduced in 2005-06 following a public consultation[3]. The Government concluded in response to that consultation that there was significant and probably sustainable market demand for issuance of gilts with ultra-long maturities and that there would be benefits for both the Government and investors in extending the maturity range over which gilts were issued in a programmatic fashion. Chart 1 shows the growth in the stock of ultra-long gilts in issue since 2005-06.

Chart 1. Stock of Ultra-long Gilts[4] in Issue (January 2006 – April 2012)



12. Since ultra-long gilts were introduced, the gilt yield curve has changed shape significantly, in part reflecting events in financial markets and changes in monetary policy since 2005. However, there has remained an inversion at the very long-end of the yield curve, as can be seen in Chart 2, indicating the

[2] There have been previous one-off issues of gilts with longer maturities. Most recently, this includes double-dated gilts such as 7¾% Treasury Loan 2012-15 (issued in 1972, 40 year maturity) and 12% Exchequer Stock 2013-17 (issued in 1978, still in issue). Some earlier double-dated issues had very long potential maturities, such as 4% Funding Loan 1960-90, which had an initial potential maturity of 71 years when it was originally issued in 1919 (the bond was redeemed after 53 years in 1972).

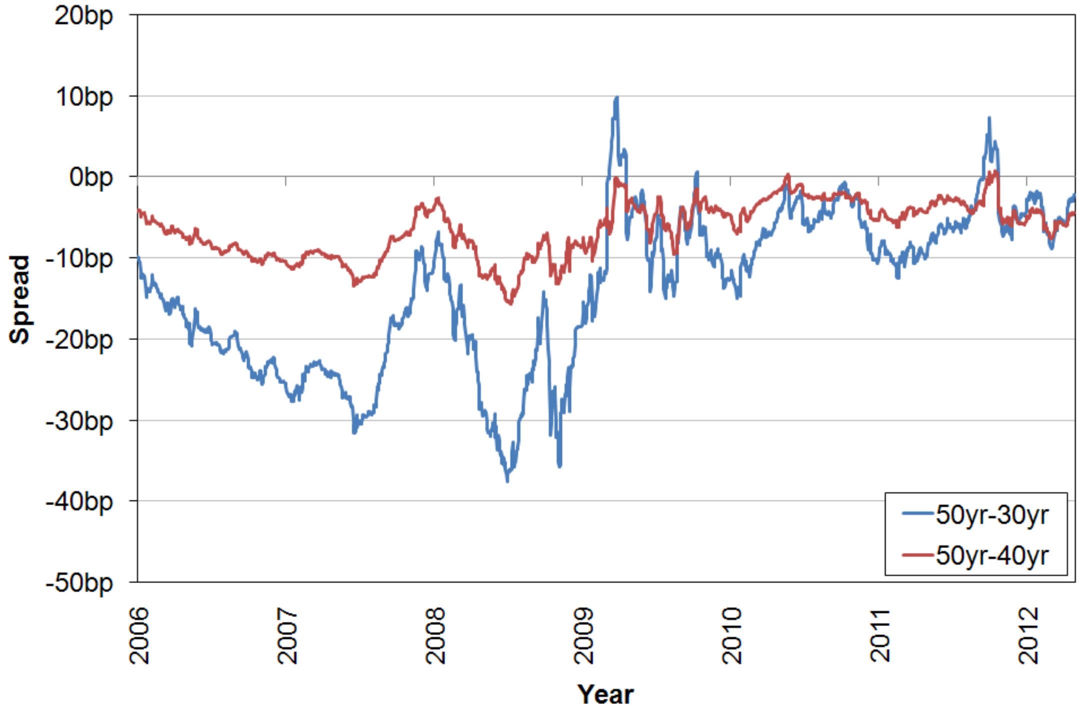
[3] UK Debt Management Office (2004). *Issuance of ultra-long gilt instruments: Consultation Document*. 2 December 2004.

UK Debt Management Office (2005). *Issuance of ultra-long gilt instruments: Response to Consultation*. 16 March 2005.

[4] For the purposes of this chart, gilts with a maturity in excess of 35 years: Annex A lists those currently outstanding.

continued existence of a preferred habitat for gilts with the longest maturities. To the extent that this preferred habitat translates into yields that are lower than market expectations of long-term future interest rates, issuance of ultra-long gilts has been, and continues to be, a cost-effective strategy for the Government. Reflecting this view, the Government has issued significant amounts of ultra-long gilts in recent years.

Chart 2. Nominal Yield Spreads (January 2006 – April 2012)



13. In light of ongoing demand for ultra-long gilts, manifested in the shape of the yield curve, the Government has decided to revisit the question of the maximum maturity of gilt issuance and establish whether there is evidence of investor demand for even longer maturity gilt issuance and/or for the issuance of perpetual gilts.

14. Specifically, the Government wishes to explore in detail the extent and sources of demand for issuance of conventional and/or index-linked gilts at maturity points greater than 50 years (potentially significantly so).

15. In particular, the Government is seeking market views on whether the longer cash flow profile, higher duration and additional convexity that such

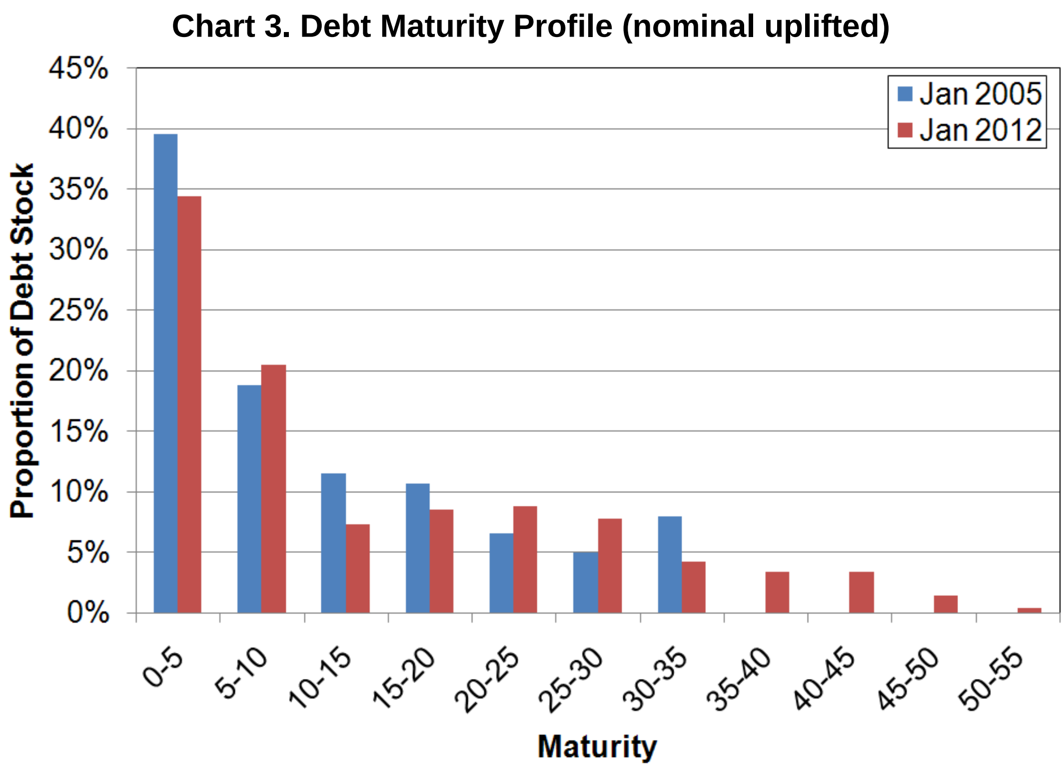
issuance could offer would be especially attractive to investors, in addition to demand from those seeking assets to match long-term liability profiles.

16. The Government also wishes to explore whether there is investor demand that would be met by the issuance of perpetual gilts. The Government welcomes market views on whether sterling fixed income instruments, without a fixed final maturity date, would offer benefits for investors by extending the range of gilt instruments available for fixed income portfolios.

17. As part of its analysis, the Government is keen to hear market views on the risks associated with the introduction of super-long and perpetual gilts, including their impact on the wider gilt market. In particular the Government welcomes views on the impact of issuance on the liquidity of existing longer-dated gilts and the potential difficulties for the market in establishing the fair value of super-long and perpetual gilts in the absence of suitable pricing references. The Government welcomes views on whether these risks are greater for super-long or perpetual issuance.

18. During the period of fiscal consolidation, the Government's risk appetite is also influenced by the need to take decisions that enhance fiscal resilience. This includes: mitigating near term exposure to refinancing risk and avoiding a concentration of redemptions in particular years; promoting the liquidity and efficiency of the gilt market; and maintaining a diversity of exposure, both real and nominal, across the maturity spectrum.

19. Chart 3 below illustrates how the introduction of ultra-long gilt issuance in 2005-06 has contributed to managing the concentration of gilt redemptions in specific years and reducing near-term exposure to refinancing risk.



20. Therefore, in evaluating the case for issuance of super-long and perpetual gilts, consideration will be given to the potential risk reduction benefits that they could bring to the management of the wider debt portfolio. However, as a consequence of the fact that super-long and perpetual gilts would be in issue for very long periods of time, the Government will also give due consideration to the risks associated with fixing the rate of interest payable on debt over such a period.

21. In summary, the Government will assess the case for the potential issuance of super-long and perpetual gilts with reference to:

- consistency with the debt management objective and the principles of openness, predictability and transparency on which debt management policy is based;
- the impact on liquidity and the good functioning of the gilt market more generally;
- the likely demand for these instruments in the context of investor preferences;

- the risk management benefits and risks to Government of issuing such instruments; and
- an assessment of the cost and resource commitment required for implementation in comparison with the potential size of demand.

Design of super-long and perpetual gilts

Super-long gilts

22. The Government would view conventional and index-linked super-long gilts as an extension of existing gilt issuance and, therefore, expects that these gilts would be structured in the same way as gilts currently in issue. The Government does not anticipate that super-long gilts would be made strippable, although this could be revisited in the future in the light of market demand.

Perpetual gilts

23. A perpetual or 'undated'[5] gilt was last issued by the Government in 1946. There are eight bonds remaining in issue today (see Annex B for more details) and they now comprise a small proportion of the gilt portfolio (0.2%[6]), with all except 3½% War Loan (1952 or after) having less than £300 million in issue.

24. The Government recognises that the design of perpetual gilts is significantly different to those that it currently issues. Although no decision has yet been made, the Government anticipates that, in common with existing undated gilts, any new perpetual issuance would pay fixed coupons and incorporate an option for the Government to redeem after a set maturity date in the future.

25. However, the Government is open to views on the overall design of any new perpetual issuance: in particular on the design of any redemption option for the Government and whether it should consider an alternative coupon

[5] These gilts have a first, but not final, maturity date.
[6] As at end-April 2012.

structure for such instruments. In setting out views on the design of perpetual gilts, respondents should in particular take into account practical considerations regarding their pricing by the market.

2. Issues on which respondents' views are sought

26. The DMO welcomes views on any of the issues raised in this paper, or any others that stakeholders consider are relevant to decisions about whether or not the Government should issue super-long and/or perpetual gilts. Respondents are requested to provide data and/or analysis in support of their views and recommendations, taking into account the key debt management criteria set out in the previous section. Respondents' views are sought in particular on the following questions:

A. Market demand for super-long or perpetual issuance

1. What are the potential sources and scale of demand (both new and existing) for super-long and perpetual gilts?

2. To what extent would demand for super-long and perpetual gilts translate into more cost-effective financing for the Government relative to existing instruments?

3. How would issuance price relative to existing ultra-long gilts?

4. To what extent would issuance of super-long and/or perpetual gilts displace demand for existing ultra-long gilts?

5. How sustainable would demand be for super-long and perpetual gilts?

6. If the longest maturity at which the Government issues conventional and index-linked gilts was to be extended, at which new maturities would there be most potential demand for issuance?

B. Supply of new instruments

7. How should the Government seek to integrate issuance of super-long and/or perpetual gilts within its existing issuance programme?

8. If the Government proceeds with issuance of super-long gilts, how much should it seek to supply per financial year?

9. Should the yield curve be extended gradually through issuance of super-long gilts, or are there specific maturities at which issuance should be directed?

10. If the Government proceeds with issuance of perpetual gilts, how much should it seek to issue and over what period of time?

11. What would be the appropriate method(s) of issuance of super-long and perpetual gilts?

C. Risks of issuance

12. To what extent would issuance of super-long and/or perpetual gilts risk fragmenting long-dated or index-linked gilt supply or liquidity? What steps, if any, could the Government take to minimise this risk?

13. Are there any other issues and risks that the Government should be aware of in launching super-long or perpetual gilts? If so, how might any such risks be managed and what is their relative importance in determining which (if any) instruments to issue?

D. Instrument design

14. Are there any changes that should be made to the design of conventional or index-linked super-long gilts relative to existing instruments?

15. If the Government were to issue new perpetual gilts, how should they be structured? What key features should be included in their design? What features should be avoided?

E. Lead time required prior to issuance

16. What would be the lead time required by Gilt-edged Market Makers (GEMMs) and investors before issuance of either super-long or perpetual gilts could take place?

F. Market maker responsibilities

17. If the DMO were to issue either super-long or perpetual gilts, should the roles and responsibilities of the GEMMs be identical to those for existing gilts?

G. Gilt market management

18. What should be the implications, if any, for existing undated gilts should the Government decide to launch a new perpetual gilt?

Annex A. Ultra-long Gilts in Issue[7,8]

Conventional

Gilt	Maturity Date	Nominal Amount (£mn)
4¼% Treasury Gilt 2049	07 Dec 2049	19,037
3¾% Treasury Gilt 2052	22 Jul 2052	14,098
4¼% Treasury Gilt 2055	07 Dec 2055	23,112
4% Treasury Gilt 2060	22 Jan 2060	16,858

Index-linked

Gilt	Maturity Date	Uplifted Nominal Amount (£mn)
0¾% Index-linked Treasury Gilt 2047	22 Nov 2047	11,512
0½% Index-linked Treasury Gilt 2050	22 Mar 2050	11,716
1¼% Index-linked Treasury Gilt 2055	22 Nov 2055	13,048
0⅜ Index-linked Treasury Gilt 2062	22 Mar 2062	8,392

[7] Defined as gilts with maturities in excess of 35 years.
[8] As at end-April 2012.

Annex B. Undated Gilts in Issue[9]

Undated gilts	Amount in issue (£mn nom)	Dividend dates	First issue date	Notice and terms for redemption	Notes on first issue
3½% War Loan (1952 or after)	1,938.6	1 Jun/Dec	1 Dec 1932	3 months	Issued in exchange for 5% War Loan 1929-1947.
2½% Treasury Stock (1975 or after)	259.0	1 Apr/Oct	28 Oct 1946	3 months	Issued for cash.
4% Consolidated Loan (1957 or after)	234.1	1 Feb/Aug	19 Jan 1927	3 months Redemption on coupon date only	Issued for cash and in exchange for 5% Treasury Bonds 1927, 4% National War Bonds 1927, 5% National War Bonds 1927, 5% Treasury Bonds 1933-1935, 4½% Treasury Bonds 1932-1934 and 4½% Treasury Bonds 1930-1932.
2½% Consolidated Stock (1923 or after)	166.7	5 Jan/Apr/ Jul/Oct	5 April 1888	No specified notice period Redemption by Act of Parliament	Issued in exchange for Consolidated 3% Annuities (1752), Reduced 3% Annuities (1752) and New 3% Annuities (1855).
3% Treasury Stock (1966 or after)	37.2	5 Apr/Oct	1 Mar 1946	3 months	Issued in exchange for Bank Stock in accordance with the provisions of the Bank of England Act 1946.
3½% Conversion Loan (1961 or after)	16.2	1 Apr/Oct	1 Apr 1921	3 months Redemption on coupon date only	Issued in exchange for 5% National War Bonds 1922, 1923 (Apr and Sep), 1924 (Feb and Oct), 1925 (Apr and Sept).
2½% Annuities	0.9	5 Jan/Apr/ Jul/Oct	13 Jun 1853	1 month Redemption by Act of Parliament	Issued in exchange for South Sea Stock, Old South Sea 3% Annuities, New South Sea 3% Annuities, Bank 3% Annuities (1726) and 3% Annuities (1751).
2¾% Annuities	0.7	5 Jan/Apr/ Jul/Oct	17 Oct 1884	1 month Redemption by Act of Parliament	Issued by exchange for New 3% Annuities, Reduced 3% Annuities and Consolidated 3% Annuities.

[9] As at end-April 2012.