# THE SOCIETY OF ACTUARIES IN IRELAND

# BRIEFING STATEMENT

## Index-linked bonds

***The Society believes that there is a strong case to be made for the Irish government to issue index-linked bonds, in particular with a view to facilitating adequate and cost-effective retirement income provision for Irish citizens.***

Currently, the Irish government's entire stock of traded debt is in the form of conventional fixed and floating rate obligations. This contrasts with the UK, where, for many years, the government has issued both fixed interest and index-linked bonds. At this stage approximately 25% of the market value of UK government securities is inflation-linked. In more recent years, a number of European governments, most notably France, as well as the US, Canada and Australia have been active in issuing inflation-linked debt in their respective capital markets.

The Society's view is that the issuance of index-linked bonds would not only have attractions from a narrow debt management perspective, but would also have much wider benefits from a social policy perspective.

There are very significant advantages for both the State as an issuer of inflation-linked debt and for the potential purchasers of such debt. For the State as issuer, the advantages are as follows:

- Inflation-linked debt provides an ideal match between future outlay and future revenues for the State. The State's revenues are inflation-linked, by definition, and it is economically logical to match the nature of future revenues with future outlay.
- Just as an investor seeks a balanced and diversified portfolio, an issuer of debt should also seek diversification. The State's debt is currently concentrated in fixed-interest commitments. The introduction of an inflation-linked element to this portfolio of debt would have sound diversification advantages.
- Inflation-linked debt is the ideal form of financing for long-term capital projects as the repayment profile can be designed to match the future revenue from the project.
- As there is a very significant level of demand for inflation-linked debt, it is very likely that the State could fund a substantial proportion of its requirements more cost-effectively through index-linked bonds. Very simply, the market will pay more for something it badly wants than for something it already has in abundance.

These factors make a very strong case for index-linked bonds. However, when the wider public policy benefits are considered, the case becomes even more compelling. The Society sees the wider issues as follows:

- The liabilities of most defined benefit pension schemes are linked to future Irish inflation but there are no capital market instruments available to match this liability[1]. As Irish defined benefit schemes mature, the need for index-linked bonds is increasing significantly.
- We believe there is an even stronger case in relation to the vast numbers of Irish workers who are not members of defined benefit pension schemes. Even if these people have accumulated sufficient assets at the point of retirement, the availability of inflation-linked annuities is very limited. The Society's view is that the facilitation of an active and liquid inflation-linked annuity market is vital for the future and present retirement income needs of Irish workers.
- The State is in effect issuing millions of euro of inflation-linked (and indeed earnings-linked) debt every day in the form of State pension obligations to public servants. It is arguably inequitable for the State not to offer inflation-linked debt at market prices to private sector pension schemes and to the growing body of workers dependent on defined contribution or PRSA arrangements.
- There is potential for corporate/private sector issuance of inflation-linked debt. This form of debt is very suitable for many types of capital projects. However, it is difficult for a private sector market to develop in the absence of a government issue to set a price level and act as a benchmark.

[1] with the exception of the small amount of Housing Finance Agency index-linked bonds issued in the 1980s