Cap Gemini Ernst & Young Consulting Services

Retail Debt Program Review

Executive Summary

Final Report

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Notice:

Where information has been withheld it has been withheld to protect sensitive third party information, information provided in confidence by another government or to protect the economic interests of Canada.

Introduction

A Strong History

The Canada Savings Bond Program (the Program), launched in 1946 following the popular Victory Bond campaign, has a strong history with Canadians. Canada Savings Bonds (CSBs) continued to help finance government expenditures throughout the post-war period, while at the same time providing Canadians with a savings vehicle valued for its security, cashability, and ease of purchase. By the late 1980s many Canadians included the offerings as part of their financial portfolios, and participation in the savings bond payroll program included more than 15,000 employers and 1.5 million employees. This popularity brought about the growth of CSBs to a pool of assets worth over $50 billion, or over 8% of all Canadian financial assets, and CSBs accounted for 33% of the total federal market debt.

THE RETAIL DEBT PROGRAM HAS PLAYED AN IMPORTANT ROLE FOR GOVERNMENT AND CANADIANS

Market Pressures

The 1990s brought increasing competition from many financial institutions that invested in product innovation, customer analytics, and dynamic sales tools. In addition, the arrival of new financial services providers to the Canadian market added to the competitive environment. Investors gained increasing levels of investment sophistication through greater direct participation in equity investments, and by using channels like the Internet and investment advisors to discover broader options for their savings. Mutual fund investments began to grow at an average annual rate of 20%, and financial planner certifications grew at a rate of 35% per year. At the same time, interest rates declined to the lowest levels seen in a generation, leading investors to reduce holdings of fixed income investments such as CSBs in favour of other investments.

Program Revitalization

In 1996, the Program was revitalized and charged with the task of stopping the decline of the portfolio. The rebranded program was to maintain a reasonable and sustainable retail share of total federal debt while ensuring a broad investor base for the government. It was also to partner with the private sector to offer a family of attractive products benefiting all Canadians. This strategy was to be consistent with the government's fiscal plan of balancing cost, risk, and market considerations.

Despite the implementation of operational, channel, and product initiatives, the Program continued to face challenges. In the face of rising costs, back office processes were outsourced to EDS in 2001. Still, the ability to extract further efficiencies was constrained by excessive exceptions handling and a need for systems innovation. To improve interaction with partners, investments in the Internet channel were implemented to drive lower cost structures, but interactions through costly telephone channels continued. New products were introduced, but these products remained uncompetitive because they were undifferentiated relative to existing market offerings.

An Independent Review

Currently, all government programs are being reviewed to ensure continued relevance, effectiveness, and value to Canadians. With regard to the Canada Savings Bond Program, the government required an independent assessment of past performance against objectives, evaluation of true future prospects, and identification of a range of strategic options. Cap Gemini Ernst & Young (CGE&Y) has a unique reputation within the Canadian financial services industry for the quality of its retail banking and wealth management expertise. In performing the *Retail Debt Program Review*, CGE&Y has assessed the value and viability of the Program, examined the relevance of its product offerings to Canadians, and evaluated the efficiency of this source of funds to the government to determine the overall value of the franchise. This document summarizes the results of that *Review*.

Review Approach

Interviews

CGE&Y conducted interviews with key stakeholders and other retail debt program experts to gain insight about important business drivers. Twelve stakeholders representing internal organizations directly and indirectly involved in the Program were interviewd, as were twelve external stakeholders who interact with the Program on a regular basis. In addition, CGE&Y interviewed nine individuals from other retail debt programs operating in the United States, the United Kingdom, Sweden, British Columbia, and Ontario.

Documentation

To ensure leverage of past Program analyses and a foundation of documented facts, CGE&Y gathered and consolidated data from a number of sources. Over 170 separate documents, provided by the Program's working group, were reviewed. In addition, CGE&Y gathered and integrated financial and statistical data from a number of sources within the Program to support financial and strategic analysis, and incorporated as much benchmarking data from additional sources as possible.

Research

CGE&Y conducted primary and secondary research without engaging in direct customer surveys or focus groups. Instead, CGE&Y leveraged its own proprietary research and analysis of the wealth management and retail banking marketplace to assess the nature of competition and important trends within the financial services environment. CGE&Y supplemented its own extensive research in the area of investor behaviour and attitudes with selected secondary research from a variety of sources.

A COMPREHENSIVE, ANALYTICAL APPROACH TO DERIVING FACT BASED CONCLUSIONS AND DEVELOPING STRATEGIC OPTIONS

Financial Analysis

To assess the financial impact of the Program, CGE&Y analyzed financial data and modeled financial scenarios. To assess the implied costs of the embedded optionality of Program products, CGE&Y employed standard, private sector option pricing theory, based on experience in capital markets and validated as an appropriate methodology by the working group. Consolidation of data from a number of sources provided valuable insight into cost drivers and performance measures.

Integration

Finally, CGE&Y integrated research and analysis to draft a broad range of strategic options, which were then analyzed within the context of emerging industry and government forces. Through the use of financial modeling and projections based on alterations to over a dozen underlying assumptions, the initial set of options was refined to a final set of four. For each of these four strategic options, the implications, advantages, disadvantages, financial estimates, issues, and considerations were documented to communicate the findings and substantiate the verdict.

Findings

CGE&Y assessed the Program's performance to determine the extent to which it met objectives, and analyzed the value to the government and to Canadians within the context of the current and future environment.

The Retail Debt Program is Losing Relevancy

Relevance to Government

The Program has lost importance as a source of funds to government

Analysis of historical trends in the non-marketable retail debt portfolio suggests that the Program has lost its importance as a source of funds to government. It represents a small and declining share of government debt, having fallen from 7% in 1996 to 5% in 2003. Changes in non-marketable outstanding retail debt demonstrate sensitivity to interest rate fluctuations similar to the wholesale debt portfolio. This sensitivity reduces the value of retail debt as a diversification tool based on debt holder behaviour, and recently balanced budgets have allowed the government to borrow in wholesale markets at more favourable rates than previously available when Canada had higher national debt levels. Investor breadth is accomplished through the recent 'retailization' of marketable debt through money market and bond mutual funds, which has also increased domestic ownership of debt.

DOES THE PROGRAM PROVIDE VALUE TO THE GOVERNMENT WHEN COMPARED TO WHOLESALE DEBT?

The Program is an expensive source of funds

The Program is an expensive source of funds relative to wholesale debt for a number of reasons. Financial analysis of the Program's cost drivers identify that a substantial subsidy in recent pricing of Canada Premium Bonds (CPBs), coupled with high redemptions of CSBs—especially within the employer channel—have amplified the impact of the declining stock of outstanding bonds. CGE&Y's ex-post cost analysis took a strict, private sector approach to each savings bond series in a sample that represented two thirds of outstanding bonds. Unlike other methodologies, this analysis treated each 10-year series as an actual 10-year obligation in order to compare the financial impact to the government of each series' interest rate differential and refinancing of redemptions against wholesale debt costs. The analysis of the sample calculates an uncovered option cost of approximately $150 million, comprising the net cost of both interest rate differential and refinancing, which when added to total operational costs of $895 million, brings the cost of the Program to more than $1 billion since 1997. In summary, results showed that despite pricing savings bonds lower than wholesale debt, the discount was not covering administration costs or the full value of the optionality inherent in the products' design.

The Program provides less social value

Evidence suggests that although the Program has a strong history of helping Canadians save conveniently, recent economic and social indicators indicate less savings behaviour now than seven years ago. In fact, Canadians have taken on more debt in recent years than ever before. From 1992 to 2002, personal savings fell at a compound annual rate of 5.1%, while consumer credit grew by a compound annual rate of 3.6%. Payroll program participation and sales have been relatively stable, with small increases in sales in the last four years, while churn in this channel has increased. This indicates that the Program is being used more as a demand account to facilitate purchases than to foster a savings discipline in those who need it most. Investor education and messages about savings tactics are provided by many private and public sector organizations with greater direct access to Canadians. For example, the Social and Enterprise Development Innovations (SEDI) organization, sponsored by Human Resources Development Canada, partners with the Royal Bank of Canada (RBC) Financial Group to target lower income Canadians with savings incentives.

Relevance to Investors

To investors, the Program's features compared favourably

CSBs and CPBs offer equivalent or higher rates than the standard guaranteed investment certificates (GICs) offered by financial institutions, and provide additional cashability and greater security for high balances that may exceed Canadian Deposit Insurance Corporation (CDIC) limits. CSBs and CPBs have also outperformed non-GIC investments such as some equity and bond funds during the period from 1998 to 2003. This supports the financial analysis, which suggests rate subsidization during this period. Access to the Program's products is economical and convenient for all Canadians. There are no fees charged on registered investments (i.e., RSPs), and the payroll program, which accounts for annual sales of over $1 billion, is available from approximately 15,000 employers. The payroll program as an employee benefit is as popular as Group RSP participation. Based on benchmark data gathered by CGE&Y, of the 16,000 companies with over 100 employees, Group RSP penetration is 85%, similar to that of the Program.

DOES THE PROGRAM PROVIDE VALUE TO INVESTORS WHEN COMPARED TO OTHER SAVINGS AND INVESTMENT OFFERINGS?

Important trends make savings bonds less competitive today

The Program has lost importance among Canadians, with only 1% of total investable assets being held in savings bonds today compared to 8.3% in 1987. The large banks that dominate both in market share and in distribution have focused tremendous energy on deepening customer relationships. They have accomplished this by investing in sophisticated technology, sales skills, and bonus interest rates that can range from 10 to 100 basis points (bps) depending on the value of customer relationships. Since they are not obligated to hold prices for an entire month like the Program, financial institutions can quickly adapt product pricing to interest rate volatility; an especially important ability in today's low interest rate environment.

Small segments continue to see value

While accurate segmentation of bondholders is unavailable, surveys have identified that older, affluent Canadians purchase savings bonds through sales agents (i.e., local banks or credit unions), whereas younger less wealthy Canadians use the payroll program. Analysis has revealed that the older segment is becoming more sensitive to investment performance, while the younger segment continues to use savings bonds as an equivalent to cash.

Program Design

In the future, savings bonds will continue to be marginalized by investors

Future demographic and behavioural changes will lead to diminished relevance of Program products to those who have the largest share of investable assets. Assets in the hands of loyal bondholders will be inherited by a generation for whom savings bonds are not perceived as a competitive investment vehicle. Financial advisors will play an increasingly important role in guiding the investment decisions of affluent Canadians.

Product development has tried to keep pace

The Program has introduced new products, like the CPB, to stem redemptions. However, the features are not sufficiently differentiated to secure a significant market share in the face of intense innovation and competition in the market. The product development process appears to have been hampered by an unclear program mandate and conflicting objectives. Marketing efforts have differentiated the Program in the Canadian marketplace but have failed to reverse the erosion in market share.

Product origination faces difficult challenges

The payroll program has been successful in maintaining its annual sales level at approximately $1 billion to $1.3 billion. However, the channel has not gained market share in the face of competing products and services and increasing investor sophistication (i.e. high interest savings accounts offered by ING Direct, frequent purchase plans offered by mutual fund companies, etc.). Furthermore, the fact that payroll investors invest for short-term needs increases the costs associated with the Program through high transaction volumes and redemption activity. The sales agent channel volume has steadily decreased because of strained relationships with financial instituitions (FIs), due to lengthy sales periods, cumbersome processes, competing products, and commissions that are insufficient to motivate collaboration.

Bondholder servicing is meeting expectations—but at a cost

A recent customer service survey indicates that satisfaction levels are very high at over 90%. This service level, when compared to existing FI and service benchmarks, points to a case of 'over delivery.' Stakeholders who were interviewed identified many cost drivers in the service functions that need to be addressed, including: a proliferation of channel volume despite migration efforts, an increasing number of processing exceptions, and frequent bondholder demands, especially among payroll program enrolees.

The Program's Future Viability is at Risk

Environmental Forces

The financial services industry is extremely competitive

The Canadian wealth management market is experiencing consolidation that is heightening competition and driving investments in product innovation, customer analytics, and sales technology. The industry has also witnessed new entrants to the market place differentiating themselves through better products, convenient access, and higher returns. In addition, financial services firms are growing more sophisticated in customer relationship management practices in order to retain clients and increase the number of products and services a household purchases. For example, a large Canadian bank using customer relationship management tools knows that its penetration of GICs among households is 10%, whereas chequing account penetration is 40%. This insight shapes the nature of customer interaction at the point of sale.

WITHIN THE CONTEXT OF A CHANGING ENVIRONMENT, NEW STRATEGIC OPTIONS ARE REQUIRED TO ADDRESS THE FUTURE VIABILITY OF THE RETAIL DEBT PROGRAM

Investors are demonstrating more sophistication in their behaviour

The combined impact of a broader range of available options and improved access to information has resulted in increasing the overall knowledge and sophistication of investors. Research into financial products and services is the third most frequent online activity among North American Internet users, which is particularly striking since the average Canadian family with Internet access spends more than 32 hours per week online. Investors are exhibiting greater diversification in their investment portfolios, embracing alternative investments, and taking advantage of access to global markets. In addition, greater interaction with professional investment advisors has provided investors with a higher level of understanding of the benefits of investing and financial planning than ever before.

Future prospects for the Program are not favourable

Canadian values are predicted to be shifting toward a post-materialism perspective and are beginning to place greater emphasis on freedom, self-esteem, and quality of life. In fact, according to a recent Environics poll, the state of the country's healthcare tops the list of perceived problems facing Canadians today, and they are starting to expect more fiscal responsibility from government at all levels while demanding more focus in the programs that serve them.

The Program has not performed within this changing environment

During years reviewed (1997 to 2003) the process of setting objectives for the Program was cumbersome and lengthy due to the lack of internal stakeholder consensus on priorities, and unclear definition of responsibility and accountability. The objectives were adapted to the federal debt situation and other influences such as the 2000 Auditor General's report, but showed a departure from quantifiable objectives, and included conflicting and unprioritized themes such as entrepreneurialism, innovation, branding, and cost effectiveness.

A review of the Program was not conducted by its fifth year of operations, as dictated by the agency's charter. Business plans and financial statements fail to provide stakeholders with sufficient information to understand objectives, performance, or overall subsidy provided by government.

CGE&Y gathered and reviewed existing Key Performance Measures (KPMs) from 1997 to 2002, and studied their evolution to assess relevance and consistency with documented objectives. This review identified a lack of quantifiable program objectives, which led to inconsistency in performance monitoring and measurement (e.g., pricing targets, share of debt, cost effectiveness, etc.). A number of factors make it difficult to assemble the necessary financial information for compiling measurements and analyzing Program performance. These factors include: lack of centralized of data, inconsistent account balances and breakdowns, lack of transparency in financial data in both Business Plans and Financial Statements, and lack of articulated definitions for critical metrics.

The Program has failed to meet important performance targets

Non-marketable debt has consistently decreased as a percentage of total federal debt. Sales have decreased by approximately 44%, while redemptions have averaged 136% of sales from 1997 to 2003. These two effects have resulted in an erosion of the stock from $33 billion to $22 billion during this period. In contrast, marketable retail debt has increased as a percentage of overall federal debt.

Likewise, the investable assets of Canadians have increased by 39% while the stock of savings bonds has declined by 47% during the period, resulting in the Program's share of the overall investable assets declining significantly from 2.5% to 1%.

The organizational structure does not enable effective delivery

CGE&Y reviewed Program documentation from 1995 until 2003, including reports, memos, and presentations from various stakeholders. Interviews and secondary research allowed a comparison of the Program's organizational structure to that of other retail debt programs.

The current organization structure is not sustainable due to difficulty in decision-making, which contributes to the challenges in planning and execution. The Program should be run within one entity, with certain functions outsourced as appropriate, and roles and responsibilities should be more clearly defined and communicated.

The Program has struggled in establishing the roles and responsibilities of each stakeholder. A memorandum of understanding (MOU) was not finalized until 2000, four years after its inception. The Program continues to experience dysfunction within its management team—despite best efforts of individual resources—due to a persistent lack of well-documented accountabilities, roles, and responsibilities.

In summary, the Program's franchise value is diminished

"Franchise value" is a term used to describe the intangible value to government that the Program provides, beyond its role as a financial intermediary bringing together borrower and investor. In 1996, it was widely felt that the planned revitalization of the Program would improve two facets of franchise value: enhancing the government's *profile among Canadians* and providing a *unique source of funds to government.* In contrast to this expectation, both values have become inapplicable to the Program.

TWO COMPONENTS OF FRANCHISE VALUE EXISTED IN 1996 BUT ARE NO LONGER APPLICABLE

Profile among Canadians: then

The Program once offered the government a public relations conduit for delivering positive messages to Canadians through events such as rate changes and product innovation. It also provided a mechanism for direct and broad branding of Canada using images and messages that resonate with Canadians (e.g., lakes, mountains, fields, etc.). Presenting the government with a valuable opportunity to disseminate educational savings messages to Canadians, the Program offered universal access to a savings product designed as a public good, and valued for its security, cashability, and ease of purchase in an environment where financial sector offerings were limited and a perceived lack of competitiveness prevailed.

Profile among Canadians: now

THE PROGRAM NO LONGER OFFERS FRANCHISE VALUE AS AN ENHANCEMENT OF GOVERNMENT'S PROFILE AMONG CANADIANS

Today, modern communication tools and techniques provide the government with numerous ways to reach Canadians with relevant messages that serve public relations requirements (such as Internet, print, television, and radio). Canadians expect action and results from government on issues such as healthcare, the economy, and security, and this expectation provides new opportunities to enhance the profile of government. The mood of the country's population has improved since the mid-1990s, with Canadians taking greater pride in their national culture, valuing Canada's respect for diversity, and cherishing its profile on the world stage.

The analysis revealed that Program advertising is interpreted as 'branding Canada,' and is seen as a duplication of the existing efforts of Canadian corporations and other government departments. As an example, the Canadian Heritage department spends $1 billion annually on education and promotion of Canadian culture.

Most financial service providers—banks, insurers, mutual fund companies—invest in marketing campaigns to promote savings behaviour. For example, London Life's "Freedom 55" campaign was a popular early articulation of savings goal setting, and many other firms have followed suit since that campaign's success. In addition, marketing efforts by all of the large banks, such as AGF's "What are you doing after work?" and Talvest's "Life's long. Be ready," are two other examples of bringing attention to the importance of financial security. More than simply marketing the importance of saving for the future, financial service providers also develop and deliver mechanisms for addressing consumer anxiety about increasing debt loads and the risk of insufficient savings. In this context, the Program's savings messages are viewed as a duplication of the efforts by the financial sector, and as a source of confusion and contradiction at the point of customer interaction.

Access to financial sector products and services is ensured for two reasons. Today's highly competitive environment among financial services companies has resulted in one of the narrowest interest spreads among G8 economies. In addition, financial services companies are subject to legislation requiring access to banking for all Canadians, as exemplified by the recent *Access to Basic Banking* regulation. In addition, protection of deposits held in member financial services companies is guaranteed through the CDIC up to $60,000. These changes, combined with the advisory role gaining popularity with an increasingly sophisticated investor base, have resulted in a drop in share of financial assets being captured by the Program from 8% in the 1980s to 1% today.

Source of funds to government: then

Facing the high debt requirements of a government in deficit and the vagaries of foreign debt holders and currency traders, the Program offered an opportunity to issue bonds to domestic investors. In addition, regular marketing to the Program's bondholders, and the purchase by each of a small amount of debt, offered the government ready access to a widely distributed network of investors. Finally, the Program provided the opportunity for debt to be held by loyal, long-term investors less sensitive than institutional players to changes in interest rate fluctuations.

Source of funds to government: now

Today, relative to 1994, Canadians have a government which has created successive budget surpluses, thereby decreasing the overall need for funding. Minister Goodale's recent pre-budget commentary indicated a desire to target further reduction of government debt to 25% of the GDP from its current 44%. Accordingly, the retail debt has lost importance as a source of funds to government with its share of overall government debt falling from 7% in 1996 to 5% in 2003.

As Canadian debt as a percentage of GDP fell during the late 1990s, issuing of cost effective debt became less of a challenge. Non-resident debt holdings dropped from 28% to 18% over this period, as the government's need for funding decreased. The Program provides less value today as a cost effective method of issuing debt.

The growth during the late 1990s in mutual funds and pension funds allowed marketable government debt to be redistributed to a retail investor base. Today, over one million Canadians hold some form of Government of Canada marketable debt via their mutual fund investments, with countless others holding marketable debt through their company's pension plan. The effect of this retailization of wholesale debt on improving the breadth of distribution was amplified by the growth in the number of independent and branch-based financial advisors who have increased the level of investor sophistication. The Program provides less value today in providing a network of ready investors because intermediaries, more adept at providing relevant offerings and creating channel loyalty, control access to investors.

Comparing marketable debt holder behaviour to that of savings bond holders reveals similar interest rate sensitivity today, and a low interest rate environment exacerbates this effect. In addition, the payroll program's high churn indicates that, despite wide participation, this channel's investor base is not holding bonds for the long term.

Overview of the Strategic Options

Based on the assessment of the Program's value and viability, and after integrating the results of research and analysis within the context of emerging industry and government forces, CGE&Y identified four strategic options for consideration: Relaunch, Refocus, Basics, and Rundown.

BASED ON AN ASSESSMENT OF THE PROGRAM'S VALUE AND VIABILITY, CGE&Y IDENTIFIED FOUR STRATEGIC OPTIONS FOR CONSIDERATION

1. Relaunch

The objectives of the *Relaunch Option* are to achieve growth in the retail non-marketable debt portfolio and encourage savings in partnership with other agencies, building the franchise value of the Program as both a vehicle to increase government's profile with Canadians, and a source of government funding.

This option positions the Program in direct competition with the FIs, with competitive products, messages, and pricing, much like the U.K.'s National Savings & Investment agency, which provides over a dozen savings products in direct competition with the private sector.

Under this option, the main focus would be on delivering financial and social value to investors, without concern for operating cost effectively. In this regard it differs from the U.K. model, which tracks and measures its "added value" to the Treasury based on the interest savings relative to wholesale.

Advantages

Advantages to this option include improving visibility of the Program among Canadians, enhancing their direct access to savings products, increasing the role of government in personal finances, and providing a platform for government to deliver savings and other positive messages to Canadians.

Disadvantages

The primary disadvantage of this option is cost, given the complexity of product design and delivery, and the required technology investments. Its sophisticated products would be perceived to benefit more affluent investors at the expense of all taxpayers, representing poor value for money. This option also risks public backlash because of misalignment with expectations of fiscal prudence. Financial services companies will likely not endorse this option since they will view it as a duplication of existing capabilities in an already competitive environment.

Verdict: The analysis does not support this option.

2. Refocus

The objective of the *Refocus Option* is to improve the cost effectiveness of a modified status quo by maintaining the franchise value of the Program as both a vehicle to increase the government's profile with Canadians through its existing product offering, and a source of government funds.

This option rationalizes the Program by selling CPBs through the sales agent and direct channels, and CSBs through the payroll channel. The social objective of promoting savings is left to the private sector, and the "branding of Canada" is left to other government departments.

Much like the retail debt program of the U.S., this option would reduce the costs of sales and marketing and rely on existing branding to generate sales.

Advantages

Advantages of this option are the continued provision to Canadians of alternatives for basic savings and investments, and the maintenance of the franchise value for future funding requirements. This option also minimizes possible negative reaction from the public because it would be viewed as partially aligning to fiscal responsibility through transparent reporting of targets and results, including the subsidy.

Disadvantages

One of the disadvantages of the Refocus option is that the public may perceive this rationalization as insufficient relative to the current priorities of enhanced healthcare and meeting other fiscal concerns. In addition, there is a risk that despite best efforts, cost containment will continue to be difficult. Financial services companies would likely be unreceptive to this option since it continues to provide competition in an already highly competitive environment.

Verdict: The analysis does not support this option.

3. Basics

The objectives of the *Basics Option* are to deliver a basic product through the most cost effective business model, and to maintain a very minimal franchise value as both a vehicle to maintaining a profile with Canadians, and a future source of government funding.

This option reduces the Program to its essential core by offering one product (CPB) through one channel (sales agent) with a cost effective price, inclusive of optionality. It involves reducing the infrastructure to a minimum core capability, stopping any further investment. The Basics Option is founded on the premise that the Program has some franchise value to government, but needs to address cost effectiveness as the primary objective. The Program would be subject to strict cost boundaries, and would need to price its product using acceptable industry methods with no subsidy for the option cost. Marketing would be minimal, and savings promotion would be left to the private sector.

The viability of this option is supported by a number of successful models currently in place by other providers. For example, Ontario offers simple savings bonds with limited cashability and a short sales period while still meeting the government's funding objectives. Ontario relies on investment dealers for almost all of their program's dollar volume. The U.S. program provides another model. Like Canada's, the U.S. program's core customer base is comprised of the elderly, and the U.S. has established that this segment is best served with simple products. U.S. marketing focuses solely on basic investor education on the program offerings. The small Internet channel usage the U.S. program has experienced supports the sales agent channel approach as the most effective for this prevalent customer segment.

Advantages

The primary advantage of the Basics option is that it maintains the franchise value for future funding requirements should the need arise. In addition, the Program would be viewed as aligning with fiscal responsibility through cost effectiveness, while fulfilling a social need for a small but important segment of the population. It would also continue to provide Canadians with a simple and secure alternative for their savings needs.

Disadvantages

A disadvantage of this option is the risk of interpretation by the public as an end of the Program, hidden behind a fiscal responsibility objective. If the stock continues to fall, it will make the cost effectiveness goal difficult to accomplish, especially in the longer term, resulting in a costly program in place for delivery of reduced value to a small number of Canadians. For these reasons, financial services companies may be unreceptive to the Basics Option.

Verdict: The analysis does not support this option.

4. Rundown

The objective of the *Rundown Option* is to reduce the savings bond portfolio in the most cost effective manner possible, while maintaining a satisfactory level of service for existing investors. This option is based on the assessment that the franchise value of the Program no longer exists because it no longer promises a future source of funds or a vehicle for maintaining a profile with Canadians. The Rundown Option is based on the premise that the Program is unsustainable, and is costing government and Canadians more than it provides. Another premise is that to ease transition of bondholders moving to other investments, some grandfathering of existing relationships should occur.

To achieve this cost effectiveness, sales of new issues would cease, as would product development, new payroll enrolments, and broad marketing efforts.

The government of B.C. ran down its retail debt program and did not experience backlash from the public, leading them to conclude that it was not providing value. The minister responsible argued that having 'liquidity insurance' in the face of capital markets volatility was an insufficient reason to maintain a cost ineffective program. He argued that with six weeks' notice, and selling through the dealer network only, they would have access to this alternative source given a competitive price.

Advantages

An advantage of the Rundown option is that it immediately moves the program towards cost effectiveness by reducing high cost items, such as sales commissions and marketing. By servicing existing bondholders, this option maintains a reduced program franchise value for the government as a source of funds should the need arise over the period of the remaining life of the bonds. In the interim, investment in the Program is reduced, allowing funding of other priorities. This option aligns with the implicit desires of the financial services sector to see the government out of the savings bond business given the numerous savings alternatives and consumer protection regulations. It also maintains a level of support for loyal bondholders while aligning with the values of fiscal responsibility.

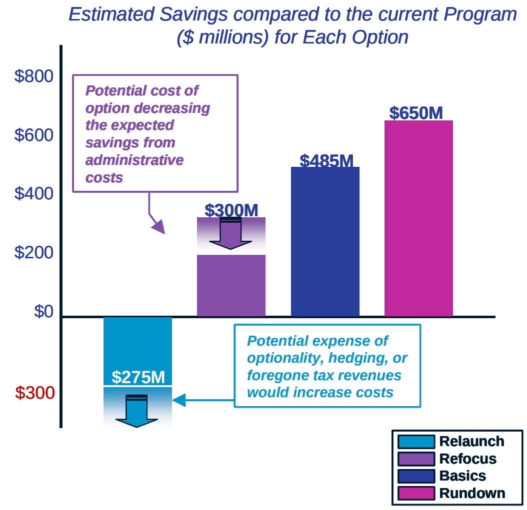
Disadvantages

A disadvantage of this option is the time consuming nature of the rundown process, which could last until 2013. [*Information withheld.*] Finally, the Rundown option would inevitably create backlash from a small segment of loyal bondholders who would see this as a drastic reduction of what many view as a national entitlement.

Verdict: The analysis supports this option.

Conclusion

Based on financial modeling of more that a dozen program design parameters and twenty financial assumptions that project the Program's performance out over nine years, the analysis supports the Rundown Option as the most viable strategy for the government. This conclusion is supported by research and analysis that assessed franchise value, value to government, value to investors, environment, organization, and design.



While the Basics option provides government with a minimal franchise value and represents the most cost effective option to maintain the Program, rundown of the Program is the option that delivers the appropriate solution in today's environment while providing the maximum savings relative to cost projections of the current Program.

The Rundown option is also aligned with the current priorities of the government, as articulated by Minister Goodale in a recent news release when he stated, *"The government's main priorities include finding permanent savings of $1 billion per year from existing federal program expenditures and developing a new culture of good governance and responsible government spending."*

The Rundown option will help the government focus on fiscal responsibility and other prioritized social programs. Canadians would understand the decision within the context of fiscal restraint and accountability, and financial services companies and industry stakeholders would welcome Rundown as a natural conclusion to a program which, for them, has outlived its purpose and is no longer relevant. New savings from investors would likely find a home in the many other products that currently make up the 99% of investable assets in the private sector.

	Total Cost by Year 9 ($ millions)	Unit Cost by Year 9 (bps)	Year 9 Savings vs. Current Program ($ millions)	Stock by Year 9 (billions)
1. Relaunch	$1,200	50	($275)	28
2. Refocus	$700	45	$300	14
3. Basics	$500	37	$485	10
4. Rundown	$350	110	$650	1

Running down the portfolio provides the government with the greatest savings relative to the projected cost of current operations, and relative to the other options analyzed. The Rundown option addresses the key issues related to the value and viability of the program when viewed within the context of the current environment.

Relative to 1996, today's government has created successive budget surpluses, thereby decreasing the overall need for funding. As Canadian debt fell during the late 1990s, issuing cost effective debt became less of a challenge. Today, Minister Goodale indicates a desire to target further reduction of government debt from its current 44% of GDP to 25%. With its share of overall government debt falling, Canada's Retail Debt Program has lost its importance as a source of funds to government.

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