ASIC wants new name for hybrids

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Corporate regulator ASIC is urging companies to refer to the commonly used “hybrids” as “capital note.” **Photo: Jim Rice**

Jonathan Shapiro

Australia’s corporate regulator is pushing companies to use the term “capital note” instead of the commonly used “hybrid security” to alert investors to the risks associated with these products.

Hybrid alludes to the dual part-debt, part-equity features of these securities, which typically rank ahead of equity but below senior debt in the capital structure.

The Australian Securities and Investments Commission has twice issued warnings to investors in regard to “equity-like” risks associated with hybrids, which it says should not be mistaken for safer fixed- income investments.

In its most recent warning, ASIC said issuers should make these products more “true to label”, suggesting use of the term capital note to “reflect the nature and features of the product”. That term highlights that such securities constitute capital rather than debt and are not afforded the same rights as a loan or bond.

Elstree Investment Management director Campbell Dawson said few investors contended that hybrids were fixed income. “Given that they are neither equity nor fixed interest, one way of looking at them is part of an income portfolio for the simple reason that at current yields, the return/risk trade off is better than the historic return of equities,” he said.

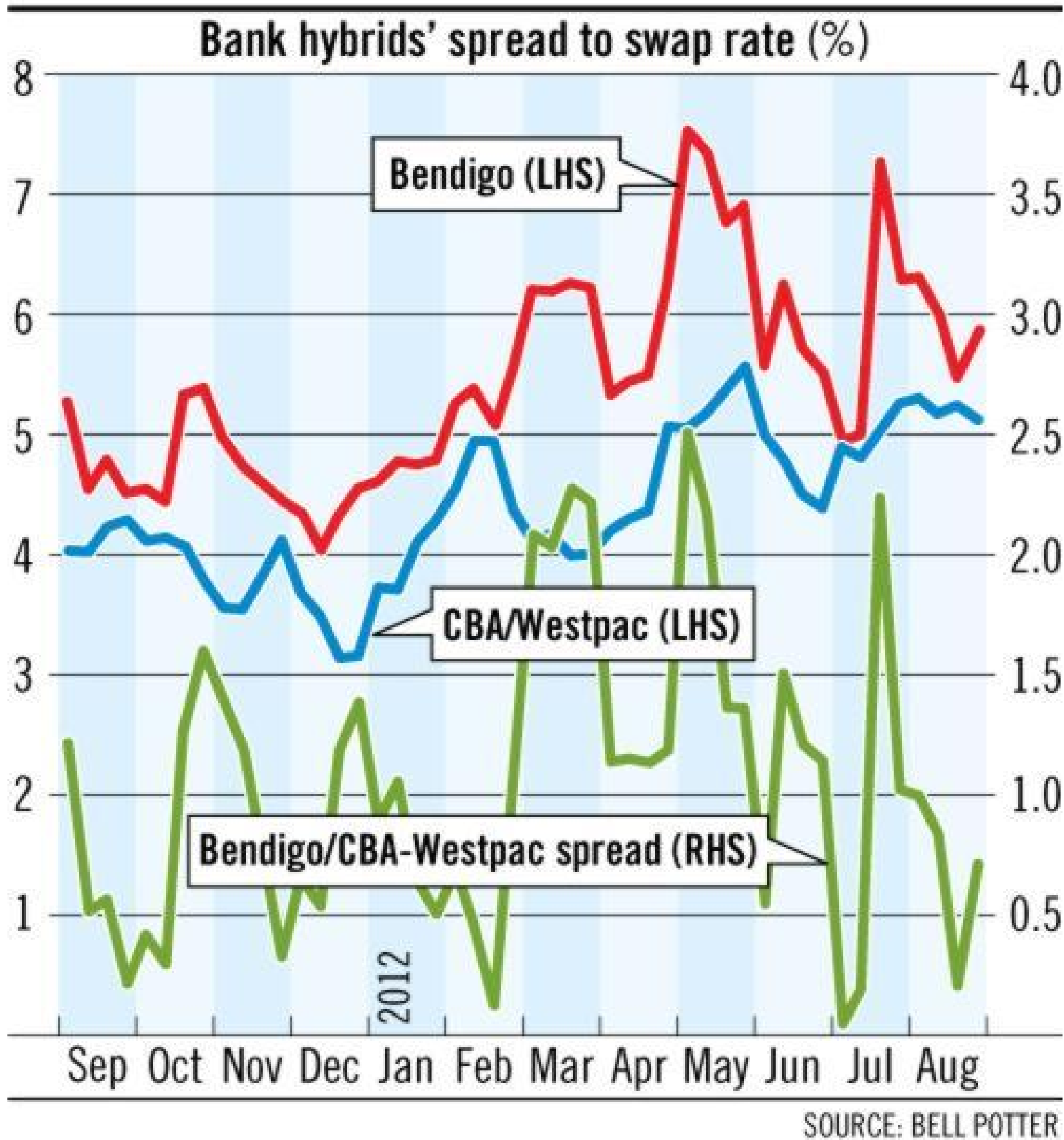
The push comes as the regional lender Bendigo and Adelaide Bank launched a $125 million offer of tier one hybrids called Convertible Preference Shares to refinance a $90 million issue of Reset Preference Shares.

The bank’s offer will qualify as capital under the Australian Prudential Regulation Authority’s application of new global banking rules, and follows a $1.5 billion issue of PERLS tier one hybrid securities by Commonwealth Bank of Australia last week.

CBA’s was the first Australian bank hybrid to meet new bank capital rules known as “Basel III” which will come into full effect from January 2013. The new rules, however, have deliberately made bank tier one hybrids riskier because they are intended to absorb losses and protect investors – providing a firewall for depositor funds.

“The Basel rules are clear that these types of securities are there to provide a buffer when the banking sector experiences times of stress,” Realm Investment’s Rob Camilleri said. “All APRA wants to do is create buffers so there is no banking crisis.It’s part of the capital management regime that’s here with us to stay.”

Schroder fund manager Mik Kase said his fund had not been allocating to the “post-Basel III” offers because they looked more like equity than previous incarnations. “It’s not that we think the issuing banks are going to default, it’s more that we aren’t getting compensated for the risk. We are buying the [higher ranking] lower tier twos and the pre-Basel III securities because we have greater certainty around repayment,” he said. “Investors need to understand, and the regulator plays a strong hand in how these new rules are implemented. The issuer holds the right to call these instruments but with many they need regulator’s approval,” Mr Camilleri said.



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Jonathan Shapiro

Jonathan Shapiro followed the Australian corporate bond markets as debt editor at Insto from July 2005. In that time he covered the dramatic events of the global financial crisis and its impact locally. Jonathan also had a year-long stint at the bond syndicate desk at ANZ, providing research and analysis to bankers, traders and senior

management. He has studied finance and economics in South Africa and journalism in Sydney.

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