Banks look offshore for hybrid raising after ATO ruling

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ANZ is looking to issue a US-dollar hybrid of at least $US750 million. **Bloomberg**

By [James Eyers](#) & [Christopher Joye](#)

In a potential game-changer for the local bank hybrid market, ANZ Banking Group is planning a US-dollar hybrid of at least $US750 million.

It comes after the Australian Taxation Office issued a private ruling that allows banks to issue hybrids via an offshore branch without having to attach franking credits to their interest payments.

The ATO ruling means the cost to banks of issuing the securities abroad will fall by approximately 30 per cent, being the value of the franking credits, in a significant development that might open the door to tens of billions of dollars of global funding for major bank hybrids.

ANZ will begin marketing the new US-dollar deal – the first for a major bank since the global financial crisis – in London on Tuesday.

Tax commissioner Chris Jordan: Banking sources said the ATO ruling has been facilitated by the emergence of a new cadre of senior officials with superior private sector experience. **Wayne Taylor**

It will be a perpetual security with either a 5-year or 10-year call date and is expected to have a cost of more than 550 basis points above the bank bill swap rate once swapped back into Aussie dollars. Standard & Poor's said on Monday it had assigned a "BBB-"rating to the securities.

The ATO's ruling says the major banks can use Section 215-10 of the Income Tax Assessment Act to issue hybrids without having to frank the interest, provided they do so via an offshore branch.

Section 215-10 is the only viable exception to the general rule prohibiting "franking streaming", which is required to put the major banks on a level playing field with competitors overseas and avoids them wasting franking credits.

Hybrid investors expect ANZ's deal will be supported by yield-starved global markets.

If the ANZ deal launches successfully, other banks may follow it into offshore wholesale markets.

This could reduce the supply of hybrids domestically, which would in turn support their prices.

Commonwealth Bank of Australia and Westpac Banking Corp recently closed successful hybrid tier-one deals on the ASX which – for the first time – saw significant institutional take-up. National Australia Bank has announced that it intends to follow them. ANZ is also considering an Australian dollar-denominated hybrid to Australian retail investors later in its financial year.

But the high volume of the major banks' ASX tier-one hybrid issuance has tended to weigh on secondary prices, which has hurt the performance of the assets.

The US-dollar deal shows banks are looking to diversifying their funding sources away from the limited domestic market for these securities.

Banking sources say the ATO ruling has been facilitated by the emergence of a new cadre of senior officials with superior private sector experience.

As credit markets have rallied in recent months, the cost differential between raising hybrid capital in Australia and the US has compressed significantly to make pricing in the US relatively more attractive.

Melbourne-based fixed-income investor Realm Investment House said the latest ANZ raising should attract strong interest from offshore investors given interest rates are low and concerns are rising around banks' equity market performance and dividend payouts.

It also pointed out in a note to clients that retail investors, desperate for yield as term deposits roll off into the low-rate environment, may be crowded out by the growing number of institutions seeking to invest in hybrid debt.

"The bad news for domestic retail investors is that institutional investors have now set up camp and are likely here to stay for a while," Realm said.

"In a yield-starved global market, this [ANZ] issuance is likely to be well received and will mean that retail investors are likely to have to share less and less supply among themselves just as rates continue to plunge headlong into un-chartered territory."
ANZ's US dollar deal is the first for a major bank since a NAB deal back in 2009 and reverses the recent trend for foreign issues to be rolled over into Australia.

ANZ says any transaction is "dependent upon market conditions as well as regulatory and other approvals" and the terms of any final deal will be disclosed to the ASX.

The deal will help replace $1.96 billion of tier-one capital listed on the ASX that ANZ is due to call in December.

A global ANZ peer, HSBC, recently priced a US$2 billion tier one deal at an annual cost of 6.875 per cent that has subsequently performed very strongly.

Swapped back into Aussie dollars, the US dollar hybrid is expected to have a cost of about 550 to 600 basis points above the bank bill swap rate, which is more expensive than domestic tier-one transactions pricing at 490 basis points above bills (after including franking).

Over the last seven years, the major banks have focused their hybrid capital raising activities, which refers to the issuance of preferred perpetual equity securities known as "additional tier-one capital" instruments, on the local listed retail market.

These securities rank ahead of shares and pay distributions to security holders unless the bank experiences stresses. In extreme circumstances, capital notes can be converted to shares or written off in value to protect more senior stakeholders, such as depositors. The yields offered by these products is enhanced by the use of franking credits, which are not accessible to investors in foreign markets.

ANZ has about $18 billion of equity capital above the 5.125 per cent capital trigger that would result in these hybrids being forcibly converted into ordinary shares.

It reports an internationally comparable common equity tier-one capital ratio of 14.2 per cent, which comfortably positions it in the top quartile of large and internationally active global banks.

Earlier this month Westpac launched a $750 million hybrid securities offer to retail investors with a margin of 4.90 per cent to 5.10 per cent over the bank bill swap rate, exceeding the highest ever margin the bank has paid for tier-one capital.

In February, CBA paid the highest ever margin for a major bank of 5.20 per cent over the bank rate to raise $1.45 billion from investors.

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