



The major banks have successfully created a market for retail hybrid securities. **Carla Gottgens**

by [Vesna Poljak](#)

Australia's bank hybrid market is wrestling with the impact of [Labor's plan to abolish cash refunds](#) for shareholders with excess imputation credits who pay little or no tax if it wins power.

The measure appears to strike at the heart of the bank hybrid market, because franking credits are a component of the dividends paid by issuers. Hybrids are marketed to investors with a targeted rate of return, generating strong enthusiasm among income-focused investors.

At the same time, hybrids have become a tidy source of funding for banks and any radical rethink of their structure could raise the cost of capital for the banking sector.

Hybrid investors believe if the securities cannot be used to distribute excess franking credits, then that shortfall needs to be supplemented with a higher cash return to replace the franking benefit. That is assuming an interpretation of the product disclosure statements favours the holders, not the issuers.

More broadly, if retail investors lose interest in hybrids, the market could dry up for banks or alternative tax concessions could be introduced to elicit interest from institutional investors.

Andrew Papageorgiou from Realm Investment House said the banks may disagree, but "it's more likely that these securities go from delivering the coupon grossed up, to delivering a cash coupon."

Further, if the banks decided to redeem the securities at 100 cents in the dollar, the majority of hybrid investors are worse off because they would be taking a haircut relative to current market prices.

"In simple terms the [additional tier 1] securities start costing the banks a lot more in cash terms than is currently the case," the fund manager explained, because payments to relevant hybrid holders are treated as a dividend and thereby not tax deductible. The beauty of AT1 securities is that they effectively allow banks to erode their "enormous" unused franking credits to pay the coupon.

"If they weren't allowed to, the cash cost would rise significantly," Mr Papageorgiou said.

The outgoing chairman of ASIC, Greg Medcraft, in 2017 labelled [hybrids a "ridiculous" option for retail investors](#), to the dismay of some investment experts and hybrid advocates.

Full Article Here:

<http://www.afr.com/markets/labors-imputation-plan-sparks-bank-hybrid-questions-20180313-h0xf33>

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