



Bank hybrid securities basics

- different ways to measure returns on bank hybrid securities

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Different ways to measure returns on bank hybrid securities

There are different ways to measure returns on bank hybrid securities. This presentation covers the most common measurements:

- ◆ Coupon or distribution rate
- ◆ Running yield
- ◆ Yield to maturity

You can find some or all of these quoted daily in broker rate sheets and in the “Interest Rate Securities” section of The Australian Financial Review

The actual method of calculation of each of these measures may differ among sources and may be based on varied assumptions, so you should seek advice from your financial adviser or other professional adviser in interpreting the information

Coupon or distribution rate

“The nominal interest rate a hybrid security pays (ie, annual income divided by the face value of the security)”

Australian Stock Exchange Limited, *Understanding Hybrid Securities*, April 2014

The terms of franked bank hybrid securities usually contain a formula similar to the following for the coupon or distribution rate:

$$\text{Distribution Rate} = (\text{Market Rate} + \text{Margin}) \times (1 - \text{Tax Rate})$$

For example, if the Market Rate is 2.29%, the Margin is 5.20% and the Tax Rate is 30%, then the Distribution Rate is 5.24%. This means that, if the face value is \$100, then:

- ◆ You should receive cash distributions totalling 5.24% per annum (subject to payment conditions); and
- ◆ You should receive attached franking credits with a value of 2.25% per annum (subject to payment conditions). This is calculated as $(\text{Market Rate} + \text{Margin}) \times \text{Tax Rate}$

If you purchased the bank hybrid securities through the public offer for \$100, or subsequently in the secondary market for \$100, then you will receive a total value of 7.49% per annum (5.24% plus 2.25%)

If you purchased the bank hybrid securities for more or less than \$100, then another return measure may be more appropriate for you to consider

Running yield

“A measure of the return on a hybrid security based on the annual coupon payments expressed as a percentage of its current market price. It takes no account of any future capital gain or loss on the security”

Australian Stock Exchange Limited, *Understanding Hybrid Securities*, April 2014

This is particularly relevant if you are considering purchasing bank hybrid securities for a market price which is more or less than the face value. It is usually calculated according to the formula:

$$\text{Running yield} = \frac{\text{Distribution Rate} + \text{franking credits}}{\text{Market price}}$$

For example, if the Distribution Rate is 5.24%, the franking credit rate is 2.25% and the current market price is \$95, then the running yield is 7.88%

However, if the Distribution Rate is 5.24%, the franking credit rate is 2.25% and the current market price is \$105, then the running yield is 7.13%

Yield to maturity

“The average annual return an investor should receive if they buy a hybrid security for its current market value and hold the hybrid security to maturity. The calculation factors in coupon payments, the time to and amount due at maturity, and the capital gain or loss that will be made on maturity. It also assumes that the coupon payments are reinvested in the hybrid security.”

Australian Stock Exchange Limited, *Understanding Hybrid Securities*, April 2014

This is particularly relevant if you are considering purchasing bank hybrid securities for a market price which is more or less than the face value, and you want to compare them against other securities which pay distributions at different times or have a different face value. It is usually calculated according to the formula¹:

$$\text{Market price} = \frac{\text{Cashflow 1}}{(1 + \text{yield})^1} + \frac{\text{Cashflow 2}}{(1 + \text{yield})^2} + \dots + \frac{\text{Repayment of face value}}{(1 + \text{yield})^n}$$

where n is the number of the last payment

For example, if the yield to maturity is 7.95%, this means that the average return you will receive is 7.95% if you hold the bank hybrid security to maturity, regardless of subsequent changes in the market price

1. Assuming an annual coupon payment and repayment of face value on the call date

Example broker rate sheet

ASX code	Security description	Last sale (\$)	Face value (\$)	Coupon rate (%)	Running yield (%)	YTM (%)
ABCHA	ABC Bank hybrid securities	95.00	100.00	7.49	7.88	7.95

Rate is set on issue or periodically on reset dates

Rate depends on market price (last sale)

Rate depends on market price (last sale) and takes the timing of all future payments into account