Credit Observer

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Hybrid Handbook

Navigating the Australian Hybrid Market

John Likos, CFA
Senior Credit Analyst, Australia
+61 2 9276 4444
john.likos@morningstar.com

Michael Murphy
Associate Credit Analyst
+61 2 9276 4444
michael.murphy@morningstar.com

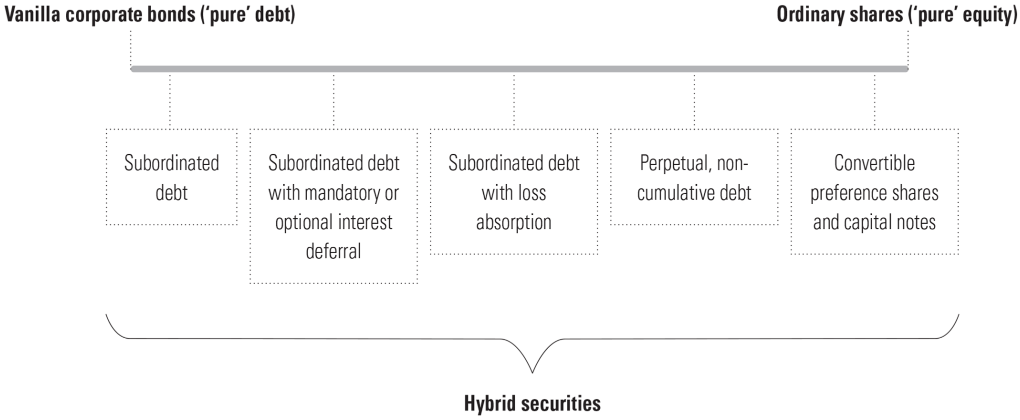
Contents

An Introduction to Hybrid Securities

What are Hybrid Securities?

Hybrid securities are securities that contain both debt-like and equity-like characteristics. We include subordinated debt, perpetual notes, convertible preference shares and capital notes in this classification. As Exhibit 1 highlights, hybrid securities fall on a spectrum between pure debt and pure equity in the capital structure[1]:

Exhibit 1 ASIC's Hybrid Securities Spectrum



Source: ASIC, Morningstar.

Some of the key distinguishing features of hybrid securities include:

- Subordination in the capital structure. In a wind-up scenario, the recovery rate on hybrid securities will be materially lower than the recovery rate on securities above them in the capital structure, such as traditional fixed income.
- Distributions may be deferrable, either at the issuer's discretion (optional deferral) or in the event of covenant breaches (mandatory deferral), or both. Distribution deferral may be cumulative, meaning missed payments accrue and must be made up at a later date, or non-cumulative depending on the terms of the hybrid.
- The payment of a predetermined rate of return. This distribution may be fixed or as is the case with the majority of the Australian hybrid universe, floating.

1 ASIC, REP 365 Hybrid Securities, 20 August 2013

- They are typically perpetual securities or have a long duration until maturity. Hybrids usually have one or more call options that give the issuer the right, but not the obligation, to redeem the security before the final maturity date. The investor does not have the right to request redemption before final maturity.

- Hybrid securities may have loss absorption mechanisms which require holders to absorb losses while the issuer is still a going concern. For example, capital notes issued by a bank which qualify as regulatory capital under the latest Basel-III prudential requirements may either convert into ordinary shares, possibly worth significantly less than the original investment, or be written off completely under certain conditions.

The further to the right of the spectrum in Exhibit 1 a hybrid security is, the more equity-like its behaviour and risk will be, and vice versa for hybrids closer to the left of the spectrum. Therefore, in times of heightened market volatility, the more equity-like hybrid securities tend to display greater price volatility relative to their more debt-like peers.

Consider for example the ANZ Bank Subordinated Notes (ASX Ticker: ANZHA). ANZHA are subordinated debt securities which rank ahead of ANZ Bank ordinary shares and capital notes such as the ANZ Capital Notes 3 (ANZPF) on ANZ Bank's capital structure. ANZHA's interest payments are not deferrable, whereas ANZPF's interest payments are discretionary and non-cumulative. This, along with other features such as having a legal maturity date and no terms or conditions requiring conversion into equity make ANZHA more debt-like and less risky than ANZPF.

Exhibit 2 New Style ANZPF More Equity-Like than Old Style ANZHA

Source: Thomson Reuters, Morningstar.

As Exhibit 2 highlights, and not surprisingly, the more debt-like ANZHA displays far less price volatility compared to the more equity-like ANZPF, highlighting the higher position of ANZHA on the ANZ Bank capital structure.

Comparing Hybrid Securities to Other Investments

The Australian Securities & Investments Commission, or ASIC, has cautioned on numerous occasions that hybrid securities are not "traditional fixed income", a common misperception among retail investors. As Exhibit 3 highlights, hybrid securities contain several equity-like features that prevents them being considered a true substitute for traditional fixed income or term deposits in an investor portfolio.

Exhibit 3 Comparing Hybrid Securities to Other Investments

	Shares	Capital Notes	Subordinated Notes	Corporate Bonds	Term Deposits
Income	Dividends. Non-cumulative. Discretionary.	Distributions. Non-cumulative. Discretionary. Subject to a dividend stopper.	Interest payments. May be deferred. May be cumulative.	Interest payments (fixed or floating).	Interest payments (fixed).
Investment Timeframe & Redemption	No maturity date. No redemption requirement.	Generally 7-10 years. Scheduled equity conversion or cash repayment at face value. No maturity date.	Up to 60 years. Issuer option for early redemption. Repaid in cash at maturity.	Fixed term. Generally 5-10 years. Cash repayment at maturity.	Fixed term. Generally between 1 month - 5 years. Cash repayment at maturity.
Early Repayment at Issuer's Discretion	No.	Yes. Generally, after a minimum of 5 years subject to terms & conditions or if trigger event occurs. May be issued with shares over cash.	Yes. On nominated dates usually after 5 years, or upon a trigger event.	Yes. In limited circumstances.	No.
Recovery in Event of Insolvency	Last in line.	Only senior to shareholders. In some instances, written off before shareholders.	Only senior to ordinary shareholders and deeply subordinated investors.	Only senior to shareholders, hybrid holders, subordinated note holders.	Deposits up to AUD 250,000 guranteed by Government.

Source: ASIC, Morningstar.

Types of Hybrid Securities

Subordinated Debt

Subordinated debt securities are typically long dated debt securities, sometimes up to 60 years, that contain equity-like terms. These may include:

- Subordination – they rank behind other debt securities in the event of a winding up;
- Coupon deferral – they allow mandatory or optional coupon deferral options; and
- Loss absorption – they allow the issuer to write down unpaid coupon payments.

Subordinated notes issued by financial institutions generally contain different features to those issued by non-financial issuers in order to satisfy prudential requirements to qualify as regulatory capital.

Perpetual Securities

Perpetual securities are typically, but not always, made up of two components, a fully paid debt security and an unpaid preference share. These two components are stapled together and constitute the perpetual security. They are often categorised as hybrid securities in that, like common stock, they don't have a maturity date. Although the issuer retains the right to redeem the securities at certain stages of their life, they are not obligated to do so. Investors' only option of redeeming the notes is by selling on market, unless the issuer voluntarily decides to redeem them. They generally rank below subordinated debt and allow deferral of interest payments.

Convertible Preference Shares

Convertible Preference Shares derive their name from the idea that holders receive 'preference' over common equity holders to receive distributions and repayment of principal in the event of a winding up. Like traditional debt, they pay a regular and defined distribution to holders; however, like equity they have an element of permanence about them as there is no guaranteed date of redemption, that is, no maturity date. Rather, they have optional and scheduled conversion dates where the shares can be redeemed or converted into common stock, provided certain conditions are met. Should these conditions not be met, the preference shares will remain outstanding until those conditions are satisfied.

Capital Notes

Capital Notes, which are very similar to Convertible Preference Shares, are subordinated, convertible, redeemable and transferrable, unsecured and pay non-cumulative distributions that are franked. Capital Notes are perpetual, which means they have no fixed maturity date and could remain on issue indefinitely if they are not redeemed, converted or written-off. Issuers must convert Capital Notes into ordinary shares if the scheduled conversion conditions on the scheduled conversion date are satisfied. Capital Notes issued by regulated financial institutions include features to comply with APRA's requirements for securities that fund regulatory capital of APRA regulated entities.

Exhibit 4 Examples of Hybrid Securities Across the Capital Structure

	Instrument Type	Issuer	ASX Ticker	Security Type	Interest Rate Payable	Franking	Maturity Date	Optional Interest Deferral	Non-Viability or Capital Trigger	Capital Structure Ranking
Most Debt Like	Subordinated Debt	ANZ	ANZHA	Subordinated, unsecured	BBSW + 2.75%	No, distributions are interest payments	Jun 2022	No, unless ANZ is insolvent	Neither	Senior to Perpetual subordinated debt, preference shares and capital notes and ordinary shares
	Subordinated Debt with Mandatory or Optional Interest Deferral	Crown Resorts	CWNHA	Subordinated, unsecured, cumulative	BBSW + 5.00%	No, distributions are interest payments	Sep 2072	Yes	N/A	Ranking only in priority to Crown's ordinary shares, junior ranking obligations and subsidiary junior ranking obligations
	Subordinated Debt with Loss Absorption	Suncorp	SUNPD	Subordinated, unsecured, cumulative	BBSW + 2.85%	No, distributions are interest payments	Nov 2023	Yes. Dividend Stopper	Non-Viability Trigger	Senior to ordinary shares and Additional Tier 1 Capital, equal with other unsecured subordinated obligations, behind all unsubordinated creditors
	Perpetual Non-Cumulative Debt	NAB	NABHA	Unsecured, stapled, non-cumulative, perpetual	BBSW + 1.25%	No, distributions are interest payments	Perpetual	Yes. Dividend Stopper	Neither	Above ordinary shareholders, equal with preference shares and capital notes but behind all other debt holders
	Convertible Preference Shares	WBC	WBCPC	Subordinated, unsecured, non-cumulative, perpetual, redeemable	BBSW + 3.25%	Yes	Scheduled Conversion (Mar 2020)	Yes. Dividend Stopper	Capital Trigger	Above ordinary shareholders, equal with preference shares and capital notes but behind all other debt holders
Least Debt Like	Capital Notes	CBA	CBAPD	Subordinated, unsecured, non-cumulative, perpetual, redeemable	BBSW + 2.80%	Yes	Scheduled Conversion (Dec 2024)	Yes. Dividend Stopper.	Non-Viability and Capital Trigger	Above ordinary shareholders, equal with preference shares and capital notes but behind all other debt holders

Source: Morningstar. BBSW refers to the 3 Month Bank Bill Swap Rate.

ASX Debt and Hybrid Naming Convention

The Australian Stock Exchange, or ASX, uses a standardised naming convention and description for debt and hybrid securities. Each security is allocated a specific code and three different descriptors. These include:

- Long form description, up to 50 characters;
- Abbreviated description, up to 18 characters; and
- Short description, up to 8 characters.

As the ASX highlights in their "Guide to Security Descriptions for Bonds and Hybrids"[2], descriptions have character constraints that might require some details to not be included. Capital Notes, for example, are subordinated by their nature, so the SUB descriptor is not included.

Consider the ANZ Capital Notes 2 (ASX Code: ANZPE) as an example. The long form description would be CAP NOTE 6-BBSW+3.25% PERP NON-CUM RED T-03-24. Despite the absence of the SUB descriptor, they are subordinated by virtue of being a Capital Note.

Exhibit 5 ASX Hybrid Naming Convention Example: ANZ Capital Notes 2 (ANZPE)

CAP NOTE	Capital Note, meaning the issuer or a third party (e.g. APRA) has a right to extinguish the security under certain circumstances.
6-BBSW+3.25%	The security pays a semi-annual floating distribution based on the 6 month BBSW + 3.25%.
PERP	The security has no legal maturity date (it is perpetual).
NON_CUM	The distributions are non-cumulative.
RED	The security is redeemable.
T-03-24	The security has a trigger date for possible conversion in March 2024.

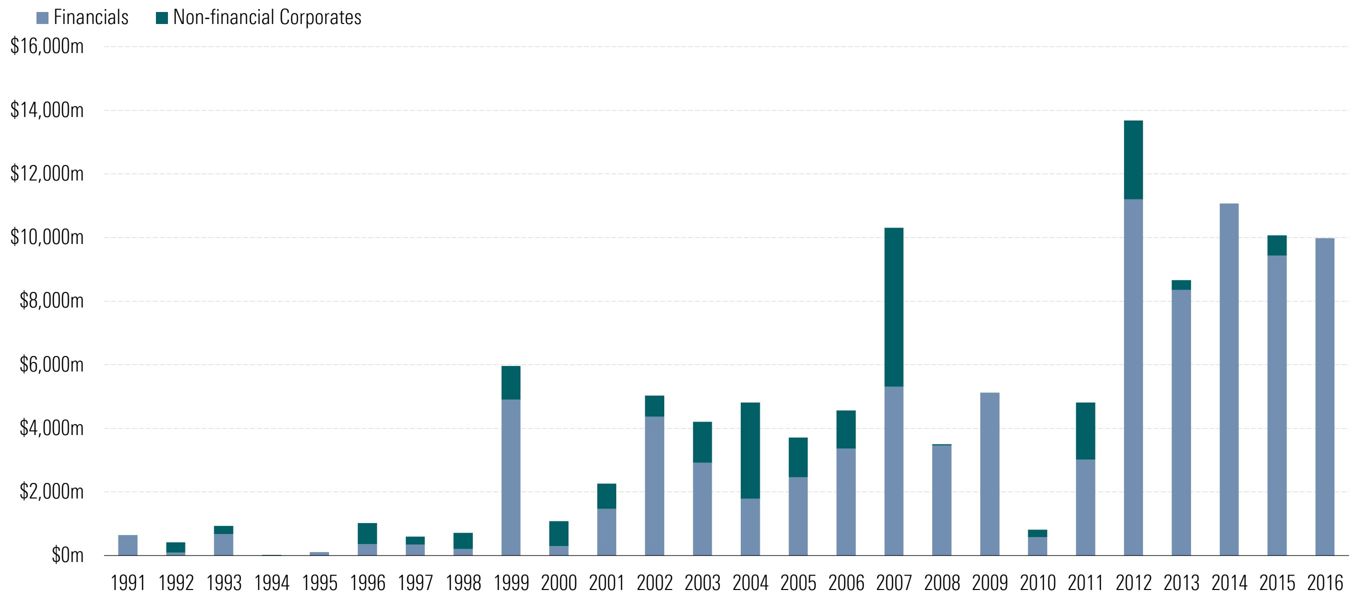
Source: ASX, Morningstar.

2 http://www.asx.com.au/documents/products/Guide_to_security_descriptions_for_bonds_and_hybrids.pdf

A History of Hybrid Securities in Australia

Hybrid securities are a relatively new phenomenon in the Australian investment landscape. In 1991, ANZ Bank issued the first domestic Converting Preference Share (CPS), or hybrid security. The AUD 600 million issue was targeted at institutional investors, although a AUD 100 million allocation was set aside for retail investors. A coupon of 13.25% helped drive the issue to being nearly AUD 70 million oversubscribed, leaving ANZ Bank management compelled to apologise for the shortfall to retail investors in their 1991 Annual Report for what they described as an "innovative issue".

Exhibit 6 A History of AUD Hybrid Issuance

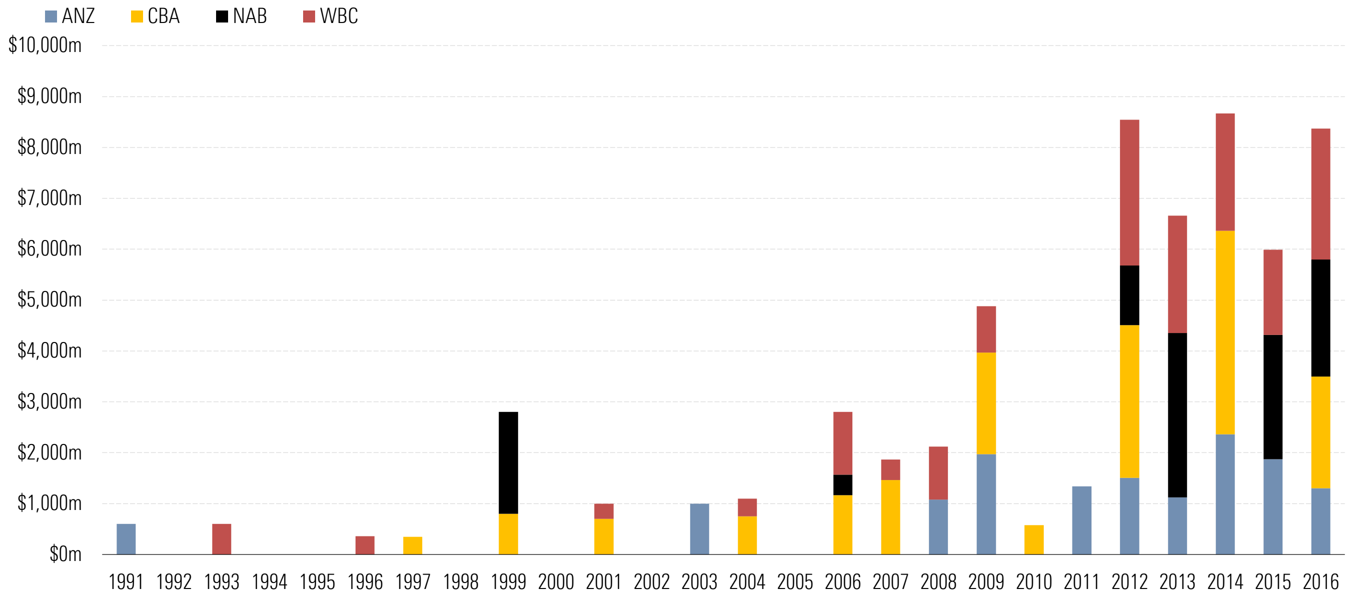


Source: Thomson Reuters, Morningstar.

The success of ANZ Bank's inaugural CPS issue prompted other issuers to come to market and issue their own hybrid securities. This included household names across both financial and non-financial industries such as Westpac Banking Corporation, Coles Myer and General Property Trust. Since then, hybrid security structures have continued to evolve in line with economic, regulatory and industry body developments.

The trend towards retail based hybrid issuance accelerated over the years, with the majority of new issuance now targeting retail investors, predominantly Self-Managed Superannuation Funds, or SMSFs. There are still institutional only hybrid issuances from Australian issuers, but these tend to be from issuers outside of the major banks seeking to raise a relatively low amount of funds. In this case, the relatively high fixed costs of launching a listed retail offer and the quicker execution make institutional issuance a convenient source of funding.

Exhibit 7 Australian Major Banks' AUD Hybrid Issuance



Source: Thomson Reuters, Morningstar.

As highlighted in Exhibit 7, hybrid security issuance by Australia's major banks has been particularly strong since 2012. This has been driven by:

- Regulatory capital requirements imposed on banks by the Australian Prudential Regulatory Authority, or APRA, as part the revised international banking regulatory framework, developed by the Basel Committee on Bank Supervision.
- Issuer desire for funding source diversification.
- Hybrids being generally cheaper than issuing equity and not dilutive to equity holders.
- Greater flexibility with regards to terms and conditions.

In contrast to bank hybrids, non-financial hybrid issuance has been relatively subdued in recent years. We attribute this to a range of factors including:

- The tightening of criteria to qualify as equity credit by rating agencies in recent years. This has resulted in corporate hybrid issues losing their 100% equity classification in place of 50% in many instances. The part debt designation increases the amount of debt an issuer holds on the balance sheet which can have negative implications on their credit rating.
- Cheaper alternative funding sources, particularly global debt markets.
- Time and cost of execution being too high relative to alternate funding options.

Who Buys Hybrids in the Domestic Market?

Hybrid securities have become the domain of the retail investor in Australia. For retail investors, when compared to direct investment in common equity, investment in hybrid securities is concentrated among a much smaller group of investors, predominantly SMSF investors.

Some of the key reasons behind this concentration towards retail ownership include:

- Higher yields relative to other investments.
- Brand recognition or reputation of the issuer.
- Ability to utilise franking benefits.
- Institutional investors generally having a greater pool of assets to choose from.

While institutions haven't been as active in the hybrid space as retail investors historically, higher issue margins during 2016 have attracted some institutional support. For example, recent issues including CommBank PERLS VIII (ASX Code: CBAPE), Westpac Capital Notes (WBCPG) and NAB Capital Notes 2 (NABPD) attracted increased institutional interest relative to previous issues.

Benefits of Issuing Hybrid Securities

Qualification as regulatory capital

For regulated financial institutions such as banks and insurers, a key benefit of hybrid funding is its ability to qualify as regulatory capital, subject to meeting the criteria prescribed by APRA. This has been the key driver behind the increase in bank hybrid issuance in recent years as global banking regulations continue to require the banks to hold higher levels of capital.

Gaining equity credit treatment by credit rating agencies

Subject to certain criteria, credit rating agencies afford the hybrid issuer equity credit, thereby supporting the credit rating. This can protect the issuer from a credit rating downgrade while obtaining the required funding. Exhibit 8 highlights how 50% equity credit can support stronger credit metrics relative to 100% debt funding for a corporate issuer.

Exhibit 8 Scenario Analysis of AUD 10 Million Raising from a Corporate Issuer Utilising 50% Equity Credit

	Current	100% Equity	100% Debt	50% Debt / 50% Equity credit
Amount to be raised:	n/a	$10,000,000	$10,000,000	$10,000,000
Issue Type	n/a	Shares	Debt	Subordinated Note
Funding cost	n/a	n/a	7.0%	10.0%
Assets	$50,000,000	$60,000,000	$60,000,000	$50,000,000
Debt	$20,000,000	$20,000,000	$30,000,000	$25,000,000
Equity	$30,000,000	$40,000,000	$30,000,000	$35,000,000
EBITDA	$10,000,000	$10,000,000	$10,000,000	$10,000,000
Interest Expense	$1,400,000	$1,400,000	$2,100,000	$1,400,000
Interest Expense inc Hybrid	-	-	-	$1,900,000
Cash Flow from Operations	$5,000,000	$5,000,000	$5,000,000	$5,000,000
Ratio Analysis				
Debt to EBITDA	2.0x	2.0x	3.0x	2.5x
EBITDA Interest Cover	7.1x	7.1x	4.8x	5.3x
Debt to Capital	40%	33%	50%	42%
CFO / Debt	25%	25%	17%	20%

Source: Morningstar.

Lower cost of funding than equity

Despite being more expensive than pure debt as a source of funding, hybrid capital is generally cheaper than pure equity. This is often reflected in the equity dividend yield premium relative to the hybrid yield.

Potentially favourable tax treatment

Tax deductibility is another incentive, particularly for corporate issuers. Coupon payments in these instances are recognised as expenses on the income statement, lowering the taxable income. Other issuers, such as the domestic major banks are able to benefit from utilising excess franking credits by paying franked distributions.

The avoidance of direct equity dilution for common stock holders

Hybrid issuance is non-dilutive to common stock holders, supporting equity metrics such as earnings per share and share price.

Diversifying funding source

Hybrid securities offer an alternative funding source to the more common equity and senior debt options, providing balance sheet flexibility to issuers. Hybrids also provide a level of issuer flexibility with regard to distributions and funding tenor.

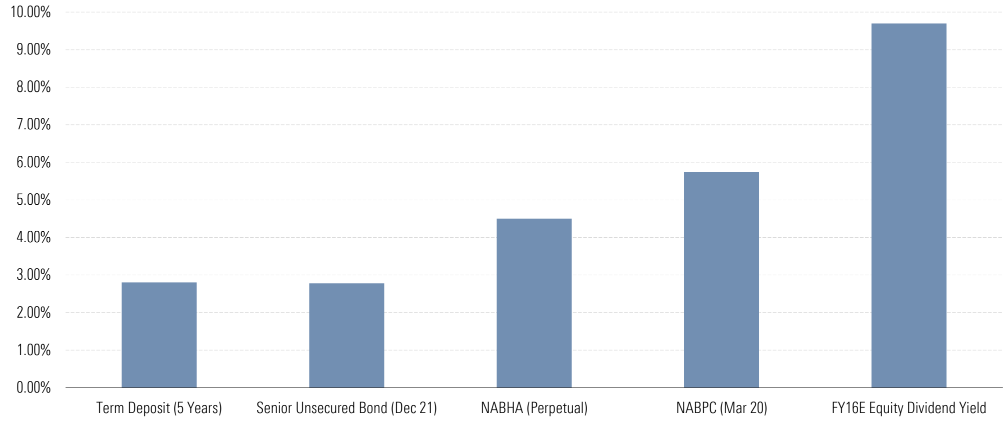
Benefits of Hybrids for Investors

Hybrid securities can offer a range of benefits to investors.

Higher rate of return

Reflecting their subordination on the issuer capital structure, hybrid securities generally offer a relatively higher rate of return compared to senior debt.

Exhibit 9 National Australia Bank Capital Structure by Returns



Source: Morningstar. Data as at 8 September 2016.

Liquidity benefits

Although hybrid securities are less liquid than the ordinary shares of the underlying issuer, their secondary market liquidity is supported by their ASX listing. We discuss liquidity in greater length in the Key Risks section.

Income at a Higher Price Volatility than Fixed Income, but Lower Price Volatility than Equity

Hybrid securities generally pay a regular distribution while displaying lower price volatility than the ordinary shares of the underlying issuer but a higher price volatility relative to the senior debt of the issuer. Nevertheless, the possibility that distributions can be suspended or price volatility exceeds that of the underlying equity remains.

Diversification benefits

Hybrid securities can diversify the overall risk of a portfolio while generating attractive returns, thereby improving overall risk-return profiles. However, we reiterate that hybrid securities should not be considered a like-for-like replacement for term deposits or pure debt. We believe they should be viewed as a separate asset class with their own asset allocation to fully benefit from diversification benefits.

Comparing Bank and Corporate Hybrid Securities

Bank Hybrids

Bank hybrids, which increasingly dominate the hybrid landscape, continue to evolve in line with regulatory requirements, becoming increasingly homogenous in the process. Under the Basel III framework, bank hybrid securities for regulatory purposes are classified as either Additional Tier 1 (AT1) or Tier 2 capital subject to meeting the criteria prescribed by APRA.

To assist in understanding bank hybrids, let's have a closer look at some of their key features surrounding:

- Subordination;
- Call structures;
- Distribution deferral; and
- Loss absorption mechanisms.

Subordination

Bank hybrid securities, like all hybrids, are deeply subordinated on the capital structure. In other words, if the issuer is wound up, the recovery rate on the hybrid securities will be materially lower than the recovery rate on securities higher up in the capital structure. Within the capital structure of a bank, AT1 hybrids are senior only to ordinary shares whereas Tier 2 hybrids are senior to all Tier 1 capital, specifically ordinary shares and AT1 hybrids.

Consider for example the position of the CommBank PERLS VIII (CBAPE) hybrid security within Commonwealth Bank's capital structure. In the event of a winding up, CBAPE ranks ahead of Commonwealth Bank ordinary shares, equal with Commonwealth Bank PERLS VI (CBAPC) and PERLS VII (CBAPD), behind senior creditors, liabilities preferred by law (such as bank deposits) and secured debt (covered bonds).

Exhibit 10 Ranking of CBAPE in the Event of a Winding Up of Commonwealth Bank

		Existing CBA obligations/securities[1]
HIGHER RANKING	Secured debt	► Covered bonds
	Liabilities preferred by law	► Liabilities in Australia in relation to protected accounts ► Other liabilities preferred by law including employee entitlements
	Senior Ranking Obligations	► Deposits (other than protected accounts) ► Senior debt ► General unsubordinated unsecured creditors ► Tier 2 Capital
	Equal Ranking Securities	► **PERLS VIII**[2] ► PERLS VII[2] ► PERLS VI[2] ► Any preference shares or other subordinated unsecured debts[3]
LOWER RANKING	Junior Ranking Securities	► Ordinary shares

1. This is a simplified capital structure of CBA and does not include every type of security issued or that could be issued in the future by CBA. CBA could raise more debt or guarantee additional amounts at any time.
2. Ranking prior to Exchange.
3. Excluding Junior Ranking Securities.

Source: CBA PERLS VIII prospectus

Source: CBA PERLS VIII prospectus, Morningstar.

Call Structures

Bank hybrids are long dated securities. AT1 hybrids are perpetual securities and Tier 2 hybrids typically have a duration of 10 years until the final legal maturity. Bank hybrids have a call option that allows them to be redeemed or exchanged prior to the final maturity. To be considered AT1 or Tier 2 capital by APRA, a bank hybrid must have a minimum period of 5 years before it can be called. In that period, it is critical that the issuer does not give the expectation that the call will be exercised. If the issuer does decide to call the hybrid on the optional call date, it must first receive APRA approval. Prior to this they can-not be called by the issuer. While bank hybrids issued before the introduction of Basel III may have a step up in the coupon offered at the call date, bank hybrids are not allowed to have coupon step ups in order to qualify as regulatory capital under Basel III.

AT1 hybrids contain a scheduled conversion date whereby the hybrid security must convert into equity if certain conditions are satisfied. This scheduled conversion date is typically two years after the optional call date. Exhibit 11 provides examples of various call structures of select Australian bank hybrids.

Exhibit 11 Comparing Call Structures of Australian Bank Hybrids

	ANZ Subordinated Notes	Westpac Subordinated Notes II	CBA PERLS VIII	NAB Capital Notes 2
ASX code	ANZHA	WBCHB	CBAPE	NABPD
Issue date	14 Jun 2012	22 Aug 2013	30 Mar 2016	7 Jul 2016
Regulatory classification	Tier 2 Capital	Tier 2 Capital	Additional Tier 1 Capital	Additional Tier 1 Capital
Basel III compliant	No	Yes	Yes	Yes
First call date	14 Jun 2017	22 Aug 2018	15 Oct 2021	7 Jul 2022
Scheduled conversion date	-	-	15 Oct 2023	8 Jul 2024
Final Maturity date	14 Jun 2022	22 Aug 2023	-	-

Source: Morningstar.

Coupon Deferral

For Basel III Compliant AT1 hybrids, distributions are discretionary and subject to various conditions being met. They are not cumulative, in other words, distributions that are not paid do not accrue and do not have to be subsequently paid. Non-payment of distributions does not qualify as a default event. However, non-payment of hybrid distributions typically places restrictions on the ability to pay dividends to ordinary shareholders and conduct other capital management activities such as buy backs. Known as a dividend stopper, this acts as a strong incentive for the issuer to continue to pay distributions.

For Tier 2 hybrids, distributions are typically non-discretionary meaning that payments cannot be missed unless the bank is insolvent when the payment is due, or the Tier 2 hybrid has been converted as a result of a non-viability trigger.

Loss absorption

Both AT1 and Tier 2 hybrids issued under Basel III contain conversion triggers that require the hybrids to be converted into equity in order to absorb losses during times of financial distress for the bank. If conversion occurs, the hybrid will be converted to ordinary shares. The value of the ordinary shares that the holder receives will likely be worth less than face value and the hybrid could be completely written off under certain circumstances.

Both AT1 and Tier 2 hybrids contain a non-viability trigger which allows APRA to require the conversion of some or all of the hybrid if APRA believes without it the bank would become non-viable. In addition, AT1 hybrids also have a capital trigger. If the issuer determines, or APRA believes, that the issuer's common equity tier-1 ratio is equal to or less than 5.125%, the issuer must exchange a sufficient amount of the security into the bank's ordinary shares to return this ratio above 5.125%.

Corporate Hybrids

Corporate hybrids, otherwise referred to as subordinated notes, may also have a combination of debt and equity-like features, although their characteristics can differ materially from financial hybrids. To assist in understanding corporate hybrids, let's have a closer look at some of their key features surrounding:

- Call structures;
- Distribution deferral; and
- Equity credit.

Call Structure

Corporate hybrids are typically perpetual securities or will have a very long duration until final maturity, often extending to 60 years or beyond. Corporate hybrids tend to have one or more call options that allow the issuer to redeem the security before the final maturity. A corporate hybrid may also have a series of step ups in the coupon offered on the security, either at or after the first call date. The sequence of call dates and coupon step ups differs from one hybrid to the next.

Typically, domestic corporate hybrids will have a first call option between 5 to 10 years after the issue date, with the option to redeem the security at any subsequent distribution date.

Exhibit 12 Comparing Call Structures of Australian Corporate Hybrids

	AGL Energy Subordinated Notes	Caltex Subordinated Notes	Crown Subordinated Notes II	Goodman PLUS II
ASX code	AGLHA	CTXHA	CWNHB	GMPPA
Issue date	4 Apr 2012	5 Sep 2012	23 Apr 2015	21 Dec 2007
First call date	8-Jun-19 or any subsequent distribution date	5-Sep-17 or any subsequent distribution payment date	23-Jul-21 or any subsequent distribution payment date	31 Dec 2017 or any subsequent distribution payment date
Coupon step-up	0.25%	0.25%	0.00%	0.00%
Coupon step-up date	-	-	23 Jul 2041	30 Sep 2022
Coupon step-up	-	-	1.00%	0.25%
Coupon step-up date	-	-	-	31 Dec 2038
Coupon step-up	-	-	-	0.75%
Final Maturity date	8 Jun 2039	15 Sep 2037	23 Apr 2075	31 Dec 2073

Source: Morningstar.

Distribution Deferral

Distributions on corporate hybrids may be deferrable, either at the issuer's discretion (optional deferral) or in the event of covenant breaches (mandatory deferral), or both. For mandatory deferral, the distribution payment is linked to a specific condition or conditions. While there are a wide variety of possible covenants, they are often based around leverage and interest coverage ratios, which are tested periodically.

An example of a corporate hybrid that has both a leverage ratio and interest coverage ratio mandatory conversion condition is Crown Subordinated Notes II (CWNHB). A mandatory deferral event occurs if Crown Resorts' leverage ratio is above 5.0 times for two consecutive testing dates; or interest cover ratio is below 2.5 times on any testing date.

Exhibit 13 Distribution Deferral Conditions for Australian Corporate Hybrids

	AGL Energy Subordinated Notes	Caltex Subordinated Notes	Crown Subordinated Notes II	Goodman PLUS II
ASX code	AGLHA	CTXHA	CWNHB	GMPPA
Discretionary coupon deferral	No	Yes	Yes	Yes
Mandatory coupon deferral	Yes	No	Yes	No
Mandatory deferral condition 1	Interest cover ratio < 3.0x or;	-	Interest cover ratio < 2.5x or;	-
Mandatory deferral condition 2	Leverage ratio > 4.0x	-	Leverage ratio > 5.0x	-
Cumulative distributions	Yes	Yes	Yes	No
Dividend stopper	No	Yes	Yes	Yes

Source: Morningstar.

The ability to defer coupons is one of the equity-like features of a hybrid as such an event does not qualify as a default event for the issuer as it would for failing to make a payment on senior debt. However, non-payment of distributions typically places restrictions on the issuer to pay dividends to ordinary shareholders and conduct other capital management activities such as buy backs. Distribution deferral may be cumulative, meaning missed payments accrue and must be made up at a later date, or non-cumulative depending on the terms of the hybrid.

Equity Credit

Rating agencies will assign equity credit according to the equity benefits the hybrid security affords the issuer. In recent years, rating agencies have tightened the criteria for corporate hybrids to receive equity credit. As a result, a number of hybrids that were initially given 100% equity credit were downgraded to 50%. Since the more stringent requirements for 100% equity treatment were introduced, new corporate hybrid issues have been structured to qualify for, at most, 50% equity treatment. Typically, they are also structured in such a way that they lose their equity credit after the first call date, providing the issuer with extra incentive to redeem on this date.

Key Hybrid Calculations

Calculating Distributions

Most domestic listed hybrid securities are floating rate securities. The distribution rate for floating rate hybrid securities is reset periodically, most commonly every 90 or 180 days, so the distribution amount will potentially be different for each payment. These securities are linked to short term interest rates, typically the 90 or 180-day Bank Bill Swap Rate (BBSW) for Australian hybrid securities.

The distribution rate, in percentage terms, is calculated using the formula:

$$gross\ distribution\ rate = benchmark\ rate + coupon\ margin$$

The benchmark rate will be the 90 day BBSW if distributions are paid quarterly or the 180 day BBSW if distributions are paid semi-annually. The coupon margin is fixed and will be determined at the time of issue and will be driven by the trading margins of comparable securities at the time of issue.

For franked distributions, the net distribution rate (i.e. the cash component of the distribution) will be:

$$net\ distribution\ rate = (benchmark\ rate + coupon\ margin) \times \frac{(1 - tr)}{\left(1 - \left(tr \times (1 - F)\right)\right)}$$

Where tr is the corporate tax rate and F is the proportion of the distribution that is franked, ranging from 0% for unfranked distributions to 100% for fully franked distributions.

The distribution amount for each payment period is calculated as:

$$D = distribution\ rate \times issue\ price \times (days\ in\ distribution\ period/365)$$

The gross distribution amount (includes franking credits) is calculated using the distribution rate and the net distribution (i.e. cash component of the distribution) is calculated using the net distribution rate.

Franking Credits

Hybrid distributions can come with or without tax credits attached. If franking credits are attached to the distribution, the cash proportion of the distribution will be scaled down by the value of the attached credits and the balance will be paid as a tax credit. It works the same as franking on dividends from ordinary shares. If a distribution is franked, then the net (cash) payment amount will be equal to:

$$cash\ distribution\ rate = gross\ distribution\ rate \times \frac{(1 - tr)}{\left(1 - \left(tr \times (1 - F)\right)\right)}$$

Where the gross distribution rate is the distribution rate including franking credits, tr is the corporate tax rate and F is the proportion of the distribution that is franked, ranging from 0% for unfranked distributions to 100% for fully franked distributions. Some companies, particularly those paying a proportion of their tax outside Australia, will have a franking proportion less than 100%. For example, Macquarie Group has a franking proportion of 40% on a number of their hybrid securities. Note that for fully franked distributions, this calculation simplifies to:

$$cash\ distribution\ rate = gross\ distribution\ rate \times (1 - tr)$$

Exhibit 14 Additional Tier 1 Bank Hybrid Distribution Example, Assuming 100% Franking

Margin	5.20%
BBSW	2.00%
Face Value of Hybrid	$100
Corporate Tax Rate	30%
Gross Distribution Rate	= BBSW + Margin = 5.20% + 2.00% = 7.20% per annum
Cash Distribution Rate	= Equivalent Unfranked Distribution Rate x (1 - Corporate Tax Rate) = 7.20% x (1 - 0.30) = 5.04% per annum
Hybrid Holder Receives in % Terms	5.04% as a cash distribution on the payment date + 2.16% as franking credits
Cash Distribution Amount	
Cash Distribution Rate	5.04% per annum
Multiplied by the face value of each hybrid	× $100.00
Multiplied by the number of days in the relevant distribution period	× (90 / 365) (assuming 90 days for a quarterly distribution period)
Quarterly cash distribution amount for each hybrid	= $1.24
Franking Credit Calculation	
Amount of franking credits per cash distribution amount	= cash distribution amount x (corporate tax rate/1-corporate tax rate) = 1.24*(0.3/0.7) = $0.53
Total Income	
The investor will receive per $100 hybrid	= $1.24 as a cash distribution on the distribution payment date + $0.53 as franking credits
Total Income assuming the investor held 100 hybrids	
Cash distribution amount	= $1.24 * 100 = $124
Franking credit amount	= $0.53 * 100 = $53

Source: Morningstar.

Net dividends received will be lower for investors that are not able to utilise franking benefits, such as foreign investors.

Exhibit 15 highlights details of distributions on a selection of domestic floating rate hybrid securities.

Exhibit 15 Examples of Recent Distributions on Hybrid Securities

	CBAPD	MQGPB	CWNHB
Security name	CBA PERLS VII	Macquaire Group Capital Notes 2	Crown Subordinated Notes II
Issue price (AUD)	100	100	100
Ex-date	6 Sep 2016	8 Sep 2016	5 Sep 2016
Payment date	15 Sep 2016	19 Sep 2016	14 Sep 2016
Days in distribution period	92	186	92
Franking proportion	100%	40%	0%
Corporate tax rate	30%	30%	30%
Distribution frequency	Quarterly	Semi-annually	Quarterly
Base rate	90 day BBSW	180 day BBSW	90 day BBSW
Base rate at time of distribution	2.03%	2.45%	2.02%
Coupon margin	2.80%	5.15%	4.00%
Gross distribution rate	4.83%	7.60%	6.02%
Net distribution rate	3.38%	6.49%	6.02%
Gross distribution (AUD)	1.22	3.87	1.52
Net distribution (AUD)	0.85	3.31	1.52

Source: Morningstar.

Although floating rate securities will not be subject to the same changes in market price resulting from interest rate changes as fixed rate securities, changes in interest rates will affect the amount received. This is because a fall in the underlying benchmark interest rate will reduce the amount received.

The distribution rate for fixed rate hybrid securities does not change during its entire term, so the distribution amount will be the same for each payment interval. A fixed interest rate security will typically appreciate in price when interest rates fall and decrease in price when interest rates rise.

Measuring Returns

Running yield

The running yield is a simple calculation of current annual distributions divided by the clean price (that is, the current market price, less accrued distributions):

$$gross\ running\ yield_k = \frac{annual\ distribution}{market\ price - accrued\ gross\ distributions}$$

Where k is the payment frequency, meaning that if there are 4 payments made per year, then this will be the quarterly gross running yield.

To annualise the gross running yield, we apply the following adjustment:

$$gross\ running\ yield = e^{\left\{k \times ln\left(\frac{gross\ running\ yield_k}{k}\right)\right\}} - 1$$

The accrued gross distributions can be calculated using the distribution calculation in the previous section and replacing the days in the distribution period with the number of days between the last ex-date and the date at which the market price is taken. The net running yield can be calculated using the following formula:

$$net\ running\ yield = gross\ running\ yield \times \frac{(1-tr)}{\left(1-\left(tr \times (1-F)\right)\right)}$$

Where tr is the corporate tax rate and F is the proportion of the distribution that is franked. The running yield identifies the yield an investor receives from distributions and does not take into account the capital gain (loss) that is incurred by the investor if the hybrid security is trading at a discount (premium) to the issue price.

This means that if the hybrid security's clean price is below (above) the issue price, the yield to maturity/reset will be greater (less) than the running yield.

Exhibit 16 Examples of Running Yield Calculations on Hybrid Securities, 9 September 2016

	CBAPD	MQGPB	CWNHB
Security name	CBA PERLS VII	Macquaire Group Capital Notes 2	Crown Subordinated Notes II
Issue price (AUD)	100	100	100
Market price (AUD), 9 Sep 2016	91.50	102.49	88.80
Last ex-date	6 Sep 2016	8 Sep 2016	5 Sep 2016
Days since last distribution	3	1	4
Franking proportion	100%	40%	0%
Corporate tax rate	30%	30%	30%
Distribution frequency	Quarterly	Semi-annually	Quarterly
Base rate	90 day BBSW	180 day BBSW	90 day BBSW
Base rate, 18 April 2016	1.73%	1.94%	1.73%
Coupon margin	2.80%	5.15%	4.00%
Gross distribution rate	4.53%	7.09%	5.73%
Accrued gross distributions (AUD)	0.04	0.02	0.06
Clean price (AUD), 9 Sep 2016	91.46	102.47	88.74
Gross runnng yield (k)	4.95%	6.92%	6.45%
Gross runnng yield (annualised)	5.04%	7.04%	6.61%
Net running yield (annualised)	3.53%	6.01%	6.61%

Source: Morningstar.

Yield to reset/maturity

This is the discount rate at which the sum of the future discounted cash flows is equal to the current traded price. The gross yield includes the franking credit portion of the distributions, whereas the net yield includes the cash component of distributions only.

The cash flows will include an estimated regular interest-style payment and final redemption of the security at the price specified in the contract (the issue price). This is also known as an internal rate of return, or IRR.

The yield to reset can be calculated by solving the following equation for YTR:

$$P = \frac{IP}{(1+YTR)^{d_N/365}} + \sum_{j=1}^{N} \frac{D_j}{(1+YTR)^{d_j/365}}$$

Where:
$YTR = yield\ to\ reset$
$P = the\ current\ market\ price\ (dirty\ price)$
$IP = security\ issue\ price\ (redemption\ value)$
$D_j = distribution\ at\ time\ j$
$d_j = days\ from\ current\ date\ to\ distribution\ D_j$
$d_N = days\ from\ current\ date\ to\ reset\ date$

The yield to reset calculation includes all distributions up to and including the reset date. It assumes that the security is redeemed for the issue price at the reset date and that all distributions can be reinvested at a rate equal to the YTR.

Trading margin

As a measure of return, the trading margin incorporates a security's issue margin above the benchmark rate and the difference between that security's market price and its expected redemption value, or face value. While it is a more comprehensive measure of hybrid returns, it does entail a particularly challenging calculation. For a floating rate hybrid security, the trading margin is determined by solving the following equation (assuming no annuity style payments):

$$P = \frac{\left(\frac{CM-TM}{k}\right) A_n^i + 1}{1 + (r+TM) \times \frac{f}{365}} \times 100$$

Where:

$$P = \frac{current\ market\ price}{issue\ price}$$

$d = number\ of\ days\ in\ current\ interest\ period$
$CM = coupon\ margin\ (as\ a\ percentage)\ paid\ in\ addition\ to\ the\ benchmark\ rate$
$TM = trading\ margin\ (as\ a\ percentage)$
$r = the\ benchmark\ rate\ to\ the\ next\ interest\ rate\ reset\ date$
$f = number\ of\ days\ to\ next\ interest\ payment\ date$

$$A_n^i = \frac{1-(1+i)^{-n}}{i}$$

$$i = \frac{s+TM}{k}$$

$k = payment\ frequency\ (e.g.\ 2 = semi\ annually, 4 = quarterly)$
$s = benchmark\ rate\ from\ settlement\ to\ maturity/reset$
$n = number\ of\ complete\ interest\ periods\ to\ maturity/reset\ as\ at\ the\ next\ payment\ date$

Note that r is benchmark rate to which distributions are based off (typically 90 or 180 day BBSW). When calculating the value for s, it is important to ensure that the rates used are of similar payment frequency to the hybrid security and then interpolated to the maturity/reset date.

The Basel Committee on Banking Supervision

Operating under the guidance of the Bank for International Settlements (BIS), the Basel Committee on Banking Supervision (Basel Committee) has its origins in 1974; post the collapse of Bretton Woods. Formed by the governors of the G10 central banks, the aim of the Basel Committee was, and remains, to set minimum standards for the regulation and supervision of the global banking system. Since its inception, it has grown in jurisdictions from the original G10 to almost 30 countries. Despite its lack of legal authority, the expectation is that national regulatory bodies implement their recommendations.

The Evolution of the Basel Accord

The Basel Committee has produced three banking supervision accords – Basel I, Basel II and Basel III. Basel I was published in 1988 and focused on credit risk and appropriate risk-weightings of assets. Basel II was published in 2004 and implemented by 2008 by most major economies. Its focus was to establish globally consistent risk and capital management criteria to ensure banks had sufficient capital to protect against losses. Basel III was published in 2009, largely in response to the Global Financial Crisis, and agreed upon by the Basel Committee in 2010 with an implementation deadline of 2019. In the meantime, discussions surrounding Basel IV have already begun; with speculation suggesting it will be based around (i) a higher minimum leverage ratio for banks; (ii) standardised internal capital calculation models, making data more comparable; and (iii) improved disclosure.

Exhibit 17 Basel III Phase In Arrangements

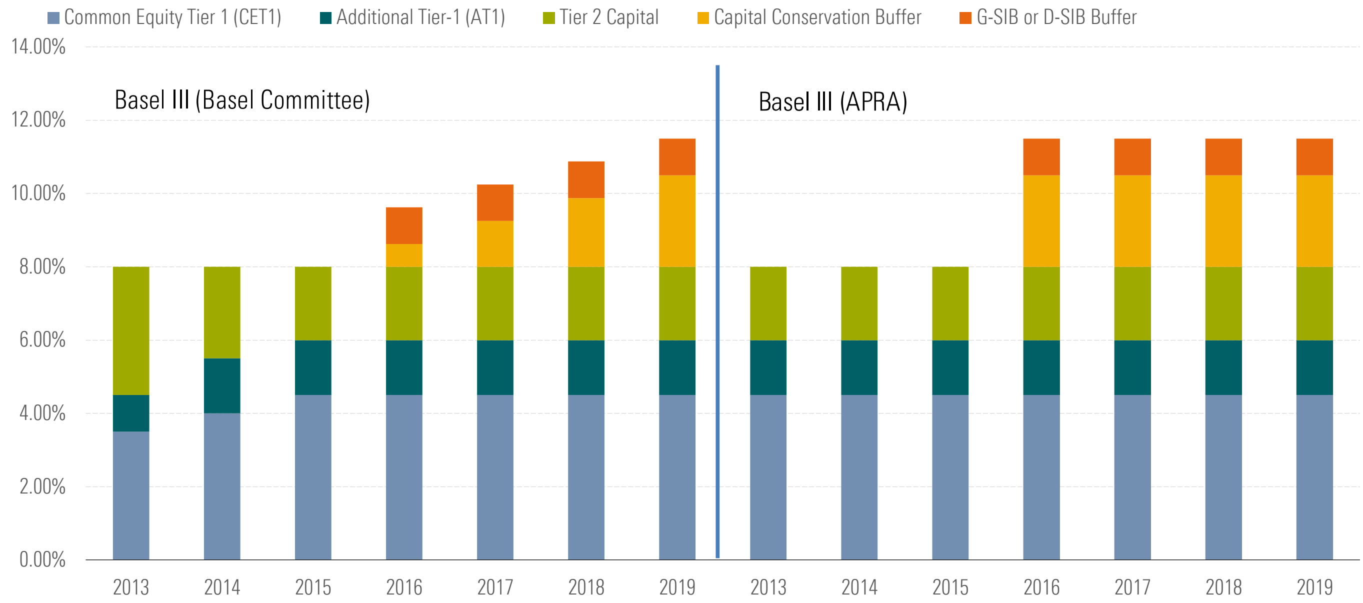
	2011	2012	2013	2014	2015	2016	2017	2018	As of 1 Jan 2019
Leverage Ratio	**Supervisory monitoring**		**Parallel run 1 Jan 2013 – 1 Jan 2017 Disclosure starts 1 Jan 2015**					**Migration to Pillar 1**	
Minimum Common Equity Capital Ratio			3.5%	4.0%	4.5%	4.500%	4.50%	4.500%	4.5%
Capital Conservation Buffer						0.625%	1.25%	1.875%	2.5%
Minimum common equity plus capital conservation buffer			3.5%	4.0%	4.5%	5.125%	5.75%	6.375%	7.0%
Phase-in of deductions from CET1 (including amounts exceeding the limit DTAs, MSRs and financials)				20.0%	40.0%	60.000%	80.00%	100.000%	100.0%
Minimum Tier 1 Capital			4.5%	5.5%	6.0%	6.000%	6.00%	6.000%	6.0%
Minimum Total Capital			8.0%	8.0%	8.0%	8.000%	8.00%	8.000%	8.0%
Minimum Total Capital plus conservation buffer			8.0%	8.0%	8.0%	8.625%	9.25%	9.875%	10.5%
Capital instruments that no longer qualify as non-core Tier 1 capital or Tier 2 capital			Phased out over 10 year horizon beginning 2013						
Liquidity coverage ratio	Observation period begins				Introduce minimum standard				
Net stable funding ratio	Observation period begins							Introduce minimum standard	

Source: BIS, Morningstar.

APRA's Application of the Basel Accords

APRA has a strong history of implementing the Basel Committee's recommendations to the domestic banking system. The most recent Basel accord, Basel III, started to come into effect in Australia on 1 January 2013, although APRA, in its powers, has opted to take a tougher stance on certain initiatives compared to the recommendations of the Basel Committee.

Exhibit 18 Minimum Regulatory Capital Requirements (% of Risk Weighted Assets)



Source: APRA, Morningstar.

The prudential standards and guidance notes for Authorised Deposit-taking Institutions, or ADIs, can be found on APRA's website.[3] For example, APRA's Prudential Standard APS 111 (Capital Adequacy: Measurement of Capital), outlines the characteristics that an instrument must have to meet regulatory capital requirements for ADIs.[4]

Minimum Capital Adequacy Requirements

APRA determines the prudential capital requirements, or PCRs, for domestic ADI's. Expressed as a percentage of risk weighted assets, the minimum PCR's that an ADI must maintain at all times is:

- Common Equity Tier 1, or CET1, Capital ratio of 4.5%;
- Tier 1 Capital Ratio of 6.0%; and
- Total Capital Ratio of 8.0%.

A maximum of 1.5% of Tier 1 Capital may be made up of AT1 instruments, or bank hybrid securities.

APRA, at its discretion, may change an ADI's PCRs at any time.

3 http://www.apra.gov.au/adi/PrudentialFramework/Pages/prudential-standards-and-guidance-notes-for-adis.aspx

4 http://www.apra.gov.au/adi/prudentialframework/documents/120928-aps-111_final.pdf

Total Capital

Total Capital, or Regulatory Capital, is made up of the following categories:

- Tier 1 Capital, which comprises:
  - Common Equity Tier 1 Capital; and
  - Additional Tier 1 Capital; and
- Tier 2 Capital.

Common Equity Tier 1 (CET1) Capital

CET1 Capital is made up of the highest quality components of capital that satisfy the following characteristics:

- Provide a permanent and unrestricted commitment of funds;
- Are freely available to absorb losses;
- Do not impose any unavoidable servicing charge against earnings; and
- Rank behind claims of depositors and creditors in the event of a winding-up of the issuer.

CET1 Capital consists of:

- Paid up ordinary shares;
- Retained earnings;
- Undistributed current year earnings;
- Other comprehensive income and disclosed reserves;
- Minority interests; and
- Relevant regulatory adjustments.

Additional Tier 1 Capital (AT1)

AT1 Capital comprises high quality capital that satisfies the following characteristics:

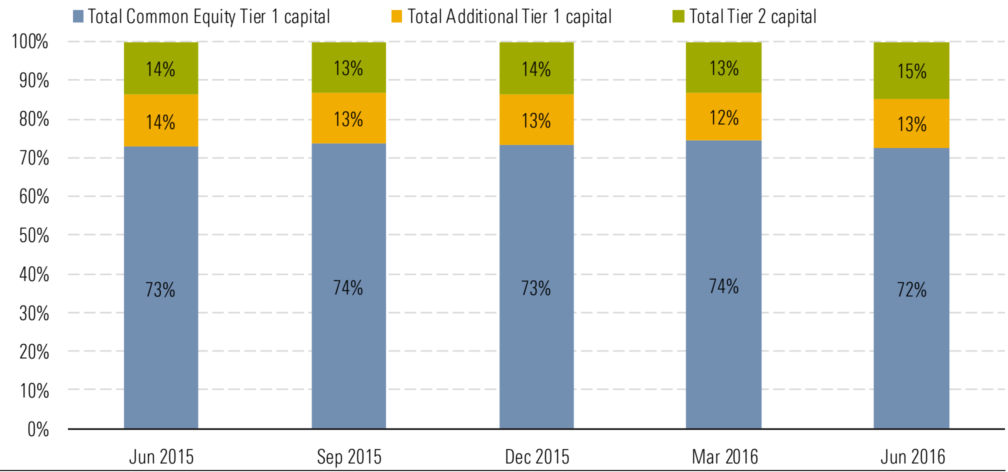
- provide a permanent and unrestricted commitment of funds;
- are freely available to absorb losses;
- rank behind the claims of depositors and other more senior creditors in the event of winding up of the issuer; and
- provide for fully discretionary capital distributions.

AT1 Capital includes subordinated and perpetual Tier 1 Capital instruments not included in the definition of CET1. Examples include the current Basel III Compliant AT1 hybrids and stapled securities provided the structure meets the required criteria as outlined in APRA's Prudential Standard APS 111.

Tier 2 Capital

Tier 2 Capital includes other components of capital that, to varying degrees, don't satisfy the requirements of Tier 1 Capital but still contribute to the overall strength of an ADI and its capacity to absorb losses. Tier 2 Capital provides holders above them on the capital structure with an additional layer of loss protection after the Tier 1 Capital is exhausted. In Australia, Tier 2 Capital is largely made up of subordinated debt, although it does also come in the form of preference shares in other instances.

Exhibit 19 Domestic ADI's Capital Adequacy



Source: Morningstar.

Capital Conservation Buffer

From 1 January 2016, APRA requires ADI's to hold a capital conservation buffer above the prudential capital requirements, or PCR, for CET1 Capital. Unless determined otherwise by APRA, the capital conservation buffer is 2.5% of the ADI's total risk-weighted assets. As a result, the sum of the CET1 Capital ratio plus the capital conservation buffer must be no less than 7.0% of the ADI's risk weighted assets, or 8.0% for domestic systemically important banks.

The capital buffer (CB) range is divided into four quartiles for the purposes of determining the minimum capital conservation ratios, as outlined in Exhibit 20. The minimum capital conservation ratios represent the percentage of earnings that an ADI is unable to distribute where its CET1 Capital ratio falls within the corresponding quartile. For example, if the CET1 Capital ratio falls within the first quartile, an ADI must cease all Tier 1 Capital distributions.

If an ADI's CET1 Capital ratio falls into the capital conservation buffer, distributions on Tier-1 hybrid securities may not be paid. This is because the ADI will only be able to use a certain percentage of its earnings to make discretionary payments such as dividends, hybrid Tier 1 distributions and staff bonuses.

Exhibit 20 Minimum Capital Conservation Standards

Common Equity Tier 1 Capital Ratio	Minimum Capital Conservation Ratios (%)
Within 1st Quartile of Buffer PCR to ≤ (PCR + 0.25CB)	100
Within 2nd Quartile of Buffer > (PCR + 0.25CB) to ≤ (PCR + 0.50CB)	80
Within 3rd Quartile of Buffer > (PCR + 0.50CB) to ≤ (PCR + 0.75CB)	60
Within 4th Quartile of Buffer > (PCR + 0.75CB) to ≤ (PCR + CB)	40
Above top of buffer > (PCR + CB)	0

Source: Morningstar.

The risk of falling into the capital conservation buffer provides another incentive for banks to ensure they have strong capital positions. Aside from the obvious benefit to hybrid holders in higher minimum capital requirements, we believe the major banks will prioritise hybrid distributions should capital levels fall into the capital conservation buffer. This is due to the dividend stoppers in place which would require issuers to cease all equity dividend payments should hybrid distributions not be made in full.

Systemically Important Bank Buffers

In October 2012, the Basel Committee finalised its Global Systemically Important Bank (G-SIB) and Domestic Important Bank (D-SIB) framework. A G-SIB is defined as a financial institution whose distress or disorderly failure would cause significant disruption to the global financial system. D-SIB's on the other hand, while not significant enough to cause disruption to the global financial system, could cause disruption to the domestic financial system in which they operate.

The Basel Committee's four key indicators of systemic importance include size, interconnectedness, substitutability, and complexity. Using these indicators as their guide, APRA determined that the following domestic ADIs are D-SIBs:

- Australia and New Zealand Banking Corporation;
- Commonwealth Bank of Australia;
- National Australia Bank; and
- Westpac Banking Corporation.

Exhibit 21 Key Indicators for Systemically Important Banks

Indicator	G-SIB	IMF	APRA
Size	Total Exposures	Total Resident Assets	Total Resident Assets
Interconnectedness	Intra-financial system assets Intra-financial system liabilities Securities outstanding	Investment securities Wholesale funding Loan/deposit ratio Intra-group exposures	Intra-financial system assets Intra-financial system liabilities Securities outstanding (Short-term securities, long-term borrowings and CDs) Large exposures
Substitutability	Assets under custody Payments activity Underwritten transactions in debt and equity markets	N/A	Assets under custody Payments activity Underwritten transactions in debt and equity markets Total gross loans and advances Total household lending
Complexity	Notional amount of OTC derivatives Level 3 assets Trading and available-for-sale securities	Trading book Trading book and qualitative information	Notional amount of OTC derivatives Trading and available-for-sale securities Risk-weighted assets for traded market risk

Source: APRA, Morningstar.

As a result of being deemed a D-SIB, these four ADIs face a higher loss absorbency, or HLA, capital requirement. This is intended to reduce the probability of failure compared to non-systemically important ADIs. APRA has determined that a 1.0% HLA requirement will apply to the four D-SIBs, which must be met by CET1 Capital. This requirement came into effect on 1 January 2016.

Countercyclical Capital Buffer

From 1 January, 2016, APRA has the authority to require ADI's to hold additional CET1 Capital, between 0% and 2.5% of risk weighted assets, as a countercyclical capital buffer. In December 2015, APRA confirmed the countercyclical buffer applicable to Australian exposures will be 0%. If applicable, the countercyclical capital buffer forms part of the capital conservation buffer.

Although the countercyclical buffer could rise, or fall, in the future, APRA has indicated that any increase to the countercyclical capital buffer will only be implemented on a minimum of 12 months' notice. Any decision to decrease the countercyclical capital buffer will take effect immediately.

Examples of jurisdictions with non-zero countercyclical capital buffers include Hong Kong, Sweden and Norway.

The Bank of England, or BoE, recently provided an example of how the countercyclical capital buffer can be changed at short notice. Shortly after the United Kingdom voted to leave the European Union, the BoE cut the countercyclical capital buffer from 0.5% to 0%. This had the intention of reducing regulatory capital buffers by approximately GBP 5.7 billion and in doing so would increase banks' capacity to lend to households and businesses by up to GBP 150 billion according to the BoE.

Basel III Impact on Additional Tier 1 and Tier 2 Capital

In January 2011, the Basel Committee announced guidelines that imposed more stringent requirements on regulatory capital coming from AT1 and Tier 2 Capital, with the aim of increasing total loss absorbing capital and thereby reducing the likelihood of taxpayers being called on to bail out banks.

Some of the key changes included;

- prohibiting margin step up provisions, thereby removing an incentive to redeem early;
- restrictions on the ability of the issuer to call the security in the first five years;
- inclusion of a non-viability trigger designed to absorb losses by forcing the AT1 or Tier 2 security to convert into common equity or be written down in times of stress;
- inclusion of a capital trigger designed to absorb losses by forcing the AT1 security to convert into common equity or be written down in times of stress.

While these features have acted to make AT1 hybrids more equity-like, they have also forced the banking industry to strengthen their capital bases, which ultimately is positive for AT1 hybrid investors.

What is the difference between Basel III Compliant AT1 and Tier 2 Capital?

Tier 1 capital is often referred to as "going concern" capital as it is intended to absorb losses while the financial institution is solvent. Tier 2 capital on the other hand absorbs losses on a "gone concern" basis, following insolvency and upon liquidation of the financial institution. Under Basel II, Tier 2 Capital was split between Upper Tier 2 (perpetual) and Lower Tier 2 (dated subordinated debt). Basel III abolished this distinction, harmonising Upper and Lower Tier 2 capital instruments.

Exhibit 22 Basel III Compliant Tier 1 and Tier 2 Capital Comparison

Feature	Tier 1 Capital	Tier 2 Capital
Perpetual or Dated Maturity	Perpetual	Dated
Coupon Payments	Discretionary: Deferrable, Non-Cumulative	Mandatory: Deferrable, Cumulative
Issuer Call	Yes, subject to prior supervisory approval	Yes, subject to prior supervisory approval
Non-Viability Trigger	Yes	Yes
Capital Trigger	Yes	No
Capital Structure Ranking	Senior only to ordinary shares	Senior only to ordinary shares and Tier 1 Capital
Instrument Type	Subordinated Notes	Subordinated Notes
Dividend Stopper	Yes	No
Convertible	Yes	Yes
Conversion Trigger	Scheduled Conversion Date or Quarterly Thereafter; Capital Trigger Event; Non-Viability Trigger Event; Change of Control Event	Non-Viability Event
ASX Listed Example	WBCPE	WBCHB

Source: Morningstar.

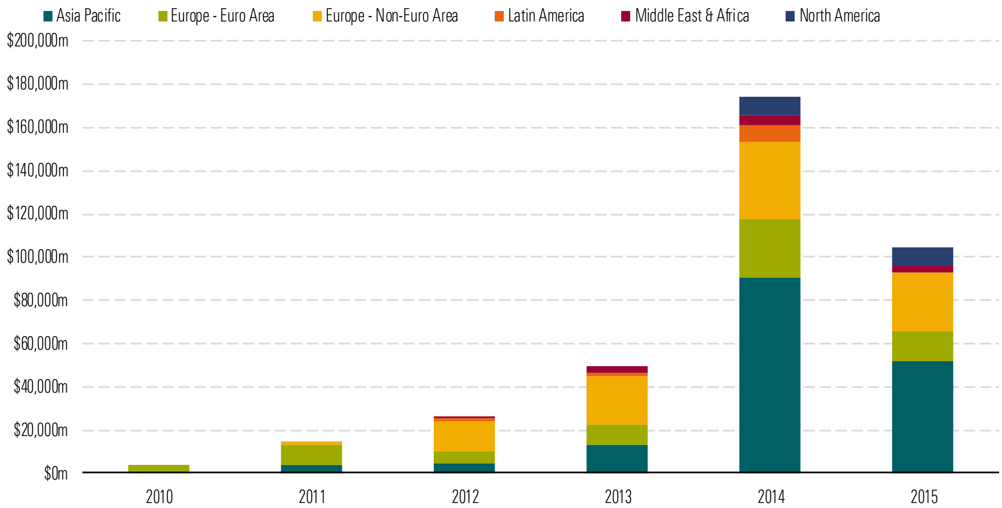
Minimum criteria for Tier 2 Capital include subordination to depositors and general creditors and having a minimum original maturity of five years. Furthermore, APRA will not allow an ADI to exercise a call option on a Tier 2 Capital instrument unless the security is replaced with capital of equal of higher quality, or the ADI demonstrates that its capital position will be well above its PCR once called.

International Trends in Basel-III Compliant Tier 1 Capital Issuance

Internationally, Basel III Compliant AT1 Capital instruments are otherwise referred to as Basel-III compliant Non-Common Equity (NCE), or Contingent Convertible Securities (CoCos). Global issuance of these securities has increased sharply in recent years as banks raise capital to satisfy Basel III requirements and replace maturing instruments. Supported by a low global interest rate environment, investors continue to display a willingness to embrace this asset class.

Driven by implementation of the Basel accords by regulators, issuance has been particularly strong in Europe, China and Australia. Within Europe, issuance increased significantly after July 2013 when Capital Requirements Directive IV, or CRD IV, came into force, which transfers Basel III into EU law. Swiss banks have been particularly active in their issuance, which is largely attributed to the new regulatory regime in Switzerland allowing systemically important banks to hold up to 9% of risk weighted assets in these instruments. For some countries in Europe, issuance is attractive as coupon payments are tax deductible for the issuer.

Exhibit 23 Global NCE Issuance (USD)



Source: Moody's Investors Services, Thomson Reuters, Morningstar.

CoCo issuance has increased significantly in China in recent years as banks look to strengthen their capital positions ahead of regulations that require China's systemically important banks to have a minimum Tier 1 Capital ratio of 9.5% by the end of 2018. Chinese regulators, which opted to decline participating in Basel I and II, are now looking to enforce Basel III in an attempt to avert the potential for a banking crisis and minimise the risk of a potential government bailout.

Similar to Europe and China, Australia has seen a surge in Basel III Compliant Tier 1 issuance in recent years. This has been driven by the domestic banks preparing themselves for the minimum capital requirements being imposed on them by APRA as a result of the Basel III accord.

US Banks do not issue hybrid instruments due to regulators not affording them AT1 Capital status under the terms of the US Basel III framework. Instead, US banks tend to utilise qualifying perpetual preferred stock to increase their AT1 Capital, typically callable after ten years with non-cumulative distributions. Under the US Basel III framework, only instruments classified as equity under US GAAP qualify as AT1 Capital. Contingent capital instruments are generally classified as liabilities. Within the International Basel III interpretation, instruments classified as liabilities can be considered AT1 Capital, provided they have a loss absorption feature.

The Difference between Contingent Convertible's and Australian Additional Tier 1 Capital
Whilst largely similar in structure, there are importance differences between CoCo's issued overseas and Australian Basel III Compliant AT1 securities. Whereas domestic Basel III Compliant AT1 instruments are highly homogenous, this is not necessarily the case with CoCos, whose terms can vary materially.

Some of the key differences include:

- CoCo's are truer perpetual instruments relative to Australian Tier 1 hybrids.

  Australian AT1 instruments contain a scheduled conversion date whereby the hybrid security must convert into equity if certain conditions are satisfied. Conversion is intended to occur while the issuer is in good condition and the stock remains sufficiently liquid to transact in. Prior to the scheduled conversion date, generally two years, the issuer also has a call option to redeem, rollover or replace the hybrid security.

  CoCos do not have a scheduled conversion provision, but contain mandatory conversion provisions on the basis of certain triggers being breached, such as capital triggers. Such provisions would generally be triggered when the issuer is in financial distress, likely rendering the equity conversion worth very little. CoCos also tend to have a reset date whereby the issuer may, at their option, redeem the securities. Reset dates are usually five years from the issue date and every five years thereafter.

- Australian Basel III Compliant Tier 1 hybrids contain dividend stoppers, which are not permitted under EU regulations despite being permitted under the global standards approved by the Financial Stability Board. Dividend stoppers prevent issuers from paying equity dividends unless distributions are paid on AT1 securities and act as a strong incentive for issuers to continue paying distributions.

- CoCos can have higher capital triggers relative to Australian hybrids, making them more likely to absorb losses and have the triggers breached. For example, some CoCos have a 7% CET1 trigger while low trigger CoCos have a 5.125% CET1 trigger. Australian AT1 hybrids only have the 5.125% capital trigger.

- Many CoCos are structured so that they are instantly written-off under a non-viability scenario, whereas in Australia the first option is conversion. Conversion is not subject to conversion terms being satisfied, however, holders would likely suffer material losses as the value of the ordinary shares will be significantly less than the face value of the hybrid. If conversion can-not occur under a non-viability scenario, the hybrids will be written-off.

- Australian Tier-1 hybrid securities attach franking credits to their distributions, whereas CoCos do not. Franking credits represent each holder's share of tax paid by the issuer on the profits from which the distributions are paid. The ability to attach franking credits is an attractive feature for Australian tax residents as it increases their potential gross return.

- The Financial Conduct Authority, or FCA, restricts firms from distributing CoCos to the retail market in the United Kingdom. In Australia, AT1 hybrid ownership continues to be highly concentrated in the hands of retail investors, particularly SMSF investors.

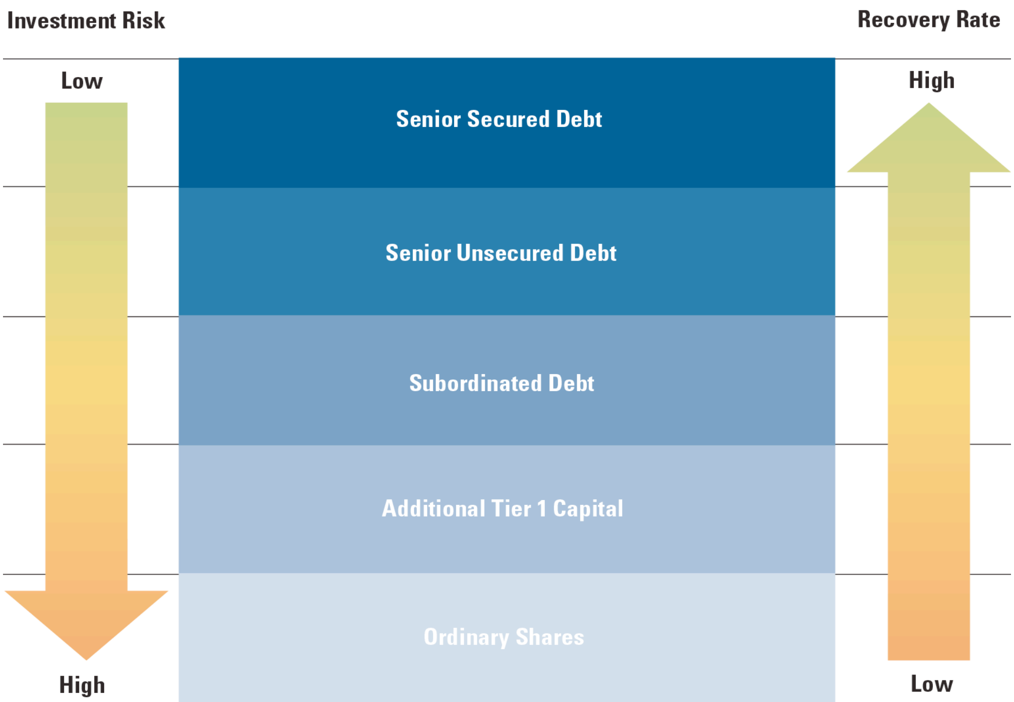
Hybrid Securities and the Capital Structure

Capital structure refers to the mix of funding sources a company utilises to fund its operations. Made up of debt and equity instruments, it is commonly composed of long-term debt, preference shares and ordinary shares.

Investors should always understand the capital structure positioning of their investments as part of their investment due diligence process. However, it is also important to highlight that not all capital structures are created equal. It is not uncommon for a security that sits lower on the capital structure of a stronger issuer to have lower credit risk relative to a security that sits higher on the capital structure of a weaker issuer. This highlights the importance of understanding the standalone risk of the issuer.

Hybrid securities are deeply subordinated on the capital structure, positioned between debt and equity. Using Exhibit 24 as a guide, Basel III Compliant AT1 securities will sit in the "Additional Tier 1 Capital" classification, while a corporate hybrid such as the Crown Subordinated Notes II (CWNHB) will sit within the "Subordinated Debt" classification.

Exhibit 24 Basic Capital Structure Framework



Source: Morningstar.

The further down the capital structure a security is, the higher (lower) its investment risk, the higher (lower) its expected return, and the lower (higher) its recovery rate in the event of a wind-up scenario.

Understanding a company's capital structure is critical for several reasons. In particular, it can tell us:

- Who has claims on a company's assets and at what cost. The maturity schedule of these claims tells us when they must be paid. Is the company in a strong position to do so?
- About a company's future borrowing capacity. Higher gearing levels may suggest a higher cost of funding and possible difficulty in sourcing future funding. How have the gearing levels and costs been trending in recent years?
- About the company's financial risk profile. Increasing debt funding in a company's capital structure will generally increase the financial risk profile of that company. Is the company generating sufficient cash flows to compensate for the increasing balance sheet risk?

Highly asset intensive industries tend to have more complex capital structures, whereas capital-light industries tend to utilise simpler capital structures. The higher use of fixed assets often requires a greater level of debt funding; which can also act as collateral for debt financing. The more debt funding that is used, the greater the likelihood of different tiers of debt, and therefore levels of funding subordination. Utilities and telecommunications are examples of highly asset intensive industries.

Banks, while not highly fixed asset intensive, are a good example of an industry that can display complex capital structures due to regulatory requirements. The Basel Accords have placed several capital based requirements on the global banking system, which has resulted in a greater spread of financing across their capital structure, particularly AT1 Capital.

Hybrid Risks

Credit Risk

Credit risk refers to the risk that the borrower, or hybrid issuer, defaults on payment obligations. An investor in a debt and hybrid security is essentially lending money to an issuer, so investors need to assess the issuer's ability to make timely distribution payments and return the principal on maturity.

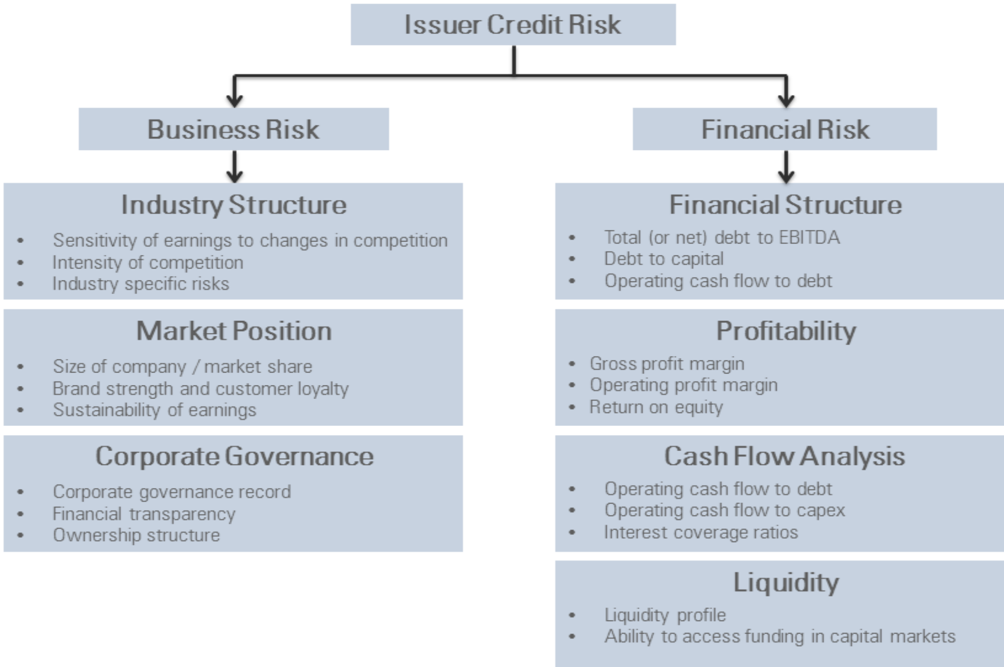
Higher credit risk requires a higher return to investors. This is to compensate investors for the higher probability of expected losses as a result of the issuer defaulting on their obligations. Morningstar's independent credit research incorporates an assessment of credit risk in determining the appropriate fair trading margin, and provides the investor with an investment risk rating of low, medium or high for each security.

Credit risk is best assessed via credit analysis of the issuer and the security in question. The security credit risk rating is determined by taking the issuer level rating and adjusting it to take into account the structural features of the security. In particular, we examine:

- The ranking of the security in the capital structure.
- The relative size of the debt above the security in the capital structure.
- Structural features of the security that would allow the issuer to withhold a payment of a distribution on the hybrid security, without defaulting on coupon or interest payments to debt obligations above it in the capital structure.

In assessing the credit quality of the issuer we apply a common framework which considers a number of issues affecting the credit risk profile of the issuer. These issues can be classified as those which assess the issuer's business risk profile, and those which evaluate the financial risk profile.

Exhibit 25 Key Considerations in the Credit Analysis Process



Source: Morningstar.

A company's business risk profile affects the amount of financial risk they can take on at a given credit rating. The business risk profile covers the competitive environment in which it operates (industry risk), the competitive advantage of the issuer in the industry in which it operates (market position) and management's stewardship of capital.

Financial risk analysis examines the financial profile of the issuer by reviewing the balance sheet, the profit and loss statement, the cash flow statement and the liquidity position. Morningstar's framework for assessing credit risk places an emphasis on examining an issuer's leverage and its ability to generate cash flow to service its on and off-balance sheet obligations. Leverage is assessed by considering ratios such as operating cash flow to debt, debt to EBITDA and debt to capital. In addition, we also focus on coverage ratios which measure the issuer's ability to service their debt obligations.

Incorporating credit risk into the fair trading margin for hybrid securities aims to ensure that investors are appropriately compensated for the possibility of losses resulting from an issuer defaulting on its obligations. The size of the margin required to adequately compensate investors depends on the probability of the issuer defaulting on its obligations and the expected size of the loss in the event of default. An issuer's credit quality can deteriorate significantly over a short period of time, increasing the credit risk on their hybrid securities. For this reason, Morningstar's hybrid framework incorporates regular reviews of issuer credit quality to ensure that our fair trading margins are up to date.

It is important to emphasize that since hybrid securities generally rank only above equity in the capital structure; losses in the event of default are expected to be high.

Payment Default Example: Gunns Forests Notes

Gunns Limited was an integrated hardwood and softwood forest products company. On 17 October 2005 it issued Gunns Forests Notes (ASX ticker: GNSPA), raising AUD 120 million. These securities paid fully franked dividends of 2.5% plus the 90-day BBSW. The margin increased by 2.50% on 14 October 2008 to 5.0% when Gunns elected not to redeem these notes. On 2 July 2012 a distribution was not declared by the company on GNSPA. On 29 August 2012, Gunns converted GNSPA into ordinary shares (which were suspended from trading on 13 March 2012). In liquidation, the receivers found that the assets under their control were insufficient to produce and return to the ordinary unsecured creditors of the Gunns Group, meaning that investors lost their entire investment in the security.

Exhibit 26 GNSPA Price (AUD)

Source: Thomson Reuters, Morningstar.

Gunns' credit metrics highlighted several warning signals prior to the distribution not being paid in July 2012. For example:

- Net debt to EBITDA spiked sharply from 4.70x at FYE10 to 8.00x at FYE11 to 9.30x at FYE12;
- EBITDA margins almost halved from 20% during FY09 to 11% during FY12;
- Interest coverage data was poor from FY09 (2.40x) through to FY12 (1.70x).
- Weak cash flow metrics including Cash from Operations to Debt between 5% and 10% during FY09 to FY10.

Exhibit 27 Gunns' Credit Metrics

	FY 2009	FY 2010	FY 2011	FY 2012
Net Debt / EBITDA	6.10x	4.70x	8.00x	9.30x
EBITDA Margin	20%	18%	12%	11%
EBIT / Net Interest Expense	2.10x	2.80x	2.90x	1.70x
Cash from Operations / Debt	6.6%	8.8%	9.4%	5.9%

Source: Thomson Reuters, Morningstar.

A thorough credit analysis process aims to identify these risks, thereby lowering the probability of investor losses.

Liquidity Risk

Liquidity risk in this context refers to the ability to buy or sell a security for a fair price on a timely basis. Low levels of liquidity make it difficult to buy or sell a hybrid, raising the risk of having to buy at an inflated price or sell at a capital loss. Although hybrid securities are not as liquid as the ordinary shares of the underlying issuer, their ASX listing does provide support.

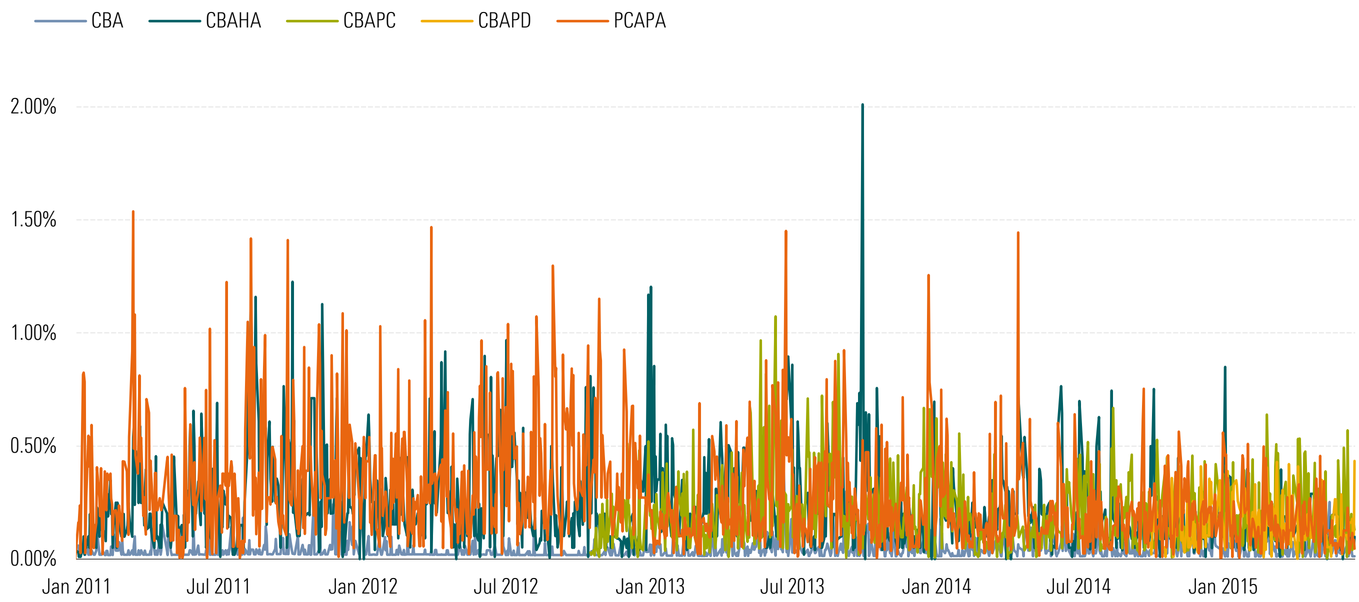
Bid-ask spread

A key measure of liquidity risk is the bid-ask spread of the security. This refers to the amount by which the ask price exceeds the bid price, or the difference between the highest price a buyer is willing to pay and the lowest price a seller is willing to sell at. The bid-ask spread is a transaction cost to the investor which has the effect of decreasing the total return on the investment. The wider the bid-ask spread, the greater risk the investor runs of having to forego some return to get the transaction done, impacting the total return of the investment. The bid-ask spread is likely to increase in times of market distress.

Bid-ask spread example: A broker-dealer quotes a bid-ask price for a hybrid of AUD 99.50-AUD 100.00, implying a bid-ask spread of 50 cents. The spread as a percentage is 0.50% (50 cents divided by the buy price of AUD 100.00). An investor who buys AUD 100 worth of this hybrid and immediately sells it back to the broker-dealer incurs a loss of 50 cents, reflecting the spread of 0.50%. If the original bid-ask price was AUD 99.00-AUD 100.00, the spread as a percentage is 1.00%, increasing the loss on the same transaction to double at AUD 1.00.

Hybrids are generally less liquid than the common equity of the issuer. Within the hybrid space, liquidity varies greatly and is dependent on a number of factors including issue size, credit worthiness of the issuer, the expected likelihood of redemption and whether the issuer is listed or unlisted. The figure below shows the daily bid-ask spread (as a percentage of the bid price) for Commonwealth bank's common shares (ASX ticker: CBA) and hybrid securities (ASX tickers: CBAHA, CBAPC, CBAPD, PCAPA).

Exhibit 28 Bid-Ask Spread of Commonwealth Bank Equity and Hybrids



Source: Morningstar.

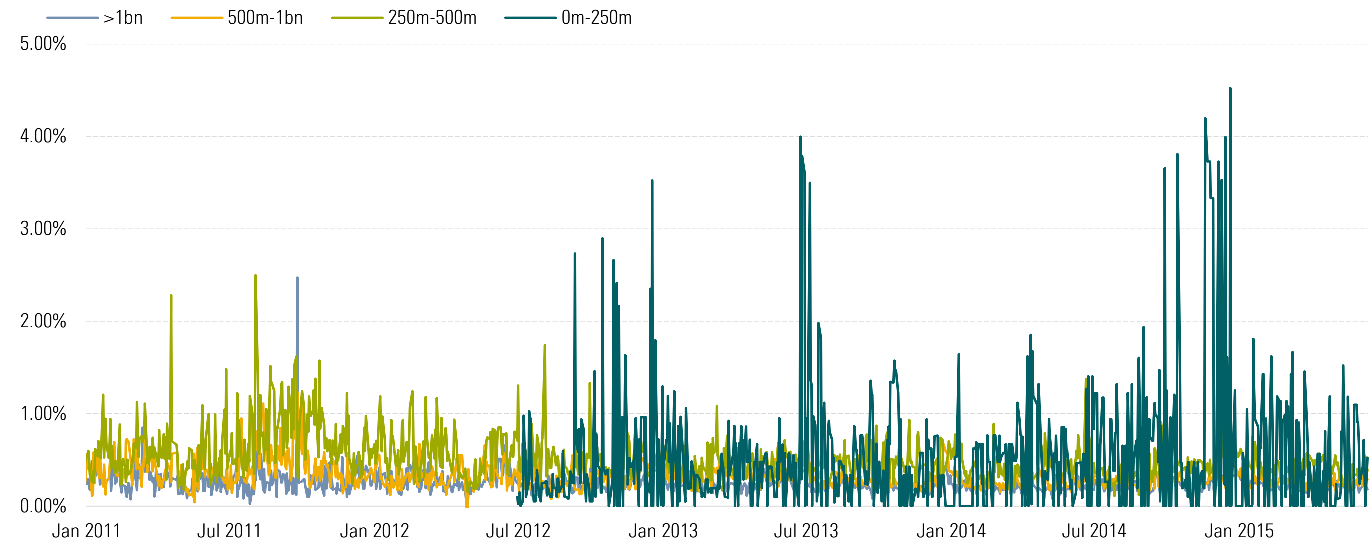
Key observations from Exhibit 28 include:

- The bid-ask spread is significantly lower for CBA's common equity than for any of its hybrids. Liquidity is a more significant issue for hybrids and must be given more careful attention before investing.
- The bid-ask varies greatly from one day to the next. This highlights the importance of timing when buying or selling a hybrid security.

Key determinants of liquidity

Issue size. The issue size of a hybrid will impact its liquidity and attractiveness to other buyers. Smaller issues will generally have a smaller investor base, resulting in lower trading liquidity. Large issues are dominated by the big four banks, with the majority of their issue sizes being over AUD 1 billion dollars.

Exhibit 29 Bid-Ask Spread by Issue Size



Source: Morningstar.

Exhibit 29 shows the daily average bid-ask spread by issue size. It shows that:

- Liquidity has generally been good over recent years, with historically low bid-ask spreads.
- The bid ask spread is significantly lower on average for the hybrids with an issue size greater than AUD 500 million and even lower for those with an issue size greater than AUD 1 billion.
- The bid ask spread is significantly higher on average for the hybrids with an issue size below AUD 250 million.
- The bid-ask spreads are highly volatile during periods of financial stress (such as the global financial crisis). During this period, the bid ask spreads for hybrids with a large issue size were significantly lower and less volatile as compared to lower issue sizes.

Credit Worthiness of the Issuer. The stronger the credit profile of the hybrid/issuer, the more likely the hybrid will display greater liquidity.

Is the Issuer a Listed or Unlisted Entity? Due to the lower levels of public disclosure required by private companies, their hybrids tend to be less liquid than those issued by a publicly listed company.

Extension Risk

Extension risk is the risk that the hybrid security is not redeemed at the first call date, which may result in the security trading like a perpetual security.

An issuer may decide not to redeem the hybrid at the first call date if the cost of new funding, in the form of issuing a new hybrid, exceeds the cost of keeping that existing security on issue including interest rate step-ups. Such a scenario may occur due to either market conditions (i.e. a general widening of hybrid trading margins), or a deterioration of the issuer's credit quality increasing the coupon rate required for investors to be willing to subscribe to the new issue. In either case, the hybrid security will likely trade at a value significantly below face if it is not redeemed at first call.

In December 2008, Deutsche Bank opted not to redeem a Lower Tier 2 subordinated bond at first call due to management deeming it non-economical to do so. By not redeeming at the first call date, Deutsche Bank extended the time for redemption for a period of up to 5 years, where the security was ultimately redeemed in 2014. The impact on the security's price is obvious when we look at Exhibit 30, with similar securities issued by Deutsche also experiencing falls in price at the time. This highlights the dramatic price impact of the increased likelihood of extension, although the price did move back to par prior to its 2014 maturity.

Exhibit 30 Deutsche Bank Subordinated Bond Price (EUR)

Source: Thomson Reuters, Morningstar.

The incentives to redeem will vary depending on the issuer and the terms and conditions of the hybrid security. However, the key drivers behind redemption include the desire to minimise reputational damage, avoidance of any coupon step-up or credit rating implications such as the expiry of equity credit treatment.

Reputational Costs

Reputational costs provide an incentive for issuers to redeem at the first call date, even if it is more expensive from a financing perspective to do so. The reputational cost to the issuer would be in the form of subsequent hybrid issues being priced to the final legal maturity, rather than first call date, increasing the coupon required as compensation. An issuer with a track record of redeeming notes at their first call date gives the market some confidence that they will continue to do so. There is, however, no guarantee that this will always be sufficient to prevent extension beyond the first call date. The decision of ANZ Bank in 2013 to not redeem a retail hybrid they issued in New Zealand illustrated that even issuers with a strong record of redeeming hybrids at the first call date may not always do so despite the potential reputational risk.

Continuing the example of Deutsche Bank not calling their subordinated bond at first call, the Bank of China at the time was a holder of the securities. Following Deutsche Bank management's decision not to call, a spokesperson for Bank of China commented that "any non-call by a given institution will result in that institution's debt being ineligible for future investment consideration". They also went on to remove Deutsche Bank from consideration as a counterparty for any credit derivative transaction in the future. Examples of Australian hybrid securities that have not been redeemed on their first call date include the Australand ASSETS, Multiplex SITES, Nufarm Stapled Securities and Ramsay CARES.

Step-Up Provisions

Hybrid securities featuring a coupon step-up provide an additional incentive to redeem the security at the first call date with a large step up providing a strong incentive to redeem at the first call date. Bank hybrid securities issued under the new Basel-III regulatory framework are prevented from providing incentives to redeem at the first call date such as coupon step-ups in order to qualify as AT1 or Tier 2 capital.

In August 2010, Ramsay Health Care announced it will not be converting or redeeming its CARES (Convertible Adjustable Rate Equity Securities) on the relevant date. As a result, the dividend margin "stepped up" by 2.0% to 4.85%. Ramsay retains the ability to convert or redeem CARES at subsequent distribution payment dates.

Diminishing Regulatory Capital Value

Bank hybrids issued pre Basel III are subject to diminishing capital treatment, as per the Basel III transitional arrangements outlined by APRA. This provides a significant incentive to redeem, especially for those hybrids eligible for transitional treatment only until their first call date. However, investors need to be aware that there is a risk that some bank hybrid securities may not be redeemed, even after they cease to be recognised as regulatory capital.

NAB National Income Securities (ASX ticker: NABHA) is a perpetual security paying quarterly interest based on the 90-day bank bill swap plus 1.25% per annum. NABHA's capital benefit to diminishes at a rate of 10% per annum from January 2013. However, this diminishing regulatory capital value is largely offset by the cheap funding it represents across NAB's capital structure (refer Exhibit 9), particularly given its perpetual term. It is also worth noting that the redemption of bank hybrids is subject to APRA approval. This is an important difference between banking and corporate hybrids, with the latter not requiring regulatory approval for redemption.

Equity Credit

For corporate hybrids, changes in their equity credit recognition by ratings agencies will also affect the issuer's incentive to redeem. One of the incentives for large corporates to issue hybrid securities is that they may be partially considered by the credit rating agencies as equity credit, with the proportion of equity assigned dependent on the terms of the hybrid security contract and how equity-like they are considered to be. As soon as this equity credit expires credit metrics are impacted, which provides an incentive for the issuer to redeem as the hybrid will be essentially become expensive debt and may adversely impact their credit rating.

Many hybrid securities are structured in a way that they cease to be recognised as equity capital after the first call date, effectively signalling to investors that the issuer is strongly incentivised to redeem at that date.

For example, consider the Woolworths Notes II (ASX ticker: WOWHC), which have a first call date of 24 November 2014. Management recently announced their intention to redeem these securities. This is a rational decision for reasons we have listed above - namely the security ceases to qualify as equity credit by the rating agencies beyond this date and a 1.00% step-up margin is triggered should they not be called. Furthermore, Woolworths' management has a strong track record of redeeming hybrid notes at their first call date, leaving their positive reputation within the hybrid market intact and in doing so, leaving this market available to them as a possible future funding source.

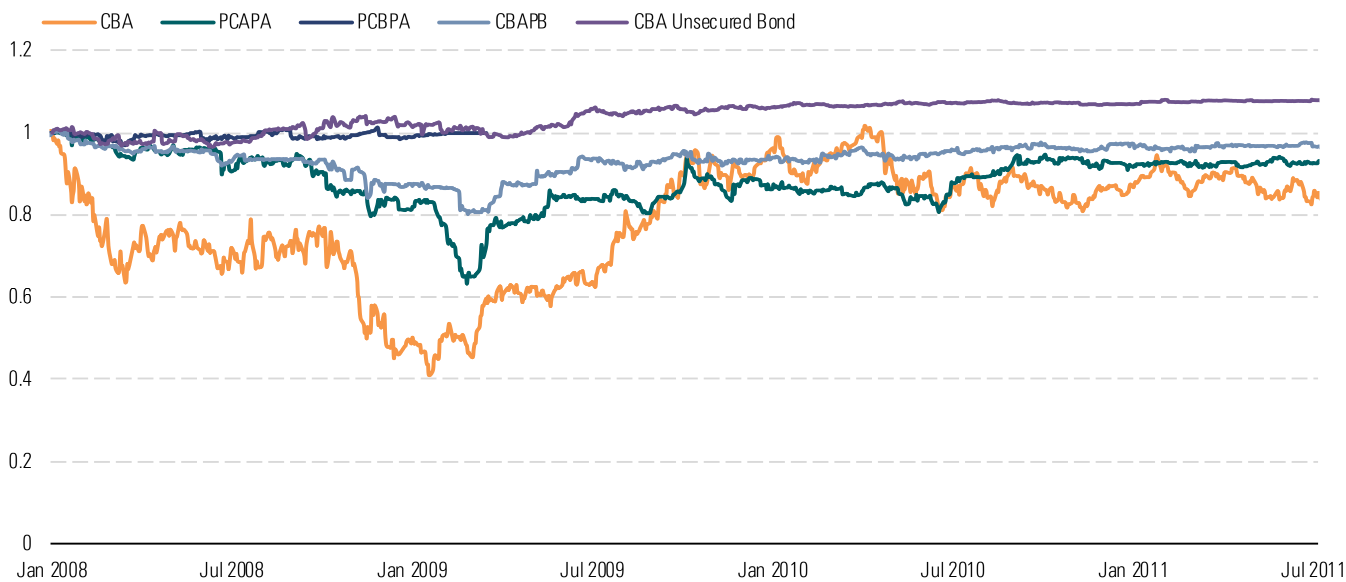
Other Hybrid Risks

Market Price Risk

While hybrid securities display more volatility than senior unsecured debt, they are less volatile than common equity, even during times of distress. This is illustrated in Exhibit 31, which shows the relative price performance of Commonwealth Bank's equity, AT1 hybrid securities and senior unsecured debt during the global financial crisis.

Commonwealth Bank's AT1 hybrid securities are referred to by the bank as Perpetual Exchangeable Resalable Listed Securities, or PERLS. At the beginning of 2008, Commonwealth Bank had the following PERLS listed on the ASX: PERLS II (ASX ticker: PCBPA), PERLS III (PCAPA) and PERLS IV (CBAPB). Exhibit 31 shows that during this period of distress in financial markets, the volatility of the individual PERLS securities varied significantly; however, they all displayed significantly less volatility than Commonwealth Bank's common equity.

Exhibit 31 Relative Performance of Various Commonwealth Bank Securities During the Global Financial Crisis



Source: Thomson Reuters, Morningstar.

In early 2009, Commonwealth Bank's common equity fell to a low approximately 60% below its price at the start of 2008. For the PERLS, falls below their 2008 starting prices were approximately 35% for PCAPA, 20% for CBAPB and no significant fall for PCBPA. In addition to having the greatest fall of the PERLS, PCAPA continued to trade at a significant discount to face value throughout the rest of 2009 and 2010. The difference in the price response of these hybrid securities can be explained by comparing their terms.

Exhibit 32 Summary of Commonwealth Bank's Tier-1 Hybrid Securities

	PERLS II	PERLS III	PERLS IV	PERLS V	PERLS VI	PERLS VII
ASX Code	PCBPA	PCAPA	CBAPB	CBAPA	CBAPC	CBAPD
Issue Date	6 Jan 2004	6 Apr 2006	12 Jul 2007	14 Oct 2009	17 Oct 2012	1 Oct 2014
Issue Price (AUD)	200	200	200	200	100	100
Margin	0.95%	1.05%	1.05%	3.40%	3.80%	2.80%
Step-Up Margin	-	1.00%	-	-	-	-
Capital Trigger	No	Yes	No	No	Yes	Yes
Non-Viability Trigger	No	No	No	No	Yes	Yes
First Call Date	16 Mar 2009	6 Apr 2016	-	-	15 Dec 2018	15 Dec 2022
Scheduled Conversion Date	-	-	31 Oct 2012	31 Oct 2014	15 Dec 2020	15 Dec 2024
Date Redeemed	16 Mar 2009	6 Apr 2016	31 Oct 2012	31 Oct 2014	-	-

Source: Morningstar.

Unlike subsequent issues, PCBPA gave investors, rather than the issuer, the option to redeem the notes at the first call date (referred to as the "Rollover Date" in the prospectus). Prior to this date, Commonwealth Bank had the option to offer a new set of terms which would apply to the next Rollover Date. Commonwealth Bank elected to not offer a new set of terms and instead redeemed the entire issue of PCBPA on 16 March 2009. These notes did not trade at a significant discount to face value in the period until redemption, indicating that investors did not believe there was a significant risk of Commonwealth Bank becoming insolvent before this date. The other two PERLS notes on issue at the start of 2008, PCAPA and CBAPB, experienced a significant fall in price in early March 2009.

Of the PERLS, PCAPA suffered a greater fall in price and continued to trade at a greater discount to face value throughout 2009 and 2010. The reasons for this were the following:

- PCAPA had a longer time until first call. A security with a longer time until first call will generally display greater price sensitivity to changes in trading margins.
- PCAPA had a capital trigger that requires immediate exchange of some, or all, hybrid securities into ordinary equity if the bank's core capital ratio falls below 5.125%. This equity-like feature made PCAPA riskier than CBAPB. During times of financial distress, there is a greater risk of such a trigger being activated and the security is likely to see a fall in price to reflect this.

Capital Trigger Risk

Basel III Compliant AT1 securities contain a capital trigger clause which requires immediate exchange of some, or all, hybrid securities into ordinary equity if the bank's core capital ratio falls below 5.125%. For Australian banks, this ratio is not likely to trickle down to 5.125%, as action would be taken beforehand. Any fall to, or below, 5.125% would likely be sudden, possibly the result of a major operational failure or sharp increases in bad debts. If this ratio did fall below 5.125%, holders of the hybrid security would likely suffer a capital loss as a result of the maximum exchange number of shares condition, where holders could potentially receive ordinary shares worth less than the face value of the hybrid securities.

Non-Viability Risk

Basel III Compliant AT1 securities contain a non-viability trigger clause, which is required by the prudential regulator, APRA, as part of the Basel III reforms. A non-viability event occurs if APRA believes that the bank would become non-viable without an exchange of some, or all, of the hybrid securities, or a public-sector injection of capital, or equivalent, support. The non-viability trigger gives APRA the discretion to require some, or all, of the hybrid security to be exchanged into ordinary shares of the issuer, making these hybrid securities more equity-like than the "old-style" issues. In such a scenario, holders would likely receive ordinary shares worth less than face value.

Capital Conservation Buffer and Countercyclical Buffer Risk

From 1 January 2016, in addition to the minimum Prudential Capital Requirements, banks are required to hold an additional capital conservation buffer[5] equal to 2.5% of risk-weighted assets or 3.5% for D-SIB's.

In addition to this, APRA has the discretion to apply a countercyclical buffer to all banks, at a level of 0.0% to 2.5% of risk weighted assets. This forms part of the Capital Buffer (CB), which consists of the capital conservation buffer plus the countercyclical capital buffer. From 1 January 2016 APRA set the countercyclical buffer to 0%, making the total CET1 Capital Ratio requirement (PCR + CB) 8% for D-SIBs (7% for non D-SIBs). APRA must announce any increase in the countercyclical buffer at least 12 months before the date of implementation, giving ADIs time to take action to comply with the new level of capital required, whereas any decrease can take effect immediately.

If an ADI's CET1 capital ratio falls into the CB, i.e. below 8.0% for D-SIBs or 7% for non-D-SIBs, distributions on their Tier-1 hybrid securities may not be paid. This is because the ADI will only be able to use a certain percentage of its earnings (as outlined in Exhibit 20) to make discretionary payments such as dividends, AT1 distributions and bonuses.

Although the capital conservation buffer began to apply in January 2016, it does apply to Basel III Tier 1 hybrids issued prior to this date, so it is critical to check the terms and conditions of the prospectus.

Distributions that are not paid do not accrue and will not subsequently be paid. However, if this occurs, the dividend stopper will take effect, preventing the ADI from either: (i) declaring a dividend on ordinary shares; or (ii) returning capital or undertaking any buybacks or repurchases in relation to ordinary shares.

5 Any amount of CET1 Capital required to meet an ADI's PCRs for Tier 1 Capital or Total Capital, above the amount required to meet the PCR for CET1, is not eligible to be included in the capital conservation buffer.

Distribution Deferral Risk

Distributions on hybrid securities may be discretionary or subject to mandatory deferral conditions. In either case, the issuer may withhold distributions without defaulting on senior ranking obligations. Deferred distributions may be cumulative, meaning that they must be made up at a later date, or non-cumulative. If distributions are deferred, a dividend stopper will typically apply which prevents distributions on ordinary shares of the issuer and other equally ranking securities and share buy-backs.

Scheduled Conversion Risk

It is common for hybrid securities to have a scheduled conversion date (also referred to as a mandatory conversion date), where the securities are converted into ordinary shares of the issuer at a specific date, subject to conversion conditions (usually regarding the price of the issuer's common equity in the period immediately before the scheduled conversion date). This differs to conversion following a capital or non-viability trigger where investors would likely receive shares worth less than face value due to maximum number of shares condition.

A fall in the issuer's share price to below the minimum exchange price near the scheduled conversion date would result in the hybrid security not being exchanged and remaining on issue until the next distribution payment date when the exchange conditions are met. The higher the minimum exchange price (relative to the price of the issuers common equity), the greater the risk of the hybrid security not being exchanged. Exhibit 33 shows the conversion conditions of various Westpac Tier 1 hybrids and shows that since the price of Westpac's common equity has been rising in the period between WBCPC and WBCPE being released, the mandatory conversion hurdles have also been increasing.

Exhibit 33 Conversion Conditions of Various Westpac Tier 1 Hybrids

	WBCPC	WBCPD	WBCPE
Security name	Westpac CPS	Westpac Capital Notes	Westpac Capital Notes 2
Issue Date	23 Mar 2012	8 Mar 2013	24 Jun 2014
VWAP at Issue (AUD)	20.83	29.89	34.37
Conversion Condition 1	Volume weighted average price, or VWAP, of Westpac shares on the twenty-fifth business day preceding the scheduled conversion date must be greater than 56.12% of the issue date VWAP.	Volume weighted average price, or VWAP, of Westpac shares on the twenty-fifth business day preceding the scheduled conversion date must be greater than 56.12% of the issue date VWAP.	Volume weighted average price, or VWAP, of Westpac shares on the twenty-fifth business day preceding the scheduled conversion date must be greater than 56.12% of the issue date VWAP.
Condition 1 Price (AUD)	11.70	16.78	19.30
Conversion Condition 2	VWAP, of Westpac shares during the preceding 20 business days of the scheduled conversion date is greater than 50.51% of the issue date VWAP.	VWAP, of Westpac shares during the preceding 20 business days of the scheduled conversion date is greater than 50.51% of the issue date VWAP.	VWAP, of Westpac shares during the preceding 20 business days of the scheduled conversion date is greater than 50.51% of the issue date VWAP.
Condition 2 Price (AUD)	10.52	15.10	17.36

Source: Morningstar.

Subordination Risk

If a company issues more equal- or higher-ranking securities in the capital structure, the hybrid security in question effectively becomes further subordinated. The further subordinated a security is, the lower the recovery rate in the event of a default.

Glossary

Additional Tier-1 Capital (AT1): Hybrid capital instruments with characteristics most similar to common equity are classified as AT1 Capital under Basel III and designed to absorb losses on a "going concern" basis. For hybrid capital instruments to qualify as AT1 capital under the Basel III framework, they must have a capital trigger and a non-viability trigger. AT1 capital instruments do not have a maturity date, distributions are discretionary and in a liquidation they rank only senior to common equity.

APRA: The Australian Prudential Regulation Authority (APRA) was established in 1998 and oversees banks, credit unions, building societies, general insurance and reinsurance companies, life insurance, private health insurance, friendly societies and most members of the superannuation industry.

Basel III: The latest global bank prudential rules, developed by the Basel Committee, to strengthen the regulation, supervision and risk management of the banking sector.

BBSW: The Bank Bill Swap Reference Rate is a commonly used benchmark for financial instruments, which is published by Australian Financial Markets Association (AFMA). It is set once a day at around 10.00 am each business day. It covers terms from one month to 15 years. Floating-rate hybrids are priced off either the 90-day or 180-day BBSW. The previous business day's BBSW rates can be found in The Australian Financial Review or on the AFMA website (http://www.afma.com.au/home.html).

Base rate: The benchmark interest rate for floating-rate securities, typically the 90-day or 180 day BBSW for Australian hybrid securities.

Bid/Ask Spread: This is the percentage difference between the lowest price a seller is willing to sell a security and the highest price a buyer is willing to buy a security. Securities with relatively low liquidity will tend to have wider bid/ask spreads than those with higher liquidity.

Capital Structure: the composition of a company's debt and equity obligations. Hybrid securities typically rank ahead of ordinary shares, equally with equal ranking hybrid securities, and behind senior creditors, liabilities preferred by law (such as bank deposits) and secured debt.

Capital trigger event: Applies to banking securities that have a capital trigger event clause. If the issuer determines, or APRA believes, that the issuer's common equity tier-1 ratio is equal to or less than 5.125%, the issuer must exchange a sufficient amount of the security into ordinary shares to return this ratio above 5.125%. Holders of the security could potentially receive ordinary shares of the issuer worth less than face value.

Call date: This is a date before the maturity date that gives the issuer an option, but not the obligation, to redeem/convert early. If not exercised, usually the issuer has the option to convert/redeem at any subsequent distribution payment date. This date may be referred to as the optional conversion/redemption/resale date in the security prospectus.

Cash distribution rate: for fully franked distributions, the annual cash distribution rate is calculated using the formula D = (base rate + margin) x (1 – tax) where tax is the corporate tax rate (currently 30% in Australia). For non-franked distributions, the annual cash distribution rate is calculated as D = (base rate + margin). Payments on hybrid securities are typically paid either quarterly or semi-annually. The cash distribution amount each payment period is calculated as (distribution rate x issue price x number of days in distribution period)/365.

Clean price: Price of hybrid security excluding interest that has accrued since issue or the most recent coupon payment.

Conversion: Where the security is converted into another type of security, usually ordinary shares of the issuer.

Conversion discount: The discount to the conversion price. For example, a hybrid security has a 1% conversion discount and $100 face value. This means for each security a person owns, they will receive $101.00 worth of that issuer's shares: face value/ (1-conversion discount) or $100/(1-0.01).

Coupon rate: Annual distribution as a percentage of the face value.

Cumulative distributions: Such a condition means missed distributions must be made up.

Dirty price: Price of hybrid security including accrued interest.

Distribution payment test: These are specific hurdles the issuer must meet to be able to pay distributions on the security. For example, with Basel III Compliant AT1 securities, payment of distributions is subject to payment conditions being satisfied, the most material being that payment does not cause the issuer to breach its regulatory capital requirements or become insolvent and APRA not objecting. The hurdles can be specific financial metrics such a gearing and/or interest cover ratio.

Dividend stopper: This is a condition which stops the issuer paying distributions on some or all other securities on issue if it misses a payment on the security. Typically, such a condition stops distributions on ordinary shares of the issuer and other equally ranking securities.

Exchange: Can be either a redemption or conversion.

Ex-date: The ex-date is the day that a security begins to trade without the previously declared distribution. On the ex-date, the security usually declines by approximately the value of the distribution to account for the loss of the distribution.

Face value: This is the issue price. Most income securities have a $100 face value.

Fair Margin: An estimate of the margin above a benchmark that a security should trade at to compensate for the risks inherent in holding a security. It comprises a credit spread and additional spreads to account for transaction costs associated with illiquidity, and small additional spreads to represent the inconvenience or risks of other characteristics of the security, such as having perpetual or non-cumulative distributions, and the maximum number of shares on conversion.

Fixed-rate security: The interest rate for such a security does not change during its entire term, so the annual distribution amount will be the same for each payment.

Floating-rate security: The interest rate for such a security is reset periodically, most commonly every 90 or 180 days, so the distribution amount will potentially be different for each payment.

Franking: Distributions can come with or without tax credits attached. If a distribution is franked, then the cash payment amount will be equal to the face value x interest rate x franking proportion x (1-corporate tax rate). The balance will come as a tax credit. It works the same as franking on dividends from ordinary shares.

Franking proportion: The proportion of the distribution that is franked, ranging from 0% for unfranked distributions to 100% for fully franked distributions. Some companies (particularly those paying a proportion of their tax outside Australia) will have a franking proportion less than 100%.

Holder call rights: Relates to what rights the securityholder has to redeem/convert a security.

Interest rate: For a floating rate security, the interest rate is the sum of the margin and benchmark interest rate. For a fixed-rate security, the rate is set at the issue date. It may be set at a margin above a benchmark or just be a specified rate.

Issue price: The face value of the security at the time of issue, usually AUD 100 for most Australian hybrid securities.

Issuer: The company that issued the security.

Issuer call rights: Relates to what rights the issuer has to redeem/convert a security.

Maturity date: This is the date on which a security must be redeemed. Many hybrid securities are perpetual securities, meaning that they have no fixed maturity date and if not redeemed could remain on issue indefinitely.

Mandatory conversion: Refer to Scheduled Conversion.

Margin: The per annum spread above a benchmark interest rate that distributions are based upon.

Maximum number of shares on conversion: The maximum number of ordinary shares a holder is entitled to under a hybrid conversion scenario. Under such a condition, a hybrid holder could potentially receive shares worth less than face value.

Non-common equity (NCE) regulatory capital: Hybrid securities that qualify as either Additional Tier 1 (AT1) or Tier 2 regulatory capital.

Non-cumulative distributions: Such a condition means missed distributions do not have to be made up.

Non-viability trigger event: A non-viability trigger event occurs if APRA notifies the issuer that it believes that exchange of some, or all of the security is required, because without it the issuer would become non-viable; or a public-sector injection of capital is required because without it the issuer would become non-viable. Following such an event, the issuer must immediately exchange such number of the securities that is specified by APRA or necessary to satisfy APRA that the issuer will no longer be non-viable. Exchange following this event is not subject to scheduled conversion conditions being satisfied. The consequence is similar to exchange following a capital trigger event where security holders could potentially receive the issuer's ordinary shares worth less than AUD 100.

Optional conversion/redemption date: This is a date before the maturity date that gives the issuer an option to redeem/convert early. If not exercised, usually the issuer has the option to convert/redeem at any subsequent distribution payment date.

Payment date: The date on which a distribution is scheduled to be paid.

Perpetual securities: Securities which do not have a maturity date.

Preference Share: A security which pays a fixed or floating rate distribution, which ranks above common equity in the capital structure.

Redemption: Where face value plus accrued interest is returned in the form of cash to the securityholder.

Remarketing date: This is an older term but is similar to a reset date.

Resale: Where the issuer organises a third party to acquire the hybrid for face value. For a security holder, the effect is essentially the same as a redemption.

Reset date: This is the first date when the terms of a security (including the margin) may be changed. This date will correspond to the first call date, scheduled conversion date or maturity of the security.

Running yield: The running yield is a simple calculation of current annual distributions divided by the clean price (that is, the current market price, less accrued distributions). The calculation is grossed up for franking credits.

Scheduled conversion date: This is the date on which the security must be converted into ordinary shares of the issuer, subject to certain conditions being satisfied. This is often referred to as mandatory conversion.

Secured: The security is backed by collateral.

Step up note: Securities where the margin steps up after the step-up date if the issuer: (i) does not elect to redeem the note; or (ii) if a step-up event happens.

Step-up margin: The amount the issue margin increases in the event of a "step-up" event.

Subordination: A loan or security that ranks below other loans or securities with regard to claims on assets or earnings.

Ticker symbol: Otherwise called the security code. This is the unique symbol given to each security listed on an exchange.

Tier 1 capital (T1): For banks, regulatory capital is considered in two tiers. Tier 1, or core capital, is the highest quality capital and consists of funding sources that a bank can most freely allocate losses without triggering bankruptcy. It includes issued common equity, general reserves, retained earnings, along with preference shares and convertible securities (i.e. hybrid securities) that meet the qualifying criteria provided by APRA.

Tier 2 capital: For banks, regulatory capital is considered in two tiers. Tier 2, or supplementary capital, represents other elements which do not satisfy all of the characteristics of Tier 1 capital but which contribute to the overall strength of a bank as a going concern.

Trading margin: The trading margin of a security (y) is the effective margin at which it trades – it is the margin which a new security (x) with face value of $100 would need so the sum of the discounted cash flows of x equal the discounted cash flows of y, assuming redemption of both s and x at the pseudo maturity date of y. It is approximately the difference between the gross yield and the corresponding swap rate. In simple terms, for a new issue with a $100 face value, the issue margin and trading margin will be identical.

Trigger events: These are specific events such as an acquisition, or a change in regulation or taxation rules which can give the issuer the right to redeem or convert a security early. It may also give the securityholder a right to request redemption.

Unit trust: A form of collective investment constituted under a trust deed. The investor is effectively the beneficiary under the trust.

Unsecured: The security is not backed by any collateral. In a wind-up scenario, unsecured creditors join the queue for remaining assets after all secured creditors' obligations have been met.

Vanilla: A standard version of a financial instrument.

VWAP: Daily volume-weighted average sale prices of a security over specific period. This is typically used to determine a conversion price for conversion into an ordinary share. The reason a VWAP is used rather than, say, a closing price on a single day is that it is an average price where a closing price is the just one trade, that is, the last trade. This limits the risk of someone being able to drive the ordinary share price down in order to increase the number of shares on conversion.

Yield to maturity/reset: This is the discount rate at which the sum of the future discounted cash flows is equal to the current traded price. The gross yield includes the franking credit portion of the distributions, whereas the net yield includes the cash component of distributions only. The cash flows will include an estimated regular interest-style payment and final redemption of the security at the price specified in the contract (the issue price). This is also known as an internal rate of return or IRR.

Term Sheets

Financial Issuers	ASX Code
AMP Limited	AMPHA
Australia & New Zealand Banking Group	ANZHA, ANZPC, ANZPE, ANZPF, ANZPG
Commonwealth Bank of Australia	CBAPC, CBAPD, CBAPE
Colonial Holding Company Limited	CNGHA
Insurance Australia Group	IAGPC, IANG
Macquarie Group Limited	MBLHB, MBLPA, MQGPA, MQGPB
National Australia Bank Limited	NABHA, NABHB, NABPA, NABPB, NABPC, NABPD
Suncorp Group Limited	SUNPC, SUNPD, SUNPE
Westpac Banking Corporation	WBCHA, WBCHB, WBCPC, WBCPD, WBCPE, WBCPF, WBCPG

Non-financial Issuers	ASX Code
AGL Energy Limited	AGLHA
APA Group	AQHHA
Caltex Australia Limited	CTXHA
Crown Resorts Limited	CWNHA, CWNHB
Goodman Group	GMPPA
Origin Energy Limited	ORGHA
Ramsay Health Care Limited	RHCPA
Seven Group Holdings Limited	SVWPA
Tabcorp Holdings Limited	TAHHB
Tatts Group Limited	TTSHA
Woolworths Limited	WOWHC

AGLHA AGL Energy Subordinated Notes

Security Investment Risk	Medium
Issuer Name	AGL Energy Limited
Issuer Economic Moat Rating	Narrow
Issuer Stewardship Rating	Standard
Sector	Utilities
Issue Date	4 April 2012
Issue size (AUD million)	650
Call Date	8 June 2019
Scheduled Conversion / Maturity	8 June 2039
Issue Price (AUD)	100
Coupon Margin	3.80%
Base Rate	90-day bank-bill swap
Franking	0%
Distribution Frequency	Quarterly
Step-Up Margin	0.25%
Discretionary Distributions	-
Mandatory Deferral	Yes
Cumulative Distributions	Yes
Dividend Stopper	-
Capital / Non-Viability Trigger	-

Contract Summary

First step-up and optional redemption date is 8 June 2019, with AGL holding the option to redeem the note. Security holders will receive face value of AUD 100 plus any deferred interest payments if AGL opts to redeem. If the note is not redeemed, margin on the notes step up by 0.25% per annum. Thereafter, AGL may redeem the note on any distribution date. The note must be redeemed by AGL on 8 June 2039.

Interest payment is deferred if AGL's interest cover ratio is less than 3 times on any testing date, and if its leverage ratio exceeds 4 times on two consecutive testing dates. The testing dates are its interim and financial year-end. AGLHA are unsecured notes which rank above equity, but below all senior debtors. This means in the event of a default, senior debtors have prior rights to distribution than AGLHA note holders. AGL can issue further notes or instruments which rank behind, equally with or ahead of AGLHA. AGL Energy may redeem the note before the maturity date if a change of control event, a tax event, capital event or a clean-up event occurs.

AGLHA note holders have the right to request redemption if a change-of-control event occurs. This is defined as an individual and its associates holding more than 50% of AGL's ordinary shares outstanding. A clean-up event is defined as 80% of face value of notes on issued date is redeemed, and less than 20% of the notes are remaining on market. A capital event is said to have occurred if AGLHA is no longer considered as "equity credit" by a rating agency. In the event of an early redemption, AGLHA is redeemed at face value plus accrued interest outstanding. This is a brief contract summary and investors should read the prospectus before investing in the security.

Issuer Description

AGL Energy Limited (AGL) is an integrated energy company and owner, operator and developer of renewable energy generation in Australia. It has a diverse power generation portfolio including base, peaking and intermediate generation plants, spread across traditional thermal generation as well as renewable sources including hydro, wind, landfill gas, solar and biomass. The Company has four operating segments which are Energy Markets, Group Operations, New Energy and Investments.

Issuer Bull / Bear Case

Bull case: As AGL Energy is a provider of an essential product, earnings should prove highly defensive. Increases in energy prices should underpin profit growth, despite margin compression from increased competition. A large exposure to low-cost coal-fired electricity generation is likely to benefit from rising natural gas and wholesale electricity prices.

Bear Case: Deregulation and privatisation of retail energy markets have caused increased price-based competition. The regulatory environment is unpredictable and has a significant impact on AGL Energy's earnings. The structural move to a low-carbon world could potentially affect AGL's portfolio of generation assets.

AMPHA AMP Subordinated Notes 2

Security Investment Risk	Medium
Issuer Name	AMP Limited
Issuer Economic Moat Rating	Narrow
Issuer Stewardship Rating	Standard
Sector	Financial Services
Issue Date	18 December 2013
Issue size (AUD million)	650
Call Date	8 June 2019
Scheduled Conversion / Maturity	8 June 2039
Issue Price (AUD)	100.00
Coupon Margin	2.65%
Base Rate	90-day bank-bill swap
Franking	0%
Distribution Frequency	Quarterly
Step-Up Margin	-
Discretionary Distributions	-
Mandatory Deferral	-
Cumulative Distributions	Yes
Dividend Stopper	-
Capital / Non-Viability Trigger	Non-Viability Trigger

Contract Summary

AMP Subordinated Notes 2 are unsecured, subordinated and cumulative notes. AMPHA forms part of AMP Limited's capital management strategy and represents tier-2 regulatory capital. This security has a legal maturity at 10.5 years and, because it has a five-year call option, is eligible to be counted as regulatory capital only for a period of five years, after which it simply becomes expensive debt. The other significant structural terms are the solvency condition and risk of unscheduled conversion (or write-off) due to a non-viability trigger event. The solvency condition is a condition precedent to all payments on the notes. This condition was included in previously issued ANZHA (Australia & New Zealand Banking Group), NABHB (National Australia Bank) and WBCHA (Westpac Banking Corporation). If this condition is not met, then failure to make payment does not constitute an event of default.

The largest risk to AMPHA holders is unscheduled conversion due to a non-viability trigger event. Although we consider this an unlikely event, the implications for holders are substantial. Unscheduled conversion forced by the regulator will only happen in the case of a large downside event which would otherwise lead to insolvency. The Australian Prudential Regulation Authority, or APRA, has decided not to provide a clear and objective definition of non-viability to ensure it has full discretion to convert in a time of stress. Note that there are no conversion conditions for AMPHA.

Issuer Description

AMP is a diversified and vertically integrated financial services provider managed in two distinct divisions, AMP Financial Services and AMP Capital. AMP Financial Services is the group powerhouse, accounting for the large majority of earnings. The division includes wealth management (38% of group earnings), life and income protection insurance (9% of earnings), extensive wealth and insurance operations in New Zealand (12% of earnings), banking (12% of earnings) and a legacy book of closed traditional insurance products in long-term run-off, currently generating about 13% of earnings. AMP boasts the largest financial adviser network in Australia/New Zealand, with approximately 3,800 advisers. AMP Capital is the smaller of the two divisions, accounting for 16% of group earnings, and operates an established asset-management business with increasing exposure to a fast-growing Asia.

Issuer Bull / Bear Case

Bull case: AMP is well placed to take advantage of structural advantages of a compulsory superannuation system, generous tax incentives and an ageing, increasingly wealthy population. The superannuation industry is expected to double in size by 2026. Increasing complexity in superannuation and taxation rules will boost demand for financial advice, and AMP has the largest adviser network in Australia/New Zealand. Operational expertise, distribution and scale enable AMP to implement major regulatory reforms without materially affecting profitability.

Bear Case: Unfavourable regulatory and government policy changes could damage AMP's products and services. The regulatory environment remains uncertain, with a wide range of government and regulator reviews under way. A regulatory requirement for financial advisers to operate in their clients' best interests could threaten AMP's success in selling a large proportion of AMP products to their clients. Despite the business impact, AMP continues to support the Future of Financial Advice reforms.

ANZHA ANZ Subordinated Notes

Security Investment Risk	Low
Issuer Name	Australia & New Zealand Banking Group
Issuer Economic Moat Rating	Wide
Issuer Stewardship Rating	Standard
Sector	Banks
Issue Date	20 March 2012
Issue size (AUD million)	1,500
Call Date	20 June 2017
Scheduled Conversion / Maturity	20 June 2022
Issue Price (AUD)	100
Coupon Margin	2.75%
Base Rate	90-day bank-bill swap
Franking	0%
Distribution Frequency	Quarterly
Step-Up Margin	-
Discretionary Distributions	-
Mandatory Deferral	-
Cumulative Distributions	-
Dividend Stopper	-
Capital / Non-Viability Trigger	-

Contract Summary

ANZHA is a subordinated note. It pays quarterly interest payments in arrears. The interest rate is calculated using the formula I = (base + margin), where base is the 90-day BBSW, and the margin is 2.75% per annum. Interest payments each quarter are calculated as: (I x issue price x (number of days in interest period/365). The distributions are interest payments, so are not franked. Interest payments are not deferrable. ANZ Bank, must make interest payments, unless it is not solvent when the payment is due, or will not be solvent after making a payment.

ANZHA mature on 20 June 2022 but ANZ Bank has an option to redeem the notes on the first redemption date, 20 June 2017, or on an interest payment date for taxation reasons, subject to approval by the Australian Prudential Regulation Authority, or APRA. There is no step-up in the margin if the notes are not redeemed on the first redemption date. The redemption amount is AUD 100 face value plus accrued and any unpaid interest. Holders cannot request the notes be redeemed early. In a wind-up ANZHA rank: behind all unsubordinated creditors (including depositors, bondholders and other creditors); equally with other equal-ranking securities; and ahead of ANZ Bank ordinary and preference shares (including the ANZ Bank hybrids on issue: ANZPA and ANZPC).

Issuer Description

Australia and New Zealand Banking Group Limited (ANZ) provides a range of banking and financial products and services to retail, small business, corporate and institutional clients. ANZ operates in Australia, New Zealand, Asia Pacific region, the United Kingdom and the United States. ANZ main business divisions consist of Retail, Corporate and Commercial Banking, Global Wealth and International and Institutional Banking Division.

Issuer Bull / Bear Case

Bull case: New CEO Shayne Elliot wasted no time in overhauling senior management and highlighting subtle change in strategy. The focus on retail, commercial and institutional banking is expected to improve earnings with less emphasis on the eight year old "super regional" Asia strategy. Despite de-emphasising the Asian growth strategy, ANZ Bank is best placed of peers to capitalise on long-term growth in trade and investment flows with Asia. ANZ Bank's international business supplements solid and more profitable domestic growth. Despite recent uncertainty in the region, Asia remains the trade hub of the world and its importance will continue to grow for decades. ANZ Bank is the only Australian bank with a core strategy to leverage Australia's links with Asia, the fast-growing emerging market region. Trade flow between Asia and Australia are strong and are expected to grow significantly in time.

Bear Case: As expected, significant restructuring charges were announced with first-half fiscal 2016 results on 3 May 2016. Loan loss provisioning nearly doubled due to increased stress in some the bank's more vulnerable sector exposures. ANZ Bank wrote down the value of its partnership investment in Malaysia and reduced capitalised software. Overshadowing the management changes is increasing concern of slower earnings growth, increased loan loss provisioning, higher restructuring charges, pressure on capital levels and potential for lower dividends. We see this as another classic case of a new CEO "clearing the decks." When wholesale funding costs rise, interest margins come under pressure. In such circumstances, ANZ Bank might not be able to pass on higher funding costs and still retain desirable market share.

ANZPC ANZ CPS 3

Security Investment Risk	Low
Issuer Name	Australia & New Zealand Banking Group
Issuer Economic Moat Rating	Wide
Issuer Stewardship Rating	Standard
Sector	Banks
Issue Date	28 September 2011
Issue size (AUD million)	1,340
Call Date	1 September 2017
Scheduled Conversion / Maturity	1 September 2019
Issue Price (AUD)	100
Coupon Margin	3.10%
Base Rate	180-day bank-bill swap
Franking	100%
Distribution Frequency	Semi-Annual
Step-Up Margin	-
Discretionary Distributions	-
Mandatory Deferral	-
Cumulative Distributions	No
Dividend Stopper	Yes
Capital / Non-Viability Trigger	Capital Trigger

Contract Summary

ANZ CPS3 are fully paid preference shares issued by ANZ.

Scheduled conversion into ordinary shares on 1 September 2019 are subject to the following conditions:
- The volume weighted average price (VWAP) of ordinary ANZ Bank shares on the 25th business day before the mandatory conversion date is greater than 56% of the issue date VWAP;
- The VWAP for the period of 20 business days before the mandatory conversion date is greater than 50.51% of the issue date VWAP;
- Ordinary shares remain listed and admitted to trading on the Australian Securities Exchange (ASX), and trading of ordinary shares has not been suspended for at least five consecutive business days prior to a possible mandatory conversion date.

At its discretion, ANZ Bank may choose to exchange CPS3 early on 1 September 2017 and each subsequent payment date (subject to APRA approval). ANZ CPS3 pay preferred and non-cumulative variable dividends based 6-month BBSW plus 3.10%. This is paid on a semi-annual basis in arrears, subject to the payment tests. ANZ CPS3 terms and conditions include a common equity trigger event.

Issuer Description

Australia and New Zealand Banking Group Limited (ANZ) provides a range of banking and financial products and services to retail, small business, corporate and institutional clients. ANZ operates in Australia, New Zealand, Asia Pacific region, the United Kingdom and the United States. ANZ main business divisions consist of Retail, Corporate and Commercial Banking, Global Wealth and International and Institutional Banking Division.

Issuer Bull / Bear Case

Bull case: Despite de-emphasising the Asian growth strategy, ANZ Bank is best placed of peers to capitalise on long-term growth in trade and investment flows with Asia. ANZ Bank's international business supplements solid and more profitable domestic growth. Despite recent uncertainty in the region, Asia remains the trade hub of the world and its importance will continue to grow for decades.

Bear Case: Significant restructuring charges were announced with first-half fiscal 2016 results on 3 May 2016. Loan loss provisioning nearly doubled due to increased stress in some the bank's more vulnerable sector exposures. ANZ Bank wrote down the value of its partnership investment in Malaysia and reduced capitalised software. Overshadowing the management changes is increasing concern of slower earnings growth, increased loan loss provisioning, higher restructuring charges, pressure on capital levels and potential for lower dividends. When wholesale funding costs rise, interest margins come under pressure. In such circumstances, ANZ Bank might not be able to pass on higher funding costs and still retain desirable market share.

ANZPD ANZ Capital Notes

Security Investment Risk	Low
Issuer Name	Australia & New Zealand Banking Group
Issuer Economic Moat Rating	Wide
Issuer Stewardship Rating	Standard
Sector	Banks
Issue Date	7 August 2013
Issue size (AUD million)	1,120
Call Date	1 September 2021
Scheduled Conversion / Maturity	1 September 2023
Issue Price (AUD)	100
Coupon Margin	3.40%
Base Rate	180-day bank-bill swap
Franking	100%
Distribution Frequency	Semi-Annual
Step-Up Margin	-
Discretionary Distributions	Yes
Mandatory Deferral	-
Cumulative Distributions	No
Dividend Stopper	Yes
Capital / Non-Viability Trigger	Capital Trigger & Non-Viability Trigger

Contract Summary

ANZPD are fully-paid, subordinated, non-cumulative, unsecured, mandatorily convertible notes. They are issued directly by ANZ Bank and will be treated as eligible regulatory capital under the new Basel III requirements. Issue proceeds will be used for funding and capital management purposes. These notes offer semi-annual interest payments of 180-day BBSW rate plus 3.40%.

ANZPD are legally perpetual securities but with scheduled conversion on 1 September 2023, subject to the following conversion conditions:
- VWAP of ANZ Bank shares on the 25th business day preceding the mandatory conversion date is greater than 56% of the issue date VWAP (AUD 29.16)
- VWAP of ANZ Bank shares during the preceding 20 business days before the mandatory conversion date is greater than 50.51% of the issue date VWAP (AUD 29.16).
- No delisting of ordinary shares.

The optional redemption date is 1 September 2021. On this date, the issuer has the option to convert, redeem or resell ANZPD (subject to APRA approval).

The security is also subject to unscheduled conversion due to:
- a common equity trigger event
- a non-viability trigger.

Issuer Description

Australia and New Zealand Banking Group Limited (ANZ) provides a range of banking and financial products and services to retail, small business, corporate and institutional clients. ANZ operates in Australia, New Zealand, Asia Pacific region, the United Kingdom and the United States. ANZ main business divisions consist of Retail, Corporate and Commercial Banking, Global Wealth and International and Institutional Banking Division.

Issuer Bull / Bear Case

Bull case: Despite de-emphasising the Asian growth strategy, ANZ Bank is best placed of peers to capitalise on long-term growth in trade and investment flows with Asia. ANZ Bank's international business supplements solid and more profitable domestic growth. Despite recent uncertainty in the region, Asia remains the trade hub of the world and its importance will continue to grow for decades. ANZ Bank is the only Australian bank with a core strategy to leverage Australia's links with Asia, the fast-growing emerging market region. Trade flow between Asia and Australia are strong and are expected to grow significantly in time.

Bear Case: As expected, significant restructuring charges were announced with first-half fiscal 2016 results on 3 May 2016. Loan loss provisioning nearly doubled due to increased stress in some the bank's more vulnerable sector exposures. ANZ Bank wrote down the value of its partnership investment in Malaysia and reduced capitalised software. Overshadowing the management changes is increasing concern of slower earnings growth, increased loan loss provisioning, higher restructuring charges, pressure on capital levels and potential for lower dividends. When wholesale funding costs rise, interest margins come under pressure. In such circumstances, ANZ Bank might not be able to pass on higher funding costs and still retain desirable market share.

ANZPE ANZ Capital Notes 2

Security Investment Risk	Medium
Issuer Name	Australia & New Zealand Banking Group
Issuer Economic Moat Rating	Wide
Issuer Stewardship Rating	Standard
Sector	Banks
Issue Date	31 March 2014
Issue size (AUD million)	1,610
Call Date	24 March 2022
Scheduled Conversion / Maturity	24 March 2024
Issue Price (AUD)	100
Coupon Margin	3.25%
Base Rate	180-day bank-bill swap
Franking	100%
Distribution Frequency	Semi-Annual
Step-Up Margin	-
Discretionary Distributions	Yes
Mandatory Deferral	-
Cumulative Distributions	No
Dividend Stopper	Yes
Capital / Non-Viability Trigger	Capital Trigger & Non-Viability Trigger

Contract Summary

ANZPE are fully-paid, subordinated, non-cumulative, unsecured, mandatorily convertible notes with a face value of $100. They are issued directly by ANZ Bank and will be treated as eligible regulatory capital under the new Basel III requirements. Issue proceeds will be used for funding and capital management purposes. These notes offer semi-annual interest payments of 180-day BBSW rate plus 3.25% (inclusive of franking credits).

ANZPE are legally perpetual securities but with scheduled conversion on 24 March 2024, subject to the following conversion conditions:
- VWAP of ANZ Bank shares on the 25th business day preceding the mandatory conversion date is greater than 56% of the issue date VWAP (AUD 32.30)
- VWAP of ANZ Bank shares during the preceding 20 business days before the mandatory conversion date is greater than 50.51% of the issue date VWAP (AUD 32.30).
- No delisting of ordinary shares.

The optional redemption is 24 March 2022. On this date, the issuer has the option to convert, redeem or resell ANZPE (subject to APRA approval). The security is also subject to unscheduled conversion due to:
- a common equity trigger event.
- a non-viability trigger.

Issuer Description

Australia and New Zealand Banking Group Limited (ANZ) provides a range of banking and financial products and services to retail, small business, corporate and institutional clients. ANZ operates in Australia, New Zealand, Asia Pacific region, the United Kingdom and the United States. ANZ main business divisions consist of Retail, Corporate and Commercial Banking, Global Wealth and International and Institutional Banking Division.

Issuer Bull / Bear Case

Bull case: Despite de-emphasising the Asian growth strategy, ANZ Bank is best placed of peers to capitalise on long-term growth in trade and investment flows with Asia. ANZ Bank's international business supplements solid and more profitable domestic growth. Despite recent uncertainty in the region, Asia remains the trade hub of the world and its importance will continue to grow for decades. ANZ Bank is the only Australian bank with a core strategy to leverage Australia's links with Asia, the fast-growing emerging market region. Trade flow between Asia and Australia are strong and are expected to grow significantly in time.

Bear Case: As expected, significant restructuring charges were announced with first-half fiscal 2016 results on 3 May 2016. Loan loss provisioning nearly doubled due to increased stress in some the bank's more vulnerable sector exposures. ANZ Bank wrote down the value of its partnership investment in Malaysia and reduced capitalised software. Overshadowing the management changes is increasing concern of slower earnings growth, increased loan loss provisioning, higher restructuring charges, pressure on capital levels and potential for lower dividends. When wholesale funding costs rise, interest margins come under pressure.

ANZPF ANZ Capital Notes 3

Security Investment Risk	Medium
Issuer Name	Australia & New Zealand Banking Group
Issuer Economic Moat Rating	Wide
Issuer Stewardship Rating	Standard
Sector	Banks
Issue Date	5 March 2015
Issue size (AUD million)	970
Call Date	24 March 2023
Scheduled Conversion / Maturity	24 March 2025
Issue Price (AUD)	100
Coupon Margin	3.60%
Base Rate	180-day bank-bill swap
Franking	100%
Distribution Frequency	Semi-Annual
Step-Up Margin	-
Discretionary Distributions	Yes
Mandatory Deferral	-
Cumulative Distributions	No
Dividend Stopper	Yes
Capital / Non-Viability Trigger	Capital Trigger & Non-Viability Trigger

Contract Summary

ANZPF are fully-paid, non-cumulative, convertible, transferrable, redeemable, subordinated, perpetual, unsecured notes with a mandatory exchange date of 24 March 2025. This is subject to exchange conditions, unless it is exchanged earlier as a result of a trigger event or ANZ Bank exercising an option to call the security two years early on 24 March 2023.

If ANZPF has not been exchanged or redeemed earlier, on 24 March 2025, ANZPF will convert into a variable number of ANZ Bank ordinary shares worth approximately AUD 101.01 at a 1% discount to the 20 business day VWAP of ANZ Bank ordinary shares. This is subject to exchange conditions. If these conditions are not satisfied, exchange will be deferred until the next distribution payment date upon which the conditions are met. The scheduled exchange conditions are:

- The VWAP of ANZ Bank ordinary shares on the 25th business day before (but not including) a possible mandatory conversion date is equal to or greater than 56% of the issue date VWAP of ANZ Bank ordinary shares (AUD 21.38);
- The VWAP of ANZ Bank ordinary shares during the 20 business days before (but not including) a possible mandatory conversion date is equal to or greater than 50.51% of the issue date VWAP of ANZ Bank ordinary shares (AUD 19.28); and
- ANZ Bank ordinary shares are listed and admitted to trade on the Australian Securities Exchange.

Unscheduled exchange could arise through either a capital trigger event or a non-viability trigger event. The maximum number of shares on exchange condition does not apply for exchange following a capital or non-viability trigger event.

Issuer Description

Australia and New Zealand Banking Group Limited (ANZ) provides a range of banking and financial products and services to retail, small business, corporate and institutional clients. ANZ operates in Australia, New Zealand, Asia Pacific region, the United Kingdom and the United States. ANZ main business divisions consist of Retail, Corporate and Commercial Banking, Global Wealth and International and Institutional Banking Division.

Issuer Bull / Bear Case

Bull case: Despite de-emphasising the Asian growth strategy, ANZ Bank is best placed of peers to capitalise on long-term growth in trade and investment flows with Asia. ANZ Bank's international business supplements solid and more profitable domestic growth. Despite recent uncertainty in the region, Asia remains the trade hub of the world and its importance will continue to grow for decades.

Bear Case: As expected, significant restructuring charges were announced with first-half fiscal 2016 results on 3 May 2016. Loan loss provisioning nearly doubled due to increased stress in some the bank's more vulnerable sector exposures. Overshadowing the management changes is increasing concern of slower earnings growth, increased loan loss provisioning, higher restructuring charges, pressure on capital levels and potential for lower dividends. We see this as another classic case of a new CEO "clearing the decks." When wholesale funding costs rise, interest margins come under pressure. In such circumstances, ANZ Bank might not be able to pass on higher funding costs and still retain desirable market share.

ANZPG ANZ Capital Notes 4

Security Investment Risk	Medium
Issuer Name	Australia & New Zealand Banking Group
Issuer Economic Moat Rating	Wide
Issuer Stewardship Rating	Standard
Sector	Banks
Issue Date	27 September 2016
Issue size (AUD million)	1,300
Call Date	20 March 2024
Scheduled Conversion / Maturity	20 March 2026
Issue Price (AUD)	100
Coupon Margin	4.70%
Base Rate	90-day bank-bill swap
Franking	100%
Distribution Frequency	Quarterly
Step-Up Margin	-
Discretionary Distributions	Yes
Mandatory Deferral	-
Cumulative Distributions	No
Dividend Stopper	Yes
Capital / Non-Viability Trigger	Capital Trigger & Non-Viability Trigger

Contract Summary

ANZPG are fully-paid, non-cumulative, convertible, transferrable, redeemable, subordinated, perpetual, unsecured notes with a scheduled conversion date of 20 March 2026. This is subject to exchange conditions, unless it is exchanged earlier as a result of a trigger event or ANZ Bank exercising an option to call the security two years early on 20 March 2024. Distributions are discretionary, non-cumulative, fully franked with dividend and capital restrictions. They are paid quarterly in arrears, based on the 90-day BBSW, rate plus a 4.70% per annum. Distributions are subject to payment conditions being satisfied, the most material being payment does not cause ANZ Bank to breach its regulatory capital requirements or become insolvent and APRA not objecting.

If ANZPG has not been exchanged or redeemed earlier, on 20 March 2026, ANZPG will convert into a variable number of ANZ Bank ordinary shares worth approximately AUD 101.01 at a 1% discount to the 20 business day VWAP of ANZ Bank ordinary shares. This is subject to exchange conditions. If these conditions are not satisfied, exchange will be deferred until the next distribution payment date upon which the conditions are met.

Unscheduled exchange could arise through either a capital trigger event or a non-viability trigger event. Under a capital trigger event, ANZ Bank determines, or the Australian Prudential Regulation authority, or APRA, notifies ANZ Bank that it believes ANZ Bank's common equity tier-1 capital ratio is equal or less than 5.125%. Under a non-viability trigger event, APRA notifies ANZ Bank that it believes exchange of some or all of the notes, or a public sector injection of capital (or equivalent support), is necessary, otherwise ANZ Bank would become non-viable.

Issuer Description

Australia and New Zealand Banking Group Limited (ANZ) provides a range of banking and financial products and services to retail, small business, corporate and institutional clients. ANZ operates in Australia, New Zealand, Asia Pacific region, the United Kingdom and the United States. ANZ main business divisions consist of Retail, Corporate and Commercial Banking, Global Wealth and International and Institutional Banking Division.

Issuer Bull / Bear Case

Bull case: Despite de-emphasising the Asian growth strategy, ANZ Bank is best placed of peers to capitalise on long-term growth in trade and investment flows with Asia. ANZ Bank's international business supplements solid and more profitable domestic growth. Despite recent uncertainty in the region, Asia remains the trade hub of the world and its importance will continue to grow for decades.

Bear Case: As expected, significant restructuring charges were announced with first-half fiscal 2016 results on 3 May 2016. Loan loss provisioning nearly doubled due to increased stress in some the bank's more vulnerable sector exposures. Overshadowing the management changes is increasing concern of slower earnings growth, increased loan loss provisioning, higher restructuring charges, pressure on capital levels and potential for lower dividends. We see this as another classic case of a new CEO "clearing the decks." When wholesale funding costs rise, interest margins come under pressure. In such circumstances, ANZ Bank might not be able to pass on higher funding costs and still retain desirable market share.

AQHHA APA Group Subordinated Notes

Security Investment Risk	Medium
Issuer Name	APA Group
Issuer Economic Moat Rating	Narrow
Issuer Stewardship Rating	Exemplary
Sector	Utilities
Issue Date	18 September 2012
Issue size (AUD million)	515
Call Date	31 March 2018
Scheduled Conversion / Maturity	30 September 2072
Issue Price (AUD)	100
Coupon Margin	4.50%
Base Rate	90-day bank-bill swap
Franking	0%
Distribution Frequency	Quarterly
Step-Up Margin	1.00%
Discretionary Distributions	Yes
Mandatory Deferral	-
Cumulative Distributions	Yes
Dividend Stopper	Yes
Capital / Non-Viability Trigger	-

Contract Summary

AQHHA is a subordinated note so there is no conversion into APA ordinary equity. It pays quarterly interest payments in arrears. The interest rate is calculated using the formula I = (base + margin), where base is the 90-day BBSW, and the margin is 4.50% per annum. Interest payments each quarter are calculated as: (I x issue price x (number of days in interest period/365). The distributions are interest payments, so are not franked.

Interest payments are deferrable at the issuer´s option but there are no mandatory deferral conditions. Deferred interest payments are cumulative and compounding. If an interest payment is not made in full within 20 business days after the relevant payment date then, subject to conditions, a number of capital and dividend restrictions are imposed upon APA until all outstanding payments are made in full.

AQHHA mature on 30 September 2072 unless the issuer exercises an option to redeem at the first call date on 31 March 2018, on any subsequent interest payment date or following a trigger event. If the notes are not redeemed on the 31 March 2038 step-up date, the margin steps up once by 1.0% per annum. If AQHHA are not redeemed following a change of control event, the margin steps up by 3.0% per annum. The redemption amount is AUD 100 face value plus accrued interest except following a capital trigger event, holders will receive AUD 101 plus accrued interest. Holders cannot request the notes be redeemed. In a wind-up AQHHA rank:

- ahead of APA stapled securities;
- equally with other equal ranking obligations (if any); and
- behind all other creditors and other classes of securities including all debt currently on issue.

Issuer Description

APA Group (APA) comprises of Australian Pipeline Trust and APT Investment Trust, operates natural gas transportation business with interests in energy infrastructure across mainland Australia, including natural gas pipelines, gas storage facilities and a wind farm. APA also holds minority interests in a number of energy infrastructure enterprises including SEA Gas Pipeline, Energy Infrastructure Investments, GDI Allgas Gas Networks and Diamantina and Leichhardt Power Stations.

Issuer Bull / Bear Case

Bull case: APA Group owns and operates an excellent portfolio of gas infrastructure assets. Its large footprint ensures it is at least partially exposed to growth anywhere in the country. The east-coast gas grid provides improved reliability, greater flexibility, a wider range of services, and economies of scale over single pipelines. Limited regulation allows stronger returns on investment than most peers, particularly from organic expansion. Strong returns are possible from organic growth catering for immense LNG export facilities in Queensland, though it is uncertain what opportunities will be available.

Bear Case: Relatively high gearing and reliance on access to debt markets could be an issue if credit markets deteriorate again as they did during the global financial crisis. The regulatory environment is unfavourable. This is seeing returns on regulated assets cut at regulatory resets to reflect lower interest rates and to protect households from rising utility bills. APA is also likely to accept lower returns on its unregulated assets, as there is an implicit link to regulatory returns.

CBAPC CBA PERLS VI

Security Investment Risk	Medium
Issuer Name	Commonwealth Bank of Australia
Issuer Economic Moat Rating	Wide
Issuer Stewardship Rating	Exemplary
Sector	Banks
Issue Date	17 October 2012
Issue size (AUD million)	2,000
Call Date	15 December 2018
Scheduled Conversion / Maturity	15 December 2020
Issue Price (AUD)	100
Coupon Margin	3.80%
Base Rate	90-day bank-bill swap
Franking	100%
Distribution Frequency	Quarterly
Step-Up Margin	-
Discretionary Distributions	Yes
Mandatory Deferral	-
Cumulative Distributions	No
Dividend Stopper	Yes
Capital / Non-Viability Trigger	Capital Trigger & Non-Viability Trigger

Contract Summary

CBAPC are perpetual, exchangeable, unsecured, subordinated notes with a scheduled exchange date of 15 December 2020, subject to conditions, unless they are redeemed or exchanged earlier following specific events (see key terms) or Commonwealth Bank exercising an option to call the security two years early. Face value is AUD 100.

Fully franked dividends are discretionary and non-cumulative. Distributions are discretionary and not cumulative. They are also subject to a payment test, the most material elements being: Commonwealth Bank having sufficient distributable profits; the payment will not breach Commonwealth Bank's capital requirements; the payment will not cause Commonwealth Bank to become insolvent; and APRA not objecting. Dividends and gross-up amounts are not cumulative, so Commonwealth Bank does not have to make up for missed distributions.

If a CBAPC distribution is not paid then dividend and capital restrictions will apply to Commonwealth Bank ordinary shares from that distribution payment date until a distribution is paid in full on a subsequent distribution payment date. Subject to some exceptions, Commonwealth Bank cannot: declare, determine, or pay a dividend or distribution on Commonwealth Bank ordinary shares; or return any capital or undertake buybacks or repurchases in relation to Commonwealth Bank ordinary shares.

Issuer Description

Commonwealth Bank of Australia, or CBA, is one of Australia's four highly profitable major banks. CBA offers a full suite of banking services in Australia and New Zealand, also operates in certain Pacific and Asian countries, and sells wealth management, as well as life and general insurance in Australia. The loan book's large weighting to home loans and the high proportion of customer deposits in funding reduce risk.

Issuer Bull / Bear Case

Bull case: Despite industry headwinds Commonwealth Bank of Australia's conservative management, diversified revenue stream, and strong and stable balance sheet continue to consistently deliver solid financial results. Costs are under control, and supporting earnings during a period of weak revenue growth. Growing economies of scale make ongoing gains in cost efficiency likely. Commonwealth Bank comfortably meets the current Basel III capital standards applying from 2016. We see no need for large dilutive equity raisings during the next three years.

Bear Case: The cost of wholesale funding remains volatile. Price competition for loans is increasing, constraining net interest margins. Loan repricing to recover these higher costs is unpopular, but recent initiatives by the four major banks to reprice loans and deposits will support earnings growth. Noninterest income is volatile and is primarily dependent on banking fees and trading and markets income. Fee income is under pressure from consumer resistance and the rapid takeup of lower-fee online and mobile transaction services. Trading and markets income varies with trading and global market conditions. Credit growth in Australia is recovering, but remains relatively soft across most categories. However, there are signs of a longer-term recovery, particularly in residential and business lending. The market expects the Australian credit cycle to normalise after a period of very low credit losses, a view we think is appropriate. Loan impairment expenses are forecast to reach long-term trend levels by fiscal 2021.

CBAPD CBA PERLS VII

Security Investment Risk	Medium
Issuer Name	Commonwealth Bank of Australia
Issuer Economic Moat Rating	Wide
Issuer Stewardship Rating	Exemplary
Sector	Banks
Issue Date	1 October 2014
Issue size (AUD million)	3,000
Call Date	15 December 2022
Scheduled Conversion / Maturity	15 December 2024
Issue Price (AUD)	100
Coupon Margin	2.80%
Base Rate	90-day bank-bill swap
Franking	100%
Distribution Frequency	Quarterly
Step-Up Margin	-
Discretionary Distributions	Yes
Mandatory Deferral	-
Cumulative Distributions	No
Dividend Stopper	Yes
Capital / Non-Viability Trigger	Capital Trigger & Non-Viability Trigger

Contract Summary

CBAPD are perpetual, subordinated, unsecured capital notes with a scheduled exchange date of 15 December 2024. This is subject to exchange conditions, unless they are exchanged earlier as a result of a trigger event or Commonwealth Bank exercising an option to call the security two years early on 15 December 2022. Face value is AUD 100. Distributions are discretionary, non-cumulative, fully franked with dividend and capital restrictions. They are paid quarterly in arrears, based on the 90-day BBSW, rate plus a 2.80% per annum. Distribution are subject to payment conditions being satisfied.

If CBAPD has not been exchanged or redeemed earlier, on 15 December 2024, CBAPD will convert into a variable number of Commonwealth Bank ordinary shares worth approximately AUD 101.01 at a 1% discount to the 20 business day VWAP of Commonwealth Bank ordinary shares. This is subject to exchange conditions. If these conditions are not satisfied, exchange will be deferred until the next distribution payment date after 15 December 2024 that the conditions are met. Scheduled exchange is subject to:

- First condition: The VWAP of Commonwealth Bank ordinary shares on the 25th business day before (but not including) the scheduled exchange conditions Date (15 December 2024) is equal to or greater than 56% of the issue date VWAP of Commonwealth Bank ordinary shares. Based on the issue date VWAP of AUD 74.62, 56% of this amount is AUD 44.02.
- Second condition: The VWAP of Commonwealth Bank ordinary shares during the 20 business days before (but not including) a possible scheduled conversion date is equal to or greater than 50.51% of the issue date VWAP of Commonwealth Bank ordinary shares. Based on the issue date VWAP of AUD 78.62, 50.51% of this amount is AUD 39.71.
- Commonwealth Bank ordinary shares are listed on the Australian Securities Exchange

Unscheduled exchange could arise through either a capital trigger event or a non-viability trigger event.

Issuer Description

Commonwealth Bank of Australia, or CBA, is one of Australia's four highly profitable major banks. CBA offers a full suite of banking services in Australia and New Zealand, also operates in certain Pacific and Asian countries, and sells wealth management, as well as life and general insurance in Australia.

Issuer Bull / Bear Case

Bull case: Despite industry headwinds Commonwealth Bank of Australia's conservative management, diversified revenue stream, and strong and stable balance sheet continue to consistently deliver solid financial results. Costs are under control, and supporting earnings during a period of weak revenue growth.

Bear Case: The cost of wholesale funding remains volatile. Price competition for loans is increasing, constraining net interest margins. Fee income is under pressure from consumer resistance and the rapid takeup of lower-fee online and mobile transaction services. Trading and markets income varies with trading and global market conditions. Credit growth in Australia is recovering, but remains relatively soft across most categories. Loan impairment expenses are forecast to reach long-term trend levels by fiscal 2021.

CBAPE CBA PERLS VIII

Security Investment Risk	Medium
Issuer Name	Commonwealth Bank of Australia
Issuer Economic Moat Rating	Wide
Issuer Stewardship Rating	Exemplary
Sector	Banks
Issue Date	30 March 2016
Issue size (AUD million)	1,450
Call Date	15 October 2021
Scheduled Conversion / Maturity	15 October 2023
Issue Price (AUD)	100
Coupon Margin	5.20%
Base Rate	90-day bank-bill swap
Franking	100%
Distribution Frequency	Quarterly
Step-Up Margin	-
Discretionary Distributions	Yes
Mandatory Deferral	-
Cumulative Distributions	No
Dividend Stopper	Yes
Capital / Non-Viability Trigger	Capital Trigger & Non-Viability Trigger

Contract Summary

CBAPE are perpetual, subordinated, unsecured capital notes with a scheduled exchange date of 15 October 2023. This is subject to exchange conditions, unless they are exchanged earlier as a result of a trigger event or Commonwealth Bank exercising an option to call the security two years early on 15 October 2021. Face value is AUD 100. Distributions are discretionary, non-cumulative, fully franked with dividend and capital restrictions. They are paid quarterly in arrears, based on the 90-day BBSW, rate plus a 5.20% per annum.

If CBAPE has not been exchanged or redeemed earlier, on 15 October 2023, CBAPE will convert into a variable number of Commonwealth Bank ordinary shares worth approximately AUD 101.01 at a 1% discount to the 20 business day volume weighted average price, or VWAP, of Commonwealth Bank ordinary shares. This is subject to exchange conditions. If these conditions are not satisfied, exchange will be deferred until the next distribution payment date after 15 October 2023 that the conditions are met.

Scheduled exchange is subject to the following conditions:
• The VWAP of Commonwealth Bank ordinary shares on the 25th business day before (but not including) the scheduled exchange date (15 October 2023) is equal to or greater than 56% of the issue date VWAP of Commonwealth Bank ordinary shares. Based on the issue date VWAP of AUD 75.50, 56% of this amount is AUD 42.28.
• The VWAP of Commonwealth Bank ordinary shares during the 20 business days before (but not including) a possible mandatory conversion date is equal to or greater than 50.51% of the issue date VWAP of Commonwealth Bank ordinary shares. Based on the issue date VWAP of AUD 75.50, 50.51% of this amount is AUD 38.14.
• Commonwealth Bank ordinary shares are listed on the ASX as at the scheduled exchange date.

Unscheduled exchange could arise through a capital trigger event or a non-viability trigger event.

Issuer Description

Commonwealth Bank of Australia, or CBA, is one of Australia’s four highly profitable major banks. CBA offers a full suite of banking services in Australia and New Zealand, also operates in certain Pacific and Asian countries, and sells wealth management, as well as life and general insurance in Australia.

Issuer Bull / Bear Case

Bull case: Despite industry headwinds Commonwealth Bank of Australia's conservative management, diversified revenue stream, and strong and stable balance sheet continue to consistently deliver solid financial results. Costs are under control, and supporting earnings during a period of weak revenue growth.

Bear Case: The cost of wholesale funding remains volatile. Price competition for loans is increasing, constraining net interest margins. Fee income is under pressure from consumer resistance and the rapid takeup of lower-fee online and mobile transaction services. Trading and markets income varies with trading and global market conditions. Credit growth in Australia is recovering, but remains relatively soft across most categories.

CNGHA Colonial Subordinated Notes

Security Investment Risk	Medium
Issuer Name	Colonial Holding Company
Issuer Economic Moat Rating	Wide
Issuer Stewardship Rating	Exemplary
Sector	Financial Services
Issue Date	29 March 2012
Issue size (AUD million)	1,000
Call Date	31 March 2017
Scheduled Conversion / Maturity	31 March 2037
Issue Price (AUD)	100
Coupon Margin	3.25%
Base Rate	90-day bank-bill swap
Franking	0%
Distribution Frequency	Quarterly
Step-Up Margin	-
Discretionary Distributions	Yes
Mandatory Deferral	-
Cumulative Distributions	Yes
Dividend Stopper	Yes
Capital / Non-Viability Trigger	-

Contract Summary

Colonial Subordinated Notes are a subordinated security. It pays quarterly interest payments in arrears. The distributions are interest payments, so are not franked. Interest payments are cumulative, meaning that any missed payment must be made up. Interest payments can be deferred for up to five years. There is a dividend stopper.

Colonial Subordinated Notes mature on 31 March 2037, but Colonial has an option to redeem the notes on the first call date, 31 March 2017, or on any subsequent interest payment. There is no step-up in the margin if the notes are not redeemed on the first call date. If the notes are not redeemed following a change of control event, then the margin steps up by 2.50% per annum. The redemption amount is AUD 100 face value plus any accrued and deferred interest (including interest on deferred interest).

In a wind-up, Colonial Subordinated Notes rank:
• Behind claims of any unsubordinated creditors, creditors preferred by law and secured creditors;
• Equal with other subordinated notes and other unsecured subordinated creditors of the issuer; and
• Ahead of Colonial ordinary shares and preference shares (which are all owned by Commonwealth Bank).

Issuer Description

Colonial Holding Company Limited is a wholly owned subsidiary of Commonwealth Bank and the holding company of Colonial Group. While Colonial is a wholly owned subsidiary of Commonwealth Bank of Australia, these securities are liabilities of Colonial and are not guaranteed by Commonwealth Bank. An investment in Colonial Subordinated Notes carries more risk than an investment in an equivalent security issued by Commonwealth Bank.

Colonial Group is one of Australia’s largest wealth management and insurance businesses. It operates a number of well-known brands, including Colonial First State Global Asset Management, Colonial First State, CommInsure and Sovereign Insurance. It provides a full range of wealth management products and services including life and general insurance, funds and asset management, and advice.

Issuer Bull / Bear Case

Bull case: Despite industry headwinds Commonwealth Bank of Australia's conservative management, diversified revenue stream, and strong and stable balance sheet continue to consistently deliver solid financial results. Costs are under control, and supporting earnings during a period of weak revenue growth.

Bear Case: The cost of wholesale funding remains volatile. Price competition for loans is increasing, constraining net interest margins. Fee income is under pressure from consumer resistance and the rapid takeup of lower-fee online and mobile transaction services. Trading and markets income varies with trading and global market conditions. Credit growth in Australia is recovering, but remains relatively soft across most categories.

CTXHA Caltex Subordinated Notes

Security Investment Risk	Medium
Issuer Name	Caltex Australia Limited
Issuer Economic Moat Rating	None
Issuer Stewardship Rating	Standard
Sector	Energy
Issue Date	5 September 2012
Issue size (AUD million)	550
Call Date	15 September 2017
Scheduled Conversion / Maturity	15 September 2037
Issue Price (AUD)	100
Coupon Margin	4.50%
Base Rate	90-day bank-bill swap
Franking	0%
Distribution Frequency	Quarterly
Step-Up Margin	0.25%
Discretionary Distributions	Yes
Mandatory Deferral	-
Cumulative Distributions	Yes
Dividend Stopper	Yes
Capital / Non-Viability Trigger	-

Contract Summary

CTXHA is a structured subordinated note. It pays quarterly interest payments in arrears at 90-day BBSW plus 4.50% per annum. Interest payments are deferrable at Caltex's discretion but there are no scheduled deferral conditions. If interest payments are deferred they are cumulative and compounding meaning that the issuer must make up for any missed payments, on a compounded basis, within 5 years.

If Caltex does not make an interest payment in full within 20 business days after the relevant payment date, then subject to conditions, a number of dividend and capital restrictions are imposed upon Caltex until all outstanding payments are made in full. If any deferred interest payments remain outstanding after five years then Caltex must pay all outstanding deferred interest payments.

CTXHA's legal final maturity is 15 September 2037. However, Caltex has the option to redeem early on 15 September 2017, and any subsequent interest payment date or following a specific trigger event (capital, tax, clean-up or change of control event). If the CTXHA are not redeemed on the first call date the margin steps up once by 0.25% p.a.

The redemption amount is AUD 100 face value plus accrued and any unpaid interest. Holders can request the notes be redeemed early following a change of control event. In a wind-up CTXHA rank:
- Ahead of Caltex ordinary shares and junior ranking obligations (if any).
- Equally with other equal ranking obligations (if any); and
- Behind all other creditors and other classes of securities.

Issuer Description

Caltex has a strong competitive position in retail and distribution, with a premier 35% Australian market share of all transport fuels sold. However, the expansion of Asian low-cost refineries and dependence on premium-priced imported light sweet crude feedstock have eroded refiner margins.

Caltex reduced its exposure to uncompetitive refineries by closing one of its two plants in 2014. The company now rests on its more competitive supply chain and long-term supply agreements struck with Chevron. The marketing segment is reliably profitable and fast-growing, and will enjoy increased cash flow for investment previously wasted on refining. Caltex's business rests largely on its fuel supply chain, and in this space it wrestles with capable competition in BP, Shell and Mobil.

Issuer Bull / Bear Case

Bull case: Caltex is well placed, with a leading market share in transport fuels. This position is backed by an extensive distribution network. Australia's demand for transport fuels is growing at close to GDP rates.
Closing the highest-cost Kurnell refining operations should materially improve return on invested capital.

Bear Case: Caltex earnings are subject to influences outside of management control--currency, crude oil prices and the Singapore refiner margin. Increasing imports from significantly larger refineries could eat into Caltex's transport fuels market share if distributed through independent operators. Refining is a capital-intensive industry, and therefore volume and price must be maintained, as well as mechanical availability.

CWNHA Crown Subordinated Notes

Security Investment Risk	Medium
Issuer Name	Crown Resorts Limited
Issuer Economic Moat Rating	Narrow
Issuer Stewardship Rating	Standard
Sector	Consumer Cyclical
Issue Date	14 September 2012
Issue size (AUD million)	532
Call Date	14 September 2018
Scheduled Conversion / Maturity	14 September 2072
Issue Price (AUD)	100
Coupon Margin	5.00%
Base Rate	90-day bank-bill swap
Franking	0%
Distribution Frequency	Quarterly
Step-Up Margin	1.00%
Discretionary Distributions	Yes
Mandatory Deferral	Yes
Cumulative Distributions	Yes
Dividend Stopper	Yes
Capital / Non-Viability Trigger	-

Contract Summary

CWNHA is a subordinated note so there is no conversion into Crown ordinary equity. It pays quarterly interest payments in arrears. The interest rate is calculated using the formula I = (base + margin), where base is the 90-day BBSW, and the Margin is 5.0% per annum. Interest payments each quarter are calculated as: (I x issue price x (number of days in interest period/365). The distributions are interest payments, so are not franked. Interest payments are deferrable at Crown's option and subject to mandatory deferral conditions. Deferred interest payments are cumulative and compounding. Crown intends to pay, but is not obliged to pay, any deferred interest payments within five years of the deferral of the oldest outstanding amount.

A mandatory deferral event occurs if Crown's:

- Leverage ratio (relevant gross debt (divided by two)/normalised earnings before interest tax depreciation and amortisation (EBITDA)) is above 5.0 times for two consecutive testing dates; or
- Interest cover ratio (normalised EBITDA/normalised net interest paid) is below 2.5 times on any testing date; and
- Crown has a solicited rating from a rating agency.

The testing occurs every six months at 30 June and 31 December. CWNHA mature on 14 September 2072 unless the issuer exercises an option to redeem at the first call date on 14 September 2018 (or any subsequent interest payment date or following a trigger event). If the notes are not redeemed on the 14 September 2038 step-up date, the margin steps up by 1.0% per annum. Holders cannot request the notes be redeemed unless an event of default occurs and is subsisting. Deferral of interest does not constitute an event of default.

Issuer Description

Crown Resorts wholly owns and operates the Crown Entertainment Complex in Melbourne, the Crown Perth Entertainment Complex in Perth and has joint ventures in the U.K., the U.S. and Macau. In addition, Crown Resorts is developing Crown Sydney, and has announced plans to develop a casino resort in Las Vegas.

Issuer Bull / Bear Case

Bull case: A benign regulatory environment and proven operating prowess are likely to ensure continued earnings resilience from the Australian casinos. Growth in earnings contributions from Melco Crown Entertainment is likely to be long-tailed, given the still-insatiable demand for gambling products from the Chinese. Longer-term blue-sky potential exists in the form of Crown Sydney, a potential entry into other Asian markets as gambling laws are liberalised, and with general leverage to the rising Chinese middle class.

Bear Case: An unforeseen change in the regulatory or licensing regime could materially affect Crown Resorts' and Melco Crown Entertainment's earnings power. A greater-than-expected or prolonged economic slowdown in China has the potential to significantly crimp Melco Crown Entertainment's profitability, especially in the high-roller business. The company may overpay and/or overspend on long-term expansion projects as it attempts to enter new casino markets.

CWNHB Crown Subordinated Notes II

Security Investment Risk	Medium
Issuer Name	Crown Resorts Limited
Issuer Economic Moat Rating	Narrow
Issuer Stewardship Rating	Standard
Sector	Consumer Cyclical
Issue Date	23 April 2015
Issue size (AUD million)	630
Call Date	23 July 2021
Scheduled Conversion / Maturity	23 April 2075
Issue Price (AUD)	100
Coupon Margin	4.00%
Base Rate	90-day bank-bill swap
Franking	0%
Distribution Frequency	Quarterly
Step-Up Margin	1.00%
Discretionary Distributions	Yes
Mandatory Deferral	Yes
Cumulative Distributions	Yes
Dividend Stopper	Yes
Capital / Non-Viability Trigger	-

Contract Summary

CWNHB is a subordinated note so there is no conversion into Crown ordinary equity. It pays quarterly interest payments in arrears. The interest rate is calculated using the formula I = (base + margin), where base is the 90-day BBSW, and the margin is 4.00% per annum. Interest payments each quarter are calculated as: (I x issue price x (number of days in interest period/365. Interest payments are deferrable at Crown Resorts' option and subject to mandatory deferral conditions. Deferred interest payments are cumulative and compounding. Crown Resorts intends to, but is not obliged to, pay any deferred interest payments within five years of the deferral of the oldest outstanding amount. A mandatory deferral event occurs if Crown Resorts': Leverage ratio (relevant gross debt (divided by two)/normalised EBITDA)) is above 5.0 times for two consecutive testing dates; or Interest cover ratio (normalised EBITDA/relevant net interest paid) is below 2.5 times on any testing date; and Crown Resorts has a solicited rating from a rating agency. The testing occurs every six months as at 30 June and 31 December. Crown Resorts' intention to pay any deferred interest within five years of the deferral may change, for example, as a result of a change in its financial position. If Crown Resorts is unable to make these payments within that five-year timeframe or its intention to do so changes, investors will not be paid any deferred interest payments during that time unless Crown Resorts elects to make such payments at its discretion or is otherwise required to make such payments. In certain circumstances, including on the maturity date, Crown Resorts must pay deferred interest payments. CWNHB matures on 23 April 2075 unless the issuer exercises an option to redeem at the first call date on 23 July 2021, on any subsequent interest payment date, or following a trigger event. If the notes are not redeemed on the 23 July 2041 step-up date the margin steps up once by 1.00% per annum. CWNHB will be redeemed at AUD 100 face value per note (plus any accrued and outstanding interest and any outstanding deferred interest payments) except where they are being redeemed prior to the first call date on account of the occurrence of a capital event or accounting event, in which case CWNHB will be redeemed at AUD 101 per note (plus any accrued and outstanding interest and any outstanding deferred interest payments). Holders cannot request the notes be redeemed unless an event of default occurs and is subsisting. Deferral of interest does not constitute an event of default. In a wind-up CWNHB ranks: Ahead of Crown Resort ordinary shares and junior ranking obligations; Equal with other equal-ranking obligations (including CWNHA); and Behind all other creditors of Crown Resorts (other than holders of equal-ranking obligations and holders of junior ranking obligations).

Issuer Description

Crown Resorts wholly owns and operates the Crown Entertainment Complex in Melbourne, the Crown Perth Entertainment Complex in Perth and has joint ventures in the U.K., the U.S. and Macau.

Issuer Bull / Bear Case

Bull case: A benign regulatory environment and proven operating prowess are likely to ensure continued earnings resilience from the Australian casinos. Growth in earnings contributions from 27.4%-owned Melco Crown Entertainment is likely to be long-tailed, given the still-insatiable demand for gambling products from the Chinese.

Bear Case: An unforeseen change in the regulatory or licensing regime could materially affect Crown Resorts' and Melco Crown Entertainment's earnings power. A greater-than-expected or prolonged economic slowdown in China has the potential to significantly crimp Melco Crown Entertainment's profitability, especially in the high-roller business.

GMPPA Goodman Plus II

Security Investment Risk	Medium
Issuer Name	Goodman Group
Issuer Economic Moat Rating	Narrow
Issuer Stewardship Rating	Standard
Sector	Real Estate
Issue Date	21 December 2007
Issue size (AUD million)	327
Call Date	30 September 2017
Scheduled Conversion / Maturity	31 December 2073
Issue Price (AUD)	100
Coupon Margin	3.90%
Base Rate	90-day bank-bill swap
Franking	0%
Distribution Frequency	Quarterly
Step-Up Margin	0.25%
Discretionary Distributions	Yes
Mandatory Deferral	-
Cumulative Distributions	No
Dividend Stopper	Yes
Capital / Non-Viability Trigger	-

Contract Summary

The terms on GMPPA were changed effective 27 September 2012. These securities are preferred trust units issued by a trust controlled by Goodman via a complex structure. Goodman can repurchase or exchange securities on each distribution payment date from 31 December 2017 unless they are repurchased or exchanged early following a specific trigger event. There are step ups in the margin of 0.25% per annum in 30 September 2022 and 0.75% per annum in 31 December 2038 if the securities are not repurchased, exchanged or successfully remarketed on or before these respective dates.

The notes mature on 31 December 2073 at which time the notes will be repurchased or exchanged. Holders have a right to request repurchase or exchange on the 31 December 2073 maturity date but Goodman can choose whether to repurchase or exchange. Before the remarketing date, Goodman may choose to: Conduct a remarketing process where Goodman proposes to change certain terms including the margin, or; Repurchase the securities for AUD 100 or exchange into GMG units to the value of AUD 101.01, or; Not to remarket so the securities remain on issue with the next remarketing date occurring in five years' time, unless they are repurchased or exchanged beforehand. If Goodman remarkets, it will propose a range of new margins, a market rate, the next remarketing date and any other changes to terms to security holders. Security holders must then submit a notice. Step-up notice: GMPPA holders send this notice if they do not want to continue to hold the security unless the market rate does not change and the remarketing margin is greater than or equal to the current margin plus any applicable step-up margin, or; Bid notice: GMPPA holders send this notice if they do not want to continue to hold the security unless the remarketing margin is equal to or greater than the margin which they bid, which must be within the range proposed by Goodman, or; Hold notice: GMPPA holders send this notice if they want to continue to hold the securities at whatever margin is proposed by Goodman.

Issuer Description

Goodman Group (GMG) is an integrated property group with operations throughout Australia, New Zealand, Asia, Europe, the United Kingdom, North America and Brazil.

Issuer Bull / Bear Case

Bull case: Growth in online retailing supports continued investment in global supply chains, with modern industrial facilities experiencing strong demand as a result of the cost efficiencies they can deliver.

Bear Case: Business risk has increased because of a greater proportion of developments in emerging markets, which have more opaque governance and legal structures. Interest rates are at long-term lows in most markets, and a return to long-term pricing of debt could materially affect asset values and distributable income. Uncommitted developments have become a larger part of the development pipeline, which increases the risk that Goodman could end up owning empty assets in the event of a slowdown.

IAGPC IAG Convertible Preference Shares

Security Investment Risk	Medium
Issuer Name	Insurance Australia Group Limited
Issuer Economic Moat Rating	None
Issuer Stewardship Rating	Standard
Sector	Insurance
Issue Date	1 May 2012
Issue size (AUD million)	377
Call Date	1 May 2017
Scheduled Conversion / Maturity	1 May 2019
Issue Price (AUD)	100
Coupon Margin	4.00%
Base Rate	180-day bank-bill swap
Franking	100%
Distribution Frequency	Semi-Annually
Step-Up Margin	-
Discretionary Distributions	Yes
Mandatory Deferral	-
Cumulative Distributions	No
Dividend Stopper	Yes
Capital / Non-Viability Trigger	Non-Viability Trigger

Contract Summary

IAGPC is a preference share. Dividends are subject to a payment test. A dividend stopper applies if a distribution is not paid; the most material consequence of the stopper condition is that dividends on Insurance Australia Group ordinary shares cannot be paid if distributions are suspended on these hybrids. On 1 May 2019, IAGPC will either mandatorily convert into a variable number of Insurance Australia Group ordinary shares worth approximately AUD 101.01 at a 1% discount to the 20-business-day VWAP of Insurance Australia Group ordinary shares. This is subject to conversion conditions or unless they are converted/redeemed earlier due to various trigger events or at the optional conversion/redemption date of 1 May 2017. If the conditions are not satisfied, then conversion will be deferred until the next dividend payment date after 1 May 2019 that the conditions are met.

The scheduled conversion conditions are:
• First condition: The VWAP of Insurance Australia Group ordinary shares on the 25th business day before a possible mandatory conversion date is greater than 23.0% (reduced from 57.5% after adjustment of the Relevant Fraction) of the issue date VWAP of Insurance Australia Group shares.
• Second condition: The VWAP of Insurance Australia Group ordinary shares during the period 20 business days before (but not including) a possible mandatory conversion date is equal to or greater than 20.202% (reduced from 50.51% after adjustment of the Relevant Fraction) of the issue date VWAP of Insurance Australia Group ordinary shares.
• Third condition: Insurance Australia Group ordinary shares are not delisted or suspended from trading.

IAGPC have a non-viability trigger event. This trigger event is an APRA requirement, so IAGPC can be classified as additional tier 1 capital under Basel III.

Issuer Description

Insurance Australia Group Ltd (IAG) is a general insurance group, with operations in Australia, New Zealand, and Asia. The Group provides a range of personal and commercial insurance products, primarily motor vehicle and home insurance. IAG also has interest in general insurance joint ventures in Malaysia, India and China. IAG has two customer facing divisions - Consumer Division and Business division being responsible for sales, service, and brand and marketing execution.

Issuer Bull / Bear Case

Bull case: New CEO Peter Harmer has wasted no time in restructuring the business, leveraging the firm's underwriting discipline, productivity initiatives, and focus on profitable growth. The 20% quota share arrangement with Berkshire Hathaway has boosted underlying insurance margins by approximately 250 basis points. A benign claims environment with a lower incidence of major catastrophes would considerably boost underwriting profits.

Bear Case: In personal and commercial insurance, competition is increasing. Popular Australian brands and competitors from overseas are entering the general insurance distribution and underwriting markets. New competitors could pressure premiums and win market share from incumbents such as Insurance Australia Group. The Asian strategy and the acquisition of Wesfarmers' Australian and New Zealand underwriting businesses increase overall execution risk.

IANG IAG Reset Exchange Securities

Security Investment Risk	Medium
Issuer Name	Insurance Australia Group Limited
Issuer Economic Moat Rating	None
Issuer Stewardship Rating	Standard
Sector	Insurance
Issue Date	11 January 2005
Issue size (AUD million)	550
Call Date	-
Scheduled Conversion / Maturity	16 December 2019
Issue Price (AUD)	100
Coupon Margin	4.00%
Base Rate	90-day bank-bill swap
Franking	100%
Distribution Frequency	Quarterly
Step-Up Margin	-
Discretionary Distributions	Yes
Mandatory Deferral	-
Cumulative Distributions	No
Dividend Stopper	Yes
Capital / Non-Viability Trigger	-

Contract Summary

IANG are a stapled security with face value AUD 100. IAG Finance (NZ) issued AUD 550 million of these securities in 2005. The floating rate security pays a franked distribution of (1- T) x (B + M) x N / 365 every quarter, where T is the tax rate, B is the 90-day BBSW, M is 4.00% (the margin), and N is the number of days in the quarter. That is 4.00% + BBSW grossed up for franking.

On 19 December 2019 the securities reset. Securityholders can request an exchange, at which time Insurance Australia Group at their option can either convert into Insurance Australia Group ordinary shares at a 2.5% discount or return $100 cash to investors. IAG can also propose new terms to investors who can accept the new terms at their option. The security is deeply subordinated and ranks behind all other creditors except equity in a windup.

Important: Insurance Australia Group Reset Exchangeable Securities (RES) used to be an unsecured note issued by IAG Finance (NZ) at an initial value of AUD 100, secured over a portfolio of short term bonds managed by Insurance Australia Group. Insurance Australia Group had an option to bring the notes on balance sheet. This structure was cancelled in November 2009 and the notes were brought onto the Insurance Australia Group's balance sheet. The securities were restructured into their present form.

Issuer Description

Insurance Australia Group Ltd (IAG) is a general insurance group, with operations in Australia, New Zealand, and Asia. The Group provides a range of personal and commercial insurance products, primarily motor vehicle and home insurance.

IAG also has interest in general insurance joint ventures in Malaysia, India and China. IAG has two customer facing divisions - Consumer Division and Business division being responsible for sales, service, and brand and marketing execution.

Issuer Bull / Bear Case

Bull case: New CEO Peter Harmer has wasted no time in restructuring the business, leveraging the firm's underwriting discipline, productivity initiatives, and focus on profitable growth. The 20% quota share arrangement with Berkshire Hathaway has boosted underlying insurance margins by approximately 250 basis points. A benign claims environment with a lower incidence of major catastrophes would considerably boost underwriting profits.

Bear Case: In personal and commercial insurance, competition is increasing. Popular Australian brands and competitors from overseas are entering the general insurance distribution and underwriting markets. New competitors could pressure premiums and win market share from incumbents such as Insurance Australia Group. The Asian strategy and the acquisition of Wesfarmers' Australian and New Zealand underwriting businesses increase overall execution risk. A higher incidence of large claims events from major catastrophes would crimp profitability.

MBLHB Macquarie Income Securities

Security Investment Risk	Medium
Issuer Name	Macquarie Finance Limited
Issuer Economic Moat Rating	None
Issuer Stewardship Rating	Standard
Sector	Financial Services
Issue Date	19 November 1999
Issue size (AUD million)	400
Call Date	-
Scheduled Conversion / Maturity	-
Issue Price (AUD)	100
Coupon Margin	1.70%
Base Rate	90-day bank-bill swap
Franking	0%
Distribution Frequency	Quarterly
Step-Up Margin	-
Discretionary Distributions	Yes
Mandatory Deferral	-
Cumulative Distributions	No
Dividend Stopper	Yes
Capital / Non-Viability Trigger	-

Contract Summary

Macquarie Income Securities are stapled securities comprising a preference share and a holder's interest. The securities are perpetual and do not convert into ordinary equity. Macquarie Income Securities pay non-cumulative, unfranked interest quarterly in arrears.

In certain circumstances (when a payment direction occurs, such as following an insolvency or capital event or Tier 1 capital ratio falling below 5% or total capital falling below 8%) investors will cease receiving interest payments. If this occurs, they become entitled to receive dividends on the preference shares, subject to payment conditions being met. These dividends would also be paid quarterly, based on a 1.70% per annum margin above the 90-day BBSW rate.

Macquarie can redeem the securities for cash at face value plus accrued interest. Investors have no right to request redemption except in case of a wind-up. In a wind-up, Macquarie Income Securities rank ahead of Macquarie ordinary shareholders and behind all deposit liabilities and creditors. There are more conditions in the contract dealing with other events, such as a takeover, merger or change to Australian law.

Issuer Description

MBLHB is issued by Macquarie Finance Limited, a wholly owned subsidiary of Macquarie Group Limited (MQG). Macquarie Group is a global provider of banking, financial, advisory, investment and funds management services, headquartered in Sydney.

Issuer Bull / Bear Case

Bull case: Macquarie is a growth-focused, niche global investment bank with the reputation for highly motivated and incentivised staff and astute management. Challenges in global credit and asset markets reaffirm the quality of risk management at Macquarie. The strong balance sheet is supported by excess capital and places Macquarie in a strong position to take advantage of distressed asset sales. The international expansion in funds management produces sustainable, lower-risk, annuity-style income. There is significant upside from the market-facing businesses when markets hit their straps.

Bear Case: Investment banking growth is dependent on favourable market conditions, and deterioration in global markets will again pressure earnings. Our near-term forecasts will suffer if the market recovery fails. Complexity and lack of transparency, particularly in the investment banking business, have been issues in the past, although management reporting is improving in this regard. Near-term issues include uncertainty in global investment markets and a relapse in the tentative global economic recovery. A collapse in global capital markets would reduce transactional activity such as mergers and acquisitions, IPOs, capital raisings, and other corporate activity.

MBLPA Macquarie Bank Capital Notes

Security Investment Risk	Medium
Issuer Name	Macquarie Bank Limited
Issuer Economic Moat Rating	None
Issuer Stewardship Rating	Standard
Sector	Financial Services
Issue Date	8 October 2014
Issue size (AUD million)	429
Call Date	24 March 2020
Scheduled Conversion / Maturity	24 March 2023
Issue Price (AUD)	100
Coupon Margin	3.30%
Base Rate	180-day bank-bill swap
Franking	40%
Distribution Frequency	Semi-Annually
Step-Up Margin	-
Discretionary Distributions	Yes
Mandatory Deferral	-
Cumulative Distributions	No
Dividend Stopper	Yes
Capital / Non-Viability Trigger	Capital Trigger & Non-Viability Trigger

Contract Summary

Macquarie Bank Capital Notes (MBLPA) are fully paid, subordinated, non-cumulative, unsecured, convertible, perpetual capital notes issued by Macquarie Bank, which is part of Macquarie Group. The security is a perpetual but has a mandatory exchange date of 24 March 2023.

Distributions are discretionary, non-cumulative and subject to payment conditions. If a distribution is not paid, dividend and capital restrictions apply to Macquarie Bank, but not to Macquarie Group. They are paid semi-annually in arrears based on the 180-day BBSW rate plus 3.30% per annum. Distributions are franked at the same rate as Macquarie Group ordinary share dividends, currently 40%. The notes must convert into Macquarie Group ordinary shares worth AUD 101.01 on, or after, the scheduled exchange date, subject to the exchange conditions unless they have converted, redeemed, resold or written-off earlier. Scheduled exchange is subject to:

- First exchange condition: volume-weighted average price, or VWAP, of Macquarie Group shares on the 25th business day preceding the mandatory exchange date must be greater than 56% of the issue date VWAP. Based on the issue date VWAP of AUD 57.93, 56% of this amount is AUD 32.44.
- Second exchange condition: VWAP of Macquarie Group shares during the preceding 20 ASX trading days of the mandatory exchange date is greater than 50.505% of the issue date VWAP. Based on the issue date VWAP of AUD 57.93, 50.505% of this amount is AUD 29.26.
- Third exchange condition: Macquarie Group shares have not been suspended from trading for the five business days prior to exchange.
- Fourth exchange condition: Macquarie Group shares have not been delisted.

Unscheduled conversion can arise following a capital trigger event or a non-viability trigger event.

Issuer Description

MBLPA is issued by Macquarie Bank Limited, a wholly owned subsidiary of Macquarie Group Limited (MQG). Macquarie Group Limited (MQG) is a global provider of banking, financial, advisory, investment and funds management services, headquartered in Sydney.

Issuer Bull / Bear Case

Bull case: Macquarie is a growth-focused, niche global investment bank with the reputation for highly motivated and incentivised staff and astute management. Challenges in global credit and asset markets reaffirm the quality of risk management at Macquarie. The strong balance sheet is supported by excess capital and places Macquarie in a strong position to take advantage of distressed asset sales. The international expansion in funds management produces sustainable, lower-risk, annuity-style income. There is significant upside from the market-facing businesses when markets hit their straps.

Bear Case: Investment banking growth is dependent on favourable market conditions, and deterioration in global markets will again pressure earnings. Our near-term forecasts will suffer if the market recovery fails. Complexity and lack of transparency, particularly in the investment banking business, have been issues in the past, although management reporting is improving in this regard. Near-term issues include uncertainty in global investment markets and a relapse in the tentative global economic recovery. A collapse in global capital markets would reduce transactional activity such as mergers and acquisitions, IPOs, capital raisings, and other corporate activity.

MQGPA Macquarie Group Capital Notes

Security Investment Risk	Medium
Issuer Name	Macquarie Group Limited
Issuer Economic Moat Rating	None
Issuer Stewardship Rating	Standard
Sector	Financial Services
Issue Date	7 June 2013
Issue size (AUD million)	600
Call Date	7 June 2018
Scheduled Conversion / Maturity	7 June 2021
Issue Price (AUD)	100
Coupon Margin	4.00%
Base Rate	180-day bank-bill swap
Franking	40%
Distribution Frequency	Semi-Annually
Step-Up Margin	-
Discretionary Distributions	Yes
Mandatory Deferral	-
Cumulative Distributions	No
Dividend Stopper	Yes
Capital / Non-Viability Trigger	Non-Viability Trigger

Contract Summary

Macquarie Group Capital Notes (MCN) are fully paid, subordinated, non-cumulative, unsecured, convertible notes. They are issued directly by Macquarie Group Limited under the terms and conditions of the trust deed. They will be treated as eligible regulatory capital under the new Basel III requirements and have been given transitional treatment by APRA under the new conglomerate regulations. Issue proceeds will be used for funding and capital management purposes.

These notes offer semi-annual interest payments of 180-day bank bill swap rate (BBSW) plus 4.00%. Slightly differently to other securities, MQGPA will be franked at a variable franking rate presently set at 40% making the cash distributions lower. This is in line with the dividend policy for Macquarie CPS, where dividends were set at 40% franking.

MQGPA are perpetual securities, subject to:
• Macquarie decides on optional exchange at the specified dates (beginning 7 June 2018), subject to APRA approval and satisfying specific conversion conditions;
• Scheduled exchange, subject to conversion conditions, at 1% discount to the volume weighted average price (VWAP) on mandatory conversion date (7 June 2021), and;
• Unscheduled conversion due to Non-viability event trigger.
The scheduled exchange date is 7 June 2021. On this date, security holders of MQGPA will be exchanged into Macquarie Group common equity at a 1% discount ($101.01) to the volume weighted average price (VWAP) of Macquarie Group common equity during the 20 business days preceding the mandatory conversion date.

Issuer Description

Macquarie Group Limited (MQG) is a global provider of banking, financial, advisory, investment and funds management services, headquartered in Sydney.

Issuer Bull / Bear Case

Bull case: Macquarie is a growth-focused, niche global investment bank with the reputation for highly motivated and incentivised staff and astute management. Challenges in global credit and asset markets reaffirm the quality of risk management at Macquarie. The strong balance sheet is supported by excess capital and places Macquarie in a strong position to take advantage of distressed asset sales. The international expansion in funds management produces sustainable, lower-risk, annuity-style income. There is significant upside from the market-facing businesses when markets hit their straps.

Bear Case: Investment banking growth is dependent on favourable market conditions, and deterioration in global markets will again pressure earnings. Our near-term forecasts will suffer if the market recovery fails. Complexity and lack of transparency, particularly in the investment banking business, have been issues in the past, although management reporting is improving in this regard. Near-term issues include uncertainty in global investment markets and a relapse in the tentative global economic recovery. A collapse in global capital markets would reduce transactional activity such as mergers and acquisitions, IPOs, capital raisings, and other corporate activity.

MQGPB Macquarie Group Capital Notes 2

Security Investment Risk	Medium
Issuer Name	Macquarie Group Limited
Issuer Economic Moat Rating	None
Issuer Stewardship Rating	Standard
Sector	Financial Services
Issue Date	18 December 2015
Issue size (AUD million)	531
Call Date	17 March 2021
Scheduled Conversion / Maturity	18 March 2024
Issue Price (AUD)	100
Coupon Margin	5.15%
Base Rate	180-day bank-bill swap
Franking	40%
Distribution Frequency	Semi-Annually
Step-Up Margin	-
Discretionary Distributions	Yes
Mandatory Deferral	-
Cumulative Distributions	No
Dividend Stopper	Yes
Capital / Non-Viability Trigger	Non-Viability Trigger

Contract Summary

Macquarie Group Capital Notes 2 (MQGPB) are fully paid, subordinated, noncumulative, unsecured, mandatorily convertible, perpetual and automatically convertible notes. These notes offer semi-annual distributions based on the 180-day bank bill swap rate (BBSW) plus a margin of 5.15% per annum. Payment of distributions is discretionary and subject to payment conditions being satisfied, the most material being that payment does not cause Macquarie Group to breach its regulatory capital requirements or become insolvent. Distributions are noncumulative, so Macquarie Group does not have to make up unpaid distributions. MQGPB are perpetual securities, unless one of the following occurs: Macquarie Group redeems or resells for cash at face value on any of the specified optional exchange dates (17 March 2021, 17 September 2021 and 17 March 2022), subject to APRA approval and satisfying specific conversion conditions. The scheduled exchange conditions are:

- First condition: The VWAP of Macquarie Group's ordinary shares in the 25th business date before (but not including) a possible scheduled conversion date is greater than 56% of the issue date VWAP of AUD 81.33, which equates to AUD 45.54.
- Second condition: The VWAP of ordinary shares during the period of 20 ASX trading days immediately preceding a possible Mandatory Exchange Date is greater than AUD 41.07, or 50.505% of the issue date VWAP (AUD 81.33). This condition also requires that the number of ordinary shares to be issued at mandatory conversion is less than or equal to the applicable Maximum Exchange Number, which in this instance is 2.46 shares.
- Third condition: No Suspension Event applies in respect of the Relevant Mandatory Exchange Date. A Suspension Event means, in respect of a date, trading of ordinary shares are suspended for at least 5 consecutive business days prior to that date.
- Fourth condition: The issuer is not delisted as at the relevant scheduled exchange date.

Unscheduled conversion could arise through a non-viability trigger event.

Issuer Description

Macquarie Group Limited (MQG) is a global provider of banking, financial, advisory, investment and funds management services, headquartered in Sydney.

Issuer Bull / Bear Case

Bull case: Macquarie is a growth-focused, niche global investment bank with the reputation for highly motivated and incentivised staff and astute management. Challenges in global credit and asset markets reaffirm the quality of risk management at Macquarie. The strong balance sheet is supported by excess capital and places Macquarie in a strong position to take advantage of distressed asset sales. The international expansion in funds management produces sustainable, lower-risk, annuity-style income.

Bear Case: Investment banking growth is dependent on favourable market conditions, and deterioration in global markets will again pressure earnings. Our near-term forecasts will suffer if the market recovery fails. Near-term issues include uncertainty in global investment markets and a relapse in the tentative global economic recovery. A collapse in global capital markets would reduce transactional activity such as mergers and acquisitions, IPOs, capital raisings, and other corporate activity.

NABHA National Income Securities

Security Investment Risk	Low
Issuer Name	National Australia Bank Limited
Issuer Economic Moat Rating	Wide
Issuer Stewardship Rating	Standard
Sector	Banks
Issue Date	29 June 1999
Issue size (AUD million)	2,000
Call Date	-
Scheduled Conversion / Maturity	-
Issue Price (AUD)	100
Coupon Margin	1.25%
Base Rate	90-day bank-bill swap
Franking	0%
Distribution Frequency	Quarterly
Step-Up Margin	-
Discretionary Distributions	-
Mandatory Deferral	-
Cumulative Distributions	No
Dividend Stopper	Yes
Capital / Non-Viability Trigger	-

Contract Summary

NABHA is a stapled security, an interest-bearing note stapled to a non-dividend-paying preference share. The interest rate is calculated on the note using the formula D = (base + margin) x period, where base is the 90-day BBSW, margin is 1.25% per annum and period is the number of days since the last payment divided by 365.

Interest is only paid if certain conditions are met, which essentially requires the absence of an APRA objection and the maintenance of National Australia Bank's capital ratios. Interest payments are non-cumulative. In a wind-up, the security is destapled and effectively converted into a preference share.

It ranks ahead of equity but behind almost all other creditors in a windup. The security is perpetual, and can be redeemed for AUD 100 at National Australia Bank's option with APRA approval. There are more conditions in the contract dealing with other events, such as a takeover, merger or change to Australian law.

Issuer Description

National Australia Bank Limited (NAB) is a financial services group that provides a comprehensive and integrated range of banking and financial services including wealth management throughout Australia, New Zealand, Asia, United Kingdom and USA. National Australia Bank is one of Australia's four major banks and is the biggest business bank in Australia.

Issuer Bull / Bear Case

Bull case: Management focus on the successful, lower-risk, and profitable domestic banking and wealth management businesses provides confidence in the earnings outlook. Growing economies of scale, improving market positions, pricing power, a strong balance sheet, and high credit ratings provide a robust platform to drive growth. As Australia's biggest business bank, National Australia Bank has the most to gain from the rebound in demand for business credit. The business division benefits from robust volumes, strong margins and stable asset quality. High-profile marketing campaigns, combined with product and fee initiatives, are delivering strong volume growth in home loans, improved customer satisfaction, and market share gains.

Bear Case: A slowdown in core earnings growth resurfaced in fiscal 2015 because of slower than expected business loan growth, margin compression, slower growth in banking fee income, subdued wealth and markets income, and a worse-than-expected cost outcome. The cost of wholesale funding remains elevated, and pressure on lending and deposit rates is likely to reduce net interest margins over the medium term. If stress returns to global credit markets, wholesale funding costs could increase, and availability of funding could be reduced. The focus on loan growth has delivered strong market share gains, but when loan growth exceeds deposit growth, more-expensive wholesale funding is required to fill the funding gap. Execution risk is increasing as the group's repositioning strategy unfolds, and National Australia Bank needs to successfully deliver on its turnaround strategy and be transparent about it. The widespread restructuring and culture change could have negative implications on staff morale and productivity

NABHB NAB Subordinated Notes

Security Investment Risk	Low
Issuer Name	National Australia Bank Limited
Issuer Economic Moat Rating	Wide
Issuer Stewardship Rating	Standard
Sector	Banks
Issue Date	18 June 2012
Issue size (AUD million)	1,173
Call Date	18 June 2017
Scheduled Conversion / Maturity	18 June 2022
Issue Price (AUD)	100
Coupon Margin	2.75%
Base Rate	90-day bank-bill swap
Franking	0%
Distribution Frequency	Quarterly
Step-Up Margin	-
Discretionary Distributions	-
Mandatory Deferral	-
Cumulative Distributions	-
Dividend Stopper	-
Capital / Non-Viability Trigger	-

Contract Summary

NABHB is a subordinated note. It pays quarterly interest payments in arrears. The interest rate is calculated using the formula I = (Base + Margin), where Base is the 90-Day BBSW, and the Margin is 2.75% per annum. Interest payments each quarter are calculated as: (I x Issue Price x (Number of Days in Interest Period/365)). The distributions are interest payments, so are not franked. Interest payments are not deferrable. NAB must make interest payments, unless it is not solvent when the payment is due or will not be solvent after making a payment.

NABHB mature on 18 June 2022 but NAB has an option to redeem the notes on the first redemption date, 18 June 2017, on any subsequent interest payment date or following a taxation or regulatory event, subject to APRA approval. There is no step up in the margin if the notes are not redeemed on the first redemption date. The redemption amount is $100 face value plus accrued and any unpaid interest. Holders cannot request the notes be redeemed early. In a wind-up NABHB rank:

- Behind all unsubordinated creditors (including depositors, bondholders and other creditors);
- Equally with other equal-ranking obligations; and
- Ahead of junior obligations such as NAB ordinary and preference shares and NAB income securities (NABHA).

Issuer Description

National Australia Bank Limited (NAB) is a financial services group that provides a comprehensive and integrated range of banking and financial services including wealth management throughout Australia, New Zealand, Asia, United Kingdom and USA. National Australia Bank is one of Australia's four major banks and is the biggest business bank in Australia.

Issuer Bull / Bear Case

Bull case: Management focus on the successful, lower-risk, and profitable domestic banking and wealth management businesses provides confidence in the earnings outlook. Growing economies of scale, improving market positions, pricing power, a strong balance sheet, and high credit ratings provide a robust platform to drive growth. As Australia's biggest business bank, National Australia Bank has the most to gain from the rebound in demand for business credit. The business division benefits from robust volumes, strong margins and stable asset quality. High-profile marketing campaigns, combined with product and fee initiatives, are delivering strong volume growth in home loans, improved customer satisfaction, and market share gains.

Bear Case: A slowdown in core earnings growth resurfaced in fiscal 2015 because of slower than expected business loan growth, margin compression, slower growth in banking fee income, subdued wealth and markets income, and a worse-than-expected cost outcome. The cost of wholesale funding remains elevated, and pressure on lending and deposit rates is likely to reduce net interest margins over the medium term. If stress returns to global credit markets, wholesale funding costs could increase, and availability of funding could be reduced. The focus on loan growth has delivered strong market share gains, but when loan growth exceeds deposit growth, more-expensive wholesale funding is required to fill the funding gap. Execution risk is increasing as the group's repositioning strategy unfolds, and National Australia Bank needs to successfully deliver on its turnaround strategy and be transparent about it. The widespread restructuring and culture change could have negative implications on staff morale and productivity

NABPA NAB Convertible Preference Shares

Security Investment Risk	Medium
Issuer Name	National Australia Bank Limited
Issuer Economic Moat Rating	Wide
Issuer Stewardship Rating	Standard
Sector	Banks
Issue Date	20 March 2013
Issue size (AUD million)	1,541
Call Date	20 March 2019
Scheduled Conversion / Maturity	22 March 2021
Issue Price (AUD)	100
Coupon Margin	3.20%
Base Rate	90-day bank-bill swap
Franking	100%
Distribution Frequency	Quarterly
Step-Up Margin	-
Discretionary Distributions	Yes
Mandatory Deferral	-
Cumulative Distributions	No
Dividend Stopper	Yes
Capital / Non-Viability Trigger	Capital Trigger & Non-Viability Trigger

Contract Summary

NABPA are fully-paid, non-cumulative, convertible, resalable, redeemable, subordinated, perpetual, unsecured preference shares issued by National Australia Bank. These securities have an expected maturity date (known as the mandatory conversion date) of 22 March 2021 and an early cash conversion (or transfer) date of 20 March 2019. Conversion is subject to APRA approval and satisfying the conversion conditions:

• First scheduled conversion condition - volume-weighted average price, or VWAP, of National Australia Bank shares on the 25th business day preceding the scheduled conversion date is greater than 56% of the issue date VWAP

• Second scheduled conversion condition - VWAP of National Australia Bank shares during the preceding 20 business days before the scheduled conversion date is greater than 50.51% of the issue date VWAP.

• No delisting event applies.

Conversion conditions are not relevant in the case of unscheduled conversion. Unscheduled conversion (which in the prospectus is called a loss absorption event) due to:

• Common equity trigger event.

• Non-viability trigger.

Issuer Description

National Australia Bank Limited (NAB) is a financial services group that provides a comprehensive and integrated range of banking and financial services including wealth management throughout Australia, New Zealand, Asia, United Kingdom and USA. National Australia Bank is one of Australia's four major banks and is the biggest business bank in Australia.

Issuer Bull / Bear Case

Bull case: Management focus on the successful, lower-risk, and profitable domestic banking and wealth management businesses provides confidence in the earnings outlook. Growing economies of scale, improving market positions, pricing power, a strong balance sheet, and high credit ratings provide a robust platform to drive growth. As Australia's biggest business bank, National Australia Bank has the most to gain from the rebound in demand for business credit. The business division benefits from robust volumes, strong margins and stable asset quality. High-profile marketing campaigns, combined with product and fee initiatives, are delivering strong volume growth in home loans, improved customer satisfaction, and market share gains.

Bear Case: A slowdown in core earnings growth resurfaced in fiscal 2015 because of slower than expected business loan growth, margin compression, slower growth in banking fee income, subdued wealth and markets income, and a worse-than-expected cost outcome. The cost of wholesale funding remains elevated, and pressure on lending and deposit rates is likely to reduce net interest margins over the medium term. If stress returns to global credit markets, wholesale funding costs could increase, and availability of funding could be reduced. The focus on loan growth has delivered strong market share gains, but when loan growth exceeds deposit growth, more-expensive wholesale funding is required to fill the funding gap. Execution risk is increasing as the group's repositioning strategy unfolds, and National Australia Bank needs to successfully deliver on its turnaround strategy and be transparent about it. The widespread restructuring and culture change could have negative implications on staff morale and productivity.

NABPB NAB Convertible Preference Shares II

Security Investment Risk	Medium
Issuer Name	National Australia Bank Limited
Issuer Economic Moat Rating	Wide
Issuer Stewardship Rating	Standard
Sector	Banks
Issue Date	17 December 2013
Issue size (AUD million)	1,717
Call Date	17 December 2020
Scheduled Conversion / Maturity	19 December 2022
Issue Price (AUD)	100
Coupon Margin	3.25%
Base Rate	90-day bank-bill swap
Franking	100%
Distribution Frequency	Quarterly
Step-Up Margin	-
Discretionary Distributions	Yes
Mandatory Deferral	-
Cumulative Distributions	No
Dividend Stopper	Yes
Capital / Non-Viability Trigger	Capital Trigger & Non-Viability Trigger

Contract Summary

NABPB securities are fully-paid, non-cumulative, convertible, resalable, redeemable, subordinated, perpetual, unsecured preference shares issued by National Australia Bank. These securities have an expected maturity date (known as the mandatory conversion date) of 19 December 2022 and an early redemption right (or transfer) date of 17 December 2020. Conversion is subject to Australian Prudential Regulation Authority approval and satisfaction of the conversion conditions:

• First scheduled conversion condition - volume-weighted average price, or VWAP, of National Australia Bank shares on the 25th business day preceding the scheduled conversion date is greater than 56% of the issue date VWAP.

• Second scheduled conversion condition - VWAP of National Australia Bank shares during the preceding 20 business days before the scheduled conversion date is greater than 50.51% of the issue date VWAP.

• No delisting event applies.

Conversion conditions are not relevant in the case of unscheduled conversion. Unscheduled conversion (which in the prospectus is called a loss absorption event) due to:

• Common equity trigger event

• Non-viability trigger.

Issuer Description

National Australia Bank Limited (NAB) is a financial services group that provides a comprehensive and integrated range of banking and financial services including wealth management throughout Australia, New Zealand, Asia, United Kingdom and USA. National Australia Bank is one of Australia's four major banks and is the biggest business bank in Australia.

Issuer Bull / Bear Case

Bull case: Management focus on the successful, lower-risk, and profitable domestic banking and wealth management businesses provides confidence in the earnings outlook. Growing economies of scale, improving market positions, pricing power, a strong balance sheet, and high credit ratings provide a robust platform to drive growth. As Australia's biggest business bank, National Australia Bank has the most to gain from the rebound in demand for business credit. The business division benefits from robust volumes, strong margins and stable asset quality. High-profile marketing campaigns, combined with product and fee initiatives, are delivering strong volume growth in home loans, improved customer satisfaction, and market share gains.

Bear Case: A slowdown in core earnings growth resurfaced in fiscal 2015 because of slower than expected business loan growth, margin compression, slower growth in banking fee income, subdued wealth and markets income, and a worse-than-expected cost outcome. The cost of wholesale funding remains elevated, and pressure on lending and deposit rates is likely to reduce net interest margins over the medium term. If stress returns to global credit markets, wholesale funding costs could increase, and availability of funding could be reduced. The focus on loan growth has delivered strong market share gains, but when loan growth exceeds deposit growth, more-expensive wholesale funding is required to fill the funding gap. Execution risk is increasing as the group's repositioning strategy unfolds, and National Australia Bank needs to successfully deliver on its turnaround strategy and be transparent about it. The widespread restructuring and culture change could have negative implications on staff morale and productivity.

NABPC NAB Capital Notes

Security Investment Risk	Medium
Issuer Name	National Australia Bank Limited
Issuer Economic Moat Rating	Wide
Issuer Stewardship Rating	Standard
Sector	Banks
Issue Date	23 March 2015
Issue size (AUD million)	1,343
Call Date	23 March 2020
Scheduled Conversion / Maturity	23 March 2022
Issue Price (AUD)	100
Coupon Margin	3.50%
Base Rate	90-day bank-bill swap
Franking	100%
Distribution Frequency	Quarterly
Step-Up Margin	-
Discretionary Distributions	Yes
Mandatory Deferral	-
Cumulative Distributions	No
Dividend Stopper	Yes
Capital / Non-Viability Trigger	Capital Trigger & Non-Viability Trigger

Contract Summary

NABPC is a fully-paid, non-cumulative, convertible, transferrable, redeemable, subordinated, perpetual, unsecured note with a AUD 100 face value and mandatory exchange date of 23 March 2022. This is subject to exchange conditions, unless it is exchanged earlier as a result of a trigger event or National Australia Bank exercising an option to call the security two years early on 23 March 2020. Distributions are discretionary, non-cumulative and fully franked with a dividend stopper. Distributions will be paid quarterly in arrears, based on the 90-day bank-bill swap, or BBSW, rate plus a margin of 3.50%. If an NABPC distribution is not paid in full within three business days of the relevant distribution payment date, then National Australia Bank cannot, without approval of NABPC holders, pay dividends on its ordinary shares, undertake a buyback or reduce capital on any ordinary shares until a distribution is paid in full on a subsequent distribution payment period. Distributions are not cumulative, so National Australia Bank is not required to make up unpaid distribution payments.

Scheduled exchange conditions are:
• First condition: The VWAP of National Australia Bank ordinary shares on the 25th business day before (but not including) a possible mandatory conversion date is equal to or greater than 56% of the issue date VWAP of National Australia Bank ordinary shares. Based on the issue date VWAP of AUD 38.03, 56% of this amount is AUD 21.30;
• Second condition: The VWAP of National Australia Bank ordinary shares during the 20 business days before (but not including) a possible mandatory conversion date is equal to or greater than 50.51% of the issue date VWAP of National Australia Bank ordinary shares. Based on the issue date VWAP of AUD 38.03, 50.51% of this amount is AUD 19.21; and
• National Australia Bank ordinary shares are listed and admitted to trade.
Unscheduled exchange could arise through either a capital trigger event or a non-viability trigger.

Issuer Description

National Australia Bank Limited (NAB) is a financial services group that provides a comprehensive and integrated range of banking and financial services including wealth management throughout Australia, New Zealand, Asia, United Kingdom and USA. National Australia Bank is one of Australia’s four major banks and is the biggest business bank in Australia.

Issuer Bull / Bear Case

Bull case: Management focus on the successful, lower-risk, and profitable domestic banking and wealth management businesses provides confidence in the earnings outlook. The business division benefits from robust volumes, strong margins and stable asset quality. High-profile marketing campaigns, combined with product and fee initiatives, are delivering strong volume growth in home loans, improved customer satisfaction, and market share gains.

Bear Case: A slowdown in core earnings growth resurfaced in fiscal 2015 because of slower than expected business loan growth, margin compression, slower growth in banking fee income, subdued wealth and markets income, and a worse-than-expected cost outcome. The cost of wholesale funding remains elevated, and pressure on lending and deposit rates is likely to reduce net interest margins over the medium term. If stress returns to global credit markets, wholesale funding costs could increase, and availability of funding could be reduced.

NABPD NAB Capital Notes 2

Security Investment Risk	Medium
Issuer Name	National Australia Bank Limited
Issuer Economic Moat Rating	Wide
Issuer Stewardship Rating	Standard
Sector	Banks
Issue Date	7 July 2016
Issue size (AUD million)	1,499
Call Date	7 July 2022
Scheduled Conversion / Maturity	8 July 2024
Issue Price (AUD)	100
Coupon Margin	4.95%
Base Rate	90-day bank-bill swap
Franking	100%
Distribution Frequency	Quarterly
Step-Up Margin	-
Discretionary Distributions	Yes
Mandatory Deferral	-
Cumulative Distributions	No
Dividend Stopper	Yes
Capital / Non-Viability Trigger	Capital Trigger & Non-Viability Trigger

Contract Summary

NABPD are perpetual, subordinated, unsecured capital notes with a scheduled conversion date of 8 July 2024. This is subject to exchange conditions, unless they are exchanged earlier as a result of a trigger event or National Australia Bank exercising an option to call the security two years early on 7 July 2022. Face value is AUD 100. Distributions are discretionary, non-cumulative, fully franked with dividend and capital restrictions. They are paid quarterly in arrears, based on the 90-day BBSW, rate plus a 4.95% per annum. Distributions are subject to payment conditions being satisfied, the most material being that payment does not cause National Australia Bank to breach its regulatory capital requirements or become insolvent and the Australian Prudential Regulation Authority, or APRA, not objecting. Effective 1 January 2016, there are restrictions on the proportion of profits that can be paid through ordinary dividends, additional Tier 1 distributions (such as NABPD) and discretionary staff bonuses if a bank's common equity Tier 1 ratio falls below 8%.

Scheduled exchange is subject to:
• First condition: The VWAP of National Australia Bank ordinary shares on the 25th business day before (but not including) a potential scheduled conversion date is greater than 56% of the issue date VWAP of National Australia Bank ordinary shares. Based on the issue date VWAP of AUD 25.27, 56% of this amount is AUD 14.15.
• Second condition: The VWAP of National Australia Bank ordinary shares during the 20 business days before (but not including) a potential scheduled conversion date is greater than 50.51% of the issue date VWAP of National Australia Bank ordinary shares. Based on the issue date VWAP of AUD 25.27, 50.51% of this amount is AUD 12.76.

Unscheduled exchange could arise through either a capital trigger event or a non-viability trigger event.

Issuer Description

National Australia Bank Limited (NAB) is a financial services group that provides a comprehensive and integrated range of banking and financial services including wealth management throughout Australia, New Zealand, Asia, United Kingdom and USA. National Australia Bank is one of Australia's four major banks and is the biggest business bank in Australia.

Issuer Bull / Bear Case

Bull case: Management focus on the successful, lower-risk, and profitable domestic banking and wealth management businesses provides confidence in the earnings outlook. The business division benefits from robust volumes, strong margins and stable asset quality. High-profile marketing campaigns, combined with product and fee initiatives, are delivering strong volume growth in home loans, improved customer satisfaction, and market share gains.

Bear Case: A slowdown in core earnings growth resurfaced in fiscal 2015 because of slower than expected business loan growth, margin compression, slower growth in banking fee income, subdued wealth and markets income, and a worse-than-expected cost outcome. The cost of wholesale funding remains elevated, and pressure on lending and deposit rates is likely to reduce net interest margins over the medium term. If stress returns to global credit markets, wholesale funding costs could increase, and availability of funding could be reduced.

ORGHA Origin Energy Notes

Security Investment Risk	High
Issuer Name	Origin Energy Limited
Issuer Economic Moat Rating	None
Issuer Stewardship Rating	Standard
Sector	Energy
Issue Date	22 December 2011
Issue size (AUD million)	900
Call Date	22 December 2016
Scheduled Conversion / Maturity	22 December 2071
Issue Price (AUD)	100
Coupon Margin	4.00%
Base Rate	90-day bank-bill swap
Franking	0%
Distribution Frequency	Quarterly
Step-Up Margin	1.00%
Discretionary Distributions	Yes
Mandatory Deferral	Yes
Cumulative Distributions	Yes
Dividend Stopper	Yes
Capital / Non-Viability Trigger	-

Contract Summary

Origin Energy Subordinated Notes are unsecured, subordinated structured notes with a face value of AUD 100. In December 2011, Origin Energy issued AUD 900 million of notes at a rate of 90-day BBSW rate plus 4.0%, paid quarterly (22 March, 22 June, 22 September and 22 December) in arrears. The first optional call date is on 22 December 2016 (when the equity credit expires) with a step-up of 1.00% on 22 December 2036 and final maturity date of 22 December 2071. At its discretion, Origin has the option to defer interest payments, but it is required to make good (cumulative) any missed payments within five years of the deferral. Mandatory deferral of interest payments will be triggered if Origin breaches a minimum interest coverage ratio of 3.5 times for two consecutive testing dates. The terms of ORGHA were amended in June 2013 so the leverage ratio covenant, of leverage (net) above 4 times, is not tested or reported from 30 June 2013 to 30 June 2016.

The terms of the note include an interest payment stopper whereby if Origin misses an interest payment due to mandatory deferral it cannot pay dividends on ordinary shares until missed payments are whole. However, in reality, as Origin has the discretionary option to defer interest payments at or before any mandatory deferral, this mechanism offers no real protection to ORGHA holders.

Issuer Description

Origin Energy (ORG) is an integrated energy company focused on gas and oil exploration and production, power generation and energy retailing in Australia. Its key operating segments include oil & gas exploration and production, LNG operation, energy retailing and power generations. It also conducts the business in New Zealand through a 53.09% investment in Contact Energy. Origin Energy controls about one third of the Australian energy retailing market. Its Energy Markets division contributes about 60% of group earnings, largely comprising Australian electricity generation and retailing. Energy retailing is a highly competitive and low-margin business, and the Australian market is mature with little growth potential. To drive earnings growth, Origin is developing the Australia Pacific Liquefied Natural Gas, or APLNG, project, which will start exporting LNG from Queensland in 2015. The project could double group earnings and will significantly expand Origin's upstream presence. The company's diversified and integrated energy exposure provides some level of hedging against energy price fluctuations, adding stability to earnings.

Issuer Bull / Bear Case

Bull case: The Australia Pacific LNG project is the largest coal seam gas to LNG project in Australia and should significantly increase and diversify earnings when oil prices recover. Origin's energy retail business is the market leader, with profit growth underpinned by regulated price rises. Origin's cash flow base is diversified, and the company is less susceptible to the vagaries of the market than a nonintegrated energy provider.

Bear Case: The value of APLNG is highly uncertain, given volatility in the oil price. Risks are further increased because of debt guarantees from Origin, which remain in place until certain tests are met, and potential conflicts of interest with "China, Inc." as both main customer and lender. Falling wholesale electricity prices have arguably created a tailwind for earnings. Higher wholesale prices could reverse this benefit. Full retail contestability and privatisation of state-owned energy retailers have resulted in high levels of customer churn, increasing competition and retention costs.

RHCPA Ramsay CARES

Security Investment Risk	Medium
Issuer Name	Ramsay Health Care Limited
Issuer Economic Moat Rating	Narrow
Issuer Stewardship Rating	Exemplary
Sector	Health Care Equipment & Services
Issue Date	24 May 2005
Issue size (AUD million)	260
Call Date	-
Mandatory Conversion / Maturity	-
Issue Price (AUD)	100
Coupon Margin	4.85%
Base Rate	180-day bank-bill swap
Franking	100%
Distribution Frequency	Semi-Annually
Step-Up Margin	-
Discretionary Distributions	Yes
Mandatory Deferral	-
Cumulative Distributions	No
Dividend Stopper	Yes
Capital / Non-Viability Trigger	-

Contract Summary

Ramsay Convertible Adjustable Rate Equity Securities ('CARES') are preference shares which offer investors a floating rate, discretionary, non-cumulative, preferred dividend set at a gross margin of 4.85% above the 180 day Bank Bill Swap Rate (including franking credits). The margin was initially set at 2.85% over the benchmark but in October 2010 Ramsay opted to increase the margin by a one-time step up of 2.00% until CARES is exchanged or converted. CARES have no maturity date but Ramsay has the option to exchange or convert this security at any payment date. There will be no further step-up events, and RHC may redeem for face value or convert into RHC ordinary shares at a 2.5% discount at any successive dividend payment date. On conversion there is no minimum number of ordinary shares but the maximum is set at 400 ordinary shares.

Issuer Description

Ramsay Health Care Limited (RHC) is a global hospital group operating 212 hospitals and day surgery facilities across Australia, United Kingdom, France, Indonesia and Malaysia. Ramsay Health Care facilities cater for a range of health care needs from day surgery procedures to complex surgery, as well as psychiatric care and rehabilitation.

Ramsay Health Care's private-care offering is clearly differentiated from the public sector, which is capacity-constrained and a haven for government bureaucracy and inefficiency. Operating costs for private hospitals are largely fixed, so increasing facility utilisation can in turn increase operating leverage, and the demand for private hospital care is rising due to an ageing population. Ramsay, through a combination of good fortune and fortuitous planning, decided to implement a significant investment program during the financial downturn. While development costs across the industry fell, this increased capital expenditure was directed to enlarge already-established key metropolitan hospitals. Many of these hospitals have now established a monopolistic regional presence for private hospital care. This added capacity is delivering a rapid increase in operating margins and returns on capital.

Issuer Bull / Bear Case

Bull case: Ramsay Health Care's dominant position in the private hospital market underpins pricing power and ability to transfer cost increases to private health insurance funds. An ageing population means that demand for medical services is growing. Ramsay is well placed to benefit, given the locations and quality of its facilities. Ramsay continues to invest capital in incremental projects. A disciplined and experienced management team will ensure returns from invested capital that exceed internal benchmarks of 15%.

Bear Case: Private hospital operators are vulnerable to the health of the private insurance industry. Regulatory change and economic weakness could lead to a contraction in spending and starve the private industry of funds. Over time, Ramsay's ability to offset higher operating costs is set to decrease. Private insurance funds will find it increasingly difficult to ask customers for more money without losing participation. Government action to address what is a chronically underfunded, capacity-constrained public system could lead to an injection of fresh capital, facilities and initiatives to turn around service levels. An efficient and effective free public system would erode the benefits of a private system.

SUNPC Suncorp Convertible Preference Shares II

Security Investment Risk	Medium
Issuer Name	Suncorp Group Limited
Issuer Economic Moat Rating	None
Issuer Stewardship Rating	Standard
Sector	Insurance
Issue Date	6 November 2012
Issue size (AUD million)	560
Call Date	17 December 2017
Scheduled Conversion / Maturity	17 December 2019
Issue Price (AUD)	100
Coupon Margin	4.65%
Base Rate	90-day bank-bill swap
Franking	100%
Distribution Frequency	Quarterly
Step-Up Margin	-
Discretionary Distributions	Yes
Mandatory Deferral	-
Cumulative Distributions	No
Dividend Stopper	Yes
Capital / Non-Viability Trigger	Non-Viability Trigger

Contract Summary

SUNPC are perpetual, unsecured, subordinated securities with a scheduled exchange date of 17 December 2019. Suncorp has the option to convert, redeem or resell SUNPC at face value (AUD 100) on the optional exchange date (17 December 2017), or earlier following specific trigger events and subject to conversion conditions:

- The VWAP of Suncorp ordinary shares on the 25th business day before the mandatory conversion date (17 December 2019) is greater than (110% x relevant fraction) x issue date VWAP of Suncorp ordinary shares.
- The VWAP of Suncorp ordinary shares (during the 20 business days before, but not including, a possible mandatory exchange date) is equal to or greater than (101.01% x relevant fraction) x issue date VWAP of Suncorp ordinary shares.
- Suncorp ordinary shares are listed or admitted to trade on the Australian Securities Exchange.

Dividends are fully franked, discretionary, non-cumulative, payable quarterly in arrears and based on the 90-day BBSW rate plus 4.65%. SUNPC have a non-viability trigger event, which is an Australian Prudential Regulation Authority, or APRA, requirement. A non-viability event occurs where APRA determines that some or all of SUNPC must be converted, because without conversion or a public sector injection of capital or equivalent support, Suncorp would become, in APRA's opinion, non-viable. Conversion as a result of this event is not subject to scheduled conversion conditions being satisfied, so a maximum conversion number of shares will apply. This means that, upon conversion, SUNPC securityholders could potentially receive Suncorp shares worth less than AUD 100.

Issuer Description

Suncorp Group Limited (SUN) is a Queensland-based financial services conglomerate offering retail and business banking, general insurance, life insurance, superannuation and investment products in Australia and New Zealand. SUN has following five core businesses: Personal Insurance, Commercial Insurance, Vero New Zealand, Suncorp Bank and Suncorp Life. Suncorp Group is well capitalised and provides good upside from major restructuring and simplification, but is heavily exposed to volatile insurance earnings.

Issuer Bull / Bear Case

Bull case: The previously underperforming business has been successfully turned around. New CEO Michael Cameron is expected to deliver solid earnings growth going forward. A benign claims environment with a lower incidence of major catastrophes would considerably boost underwriting profits. Risk management has been improved, and productivity initiatives are expected to deliver greater cost efficiencies supporting the 'through-the-cycle' minimum 12% underlying insurance margin target.

Bear Case: In personal and commercial insurance, competition is increasing. Popular Australian brands and competitors from overseas are entering the general insurance distribution and underwriting markets. New competitors could pressure premiums and win market share from incumbents, such as Suncorp. The bank's credit rating is lower than that of the highly rated major banks, resulting in higher wholesale funding costs and lower net interest margins. A higher incidence of large claims events from major catastrophes would crimp profitability.

SUNPD Suncorp Subordinated Notes

Security Investment Risk	Medium
Issuer Name	Suncorp Group Limited
Issuer Economic Moat Rating	None
Issuer Stewardship Rating	Standard
Sector	Insurance
Issue Date	22 May 2013
Issue size (AUD million)	770
Call Date	22 November 2018
Scheduled Conversion / Maturity	22 November 2023
Issue Price (AUD)	100
Coupon Margin	2.85%
Base Rate	90-day bank-bill swap
Franking	0%
Distribution Frequency	Quarterly
Step-Up Margin	-
Discretionary Distributions	-
Mandatory Deferral	-
Cumulative Distributions	-
Dividend Stopper	-
Capital / Non-Viability Trigger	Non-Viability Trigger

Contract Summary

Suncorp Subordinated Notes are unsecured, subordinated and cumulative notes. They pay interest quarterly in arrears (there is no franking and payments are not discretionary) based on the 90-day bank bill swap, or BBSW, rate plus 2.85% per annum. The notes mature on 22 November 2023, subject to not breaching tax, regulatory or non-viability events, but the issuer has the option to redeem from 22 November 2018.

SUNPD forms part of Suncorp Group's capital management strategy and represents tier-2 regulatory capital. These securities replaced Suncorp Convertible Preference Shares (ASX Code: SUNPB) issued in 2008. Suncorp Subordinated Notes are less structurally complex than the recent Suncorp CPS II. Unlike tier-1 securities, all regulated tier-2 securities do not allow the issuer discretion when paying interest, which removes a significant amount of uncertainty. This security has a legal maturity at 10.5 years and, because it has a five-year call option, is eligible to be counted as regulatory capital only for a period of five years, after which it simply becomes expensive debt.

The other significant structural terms are the solvency condition and risk of unscheduled conversion (or write-off) due to a non-viability trigger event. The solvency condition is a condition precedent to all payments on the notes. This condition was included in previously issued ANZHA, NABHB and WBCHA. If this condition is not met then failure to make payment does not constitute an event of default. The largest risk to SUNPD holders is unscheduled conversion due to a non-viability trigger event. Although we consider this an unlikely event, the implications for holders are substantial. Unscheduled conversion forced by the regulator will only happen in the case of a large downside event which would otherwise lead to insolvency. The Australian Prudential Regulation Authority, or APRA, has decided not to provide a clear and objective definition of non-viability to ensure it has full discretion to convert in a time of stress. Note that there are no conversion conditions for SUNPD.

Issuer Description

Suncorp Group Limited (SUN) is a Queensland-based financial services conglomerate offering retail and business banking, general insurance, life insurance, superannuation and investment products in Australia and New Zealand. SUN has following five core businesses: Personal Insurance, Commercial Insurance, Vero New Zealand, Suncorp Bank and Suncorp Life. Suncorp Group is well capitalised and provides good upside from major restructuring and simplification, but is heavily exposed to volatile insurance earnings.

Issuer Bull / Bear Case

Bull case: The previously underperforming business has been successfully turned around. A benign claims environment with a lower incidence of major catastrophes would considerably boost underwriting profits. Risk management has been improved, and productivity initiatives are expected to deliver greater cost efficiencies supporting the 'through-the-cycle' minimum 12% underlying insurance margin target.

Bear Case: In personal and commercial insurance, competition is increasing. Popular Australian brands and competitors from overseas are entering the general insurance distribution and underwriting markets. New competitors could pressure premiums and win market share from incumbents, such as Suncorp. The bank's credit rating is lower than that of the highly rated major banks, resulting in higher wholesale funding costs and lower net interest margins.

SUNPE Suncorp Convertible Preference Shares III

Security Investment Risk	Medium
Issuer Name	Suncorp Group Limited
Issuer Economic Moat Rating	None
Issuer Stewardship Rating	Standard
Sector	Insurance
Issue Date	8 May 2014
Issue size (AUD million)	400
Call Date	17 June 2020
Scheduled Conversion / Maturity	17 June 2022
Issue Price (AUD)	100
Coupon Margin	3.40%
Base Rate	90-day bank-bill swap
Franking	100%
Distribution Frequency	Quarterly
Step-Up Margin	-
Discretionary Distributions	Yes
Mandatory Deferral	-
Cumulative Distributions	No
Dividend Stopper	Yes
Capital / Non-Viability Trigger	Non-Viability Trigger

Contract Summary

SUNPE are perpetual, unsecured, convertible preference shares with an expected maturity (known as the mandatory exchange date) of 17 June 2022. Suncorp has the option to convert, redeem or resell SUNPE at face value (AUD 100) on the optional exchange date (17 June 2020), or earlier following specific trigger events and subject to conversion conditions:

- The volume-weighted average price, or VWAP, of Suncorp ordinary shares on the twenty-fifth business day before the mandatory conversion date is greater than (110% x relevant fraction) x issue date VWAP of Suncorp ordinary shares.
- The VWAP of Suncorp ordinary shares (during the 20 business days before, but not including, a possible mandatory exchange date) is equal to, or greater than, (101.01% x relevant fraction) x issue date VWAP of Suncorp ordinary shares.
- Suncorp ordinary shares are listed or admitted to trade on the Australian Securities Exchange.

Dividends are fully franked, discretionary, non-cumulative, payable quarterly in arrears and based on the 90-day BBSW rate plus 3.40%. The terms of SUNPE include a non-viability trigger event, which is the primary requirement under new Basel III conditions. This non-viability event occurs when APRA determines that some or all of SUNPE must be converted, because without conversion or a public sector injection of capital or equivalent support, Suncorp would become, in APRA's opinion, non-viable. APRA has not provided guidance as to how it would determine non-viability. It could be reasonably expected to include serious impairment of Suncorp's financial position or insolvency. This could extend beyond solvency measures and capital ratios. Conversion as a result of this event is not subject to mandatory conversion conditions being satisfied, so a maximum conversion number of shares will apply. This means that, upon conversion, SUNPE security holders could potentially receive Suncorp shares worth less than AUD 100.

Issuer Description

Suncorp Group Limited (SUN) is a Queensland-based financial services conglomerate offering retail and business banking, general insurance, life insurance, superannuation and investment products in Australia and New Zealand. SUN has following five core businesses: Personal Insurance, Commercial Insurance, Vero New Zealand, Suncorp Bank and Suncorp Life. Suncorp Group is well capitalised and provides good upside from major restructuring and simplification, but is heavily exposed to volatile insurance earnings.

Issuer Bull / Bear Case

Bull case: The previously underperforming business has been successfully turned around. A benign claims environment with a lower incidence of major catastrophes would considerably boost underwriting profits. Risk management has been improved, and productivity initiatives are expected to deliver greater cost efficiencies supporting the 'through-the-cycle' minimum 12% underlying insurance margin target.

Bear Case: In personal and commercial insurance, competition is increasing. Popular Australian brands and competitors from overseas are entering the general insurance distribution and underwriting markets. New competitors could pressure premiums and win market share from incumbents, such as Suncorp. The bank's credit rating is lower than that of the highly rated major banks, resulting in higher wholesale funding costs and lower net interest margins.

SVWPA Seven TELYS4

Security Investment Risk	High
Issuer Name	Seven Group Holdings Limited
Issuer Economic Moat Rating	None
Issuer Stewardship Rating	Standard
Sector	Industries
Issue Date	1 June 2005
Issue size (AUD million)	495
Call Date	-
Scheduled Conversion / Maturity	-
Issue Price (AUD)	100
Coupon Margin	4.75%
Base Rate	180-day bank-bill swap
Franking	100%
Distribution Frequency	Semi-Annually
Step-Up Margin	-
Discretionary Distributions	Yes
Mandatory Deferral	-
Cumulative Distributions	No
Dividend Stopper	Yes
Capital / Non-Viability Trigger	-

Contract Summary

Transferable extendable listed yield shares, or TELYS4 (ASX code: SVWPA) are non-cumulative, redeemable and convertible preference shares in Seven Group Holdings. In April 2010, shareholders voted in favour of the scheme of arrangement to merge WesTrac Holdings Pty Limited and Seven Network Limited, creating Seven Group Holdings. As part of this scheme, security holders of TELYS3 approved the exchange of TELYS3 shares to TELYS4 without giving holders the option of a cash exit. This effectively created AUD 496 million in convertible preference share capital for the newly formed group.

TELYS4 is a floating-rate instrument, paying distributions of 180-day bank bill swap rate plus 4.75% (including franking). This is a perpetual security, but the issuer (Seven Group Holdings) has the option to convert or exchange the securities at face value (AUD 100) on any payment date. Interest is paid semi-annually in arrears on the 31 May and 30 November of each year. Dividends are deferrable and non-cumulative, meaning unpaid interest by Seven Group Holdings does not accrue. Dividends can be paid from distributable profits and retained earnings of Seven Group Holdings, including dividends which flow to Seven Group Holdings from its subsidiaries such as WesTrac Group and Seven West Media.

If a dividend has not been paid in full on TELYS4, a dividend and capital stopper will apply to Seven Group Holdings, meaning that without special resolution, the board cannot pay dividends or reduce share capital. If Seven Group Holdings triggers this stopper, holders may notify Seven Group Holdings in writing, demanding conversion or exchange. There are more conditions in the contract dealing with other events such as change of control. We have only presented a summary of the material terms. Investors should examine the prospectus in detail.

Issuer Description

Seven Group Holdings Limited (SVW) is a diversified operating and investment company. SVW has a portfolio of industrial services, media, property and other investments. SVW is domiciled in Australia and operates in two countries, Australia and China. The main operating business is WesTrac, the sole authorised Caterpillar dealer for New South Wales, Australian Capital Territory, Western Australia, and North Eastern China. WesTrac has a 100% interest in AllightSkes and a 46% interest in Coates Hire. WesTrac is the dominant heavy-equipment supplier in its authorised regions and offers strong exposure to the local government, construction, and mining sectors. Seven Group holds a 40.9% interest in Australian-Securities-Exchange-listed Seven West Media.

Issuer Bull / Bear Case

Bull case: Seven Group operates strong industrial businesses with leading market shares and solid demand from construction and mining sectors. Media investments are well diversified across free-to-air television, pay television, newspapers, magazines and online media. Investments are highly liquid and provide solid franked dividend income.

Bear Case: A large downturn in the Chinese economy could significantly affect WesTrac's earnings and cash flow. Kerry Stokes has a 68% shareholding and may take a longer-term view on the strategic investments than minority shareholders. The business structure is complex, and the rationale behind the acquisition of some investments is difficult to understand.

TAHHB Tabcorp Subordinated Notes

Security Investment Risk	Medium
Issuer Name	Tabcorp Holdings Limited
Issuer Economic Moat Rating	Narrow
Issuer Stewardship Rating	Standard
Sector	Consumer Cyclical
Issue Date	22 March 2012
Issue size (AUD million)	250
Call Date	22 March 2017
Scheduled Conversion / Maturity	22 March 2037
Issue Price (AUD)	100
Coupon Margin	4.00%
Base Rate	90-day bank-bill swap
Franking	0%
Distribution Frequency	Quarterly
Step-Up Margin	0.25%
Discretionary Distributions	-
Mandatory Deferral	Yes
Cumulative Distributions	Yes
Dividend Stopper	Yes
Capital / Non-Viability Trigger	-

Contract Summary

Tabcorp raised AUD 250 million in debt capital in March 2012 with the issuance of Tabcorp Subordinated Notes (ASX Code TAHHB). This instrument is a floating-rate note with unfranked coupons of 90-day BBSW rate plus 4.00% per annum. First call date for the notes is 22 March 2017 with Tabcorp holding the option to redeem the note. If Tabcorp decides to redeem the note, TAHHB holders will receive AUD 100 for each note, plus any deferred interest payments and any accrued but unpaid interest payment. If the note is not redeemed, margin increases once by 0.25% per annum. Thereafter, Tabcorp may redeem the note on any distribution date. The note must be redeemed by Tabcorp on 22 March 2037.

Interest is paid quarterly on the 22nd of March, June, September, December of each year. Interest on the note is mandatorily deferred if the interest cover ratio is less than 3.0 times in any half, or the Leverage ratio is above 3.5 times in any two consecutive halves. Interest payments are non-discretionary and cumulative, meaning unpaid interest by Tabcorp accrues on a daily basis at the last interest rate until payment is made.

TAHHB are unsecured notes and ranked below all senior debtors and TAHHA bondholders, but above equity holders. This means in the event of a default, senior debtors and TAHHA bond holders have prior rights to distribution than TAHHB noteholders. TAH may redeem the note before the maturity date if a change of control event, a tax event, capital event or a clean-up event occurs. TAHHB noteholders have the right to request redemption if a change of control event occurs. This is defined as an individual and its associates holding more than 50% of Tabcorp ordinary shares outstanding. A clean-up event is defined as when 80% of the face value of notes on the issue date is redeemed, and less than 20% of the notes remain on-market. A capital event is when TAHHB is no longer considered as 'equity credit´ by the rating agency. In the event of an early redemption, TAHHB is redeemed at face value plus accrued interest outstanding.

Issuer Description

Tabcorp Holdings Limited (TAH) offers a range of gambling and entertainment products. TAH's business units include Wagering, Gaming, Keno and media activities across Australia. Customer brands includes TAB, Keno, Luxbet, Tabcorp Gaming Solutions, Trackside animated racing game, Sky Racing and Sky Sports Radio.

Issuer Bull / Bear Case

Bull case: Long-life wagering and Keno licences furnish Tabcorp with a stable earnings and cash flow profile, underpinning a relatively high dividend payout ratio. While Tabcorp Gaming Solutions is relatively small (12% of group earnings), it boasts solid growth potential, not just in the core Victorian market, but especially in the New South Wales electronic gaming machine servicing space.

Bear Case: Faster-than-expected customer migration to online betting and Internet-only competitors could materially diminish the value of Tabcorp's vast physical retail network. The company's multichannel strategy may fail to stem the spillage of its traditional customers to more nimble and innovative online betting operators. Pressure on Tabcorp from structural headwinds could have a downstream impact on the racing bodies, lead to lower-quality races and devolve into a negative economic loop for the whole wagering industry.

TTSHA Tatts Bonds

Security Investment Risk	Medium
Issuer Name	Tatts Group Limited
Issuer Economic Moat Rating	Narrow
Issuer Stewardship Rating	Standard
Sector	Consumer Cyclical
Issue Date	29 June 2012
Issue size (AUD million)	195
Call Date	-
Scheduled Conversion / Maturity	5 July 2019
Issue Price (AUD)	100
Coupon Margin	3.10%
Base Rate	90-day bank-bill swap
Franking	0%
Distribution Frequency	Quarterly
Step-Up Margin	-
Discretionary Distributions	-
Mandatory Deferral	-
Cumulative Distributions	-
Dividend Stopper	-
Capital / Non-Viability Trigger	-

Contract Summary

TTSHA is a senior ranking, unsecured debt security. It pays quarterly interest payments in arrears. The distributions are interest payments, so are not franked. Interest payments are mandatory and not deferrable. Non-payment will constitute an event of default. Following an event of default, the face value and accrued and unpaid interest is due and payable immediately.

TTSHA mature on 5 July 2019 but Tatts has the right to redeem TTSHA before maturity following a tax event or clean-up event;
• A tax event will occur if any interest payment would not be deductible for tax purposes as a result of a change in law or if Tatts is required to gross up an interest payment.
• A clean-up event will occur if less than 10% of the value of TTSHA originally issued remain on issue.
Redemption is at face value plus accrued interest. There is no conversion into Tatts ordinary shares. Holder call rights: Holders cannot request the notes be redeemed early except following a change of control event or delisting event:
• A change of control event will occur if a person or their associate comes to have a relevant interest in more than 50% of voting shares in Tatts.
• A delisting event will occur if TTSHA ceases to be quoted on the Australian Securities Exchange or trading in TTSHA is suspended for more than 15 consecutive business days.

In a wind-up TTSHA rank:
• Behind any creditors preferred by law (such as employee entitlements) and any secured creditors of Tatts;
• Equally with other senior and unsecured creditors of Tatts; and
• Ahead of Tatts' ordinary shares and subordinated creditors.

Issuer Description

Tatts Group Limited (TTS) is a portfolio of networked gambling business leisure and entertainment products and services in Australia and the United Kingdom. TTS comprises five operating segments which are Tatts Lotteries, TattBet, Maxgaming, Bytecraft and Talarius.

Issuer Bull / Bear Case

Bull case: Long-life licences for lotteries furnish Tatts with a stable earnings and cash flow profile, underpinning a relatively high and secure dividend payout ratio. Tatts' retail exclusivity and extensive brick-and-mortar distribution presence place the company in a strong position to migrate its wagering customer base to a multichannel environment. Earnings predictability and free cash generating power provide management with significant flexibility to pursue further consolidation in core businesses, without compromising Tatts' yield appeal.

Bear Case: Tatts operates mostly low-growth businesses in mature gambling markets, and expansion opportunities are scarce unless management succeeds in further consolidating the Australian lotteries or wagering market. Faster-than-expected customer migration to online betting and Internet-only competitors could materially diminish the value of Tatts' vast physical retail wagering network and, indeed, its whole portfolio of wagering licences.

WBCHA Westpac Subordinated Notes

Security Investment Risk	Low
Issuer Name	Westpac Banking Corporation
Issuer Economic Moat Rating	Wide
Issuer Stewardship Rating	Exemplary
Sector	Banks
Issue Date	23 August 2012
Issue size (AUD million)	1,676
Call Date	23 August 2017
Scheduled Conversion / Maturity	23 August 2022
Issue Price (AUD)	100
Coupon Margin	2.75%
Base Rate	90-day bank-bill swap
Franking	0%
Distribution Frequency	Quarterly
Step-Up Margin	-
Discretionary Distributions	-
Mandatory Deferral	-
Cumulative Distributions	-
Dividend Stopper	-
Capital / Non-Viability Trigger	-

Contract Summary

WBCHA is a pure debt security with a relatively simple structure and has non-deferrable interest payments subject to a solvency test. However, it is still a subordinated, unsecured security. Westpac has an option to redeem the notes early at the five-year mark, on any subsequent interest payment date, or following a taxation or regulatory event, subject to Australian Prudential Regulation Authority approval.

The notes pay quarterly interest based on the 90-day bank-bill swap rate plus a margin. The notes rank ahead of Westpac ordinary and preference shares (including WBCPB, WBCPC and WCTPA) and subordinated perpetual debt. The distributions are interest payments, so are not franked.

Issuer Description

Westpac Banking Corporation (WBC) is Australia's oldest banking and financial services group, with branches and operations throughout Australia, New Zealand and the near Pacific region as well as offices in key financial centres around the world including London, New York, Hong Kong and Singapore. The Group is organised in the following 5 Key Divisions: Consumer Bank, Commercial and Business Bank, BT Financial Group, Westpac Institutional Bank and Westpac New Zealand. Its serves nearly 13 million customers.

Issuer Bull / Bear Case

Bull case: Good operating momentum from core retail and business banking franchises, impressive cost/income performance, and solid economic conditions underpin consistent profit growth with a lower-risk domestic business model. Growing economies of scale, dominant market positions, pricing power, a superior balance sheet, and high credit ratings provide a strong platform to drive growth.
The balance sheet is built around consumer banking, which provides the retail-oriented bank with earnings diversity to complement the more volatile returns generated from business and wholesale banking activities.

Bear Case: Slow core earnings growth could resurface because of margin compression, subdued wealth and markets income, lower banking fee income, higher bad debts and a worse-than-expected outcome on costs. Although Westpac exceeds Basel III capital requirements, stricter regulations on capital, funding, and liquidity could dampen net interest margin growth and return on equity. Increasing pressure on stressed global credit markets could increase wholesale funding costs and reduce wholesale funding availability. Recouping higher funding costs by increasing lending rates is more difficult because of tougher pricing competition between the major banks. The credit cycle has turned from historical lows and bad debts will continue to increase over coming years.

WBCHB Westpac Subordinated Notes II

Security Investment Risk	Medium
Issuer Name	Westpac Banking Corporation
Issuer Economic Moat Rating	Wide
Issuer Stewardship Rating	Exemplary
Sector	Financial Services
Issue Date	22 August 2013
Issue size (AUD million)	925
Call Date	22 August 2018
Scheduled Conversion / Maturity	22 August 2023
Issue Price (AUD)	100
Coupon Margin	2.30%
Base Rate	90-day bank-bill swap
Franking	0%
Distribution Frequency	Quarterly
Step-Up Margin	-
Discretionary Distributions	-
Mandatory Deferral	-
Cumulative Distributions	-
Dividend Stopper	-
Capital / Non-Viability Trigger	Non-Viability trigger

Contract Summary

Westpac Subordinated Notes II (WBCHB) are unsecured notes with a legal final maturity on 22 August 2023 (10 years). At its discretion, the issuer has the option to redeem the securities from 22 August 2018 (five years).

WBCHB provides tier-2 regulatory capital for the issuer which complies with the Australian Prudential Regulation Authority's, or APRA's, newly-implemented capital adequacy standards (Basel III requirements). Unlike tier-1 securities, interest payments on this security are not discretionary and any missed payment will constitute an event of default. However, as the structure includes non-viability terminology, it has embedded conversion mechanics which are designed to absorb losses if the regulator deems Westpac to be non-viable.

WBCHB was the first tier-2 security issued by a domestic major bank to include non-viability conditions, making its valuation different to previously issued tier-2 securities (for example, WBCHA). The non-viability event trigger allows APRA to require conversion into ordinary equity at its discretion rather than being based on a quantitative trigger.

Issuer Description

Westpac Banking Corporation (WBC) is Australia's oldest banking and financial services group, with branches and operations throughout Australia, New Zealand and the near Pacific region as well as offices in key financial centres around the world including London, New York, Hong Kong and Singapore. The Group is organised in the following 5 Key Divisions: Consumer Bank, Commercial and Business Bank, BT Financial Group, Westpac Institutional Bank and Westpac New Zealand.

Issuer Bull / Bear Case

Bull case: Good operating momentum from core retail and business banking franchises, impressive cost/income performance, and solid economic conditions underpin consistent profit growth with a lower-risk domestic business model. Growing economies of scale, dominant market positions, pricing power, a superior balance sheet, and high credit ratings provide a strong platform to drive growth.
The balance sheet is built around consumer banking, which provides the retail-oriented bank with earnings diversity to complement the more volatile returns generated from business and wholesale banking activities.

Bear Case: Slow core earnings growth could resurface because of margin compression, subdued wealth and markets income, lower banking fee income, higher bad debts and a worse-than-expected outcome on costs. Although Westpac exceeds Basel III capital requirements, stricter regulations on capital, funding, and liquidity could dampen net interest margin growth and return on equity. Increasing pressure on stressed global credit markets could increase wholesale funding costs and reduce wholesale funding availability. Recouping higher funding costs by increasing lending rates is more difficult because of tougher pricing competition between the major banks. The credit cycle has turned from historical lows and bad debts will continue to increase over coming years.

WBCPC Westpac Convertible Preference Shares

Security Investment Risk	Medium
Issuer Name	Westpac Banking Corporation
Issuer Economic Moat Rating	Wide
Issuer Stewardship Rating	Exemplary
Sector	Financial Services
Issue Date	23 March 2012
Issue size (AUD million)	1,189
Call Date	31 March 2018
Scheduled Conversion / Maturity	31 March 2020
Issue Price (AUD)	100
Coupon Margin	3.25%
Base Rate	180-day bank-bill swap
Franking	100%
Distribution Frequency	Semi-Annually
Step-Up Margin	-
Discretionary Distributions	Yes
Mandatory Deferral	-
Cumulative Distributions	No
Dividend Stopper	Yes
Capital / Non-Viability Trigger	Capital trigger

Contract Summary

WBCPC is a preference share. WBCPC pays half-yearly franked dividends. On 31 March 2020, WBCPC will either: convert into a variable number of Westpac ordinary shares worth approximately AUD 101.01 at a 1% discount to the 20-business-day volume-weighted average price, or VWAP, of Westpac ordinary shares; or be transferred to a third party for AUD 100 cash per security. This is subject to scheduled conversion conditions or unless they are converted/redeemed earlier due to various trigger events or at the optional conversion/redemption date. If the conditions are not satisfied, then conversion will be deferred until the next dividend payment date after 31 March 2020 that the conditions are met.

Scheduled conversion conditions are:
• First condition: The VWAP of Westpac ordinary shares on the 25th business day before (but not including) the scheduled conversion date (31 March 2020) is equal to or greater than 56.12% of the issue date VWAP of Westpac ordinary shares (AUD 11.69).
• Second condition: The VWAP of Westpac ordinary shares during the 20 business days before (but not including) a possible mandatory conversion date is equal to or greater than 50.51% of the issue date VWAP of Westpac ordinary shares (AUD 10.52).

WBCPC is referred to as a Basel 2.5 compliant security, which means it has some of the new structural features but not enough to make it fully compliant to the Basel III eligibility criteria. It is eligible for transitional treatment as additional tier-1 capital under the Basel III framework.

Issuer Description

Westpac Banking Corporation (WBC) is Australia's oldest banking and financial services group, with branches and operations throughout Australia, New Zealand and the near Pacific region as well as offices in key financial centres around the world.

Issuer Bull / Bear Case

Bull case: Good operating momentum from core retail and business banking franchises, impressive cost/income performance, and solid economic conditions underpin consistent profit growth with a lower-risk domestic business model. Growing economies of scale, dominant market positions, pricing power, a superior balance sheet, and high credit ratings provide a strong platform to drive growth. The balance sheet is built around consumer banking, which provides the retail-oriented bank with earnings diversity to complement the more volatile returns generated from business and wholesale banking activities.

Bear Case: Slow core earnings growth could resurface because of margin compression, subdued wealth and markets income, lower banking fee income, higher bad debts and a worse-than-expected outcome on costs. Although Westpac exceeds Basel III capital requirements, stricter regulations on capital, funding, and liquidity could dampen net interest margin growth and return on equity. Increasing pressure on stressed global credit markets could increase wholesale funding costs and reduce wholesale funding availability. Recouping higher funding costs by increasing lending rates is more difficult because of tougher pricing competition between the major banks. The credit cycle has turned from historical lows and bad debts will continue to increase over coming years.

WBCPD Westpac Capital Notes

Security Investment Risk	Medium
Issuer Name	Westpac Banking Corporation
Issuer Economic Moat Rating	Wide
Issuer Stewardship Rating	Exemplary
Sector	Financial Services
Issue Date	8 March 2013
Issue size (AUD million)	1,384
Call Date	8 March 2019
Scheduled Conversion / Maturity	8 March 2021
Issue Price (AUD)	100
Coupon Margin	3.20%
Base Rate	90-day bank-bill swap
Franking	100%
Distribution Frequency	Quarterly
Step-Up Margin	-
Discretionary Distributions	Yes
Mandatory Deferral	-
Cumulative Distributions	No
Dividend Stopper	Yes
Capital / Non-Viability Trigger	Non-Viability Trigger & Capital Trigger

Contract Summary

Westpac Capital Notes (WBCPD) are fully-paid, non-cumulative, convertible, redeemable (and transferable), perpetual, unsecured subordinated notes issued by Westpac Banking Corporation. These securities have a scheduled conversion date of 8 March 2021 and an early cash conversion (or transfer) date of 8 March 2019.

Scheduled conversion is subject to:
- First scheduled conversion condition - volume weighted average price, or VWAP, of Westpac shares on the twenty-fifth business day preceding the scheduled conversion date (expected to be 1 February 2021) is greater than 56.12% of the issue date VWAP.
- Second scheduled conversion condition - VWAP of Westpac shares during the preceding 20 business days of the scheduled conversion date is greater than 50.51% of the issue date VWAP.

Unscheduled conversion could arise through either a capital trigger event or a non-viability trigger event.

Distributions on WBCPD are subject to three payment conditions:
- The payment of the distribution not resulting in a breach of Westpac's capital requirements
- The payment of the distribution not resulting in Westpac becoming insolvent
- APRA not otherwise objecting to the payment.

Issuer Description

Westpac Banking Corporation (WBC) is Australia's oldest banking and financial services group, with branches and operations throughout Australia, New Zealand and the near Pacific region as well as offices in key financial centres around the world including London, New York, Hong Kong and Singapore. The Group is organised in the following 5 Key Divisions: Consumer Bank, Commercial and Business Bank, BT Financial Group, Westpac Institutional Bank and Westpac New Zealand.

Issuer Bull / Bear Case

Bull case: Good operating momentum from core retail and business banking franchises, impressive cost/income performance, and solid economic conditions underpin consistent profit growth with a lower-risk domestic business model. Growing economies of scale, dominant market positions, pricing power, a superior balance sheet, and high credit ratings provide a strong platform to drive growth. The balance sheet is built around consumer banking, which provides the retail-oriented bank with earnings diversity to complement the more volatile returns generated from business and wholesale banking activities.

Bear Case: Slow core earnings growth could resurface because of margin compression, subdued wealth and markets income, lower banking fee income, higher bad debts and a worse-than-expected outcome on costs. Although Westpac exceeds Basel III capital requirements, stricter regulations on capital, funding, and liquidity could dampen net interest margin growth and return on equity. Increasing pressure on stressed global credit markets could increase wholesale funding costs and reduce wholesale funding availability. Recouping higher funding costs by increasing lending rates is more difficult because of tougher pricing competition between the major banks.

WBCPE Westpac Capital Notes 2

Security Investment Risk	Medium
Issuer Name	Westpac Banking Corporation
Issuer Economic Moat Rating	Wide
Issuer Stewardship Rating	Exemplary
Sector	Financial Services
Issue Date	23 June 2014
Issue size (AUD million)	1,310
Call Date	23 September 2022
Scheduled Conversion / Maturity	23 September 2024
Issue Price (AUD)	100
Coupon Margin	3.05%
Base Rate	90-day bank-bill swap
Franking	100%
Distribution Frequency	Quarterly
Step-Up Margin	-
Discretionary Distributions	Yes
Mandatory Deferral	-
Cumulative Distributions	No
Dividend Stopper	Yes
Capital / Non-Viability Trigger	Non-Viability Trigger & Capital Trigger

Contract Summary

Westpac Capital Notes II (WBCPE) are fully-paid, non-cumulative, convertible, redeemable (and transferable), perpetual, unsecured subordinated notes issued by Westpac Banking Corporation. The security has a scheduled conversion date of 23 September 2024 and an early cash conversion (or transfer) date of 23 September 2022.

Scheduled conversion is subject to:
• First scheduled conversion condition - volume weighted average price, or VWAP, of Westpac shares on the twenty-fifth business day preceding the scheduled conversion date must be greater than 56.12% of the issue date VWAP. Based on the issue date VWAP of AUD 34.37, 56.15% of this amount is AUD 19.30.
• Second scheduled conversion condition - VWAP of Westpac shares during the preceding 20 business days of the scheduled conversion date is greater than 50.51% of the issue date VWAP. Based on the issue date VWAP of AUD 34.37, 50.51% of this amount is AUD 17.36.

If the scheduled conditions are not satisfied at 23 September 2024, conversion will not occur until the next distribution payment date on which the scheduled conversion conditions are satisfied. WBCPE may remain on issue indefinitely if these conditions remain unsatisfied.

Unscheduled conversion could arise through either a capital trigger event or a non-viability trigger event.

Issuer Description

Westpac Banking Corporation (WBC) is Australia's oldest banking and financial services group, with branches and operations throughout Australia, New Zealand and the near Pacific region as well as offices in key financial centres around the world including London, New York, Hong Kong and Singapore. The Group is organised in the following 5 Key Divisions: Consumer Bank, Commercial and Business Bank, BT Financial Group, Westpac Institutional Bank and Westpac New Zealand.

Issuer Bull / Bear Case

Bull case: Good operating momentum from core retail and business banking franchises, impressive cost/income performance, and solid economic conditions underpin consistent profit growth with a lower-risk domestic business model. The balance sheet is built around consumer banking, which provides the retail-oriented bank with earnings diversity to complement the more volatile returns generated from business and wholesale banking activities.

Bear Case: Slow core earnings growth could resurface because of margin compression, subdued wealth and markets income, lower banking fee income, higher bad debts and a worse-than-expected outcome on costs. Although Westpac exceeds Basel III capital requirements, stricter regulations on capital, funding, and liquidity could dampen net interest margin growth and return on equity. Increasing pressure on stressed global credit markets could increase wholesale funding costs and reduce wholesale funding availability. The credit cycle has turned from historical lows and bad debts will continue to increase over coming years.

WBCPF Westpac Capital Notes 3

Security Investment Risk	Medium
Issuer Name	Westpac Banking Corporation
Issuer Economic Moat Rating	Wide
Issuer Stewardship Rating	Exemplary
Sector	Financial Services
Issue Date	9 September 2015
Issue size (AUD million)	1,324
Call Date	22 March 2021
Scheduled Conversion / Maturity	22 March 2023
Issue Price (AUD)	100
Coupon Margin	4.00%
Base Rate	90-day bank-bill swap
Franking	100%
Distribution Frequency	Quarterly
Step-Up Margin	-
Discretionary Distributions	Yes
Mandatory Deferral	-
Cumulative Distributions	No
Dividend Stopper	Yes
Capital / Non-Viability Trigger	Non-Viability Trigger & Capital Trigger

Contract Summary

WBCPF are fully paid, convertible, transferable, redeemable, subordinated, perpetual, unsecured notes with an AUD 100 face value and scheduled conversion date of 22 March 2023. This is subject to exchange conditions, unless it is exchanged earlier as a result of a trigger event or Westpac exercising an option to call the security two years early on 22 March 2021. Distributions are discretionary, non-cumulative and fully franked with a dividend stopper. Distributions will be paid quarterly in arrears, based on the 90 day BBSW rate plus a margin of 4.00%. Distributions are paid quarterly, on 22 March, 22 June, 22 September, and 22 December. Distributions are expected to be fully franked. Payment of distributions is discretionary and subject to payment conditions being satisfied, the most material being that payment does not cause Westpac to breach its regulatory capital requirements or become insolvent and APRA not objecting. Distributions are not cumulative.

The scheduled conversion conditions are:
- First condition: The VWAP of Westpac ordinary shares on the 25th business day before (but not including) a possible scheduled conversion date is greater than 56.12% of the issue date VWAP of Westpac ordinary shares of AUD 31.23, that is greater than AUD 17.53.
- Second condition: The VWAP of Westpac ordinary shares during the 20 business days before (but not including) a possible mandatory conversion date is greater than 50.51% of the issue date VWAP of Westpac ordinary shares of AUD 31.23, that is greater than AUD 15.77; and
- Westpac ordinary shares are listed and admitted to trade on the Australian Securities Exchange.

Unscheduled conversion could arise through either a capital trigger event or a non-viability trigger event.

Issuer Description

Westpac Banking Corporation (WBC) is Australia's oldest banking and financial services group, with branches and operations throughout Australia, New Zealand and the near Pacific region as well as offices in key financial centres around the world including London, New York, Hong Kong and Singapore. The Group is organised in the following 5 Key Divisions: Consumer Bank, Commercial and Business Bank, BT Financial Group, Westpac Institutional Bank and Westpac New Zealand.

Issuer Bull / Bear Case

Bull case: Good operating momentum from core retail and business banking franchises, impressive cost/income performance, and solid economic conditions underpin consistent profit growth with a lower-risk domestic business model. The balance sheet is built around consumer banking, which provides the retail-oriented bank with earnings diversity to complement the more volatile returns generated from business and wholesale banking activities.

Bear Case: Slow core earnings growth could resurface because of margin compression, subdued wealth and markets income, lower banking fee income, higher bad debts and a worse-than-expected outcome on costs. Although Westpac exceeds Basel III capital requirements, stricter regulations on capital, funding, and liquidity could dampen net interest margin growth and return on equity. Increasing pressure on stressed global credit markets could increase wholesale funding costs and reduce wholesale funding availability. The credit cycle has turned from historical lows and bad debts will continue to increase over coming years.

WBCPG Westpac Capital Notes 4

Security Investment Risk	Medium
Issuer Name	Westpac Banking Corporation
Issuer Economic Moat Rating	Wide
Issuer Stewardship Rating	Exemplary
Sector	Banks
Issue Date	30 June 2016
Issue size (AUD million)	1,702
Call Date	20 December 2021
Scheduled Conversion / Maturity	20 December 2021
Issue Price (AUD)	100
Coupon Margin	4.90%
Base Rate	90-day bank-bill swap
Franking	100%
Distribution Frequency	Quarterly
Step-Up Margin	-
Discretionary Distributions	Yes
Mandatory Deferral	-
Cumulative Distributions	No
Dividend Stopper	Yes
Capital / Non-Viability Trigger	Non-Viability Trigger & Capital Trigger

Contract Summary

WBCPG are perpetual, subordinated, unsecured capital notes with a scheduled conversion date of 20 December 2023. This is subject to exchange conditions, unless they are exchanged earlier as a result of a trigger event or Westpac exercising an option to call the security two years early on 20 December 2021. Face value is AUD 100. Distributions are discretionary, non-cumulative, fully franked with dividend and capital restrictions. They are paid quarterly in arrears, based on the 90-day BBSW, rate plus a 4.90% per annum. Distributions are subject to payment conditions being satisfied, the most material being that payment does not cause Westpac Banking Corporation to breach its regulatory capital requirements or become insolvent and APRA not objecting.

Scheduled exchange is subject to:
• First condition: The VWAP of Westpac ordinary shares on the 25th business day before (but not including) a potential scheduled conversion date is greater than 56.12% of the issue date VWAP of Westpac ordinary shares. Based on the issue date VWAP of AUD 29.48, this is AUD 16.51.
• Second condition: The VWAP of Westpac ordinary shares during the 20 business days before (but not including) a potential scheduled conversion date is greater than 50.51% of the issue date VWAP of Westpac ordinary shares. Based on the issue date VWAP of AUD 29.48, this is AUD 14.89.

Unscheduled exchange could arise through either a capital trigger event or a non-viability trigger event.

Issuer Description

Westpac Banking Corporation (WBC) is Australia's oldest banking and financial services group, with branches and operations throughout Australia, New Zealand and the near Pacific region as well as offices in key financial centres around the world including London, New York, Hong Kong and Singapore. The Group is organised in the following 5 Key Divisions: Consumer Bank, Commercial and Business Bank, BT Financial Group, Westpac Institutional Bank and Westpac New Zealand.

Issuer Bull / Bear Case

Bull case: Good operating momentum from core retail and business banking franchises, impressive cost/income performance, and solid economic conditions underpin consistent profit growth with a lower-risk domestic business model. The balance sheet is built around consumer banking, which provides the retail-oriented bank with earnings diversity to complement the more volatile returns generated from business and wholesale banking activities.

Bear Case: Slow core earnings growth could resurface because of margin compression, subdued wealth and markets income, lower banking fee income, higher bad debts and a worse-than-expected outcome on costs. Although Westpac exceeds Basel III capital requirements, stricter regulations on capital, funding, and liquidity could dampen net interest margin growth and return on equity. Increasing pressure on stressed global credit markets could increase wholesale funding costs and reduce wholesale funding availability.

WOWHC Woolworths Notes II

Security Investment Risk	Low
Issuer Name	Woolworths Limited
Issuer Economic Moat Rating	Narrow
Issuer Stewardship Rating	Standard
Sector	Consumer Defensive
Issue Date	24 November 2011
Issue size (AUD million)	700
Call Date	24 November 2016
Scheduled Conversion / Maturity	24 November 2036
Issue Price (AUD)	100
Coupon Margin	3.25%
Base Rate	90-day bank-bill swap
Franking	0%
Distribution Frequency	Quarterly
Step-Up Margin	1.00%
Discretionary Distributions	Yes
Mandatory Deferral	-
Cumulative Distributions	Yes
Dividend Stopper	Yes
Capital / Non-Viability Trigger	-

Contract Summary

* Security type: unsecured, subordinated notes * Face value: AUD 100 per security * Issue size: AUD 700.25 million * Interest rate: 3.25% + 90-day BBSW rate * Frequency of interest: Quarterly (24 Feb, 24 May, 24 Aug and 24 Nov) * Interest: All interest payments are cumulative and must be paid within five years of the deferral of the longest outstanding deferred interest payment.

Interest payment stopper: If a WOWHC payment is passed Woolworths cannot pay dividends on ordinary shares until missed payments are made. * Ranking in wind-Up: WOWHC rank ahead of ordinary shares and behind senior debt and creditors. * Woolworths' redemption rights: On the step-up date, Woolworths can either allow the margin to step up 100 basis points or redeem the notes at face value. If stepped up, Woolworths can redeem the notes on any interest payment date thereafter.

Holder redemption rights: Holders can request redemption if there is both a change of control and if Woolworths' debt rating is lowered below investment grade. There are more conditions in the contract dealing with other events such as change of control. We have only presented a summary of the material terms. Investors should examine the prospectus in detail.

Issuer Description

Woolworths (WOW) is a retailer with primary activities in Supermarkets. WOW's other operations include: BIGW discount department stores; Home Improvement; Petrol through the Woolworths/Caltex alliance; and Hotels. Woolworths has long been the largest supermarket company in Australia and has achieved strong earnings per share growth for many years. However, the entrance of discount supermarkets Aldi and Costco into the Australian market during the past decade has increased competition in the sector. In addition, Coles is a much stronger competitor following its acquisition and turnaround by Wesfarmers in 2007.

Issuer Bull / Bear Case

Bull case: Woolworths' retains a strong market position in the supermarket sector. Above-average expansion of supermarket trading area and the rollout of the new store formats, with significantly increased space allocation for fresh product, should add to incremental sales growth and margin.

Bear Case: Australia may have too many supermarkets, with retail space growing at a faster rate than population. This is intensifying competitive pressure and will lead to reduced operating margins at some firms. Increased competition from Coles, an aggressive Aldi, and independents serviced by Metcash, in addition to the entry of Costco, will raise competitive pressures and lower operating margins for smaller competitors.