Bramwell Brown Ltd

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Bramwell Brown Limited – Newsletter – December 2015

BNZ Capital Notes

Bank of New Zealand has announced an offer of up to $550 million of subordinated, unsecured notes. These notes are regarded as Tier 2 capital for the purposes of the bank's regulatory requirements, and as such are complex securities and riskier than a bank deposit. They are designed to absorb losses if a bank experiences severe financial difficulties. They are not call deposits of the issuer and may not be suitable for many investors. It is essential potential investors read the investment statement carefully and understand the nature of these securities.

The notes have a maturity date of December 17th 2025, but if previous BNZ issues are a guide they will probably be repaid on their five-year anniversary in 2020. The capital notes could be written off or converted to shares in National Australia Bank (NAB) if certain non-viability trigger events occur. A non-viability Trigger Event will occur if the Reserve Bank or a statutory manager directs BNZ to convert the capital notes into shares or write off the notes. This might occur if BNZ or NAB encounters severe financial difficulty. Clearly these securities are more complex than term deposits or fixed-rate, fixed-term bonds. The questions investors need to ask include "does the return compensate me for the extra risk?" and "what is the chance of a major trading bank facing financial difficulty?"

The interest rate payable on the notes for the first five years will be 5.314%. This is a combination of the 5 year swap rate (3.064%) plus the margin (2.25%). If not repaid in 2020 the interest rate will be reset based on the five-year swap rate at that time, plus the margin. The notes have a BBB+ credit rating from Standard & Poors and will pay interest quarterly in March, June, September and December. **The offer has been heavily scaled, therefore we have a limited allocation.**

- Interest Rate – 5.314%
- Interest paid quarterly
- Early bird interest of 3.75% paid up until the closing date
- Closing date – December 14th
- Minimum application - $5,000

Call the office as soon as possible if this offer is of interest to you.

Anti-Money Laundering & Countering Financing of Terrorism Act 2009

You will all be aware of the obligations over the last few years for financial institutions to identify their clients in an effort to combat money laundering. When we bid for new issues of securities such as the BNZ capital notes we confirm to the issuer that we have conducted the required due diligence on all clients who submit an application. If requested we are obliged to produce evidence that we have identified our clients to the required standard. It is important that you are aware of this requirement as you can only apply for these new issues if you consent to Bramwell Brown providing your information.

Financial Markets Authority Guidance on Capital Notes

The Financial Markets Authority is keen to ensure investors have a full understanding of the securities issued by banks to meet the new capital adequacy regulations. Here is a summary provided by FMA.

What are bank capital notes?

Banks must hold a certain amount of ‘capital’ to make them less likely to become insolvent (go out of business). Banks issue capital notes to help them raise the capital they need. You may hear different investments being described as ’Tier 1 capital’ or ’Tier 2 capital’ – this describes how the bank can use your money to meet its capital requirements. The important thing for investors to remember is that different capital notes have different terms and conditions, so it’s always important to read the investment statement or product disclosure statement carefully. Common features of bank capital notes include:

- The bank may stop interest payments, or reduce the amount of interest they pay to investors, even if they’re still in business.
- The bank can convert the notes into shares in the bank (or their parent company). The value of those shares at the time they are converted may be a lot less than the amount you paid for the capital notes.
- The notes may be cancelled so you lose some or all of your investment, even if the bank is still in business.

Where these features are included, they will be described in the offer document (investment statement or product disclosure statement). These features are usually subject to complex tests and conditions even experienced investors can find hard to evaluate. Capital notes can also be issued by companies other than banks, and there are other financial products with similar features and risks to capital notes. These may be called ‘hybrid securities’, ‘subordinated notes’, ‘preference shares’ or ‘convertible preference shares’. The product’s investment statement or product disclosure statement will describe its features.

Payments can be unpredictable

Bank capital notes will usually offer a good headline interest rate, but investors should think about whether this is enough to make the higher risks worthwhile, and whether those risks fit their investment needs. Some features of bank capital notes can be difficult to predict, including:

Interest payments may be reduced or stopped

Capital notes often allow the bank to stop paying interest, or reduce the amount of interest they pay, under certain circumstances. Sometimes interest payments are completely the bank's decision, even if their business is profitable. It might be difficult to predict the circumstances in which a well-known bank chooses to stop paying interest on its capital notes, but you shouldn't assume this would never happen.

Buy-back is usually the bank's decision. Although capital notes are long term investments, sometimes of 'perpetual' duration, they often contain provisions that lead investors to expect the bank will buy the notes back (called buy-back) after an initial period, often five years. Any buy-back is usually the bank's decision. You shouldn't assume that because the bank is a household name they will buy-back the notes after this initial period. Capital notes are deliberately designed with features that give banks flexibility over payments. Although it can be difficult to predict when a bank might use these features, you should be aware that they can be used when it's in the bank's interests to do so.

The market price can change quickly

Bank capital notes are usually listed on NZX, but this doesn't necessarily mean you will be able to sell your notes quickly, or at all. The market price for capital notes can change quickly. For example, the value of the note may suddenly fall if the bank suspends or defers interest payments, or if they don't buy-back the notes when the market expected them to.

Bank capital notes are designed to protect the bank

Bank capital notes are designed to make banks less likely to become insolvent. Their terms are often controlled by the requirements of 'prudential regulation', which is regulation to protect the stability of the financial system, rather than your specific investment. The risk of loss to the bank is reduced by passing this risk on to investors who purchase their capital notes. The same features that give banks flexibility to cancel or postpone their obligations create complex risks for investors.

Source: http://www.fma.govt.nz/consumers/free-resources/ Your Guide to Capital Notes - FMA

GPG (Coats)

Coats Group (formerly GPG) has announced that they are to delist from the New Zealand and Australian stock exchanges on June 24th 2016. Holders of Coats should consider whether they wish to continue owning the company. You have a number of options:

- Continue holding Coats and have your shares transferred to the London Stock Exchange
- Sell your shares on the NZX before June 21st
- Sell your shares through the Share Sale Facility arranged by Coats

These options all have varying cost/benefit implications. Phone the office if you'd like to discuss what's best for you.

Warren Buffet

I read an interesting piece from Warren Buffet recently. Buffet is the brains behind Berkshire Hathaway and is one of the world's richest men. He was speaking about share investing and the need to ride out market cycles. "<u>The share market is a mechanism that transfers wealth from the impatient to the patient.</u> The point is that even if you select a better-than-average manager, you should expect to experience periods of meaningful underperformance. And you will need the fortitude and patience to sit through that, if you want to benefit fully from the outperformance the manager may deliver over time."

For those holding Australian equities over the last two to three years these words might offer some comfort.

Market Indicators

	November 2015	**November 2014**	**November 2013**
S&P NZX50 Index	6105	5424	4794
S&P ASX 200	5148	5266	5276
NZ/AU Exchange Rate	0.9084	0.9218	0.8923
NZ/US Exchange Rate	0.6535	0.7856	0.8129
NZ/GB Exchange Rate	0.4346	0.4998	0.4975
Official Cash Rate	2.75%	3.50%	2.50%
3 Month bank bill rate	2.84%	3.67%	2.69%
5 Year Swap Rate	3.045%	4.115%	4.555%
10 Year Swap Rate	3.535%	4.345%	5.135%