Bail-in update: why did CBA need $910 million in a hurry?

If you are a self-funded retiree or self-manage your super, beware the snake oil that the Commonwealth Bank is aggressively selling to investors like you. Last month CBA issued $910 million in so-called hybrid securities at 7.48 per cent interest—a very generous 5.2 percentage points higher than the standard bank rate. Most hybrid issues are around 3 percentage points higher than the bank rate; "CBA is offering the fattest premium in history", Jonathan Shapiro observed in the 27 February *Australian Financial Review*.

Hybrid securities are in fact "bail-in" bonds: securities sold as bonds that get automatically bailed in if the bank runs into trouble, converting to less valuable shares—much less, given the bail-in means the bank is in trouble. Such securities are very complex and have numerous bail-in triggers; this complexity has led other countries, including the UK, to ban banks from selling them to unsophisticated "mum and dad" retail investors who may not understand the risk.

However, Australia's banks are actually *targeting* such mum and dad investors, which the Australian Prudential Regulation Authority (APRA) is allowing. They list their hybrids on the Australian Securities Exchange (ASX) and sell them to individuals via stockbrokers. The *AFR's* Shapiro noted they are especially targeting self-managed super funds which "have proved to be a deep pool of capital. *These investors know and trust the banks*…" (Emphasis added.) Shapiro continued, "But the fact that the banks are selling *crisis insurance* to the same constituent they are seeking to protect—their customers and depositors—has its complications. *It is much harder for banks and their regulators to force losses on bondholders or hybrid holders if they're also the depositor and customer in the same banking system*." (Emphasis added.)

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Rate sheet

Major bank hybrid terms

Issuer	ASX code	Call date	Margin (%)	Current rate (margin +2.28% bank rate, %)	Price ($)	Running yield (current rate/ price, %)	Yield to maturity (est %)
ANZ	ANZPA	Dec 16	3.10	5.38	99.65	5.39	5.44
ANZ	ANZPC	Sep 17	3.10	5.49	99.35	5.52	5.88
ANZ	ANZPD	Sep 21	3.40	5.79	91.20	6.34	7.76
ANZ	ANZPE	Mar 22	3.25	5.64	90.80	6.21	8.08
ANZ	ANZPF	Mar 23	3.60	5.99	91.11	6.57	8.14
CBA PERLS 6	CBAPC	Dec 18	3.80	6.08	98.95	6.14	6.96
CBA PERLS 7	CBAPD	Dec 22	2.80	5.08	86.70	5.85	7.82
CBA PERLS 8	New listing	Oct 21	5.20	7.48	100.00	7.48	7.48
NAB	NABHA	Perpetual	1.25	3.53	63.85	5.52	6.00
NAB	NABPA	Mar 19	3.20	5.48	96.12	5.70	7.25
NAB	NABPB	Dec 20	3.25	5.53	92.80	5.95	7.59
NAB	NABPC	Mar 20	3.50	5.78	94.75	6.09	7.57
Westpac	WBCPC	Mar 18	3.25	5.64	100.12	5.63	6.75
Westpac	WBCPD	Mar 19	3.20	5.48	95.50	5.73	7.07
Westpac	WBCPE	Sep 22	3.05	5.33	88.15	6.04	7.84
Westpac	WBCPF	Mar 21	4.00	6.28	95.50	6.57	7.62
Westpac	WCTPA	Jun 16	1.00	3.28	99.50	3.29	6.18

The CBA's most recent hybrid (bail-in) security issue was at a much higher interest rate than similar hybrid issues, as evident in this *AFR* table of major bank hybrid issues. "Mum and dad" investors buy these securities, believing Australia's banks are safe, but why would CBA need to offer such a high rate unless it was desperate for the money?

The truth is APRA, which otherwise states it won't bail-in Australian bank deposits to prop up banks, has established in Australia a system of contractual bail-in to achieve the same result, and is therefore letting the banks target the same people who would be victims of depositor bail-in—mums and dads.

The only assurance Australians have is the widespread belief that the Big Four banks, especially CBA, are the strongest banks in the world. Like picking daisies in a minefield, that belief requires people to ignore certain explosive realities, especially the massive property bubble in Australia, which, stretched to bursting, will bankrupt the entire banking system when it crashes. In late February just two media reports on Australia's housing market being a bubble triggered carnage in Australian banks stocks and a flurry of derivatives bets that the banks would default.

Which brings up, again, CBA's most recent hybrid issue. Why did CBA offer an interest rate so much higher than comparable securities issues? The most logical explanation is that, at that time, CBA really needed the money—fast. (Interest rates tend to rise fast when there is desperation borrowing in financial markets of the sort that keeps loans sharks in business.) If this was the case, the question is why? Since 2012 CBA, the biggest and supposedly the most profitable of the Australian banks, has had a policy of not disclosing its full exposure to derivatives obligations; it is embroiled in a slew of other scandals; and last week it issued a $1.6 billion residential mortgage-backed security (RMBS)—more than double the initial $750 million issue the bank had announced—priced at 1.4 per cent above the baseline rate, more than one third higher than its previous RMBS. All of this raises the question: is CBA engaged in high-risk activities to inflate its profits, that are catching up with it and putting its bail-in bond holders at risk?