# Replacing upcoming maturing bank hybrids

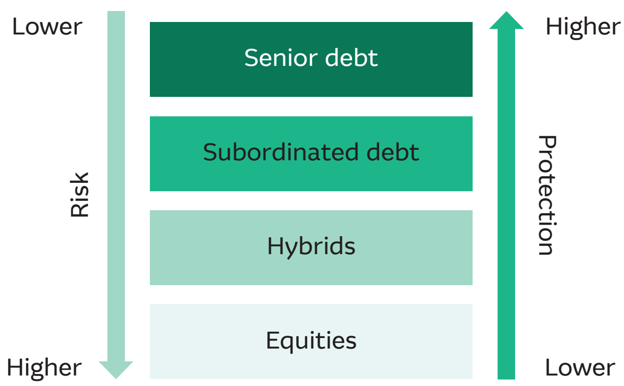
## What has happened?

APRA, the banking regulator, has made the decision to phase out bank hybrids. Accordingly, investors holding hybrids with upcoming maturities may be looking to evaluate alternate replacements.

## What are the alternatives?

Given hybrids have commonalities with both bonds and equities there are a range of alternatives that could be considered. When analysing the features, returns and characteristics of hybrids, subordinated debt emerges as one of the closest alternatives. In fact, Brett Lewthwaite, the CIO and Global Head of Fixed Income at Macquarie Asset Management, described subordinated debt as, "the most genuine hybrid replacement, with a similar risk-return profile across high quality issuers.'

This is because subordinated debt is the closest security to hybrids in a banks' capital structure. Hence, with the removal of hybrids, APRA has mandated that the major banks replace most of their own hybrid exposure with subordinated debt.




## How do you access subordinated debt?

One of the attributes investors liked as part of the hybrid structure was their accessibility as they were traded on the ASX. However, one of the hurdles to investing in subordinated debt is that unlike hybrids, these bonds do not trade on the stock exchange, making it harder to access.

Macquarie Asset Management has recently launched the **Macquarie Subordinated Debt Active ETF (ASX: MQSD)**, which being an ETF, is tradable on the ASX and can provide access to subordinated debt. An active ETF like MQSD gives investors access to a wide range of bonds from predominately Australian banks and other financial institutions - diversifying risk away from one bank or specific hybrid, while investors benefit from the professional management of Macquarie Asset Management, one of Australia's largest and most experienced active asset managers.

## Active ETF vs hybrid security: a comparison

It is important to note that whilst subordinated debt is one of the closest alternatives, it is not an identical security to bank hybrids. Below we outline some of the key similarities and differences. Whilst subordinated debt does not offer franking credits, which are now only available via Australian equities, it does still offer a compelling yield relative to hybrid securities. In addition, it offers a potential monthly income stream and diversification across major banks and other financial institutions. Providing a potential for a regular stable distribution designed for those with an income related goal.

| | Macquarie Subordinated Debt Active ETF | Typical hybrid security |
|---|---|---|
| Income frequency | Typically monthly | Quarterly |
| Tradable on the ASX? | Yes | Yes |
| What the capital structure rank? | Higher (subordinated) | Lower (hybrid) |
| Is the investment diversified | Yes, a range of subordinated debt securities | No, single security |
| Are there franking credits? | No | Yes |

## Target investors

The Target Market Determination **(TMD)**, **available at macquarie.com/mam/TMD**, includes a description of the class of consumers for whom the Fund is likely to be consistent with their objectives, financial situation and needs.

## Risks

All investments carry risk. Different investments carry different levels of risk, depending on the investment strategy and the underlying investments. Generally, the higher the potential return of an investment, the greater the risk (including the potential for loss and unit price variability over the short term). The risks of investing in this fund include:

**Investment risk:** The Fund seeks to generate higher income returns than traditional cash investments. The risk of an investment in the Fund is higher than an investment in a typical bank account or term deposit. Amounts distributed to unitholders may fluctuate, as may the Fund's NAV unit price, by material amounts over short periods.

**Manager risk:** There is no guarantee that the Fund will achieve its performance objectives, produce returns that are positive, or compare favourably against its peers, or that the strategies or models used by the Investment Manager will produce favourable outcomes.

**Income securities risk:** The Fund may have exposure to a range of income securities. The value of these securities may fall, for example due to market volatility, interest rate movements, perceptions of credit quality, supply and demand pressures, a change to the reference rate used to set the value of interest payments, market sentiment, or issuer default.

**More information on the risks of investing in the Fund is contained in the Product Disclosure Statements for each class of units in the Fund, which should be considered before deciding to invest in the Fund.**

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