



CBA unlocks market for retail bonds

Now there's an alternative to online savings accounts and term deposits, with more room to move. writes **John Collett**

MANY small investors who want safe, income-producing investments have had a rough time in recent years. But the launch of a bond series by the Commonwealth Bank signals the creation of the retail bond market that is badly needed by investors. The bond will be listed on the Australian share-market and is expected to pay more than 6 per cent a year, provided the cash rate does not fall. It's important for potential investors to understand that the bond differs from fixed rate invest-

ments, like term deposits, in that the interest rate on the bond will rise or fall to reflect any increases or decreases in the cash rate.

Investor demand is likely to be strong, given the financial strength and brand power of the bank. And importantly, the minimum amount to invest is only \$5000.

It's likely to appeal, especially, to those thousands of older investors who thought they were investing in safe, income-producing mortgage funds only to see their capital frozen or withdrawals restricted. To shore

up confidence in deposit-taking institutions when fears of the global financial crisis peaked in late 2008, the government introduced its guarantee on deposits with banks, credit unions and building societies. Cash flowed into these accounts and stopped flowing into mortgage funds.

Many investors in these funds wanted their money back. But the underlying assets – mortgages – could not be sold quickly and the funds had to freeze or restrict

redemptions. There is still about \$9 billion locked up in mortgage funds and about the same amount in property funds.

Until now, investors have not had many alternatives for cash. The bonds of the big four banks usually have investment minimums of

\$500,000, limiting their use to “wholesale” investors, such as super funds.

CBA's retail bond pays a constant 1.05 percentage points margin above the 90-day bank bill rate. At the moment, the bank bill rate is about 5 per cent. The bank bill rate normally is about 0.25 percentage points above the cash rate. If that margin holds, CBA bonds can be expected to pay about 1.25 percentage points above the cash rate set by the Reserve Bank. The cash rate is 4.75 per cent so expect the bond to pay just above 6 per cent.

Most market watchers expect the cash rate to go higher so the CBA bond compares well to term deposits, says a senior client adviser and strategist with Austock Securities, Michael Heffernan. “I cannot come up with too many negatives for it,”

The minimum amount to invest is only \$5000.

27-Nov-2010

Page: 14

Business News

By: John Collett

Market: Sydney

Circulation: 211066

Type: Capital City Daily

Size: 494.48 sq.cms

Frequency: MTWTFS-



BONDS V SAVINGS ACCOUNTS

	Online savings account	Term deposit	CommBank retail bonds
Issuer	Bank, credit union or building society	Bank, credit union or building society	Commonwealth Bank of Australia
Protection under government guarantee	Yes	Yes	No
Term	At call	One month to five years	Five years
Interest rate	Variable	Fixed	Floating
Interest payment dates	Usually monthly	End of term or per annum	Quarterly
Access	Yes, though may lose any "bonus" interest rate	No. Break fee for early termination	Yes, listed on ASX

SOURCE: CBA/SMH



27-Nov-2010

Page: 14

Business News

By: John Collett

Market: Sydney

Circulation: 211066

Type: Capital City Daily

Size: 494.48 sq.cms

Frequency: MTWTFS-

But to get the bonus interest, certain conditions have to be met, such as maintaining a minimum balance or not making any withdrawals.

The CBA bond pays the interest quarterly and investors receive their initial capital back at the end of the five-year term. As the bond will be listed on the sharemarket, investors can sell their bonds at any time but will have to pay brokerage costs.

With most investments, retail investors typically pay more than wholesale investors.

"It is great to see that retail investors in the CBA deal are set to receive a return similar to that available at the wholesale end of the market," says Elizabeth Moran, the director of fixed income research at FIIG Securities, a co-manager of the

bond issue.

There is no franking as the bond is an interest-bearing debt instrument and tax on the income is paid at the investor's marginal tax rate, though tax could be saved by holding the bonds in a self-managed super fund.

The bonds are not covered by the government deposit guarantee but that is not likely to deter small investors. "There are not too many 'AA' rated banks left globally and we have four of them," Moran says.

Earlier this year the Australian Securities and Investments Commission, working with Treasury, allowed listed companies to issue "vanilla" bonds for retail investors that require only short-form disclosure, to make it cheaper for companies to issue bonds in small parcels.

The Commonwealth Bank is issuing \$500 million worth of bonds but is prepared to issue up to twice that if there is demand. However, if the offer is oversubscribed and there is a scale-back, Commonwealth Bank shareholders and customers will be given priority allocation.

Moran says this is the start of a retail bond market. "We do expect this will pave the way for the other big banks to follow," she says.

The banks are passing on their higher funding costs by raising the interest rates on their mortgages by more than the increases in the official cash rate. "They all have similar funding pressures and for them to have an additional source of funding makes sense," Moran says.

CommBank Retail Bonds Series 1

- ▶ **Interest rate** 1.05 percentage points above the 90-day bank bill rate.
- ▶ **Interest paid** Quarterly. For the first quarter, the interest rate will be no lower than 6 per cent.
- ▶ **Term** Five years.
- ▶ **First interest payment** April 15, 2011.
- ▶ **Maturity** December 24, 2015
- ▶ **Minimum amount** \$5000.
- ▶ **Offer closes** December 17, 2010.
- ▶ **Lists on ASX** December 24, 2010.
- ▶ **Offer document and application form** Phone 1800 022 440 or visit commsec.com.au.