GUIDANCE NOTE – Hybrid Securities

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Introduction

The growth in the NZDX market over recent years has been very significant, both in terms of new securities issued, as well as in the secondary trading of these securities.

The range of new debt securities offered has also become increasingly sophisticated with the introduction of both (i) instruments that have both debt and equity characteristics; and (ii) products which group debt securities to provide investors with a degree of diversification.

The traditional distinction between debt and equity securities is now less distinctive. In reality, many recent debt issues have incorporated equity aspects, which provide listed issuers with a greater degree of flexibility in capital raising options than traditional vanilla fixed interest investments. For example, the ability to convert, and the ability to call early, such instruments have created a class of hybrid securities which have provided issuers with an extended range of financing options.

NZX has recognised these different characteristics in the treatment of these securities under the Listing Rules and will now reflect these differences in the pricing of hybrid securities as set out below.

Background on treatment under the Listing Rules

Hybrid securities have both debt and equity characteristics and sit in the middle of the debt/equity spectrum. NZX has the discretion to determine whether a security will be considered an equity security or debt security under the Listing Rules. Increasingly, securities have been created that have both equity and debt characteristics which makes it difficult to define which category they fall into under the Listing Rules.

Where a security has both debt and equity characteristics, by default, it is considered an Equity Security under the Listing Rules. The Listing Rules define an Equity Security by reference to the ability to share in the profits of an Issuer, voting rights, rights on liquidation and convertibility. Issuers often apply to NZX for Ruling that their security be considered debt under the Listing Rules, when in the absence of such ruling the security would be treated as Equity.

This Guidance Note is intended to assist applicants by setting out the considerations NZX may apply in exercising its discretion to rule whether a security (particularly hybrids) is debt or equity.

Characteristics for assessing hybrid securities

While not determinative, if a security has any one of the following characteristics, it is likely to be described as a hybrid security:

- Predictable dividend returns through the term of the security.
- Ability to elect to convert into another security of the Issuer on a reset date with the Issuer having the first right to redeem the security for cash if such an election is made.
- A convertibility aspect. This can include where conversion is being based on the face value of the hybrid security to the current market value of the security which the hybrid security is being converted in to.
- Variable return on the maturity (if not perpetual).

Treatment of Hybrid Securities

Under the Listing Rules, a hybrid security is likely to be an Equity Security. The Issuer may apply to NZX for a ruling that its security be treated as a Debt Security. Where NZX, in its discretion, determines that a hybrid security should be treated as a Debt Security under the Listing Rules, it may decide to impose conditions such as:

- Where there is subordination, that the offer documents contain clear disclosure of the terms of subordination and ranking.
- If the hybrid security converts into Equity Securities (e.g. shares), any future offer documents for the issue of Equity Securities contains full disclosure of the terms of conversion of the hybrid securities.
- The conversion of the hybrid securities must be approved by shareholders of the Issuer.

Where a security has both debt and equity characteristics under the Listing Rules (i.e. a hybrid security) and, upon application by the Issuer, NZX has determined that security to be a Debt Security, then the pricing schedule below shall apply to that security.

Applicable Fees for Hybrid Securities

Normally, because of the quotation basis and equity characteristics, the applicable listing fees would be based on equity. In recognition of dual status of hybrid securities and the determination by NZX that the hybrid security is to be considered a Debt Security under the Listing Rules, the listing fees are based on a mid point between debt and equity fees.

Initial Listing Fees *Applicable debt fee + 20% of (applicable equity fee – applicable debt fee)*			
Market Cap	NZDX	Hybrid ILF	NZSX
$50 million	$8,250	**$13,500**	$33,500
$100 million	$8,250	**$17,240**	$53,200
$200 million	$8,250	**$23,309**	$83,545

Subsequent Listing Fees *Applicable debt fee + 20% of (applicable equity fee – applicable debt fee)*			
Market Cap	NZDX	Hybrid	NZSX
$50 million	$4,125	**$7,740**	$22,200
$100 million	$4,125	**$9,040**	$28,700
$200 million	$4,125	**$11,120**	$39,100

Annual Listing Fees *Applicable debt fee + 25% of (applicable equity fee – applicable debt fee)*			
Market Cap	NZDX	Hybrid	NZSX
$50 million	$6,300	**$8,475**	$15,000
$100 million	$7,700	**$12,025**	$25,000
$200 million	$8,500	**$15,125**	$35,000

Implementation details

Effective date

The applicable fees for hybrid securities set out above will apply to any hybrid securities that commence quotation from 5 March 2007.

Existing hybrid securities

All existing hybrid securities will continue under their current pricing scheme in relation to annual fees and fees relating to issues of additional securities of the same class. If an Issuer issues a further class of hybrid securities, then the hybrid pricing schedule shall apply to the new class of securities. The existing class of hybrid securities will continue to be charged under their existing fee schedule.

Examples of pricing for new hybrid securities

Example 1: Issuer A has $50m of hybrid securities paying an 8% coupon with a conversion date of 30 June 2008 and was issued on 30 June 2006. Issuer A's annual fees do not change under this pricing update.

Example 2: On 1 April 2007, Issuer A issues $50m more hybrid securities but this time paying an 8.25% coupon with the conversion date of 30 June 2008. This is a new security class and the new annual listing fee of $8,475 and subsequent listing fee of $7,740 applies.

Scope of Change

It is important to note that this Guidance Note is limited to the pricing and treatment of hybrid securities. It does not make any changes to the way in which hybrid securities will be traded (other than confirming that hybrid securities will sit on the NZDX) or the way in which hybrids are reported i.e. there is no separate data reporting for hybrid securities.

For any queries on this Guidance Note please contact:

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