focus

Bonus Bonds
The house was the winner

1970 — The Beatles released their final album 'Let it Be', Brazil became the first team to win the FIFA World Cup three times, pirate radio station Radio Hauraki was finally awarded a license, and the New Zealand Government launched Bonus Bonds through the Post Office Savings Bank.

FORSYTH BARR

...Every dollar held gave you an entry into a monthly prize draw...

While by no means the highlight of 1970, Bonus Bonds were dreamt up by the government to promote New Zealanders to save more. Attracting $400m in the first few years, this appeared to have worked and they proved to be a beloved product and a key item (along with socks and undies) in a grandparent's birthday and Christmas gift armoury. But no longer.

ANZ, who acquired Bonus Bonds through the purchase of Postbank, announced that they are winding up the product. While this may disappoint the estimated 1 million bondholders, who as at 18 August held $3.3bn in Bonus Bonds, the reality is that the biggest winner was always ANZ.

From a customer's point of view Bonus Bonds were simple and enticing. Every dollar held gave you an entry into a monthly prize draw - with major prizes of $1million, $100,000 and $50,000. Each month the lucky few received their prize money and the unlucky majority received nothing, although you still kept your Bonus Bonds and continued to be eligible for future draws.

Like Lotto, most bondholders appeared to be enchanted by the prospect of a major prize win, but failed to recognise the low overall expected returns. All one need do is check the odds. Based on August's numbers a bondholder with $100 would have a 1-in-32,888,786 chance of winning the million and a 99.9% chance of receiving nothing. While we acknowledge that every month a winner receives a potentially life-changing $1 million, over the long-run most people would have been better off with their money elsewhere. Based on the August prize draw, the total expected return from Bonus Bonds across all holders was 0.82% per year, even less than you'd receive in the bank.

ODDS OF WINNING BASED ON AUGUST'S PRIZE LEVEL DRAW

Prize Level	Number of prizes Drawn	Odds of winning with $100 of Bonus Bonds
$1,000,000	1	1 in 32,888,786
$100,000	1	1 in 32,888,786
$50,000	1	1 in 32,888,786
$5,000	10	1 in 3,288,879
$500	35	1 in 939,680
$100	18	1 in 182,715
$50	1160	1 in 28,352
$20	48,062	1 in 684
$0	3,288,829,352*	Very high (99.9%)

Source: ANZ, Forsyth Barr

*Assuming the same number of bondholders as at 18 August

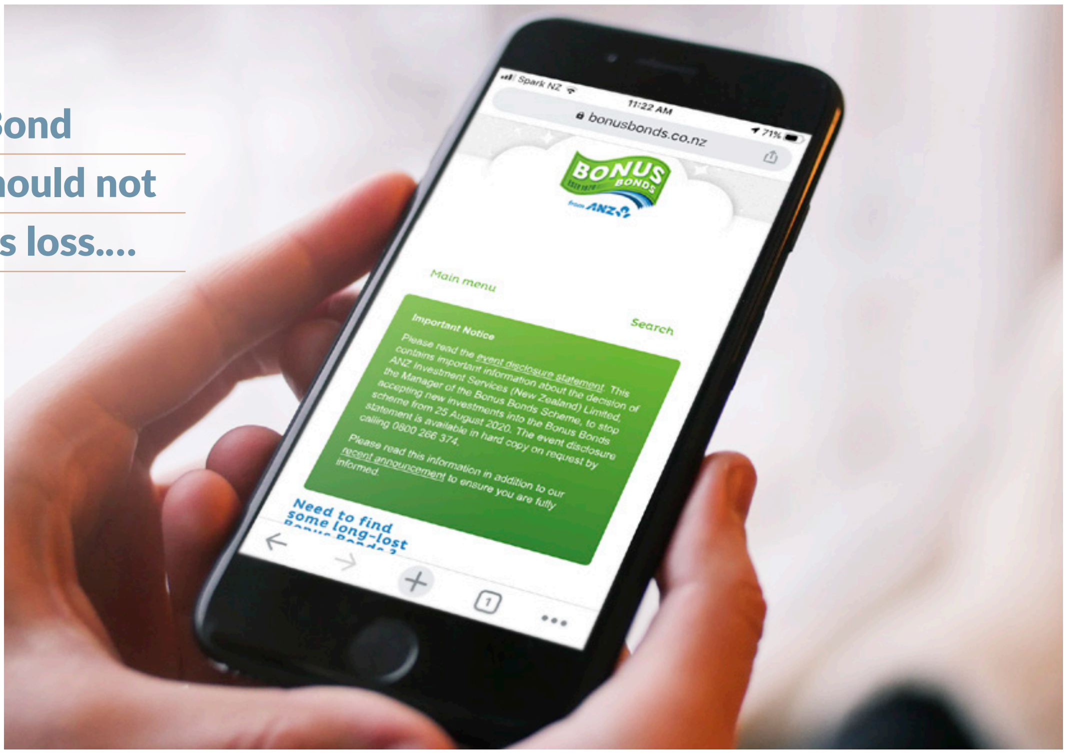
...even to the extent of declaring Bonus Bonds a “gravy train” for ANZ...

These prizes have been successfully marketed as winnings, but bondholders are really just receiving a return on investment. The prize money doesn’t grow on trees, the funds from Bonus Bonds are pooled together and invested in low-risk assets (think government bonds and term deposits). The interest generated from these investments is what forms the prize pool. The winners are given the lions share and the majority receive no return at all. The money in the prize pool is of course after taxes and the management fees ANZ receives for running the scheme, which for the year ended March 2019 is reported to have been $40.7 million - exceeding the total prize money paid out ($39.6 million). Like a casino, the house was the winner.

As you might expect these fees have led to criticism, including from fund managers and academics, even to the extent of declaring Bonus Bonds a “gravy train” for ANZ. So then why has the gravy run out? It is a casualty of the low-interest-rate environment. With interest rates looking set to stay at ultra-low levels for the foreseeable future it becomes difficult to earn enough return to maintain the prize pool (even after ANZ reduced the management fees from 0.95% to 0.4% in July).

Now Bonus Bond holders are faced with a choice – cash in their Bonus Bonds before October and be guaranteed $1 per Bonus Bond, or go through the wind-up process. This process could take up to a year, during which ANZ converts the scheme’s assets into cash. Will this be worth the wait?

...Bonus Bond holders should not mourn this loss....



ANZ has said it has $56m in Bonus Bonds reserve. Provided the costs of winding up the scheme don't exceed this amount (they shouldn't come close) those still holding Bonus Bonds would receive their $1 per Bonus Bond plus their share of the reserve. $56m sounds like a lot of money, but when divided across all the Bonus Bonds currently on issue it's only 2 cents each! Rather ironically, though it's still a higher return than the average holder received in the last year.

Bonus Bond holders should not mourn this loss. For the thrill seekers hoping to strike it lucky; buy a Lotto ticket. For the investors wishing to grow their wealth; the vast majority were better off elsewhere anyway.

Matt Noland
Analyst, Wealth Management Research

Thinking about what to do with your Bonus Bond proceeds? You may be wanting to add it to your first home savings inside KiwiSaver, or seeking an actively managed investment across different investment sectors as an alternative to term deposits. Talk to your Financial Adviser about how the Forsyth Barr Investment Funds and the Summer KiwiSaver scheme can be used to support your investment objectives.

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