CANACCORD Genuity

Preference Shares and Permanent Interest Bearing Shares

What are Preference Shares?

Preference shares (prefs) are so called because they have preference over ordinary shares for payment of dividend or return of capital. However, they are junior to all forms of company debt, including debentures, loan notes and bank debt on a winding-up.

A company can be put into administration if it fails to pay interest on its debt, but preference dividends, like ordinary dividends, are paid at the discretion of directors. This means that preference shareholder rs have no recourse to the company in the event of non-payment, although the company will not be able to pay an ordinary dividend until preference dividends have been paid.

Prefs pay dividends twice annually. Dividends are paid net: this means that the basic rate Income Tax liability of a UK investor has already been discharged. Most prefs are undated, but one or two have a final redemption date. Most are cumulative: this means the company is obliged to pay any pref arrears from previous years before it can pay an ordinary dividend. There are also, however, some non-cumulative bank pref shares, which were issued by banks to boost their tier 1 capital bases.

Purchases of prefs, like equities, are subject to 0.5% stamp duty. The capital gains and income tax treatment is also the same as for equities. Prefs are dealt "dirty price" i.e. with accrued dividend in the dealing price, and not dealt separately as with bonds.

What are Permanent Interest Bearing Shares?

Permanent Interest Bearing Shares (PIBS) are building society shares listed and traded on the London Stock Exchange. Generally they have a fixed coupon, and are irredeemable or callable at the issuer's option. Often the coupon is reset to a floating rate if the call is not exercised.

On a winding up, PIBS holders rank behind all other lenders, depositors and members holding share accounts, and any repayment would be limited to par, or 100p per share. Unpaid interest is non-cumulative: i.e. if the society fails to pay interest one year, it will not be required to pay any arrears in future.

Interest is paid gross semi-annually: an investor should then declare it on his tax return.

PIBS are dealt clean of interest: this means that the accrued interest is settled separately, as it is with bonds. No stamp duty is payable on UK issues.

Where a former building society has been taken over or converted to a plc, the PIBS have been converted to perpetual subordinated bonds, whose characteristics are similar to PIBS: typically, however, any unpaid interest on subordinated bonds is cumulative, and arrears can be made up in future years.

PIBS and subordinated bonds can be dealt only in round amounts, varying from 1,000 shares up to 100,000.