The wisdom of crowds

THE UK RETAIL BOND MARKET IS BEING TALKED UP AS AN UNTAPPED SOURCE OF CORPORATE FUNDING. **PETER WILLIAMS** ATTENDED AN ACT BREAKFAST BRIEFING TO FIND OUT MORE.

To find the last active UK retail bond market you have to go way back to the late Victorian era when companies engaged in building railways in faraway countries regularly issued such paper. Peter Matza, head of publishing at the ACT and chair of the breakfast briefing, suggested that it was safe to discount this 19th century experience and to treat the rise of the UK retail bond as a new phenomenon.

Introducing the speakers, he wondered why, with such well-established markets as the US private placement and the continental European retail bond market, a UK market has to date been conspicuous by its absence.

The answer was provided by Adrian Bell, head of debt advice and origination at Evolution Securities, who suggested that several factors were contributing to a seismic shift in the retail savings market. He said that the search for yield, the desire to diversify away from bank deposits and equity – both of which were seen as sources of too much risk – and the re-emergence of inflation were all encouraging retail customers to look for new ways to save.

Bell told the audience: “There had not been a retail bond market because UK short-term rates had been far higher than continental Europe or US rates. When interest rates collapsed, savers went out on the yield curve but they got worried after three years. People were also impacted by the rising rates of marginal tax, so they looked around for security and a par return and they found that certainty was not around.”

While bond funds gained from this trend, investors are looking to make direct investments – often for the first time – attracted by the certainty of income and capital repayment at par on maturity. The

London Stock Exchange responded to this move with the launch of the Order Book for Retail Bonds (ORB) in February 2010 (see box).

Bell described the burgeoning retail bond market as an exciting and unique new opportunity for borrowers. In the first half of 2010 there were three issues, totalling £100m; in the first half of 2011 there were seven, raising £840m. The market provides issuers with diversification, greater flexibility on size (issues can start at £25m), predictability, a good price and brand enhancement.

This market allows an issuer to tap a new group of investors who provide steady demand with a preference for frequent issuance and who are happy that the bonds can be made tax-efficient through the use of ISAs or SIPPs. Accessibility is the key, and although investors prefer to buy bonds from named corporates, this problem is not insurmountable, as Places for People (PfP) recently demonstrated. Demand is currently far outstripping supply.

The meeting also heard from PfP, the latest organisation to issue a retail bond. Chris Jones, group head of tax and treasury at PfP, explained the thinking behind its £140m issue with a coupon of 5% and a maturity date of 2016. One of the largest housing associations in the UK, PfP is a commercially run business whose objective is to build sustainable communities and which currently provides 62,000 social homes nationwide. He described the business as a safe haven ethical asset class.

The rationale behind accessing retail investors was a change to the traditional funding model, which historically was 40% housing grant and 60% bank debt. With bank funding more challenging to source, PfP wanted to diversify its funding sources and investor base. Retail bonds provided that desired further diversification of the investor base. Jones said that the bonds provided scope to fill the five to 10-year maturity bucket with demand from retail investors. He added that the LSE's introduction of ORB helped issuers by providing investors with greater transparency on pricing and easier access to new bond offers.

PfP was able to use existing documentation from its existing euro medium-term note (EMTN) programme. Fresh from issuing the bond, Jones was able to explain how PfP had handled the process.

The general process is not that dissimilar to wholesale bond issuance. Jones suggested that a clear strategy is required – including size of issue, coupon and covenant parameters – but that flexibility should be built in. Early in the process it is important to engage and educate the intermediaries – brokers, private banks and wealth managers – particularly if the brand and sector is unfamiliar to investors.

An investor roadshow lasting two or three weeks is a must, and Jones suggested that issuers had to do more than visit just Edinburgh and London. PfP also travelled to Leeds, Liverpool, Birmingham and the Channel Isles and talked to more investors through telephone conferences. One of the key differences between wholesale and retail bonds is the marketing and publicity campaign required. PfP advertised in key financial press and talked to financial journalists as part of a PR campaign to ensure the key messages about the retail bond were widely understood. Jones said that this had resulted in strong and positive coverage from influential journalists.

The issuer also has to appoint a range of distributors: execution-only brokers, stockbrokers, private banks and wealth managers. And the bond offerings must be announced via the LSE's Regulatory News Service (RNS), normally setting out a two-week offer period.

Finally, Jones addressed the issue of brand profile, reputation and loyalty. While PfP is well known in the social housing sector it has little profile in the wider public domain. At first this was seen as a major potential barrier to execution success. However, Jones and his colleagues made considerable efforts to educate distributors about the business model, the sector and the challenges and opportunities both prior to and during the roadshow. The work paid off. Investors welcomed the diversification – previous retail bond issuers were mainly financial companies – and after an initial announcement that PfP was seeking to raise £50m, this sum was subsequently increased three times until the £140m final issuance.

Closing the breakfast briefing chairman Matza recalled being quizzed while in Germany receiving treatment by a dentist who was a serious bond investor. It would be unfair to compare the current retail market with pulling teeth but when such a conversation comes to the UK's dental treatment rooms, then we will know the retail bond market really has taken root.

Reread the article by Adrian Bell and his colleagues in the July/August issue of The Treasurer: Stores of Capital, page 20.

The Order Book for Retail Bonds

The Places for People story is another important milestone in the work of the London Stock Exchange to establish an Order Book for Retail Bonds (ORB). The initial offering in February 2010 has now been expanded to support over 90 corporate and four supranational bonds. RBS issued the first bond for the new platform tradeable in denominations of £100.

According to Gillian Walmsley, head of fixed income products at the LSE, ORB was a response to the exchange's perception that private investors were increasingly focusing on fixed income products in their search for an alternative asset class given the low interest rate environment and recent equity market volatility. Trading in individual debt securities allows investors to select particular bond issues and so tailor their portfolio.

The IMA Asset Management Survey 2009/10 found that investment in bonds had increased 27% on the previous year, with private investors making up 90% of the net total bonds inflow of £10.7bn.

ORB has two main aims: to develop an efficient and transparent secondary market in bonds for UK private investors, and to establish a primary market for the distribution of dedicated retail bonds.

The market, according to Walmsley, is transparent and has a high degree of regulatory supervision. Currently five market makers are quoting two-way prices in a range of retails bonds throughout the trading day, which means that private investors can see continuous tradeable prices on screen to monitor the value of their portfolio.

Peter Williams is editor of The Treasurer.
editor@treasurers.org