EUROWEEK

Order book for Retail Bonds (ORB) Roundtable

September 2013

In association with:

London Stock Exchange

Simon Atkinson, London Stock Exchange Group

Marcus Coverdale, Lloyds Bank

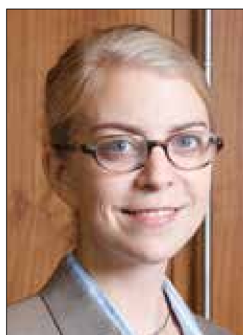
Patrick Gordon, Killik & Co LLP

Darren Ruane, Investec Wealth & Investment

Phil Shepherd, Provident Financial

Gerard Tyler, Severn Trent

Gillian Walmsley, London Stock Exchange



Nina Flitman, *EuroWeek*

ORB at the centre of corporate financing shift

In February 2010, the London Stock Exchange's Order book for Retail Bonds (ORB) opened the debt capital markets to UK retail investors, allowing them to access selected Gilts, supranational and corporate bonds. For the domestic corporate borrower base looking for an alternative, flexible source of capital to bank funding, the ORB has become increasingly attractive, while the platform has also provided greater accessibility and transparency in secondary market bond trading for private investors.

Since its launch, ORB has enabled UK firms to raise over £3.4bn, but now the focus has shifted to how the platform can grow to attract a wider range of participants on both sides of the market.

Some of the investors and borrowers that have participated in ORB transactions gathered in London in early September to discuss their experiences of the market and how they want it to develop.

Participants in the roundtable were:

Simon Atkinson, group treasurer, London Stock Exchange Group

Marcus Coverdale, director fixed income debt capital markets, Lloyds Bank

Patrick Gordon, senior investment strategist, head of fixed income, Killik & Co LLP

Darren Ruane, head of fixed income, Investec Wealth & Investment

Phil Shepherd, group treasurer, Provident Financial

Gerard Tyler, treasurer, Severn Trent

Gillian Walmsley, head of fixed income UK, London Stock Exchange

Moderated by **Nina Flitman**, syndicated loans and leveraged finance editor, *EuroWeek*

EUROWEEK: As Provident Financial is one of the borrowers that has been a repeat issuer in the ORB market, how has it fitted into your financing strategy?

Phil Shepherd, Provident Financial: Provident Financial is a FTSE 250 business with, for a financial institution, a relatively modest funding requirement of a little over £1bn. Before the crisis, we were predominantly funded through the bank markets with a small amount of US private placements. With our requirement, we are almost too small for the institutional bond markets as we can't be a repeat issuer. We do have an institutional bond in issue, but it's relatively illiquid given our size. So we identified the retail bond market early on as being a good market for us, and we've now done four issues. We were one of the first originators back in April 2010, and we've done an issue in March or April every year since.

The attraction of the retail bond market was to diversify our financing, but we were also interested in the ability to do smaller issue sizes. A size of £50m-£100m meets our requirements on a repeat issuance basis. We've enjoyed strong success in the market by making sure that we price appropriately and by having a very clear view of what we wanted to achieve in the market. This has helped us to achieve our overall objective of diversifying our funding.

Marcus Coverdale, Lloyds Bank: I think the ability to print in small sizes is key to the importance of the retail bond market. Many borrowers have had institutional bonds in issue of £200m-£300m, which is the minimum benchmark size, and they've all suffered from poor secondary market performance. This can impact the next

time you want to come to the market and the pricing you can achieve. So I think the small deal sizes you can do in the retail market is really important.

EUROWEEK: How can the small sizes of deals available allow borrowers to manage their maturity curves?

Shepherd, Provident Financial: If you look at our balance sheet, our £250m institutional bond made up at the time of its issue about a quarter of our debt, and has a bullet repayment. I think doing £50m deals over a number of years enables you to have a smoother maturity profile. Having £50m or £100m maturing in any single year is clearly more sensible for a business like ours than having £250m maturing in a single year.

Darren Ruane, Investec: If I can add to that point, from what we see from the investor's side, issuers quite like the idea. Many of them come to us and say that they have bank financing that's due in the next two or three years and that they'd like to term that out as far as they can. As interest rates are quite low at the moment, they want to term it out at these rates. For many of these issuers it makes sense for them to do smaller deals on a retail basis.

Patrick Gordon, Killik: I think the fact that under the ISA rules a bond needs to have five years until maturity at the time of purchase in order to qualify for inclusion in the ISA means that this product fits that gap in the market that is slightly beyond a company's traditional bank financing. So for a deal to also be of interest in the secondary market for ISA investment, 5-1/2 to seven years seems to be the sweet spot.

Gillian Walmsley, London Stock Exchange: In terms of the funding sizes, we've seen really good, strong liquidity in the £25m and £35m issues. What's been particularly attractive to all issuers is that there's quite a diversity in terms of the size that can come to market. ORB can support a small issue of £25m or £35m and the much larger issues, like the £282.5m from National Grid and the £300m from the Stock Exchange Group.

Simon Atkinson, London Stock Exchange Group: Speaking of our deal, I would support Phil's objectives for issuing — it was equally about diversifying away from bank financing and also extending the maturities of our debt profile.

We came to the retail bond market last autumn for the first time. We were keen to push our maturity profile beyond 2020, and one of the questions for us with our lead managers at that time was about whether the market would have appetite for that. But that was something that was not an issue in the end — a nine year deal was clearly not beyond the market, and we achieved a very big size. The London Stock Exchange Group has now moved its debt levels up to beyond £1bn with the financing of the recent acquisition of 58% of the LCH Clearnet Group, and so the £300m retail bond fits reasonably well into that profile. We also have a growth strategy as a group, and potentially as our earnings increase, our debt capacity will increase as well.

So not only was the amount helpful to us, in the context of what we've financed since, but also the appetite we found in the longer maturity certainly helped our profile.

Simon Atkinson,
LONDON STOCK EXCHANGE GROUP

Gerard Tyler, Severn Trent: From our point of view at Severn Trent, the £75m retail bond we did is never going to replace our reliance on the wholesale market —we did £500m there earlier this year and that market's always going to be the mainstay of our funding. So our retail deal was a diversification play, but we're also interested in a couple of other things.

One was that we have quite a wide, small investor base that is a legacy of our privatisation 20-odd years ago. We realised that there was probably quite a considerable following of small shareholders who might be interested in investing into our bonds through their ISAs or their pension schemes. We were also quite keen to be able to use it as a bit of promotion for the company. When we go on the road and talk to the fund managers and the brokers they're interested in our equity, but bonds are an adjunct to that. They're a useful addition. But while retail bonds are a source of diversification they will never replace either bank financing or wholesale bonds for us.

Atkinson, London Stock Exchange Group: Gerard's point about brand and name is a good one, and it's important in this market. There's a great promotional opportunity here for issuers that shouldn't be underestimated. Maybe that's where the market needs to position itself to potential retail investors.

We had advice that our name would trade well in the market, and indeed it did ultimately. The ORB is also a good debt diversification play for us. We've got two institutional bonds out in the sterling market, and so our retail issue diversifies the investor base for us. But it is still important to have a recognisable name to ensure success at this stage — particularly if a large size of deal is targeted.

Shepherd, Provident Financial: Provident Financial clearly isn't a household name for investors in the retail bond market, but we are a FTSE 250 business, we're a rated entity, we have a good track record, we priced our issues appropriately and they sat appropriately in the capital structure. They are senior unsecured, along with our bank debt and our institutional bond. So I don't think it's necessarily about the brand. Certainly, through our repeat issuance and through being very clear about our objectives and how we were going to price the issues, we have been able to establish a good and strong presence in this market.

Gordon, Killik: If you want a large issue size, brand is

a real help. But that's only one end of the spectrum in terms of the issuers in this market.

Ruane, Investec: From our perspective, I think brand name does help issuers in terms of pricing, but that's not to say that we are not very happy to invest in names that the household wouldn't know. There have been lots of issues from companies that are FTSE 250 or maybe smaller property companies, and we've been happy to invest in them because we've looked at them from a credit point of view.

Credit ratings also really help. Not having them really reduces the number of people who might buy a deal — we have clients that are charities, and we have a mandate to say that we can only buy bonds that are investment grade. If they don't have a rating, we can't buy it.

EUROWEEK: How key is this idea of the importance of a public ratings and how much information issuers have to provide to the investors?

Ruane, Investec: As an investor we prefer to see ratings because it's going to increase the number of people that might want to buy the bonds. But we also review every bond we buy. We've got access to the rating agencies' methodologies; we will rate them ourselves according to where we think they are so they go under the same credit review process, whether they're rated or not.

Darren Ruane,
INVESTEC WEALTH & INVESTMENT

Gordon, Killik: I'd endorse that completely. Whether an issuer has a credit rating or not, we would do our own analysis and due diligence on the bond.

In order to make the universe of potential investors as large as possible, it does help to have a credit rating. From a portfolio manager's point of view, there's a limit to how many unrated bonds you want to have in a portfolio.

Tyler, Severn Trent: Like most larger corporates we are rated and have been for a long time, so it isn't really a consideration for us. But for smaller companies coming to the market for the first time, having to get a rating is a time consuming, expensive and unusual process for them. Once you've got a rating you've got to maintain it as well. So needing a rating might be a negative factor for companies making the decision whether to move from bank funding exclusively to access this market.

Coverdale, Lloyds Bank: It's a really important part of this market though. The investors have the capacity to do their own credit work and to look at unrated paper, so this does provide that bridge for smaller companies to move from the bank markets to alternative sources of funding. For these names, the wholesale bond market is quite a distance away — you really need to be quite a big firm to need £250m of debt on your balance sheet. So I think for the FTSE 250 community, having that unrated bridge into the public market is really important.

Ruane, Investec: We do see lots of issuers that might come and say that seeing as they only want to have to do one bond deal, there's no point in us having a credit rating. And we completely understand that, and we'll do the credit work. But the reality is that our investor base has got to be smaller as a result.

Atkinson, London Stock Exchange Group: It's a careful judgement for a smaller company to make. You need to get a sense of how the different agencies operate around your sector. You need to be aware of what stage of your growth/development cycle you're at and whether the rating is going to add value to the issuance process. I would agree with Gerard that in terms of cost, resource and effort it's quite a time consuming exercise, particularly at the outset.

EUROWEEK: Aside from ratings, how does the process of coming to the retail bond market differ from issuing in the wholesale market?

Tyler, Severn Trent: It's a very different process. For the wholesale market, we keep in regular contact with our major wholesale investors, and we know that there are 10-20 key investors in the City of London who will make a bond issue go well if they support it. And the exposure to the market is a morning — we'll launch around breakfast time and close before lunch. Building the book is a very rapid process and investors are price-sensitive. The retail market is very different. There was a lot of work on the road before we launched, meeting the new investor base, and then the deal sat open for two weeks. The brokers are going back to individual clients, circulating the details of the transaction and then getting subscriptions coming in. As a borrower, though, we could see the book build, day-by-day, as we went through that two-week period.

Coverdale, Lloyds Bank: Were you nervous about Gilt rate fluctuations during that period?

Tyler, Severn Trent: Because it was relatively small transaction compared with the size of our debt that mattered less. We went out knowing that the company runs that risk, but on a relatively small bond you just have to go with that. For a wholesale bond what is going on in the market is critical, and one of the reasons that you finish before lunch is that you don't want any disruptions to impact pricing. But the investors buying in the retail space, the people who are going to tuck that bond away as part of an ISA or a pension scheme, mean that it's going to stay there for a number of years or to maturity. You know that once they've got it, they'll hang on to it.

Shepherd, Provident Financial: For smaller issuers it's not a question of the retail market versus the institutional market, but a retail bond transaction versus the bank or the private placement market. These two routes

are very different. One is a private transaction where you have a bilateral relationship with a bank or other debt lender, while the retail market is more remote and you won't know the ultimate lender. That's a very different dynamic for a lot of smaller corporates who've never had any experience of the public debt market.

Walmsley, London Stock Exchange: I want to return to the point about distribution mechanisms and the two weeks it generally takes for the offer period. This is an entirely new model that has arisen because of the retail bond market, and really I think the longer marketing process can be quite helpful for the smaller companies. It helps in terms of brand awareness: lesser known companies that might not be a recognisable brand name can hold roadshows and discussions, and engage with investors over that marketing period. An education process about the company has effectively been worked into this new retail distribution model.

Patrick Gordon,
KILLIK & CO LLP

Gordon, Killik: Also, that initial two week period has come in quite significantly. A lot of the bond issues have closed earlier than that two weeks that was set out. The whole process has become much more efficient.

Walmsley, London Stock Exchange: Yes, absolutely, and that's part of the natural evolution of the market as it becomes more sophisticated, and as that investor base grows. Books are closing much earlier, and we see this as a sign of the growing depth of appetite.

Coverdale, Lloyds Bank: We're also looking at different methodologies and hybrid mechanisms for getting deals done. We recently did an intra-day deal targeting the retail wealth management community that worked very well. We're also looking at bringing in institutional demand to get things done on an intra-day basis, and that might point a way forward.

Atkinson, London Stock Exchange Group: From a larger corporate's perspective, I think the interesting thing about the retail market versus the institutional market is that you have a dynamic of demand discovery rather than price discovery. The price is set, and then you go out and try to attract the demand. At one level, there's a different type of anxiety. But we were well supported by our lead managers and the information flow was accurate — I had a real-time, web-based update on the book that I could follow hour by hour.

Ruane, Investec: It's probably worth noting that when we talk about the retail investor base, it's very diverse. We will look at deal centrally and decide whether we like it or not. If we do, we'll put the information out to all of our 16 branches around the UK. However, the ability to buy the bonds goes right through to the man in the street who sees in his weekend paper that, say, Severn Trent or Provident Financial is doing a deal. He may decide that he'd like to buy some of that — without having the ability to do any credit work on it, just taking a view on it because it's there.

Another thing that's important is that we feel that a retail transaction should get the same terms as an institutional deal. If a firm already has some institutional deals out there and they try to get much better terms from retail investors, we think that's not fair and we don't participate. There should be a fair playing field.

Gordon, Killik: I'd agree.

Coverdale, Lloyds Bank: This is a very important point in the Lloyds Bank view. We are very keen to see retail investors treated fairly in relation to any bank lending, and particularly any bank security that might be in place. We will not work on a transaction which we don't feel would work in the institutional market on similar terms. That's not to say that deals don't get done in that format. There are arrangers out there that will take the view that the market should find its own level, that investors should make their own decisions, and it should be priced correctly. But our house view is that retail investors should not be treated unfairly compared to bank lenders.

Tyler, Severn Trent: I'd like to bring up some documentary issues here, because the prospectus directive and reporting requirements for a deal are a real constraint on this market. For example, we issued from our parent company, which is a public company, as that's the company that complies with the semi-annual accounting and reporting requirements. But our main bond issuing company doesn't issue semi-annual accounts. The requirements mean that if an issuer, who may be quoted on one of the exchanges, wants to issue retail bonds, they're almost forced to do so through the parent company. That might put the retail debt structurally subordinate to normal bank debt, which will be much closer to the assets of the group.

If I were to suggest one thing that needs to develop in this market it would be sorting the prospectus directive so that companies that issue can have less onerous reporting requirements, or can issue from the company that is quite satisfactory for the wholesale market.

Atkinson, London Stock Exchange Group: I understand this point, although we issued out of the same company that we used for the institutional bonds, which is the holding company of the group.

We were sensitive to wanting to find a fair price for retail investors — particularly given last year's bond was our debut issue and we run the ORB market. That in itself requires some work — you've got to make sure the economics work and make sure you're getting good value from the retail market. But equally, being a company that issues in the institutional market as well, we don't want to be seen to disadvantage our institutional investors. There's a middle ground that needs to be found.

Also, potential issuers need to consider quite carefully

the rigorous process around disclosure, the construction of a prospectus and the various risk factors involved. It continues to be somewhat of a concern to companies that there is a need to do more work for retail investors as opposed to institutional investors because of the prospectus directive — and this is understandable because this is a sensitive area. It's perhaps more of an issue, and more obvious, for larger companies that will go to the institutional market as an alternative.

Shepherd, Provident Financial: We also issue from the holding company, which is where our bank debt is issued from and there are various guarantees in place from certain of our operating companies. I do think it's important for issuers to understand that there's a broad spectrum of retail investors, many of whom are as sophisticated as institutions. However, there are also the individuals who see an advert in the newspaper and invest with no guidance or advice.

There are two things all investors need to consider. The first is the probability of default. For most companies, especially plcs, there's a lot of information available on strategy, results and management that investors can use to make an informed assessment of this.

The other aspect is the loss given default — i.e. how much will I lose if it goes wrong. It's clearly more difficult for a retail investor to make an assessment of this, especially if there's a complicated capital structure or there's structural subordination. In the equity markets, retail customers understand those markets well and use the history of companies that have failed to better understand and predict what they might lose.

EUROWEEK: Might it be that once the market is more established investors will become more comfortable with what happens in a default?

Coverdale, Lloyds Bank: There's an ongoing requirement for investor education and a need to understand credit as opposed to equities. In terms of personal investment, the UK has an equity culture and credit can seem to be a bit of a mystery for some people. If you look at the last five years of performance in the FTSE 250, for example, you can see how many defaults there have been. How robust has the credit been in that community? That may be a good proxy for retail bond issuers. As banks and as market commentators, we need to focus on getting the message out to investors that single name credit can be a good asset class, but you have to do your homework.

Marcus Coverdale,
LLOYDS BANK

Atkinson, London Stock Exchange Group: Interestingly, there have been one or two issuances on the ORB that have been pulled, which may have been a warning shot to the market.

But the important thing to remember is that there is a rump of retail investor demand channelled through sophisticated wealth managers, such as Investec or Killik, and if their support isn't there a deal is unlikely to be successful. So I think there are checks and balances in place already to add some control.

Ruane, Investec: Of course, you have to remember that retail investors have experienced defaults in the bond market in the last five years. Investors in Bradford & Bingley debt, Northern Rock debt or Co-op debt may have held their investments for 15 to 20 years before discovering that these things can go down to zero.

But the responsibility is on all of us in this room — issuers, managers and investors — that if a weak deal comes we reject it.

Gordon, Killik: That's right. I think the whole due diligence process is absolutely essential, to weed out issuers who should not be coming to the market. I think it's important we all play a role in that.

Also I believe that education is essential. There is a big problem with the word bond itself. It is often assumed to be a fixed deposit account in a bank — a savings bond. A large part of the investor base has now recognised the difference and recognise the risks that are involved in corporate bond investing relative to a fixed deposit account, but it is an ongoing educational process.

Walmsley: London Stock Exchange: There does seem to be some confusion — especially with 'mini-bonds' or 'brand loyalty bonds'. There's been an increase in these mini-bonds recently, which are unlisted, brand loyalty products where coupons are offered alongside other incentives such as chocolate or wine. These are quite often mentioned alongside retail bonds on the ORB as if they are like for like. There needs to be a significant drive in education, because it may be that investors don't understand the difference between a listed corporate bond — which has been through a prospectus review, which is traded on the London Stock Exchange and for which there will be continuous quoting of a secondary market price — and an unlisted security where there just isn't any transparency or tradeablity.

And then there is also confusion about the term bond being used to denote a deposit account, as well as why those types of bonds are covered by the Financial Services Compensation Scheme and why corporate bonds are not. There are a number of perfectly valid reasons why that should not be the case.

Tyler, Severn Trent: One reason why we're keen on this market is that we've identified trends in savings and investment. As more people go into defined contribution or auto-enrolment pension schemes, they're going to start paying more attention to what they are invested in. Some of them will choose to run parts of their money for themselves, or through wealth managers, and therefore will be interested in things that earn them a bit more than the traditional Gilts and investment safe havens.

We looked at what happens on the continent; the 'Belgian dentist' is a key buyer of retail bonds over there,

and in the US there's a very deep retail market. That's what we would expect to see at some stage in the UK.

Gordon, Killik: I think that's right. There's a growing recognition of the corporate bonds asset class among investors now.

Walmsley, London Stock Exchange: I think this point about a growing appetite and a shift into fixed income is an important one. When we launched the retail bond market in 2010, it was in response to market conditions where we saw a shift in retail appetite for fixed income. There was huge appetite for bonds. One of the questions that was put to us was whether this appetite would disappear when the market swung back. But we would say absolutely not. We've seen the start of the process of UK investors recognising that bonds should form part of a balanced portfolio. Many UK investors have historically been unbalanced in terms of their focus on equity. If you look at other retail bond markets such as the US, Germany and Italy, there's an entirely different culture in terms of investing in fixed income products. These investors are highly sophisticated, they understand the mechanics of bond pricing and they do some of the credit analysis themselves. Our aim is to improve education in the UK, and I think we've already made a good start on that.

Ruane, Investec: One of the key developments for this market has been that you can buy these bonds in £1,000 denominations. In the past, the prospectus directive meant that unless there was a lot of disclosure, borrows could only issue their bonds in £100,000 minimum denominations. That meant that most retail investors couldn't buy individual retail bonds, and that led to the exorbitant growth of the corporate bond fund industry. But now retail investors find it hard to buy individual corporate bonds.

EUROWEEK: So the smaller denominations of £1,000 or £2,000 available is encouraging diversification and enabling investors to manage a well spread portfolio on their own?

Gordon, Killik: It is. It allows you to invest in more than one individual corporate bond. You can build a portfolio of individual corporate bonds, and benefit from the visibility that that affords you.

EUROWEEK: Similarly, you have the transparency of a secondary market where you can just log on to the website and see where everything is trading. How much of a benefit is that?

Gordon, Killik: Pricing transparency certainly helps, and as a reference point even for off order book trades hopefully it'll bring in the spreads. We do still think that some spreads are quite wide and we would like to see them narrow further, and I guess with more market makers joining the platform, that may happen.

Walmsley, London Stock Exchange: We've seen a tightening of spreads over time since the introduction of the electronic platform. There are 11 market makers now quoting on the platform. It's key for us to develop that secondary market liquidity, because it's so important in terms of supporting the primary market for retail bonds.

Ruane, Invsetec: The lack of liquidity is one of the disadvantages of the market. If you want to do something of a reasonable size, such as a few hundred thousand pounds worth, it can be difficult. Some of these bonds are locked away, and some investors don't want to trade them. So we would welcome the development of that side of the market over time. Generally as a large company we prefer to see larger issue sizes. The bigger the issue, the greater the likelihood of liquidity in the secondary market.

Walmsley, London Stock Exchange: I think that's true. But we've actually been surprised by the levels of liquidity even in those small size issues of £25m or £35m. Because we have a model where there are multiple market makers, even though those market makers may be quoting in relatively small size when you compare it to the wholesale markets, if there are several quoting at the same time that means there's always a reasonable size being shown on the screen.

EUROWEEK: How important is it to the borrowers to have liquidity in the secondary market?

Shepherd, Provident Financial: For us it's very important as we are a repeat issuer. Giving investors a good experience and seeing liquidity in the secondary market is vitally important.

Gerard Tyler,
SEVERN TRENT

Tyler, Severn Trent: I disagree. We don't see a great deal of trading in the secondary market. But we've got a very deep portfolio of wholesale bonds, so when we come back to the retail bond market, any future price discovery will be based on looking quite closely at where our institutional bonds are trading. We will price relative to our curve of institutional bonds.

As we went round on the road before our issue though, we got the sense that the investors had a certain benchmark minimum price in mind. I think one reason a lot of corporates haven't come to the market in current conditions is that they can issue institutional bonds for longer maturities and at lower coupons than are available in the retail market. So for index-linked we were told investors wanted to see at least 1%, partly because that's the fee that the custodians and the managers will take. Investors were used to receiving 5% plus for deposits, and haven't quite caught up to the fact that bank deposits now offer far lower than that and wholesale rates are lower. As interest rates rise, then expectations will align much more with the wholesale market, and we won't see as much pricing inefficiency in the retail market.

Shepherd, Provident Financial: We're a very different entity — obviously Severn Trent has more institutional debt than retail, but we're the other way around. Just as I'm sure Gerard looks at how his institutional bonds are trading, we look at how our retail bonds are trading. Also, we've seen a benefit to the trading of our institutional bond through our access to the retail bond market.

Atkinson, London Stock Exchange Group: Now that the Gilt is rising perhaps the retail market bond market will become more attractive to bigger corporates? For us, it was an interesting journey. We issued in what could be considered benchmark size for the institutional market. We clearly set ourselves up to sell to the retail market initially, but I wonder whether institutions then were attracted in by the benchmark size of the issuance. There was very strong secondary trading in the month or two after we issued. We were also in the position where we already had two institutional bonds, which were very thinly traded. For us, the reasoning behind issuing a retail bond was partly about diversifying the investor base, but also about adding that little bit of competitive tension — signalling to investors that we can go to more than one market.

EUROWEEK: Is there a pricing premium to pay to come to the retail market over the institutional market?

Tyler, Severn Trent: I think that's why there haven't been more bonds issued by large corporates. One reason we went to the index-linked format is that it was a better fit for us and because there was less of a premium. We could see a premium that we'd have to pay to issue a successful wholesale fixed rate bond at that time, because of where rates were, but an index-linked issue had much better arbitrage. We provided what was quite a rare investment opportunity to retail investors, and it priced very well. But I think it's the shape of the yield curve that has probably meant that other large corporates who might look at the retail market have just found it so cheap at the moment to issue in the institutional market. They don't need to come to this retail market now. But we considered it as important to start diversifying our sources of funding, and if there was a small premium then we could stand that this time, because we were sure we were opening the door for the future.

Ruane, Investec: It was an unwelcome development in the market that some people on the investor side gave feedback that they wanted to see bonds that had a 5% minimum coupon. This was going a little while back, when Gilt yields were much lower. We would really like to see some really good blue chip companies come to this market and give us an institutional type deals that can be accessed by retail names.

In our view, investment grade credit at the moment is actually fully priced. For example, BAT came to the market at the start of September with a 13 year deal priced at Gilts plus 120bp. So for us, one of the good things about the retail market is that you can find much higher spreads. The downside to that is that we have to look at companies that maybe we don't know as well, and that means that we have got to do a bit more work on our side. But I would certainly welcome more companies of a blue chip nature, maybe offering institutional-type returns but in retail size.

Atkinson, London Stock Exchange Group: Issuers in the retail market — and especially larger issuers — need to be conscious that retail investors are looking at a different portfolio of alternative investments. Conditions last year were right for us to look at the retail market as a viable alternative to the institutional market, because the yields worked for us and clearly investors as well and compared very well to the alternatives available to retail investors at that time. Comparison to alternative yields in other assets is going to continue to be an important factor for investors but also in steering the decisions made by issuers.

Gordon, Killik: I think that is right. Most investors coming to the fixed income market are coming for yield, ultimately, and I think there is competition out there from other products.

Where the Gilt market is moving at the moment, we might come back to an environment where we can see some of these bigger names coming to the market. Recent issuance has become very focused on certain sectors, such as property, so I think greater diversification would be welcomed.

EUROWEEK: How might the involvement of institutional investors in retail bonds affect the market, both in terms of liquidity and pricing?

Walmsley, London Stock Exchange: I think it will be important in terms of further building liquidity. The Italian retail bond market is highly liquid and because of the retail liquidity that's built on that platform, it has attracted institutional liquidity.

In the UK market, increased institutional investor interest would be helpful in terms of attracting new issuers. We might see hybrid distribution structures, as Marcus mentioned earlier, and it will certainly be of interest if it means that it will lead to greater diversification of the types of companies that are coming to the platform. But it's not to say that we're aiming to develop an institutional market. This market was developed in response to what we heard from private investors and retail brokers, and they very much wanted a dedicated retail market from the London Stock Exchange.

Coverdale, Lloyds Bank: Obviously Gilt movements have been pretty volatile over the last four months or so, and that impacts on some issuers and also on some investors. Some of the big institutional investors are nervous about the exposure there in extended bookbuilds.

Walmsley, London Stock Exchange: If partial institutional investor participation in a transaction means that the window will be shortened, that might be interesting for companies who may have been deterred by the two week standard offer period.

Ruane, Investec: It could certainly shorten the bookbuild. Then we could work out a way of doing intra-day bookbuilds for retail-type deals, so that all the buyers can respond within that kind of time frame.

EUROWEEK: So this will remain primarily a retail market, but the involvement of institutional investors might enable more sophisticated transactions?

Ruane, Investec: We have to be careful with definitions. We have around £22bn in assets under manage-

ment, so arguably we're of an institutional size. But all our underlying clients are private investors. If there's an institutional deal, we can turn our commitment around in an hour or two. But we'd have a lot more comfort if we have a day, or two, or even a week, because we'll have more chance for the wealth managers to speak to their clients and to build bigger demand.

Gordon, Killik: Yes, I think that a pre-marketing period before the deal is actually launched would be helpful.

Coverdale, Lloyds Bank: So if you announced the deal, ran a proper roadshow and had a considered feedback period before you opened the book, investors would be engaged properly and have the time to do the work.

Gordon, Killik: We'd also like to see that extend beyond just the discretionary pools of money and reach out to an advisory base as well.

Ruane, Investec: What you've just outlined is exactly what happens in the institutional market: a roadshow, then a discussion around pricing, then the launch and you participate.

Coverdale, Lloyds Bank: Absolutely, but often those institutional roadshows will be focused on the big investment houses, and smaller retail funds may not get as much focus as the really big accounts.

Atkinson, London Stock Exchange Group: I wanted to go back to the credit rating point. Darren, within your firm do you have limits on how much you can invest in individual issuances? Is that determined also by whether they're rated or not?

Ruane, Investec: It does and it doesn't. Within our business there are several desks that will each have a couple of billion in assets under management. Often they will have mandates that say they can only hold investment grade credit. For private investors, of course, we don't have such mandates. These investors won't ever say never to buy high yield bonds, as this might exclude buying into the likes of the Daily Mail, William Hill or Ladbrokes. It's a mix, really.

Tyler, Severn Trent: This brings up the topic of maintenance. In terms of investor relations, it's good practice, once a bond's out there, for a company to spend a number of days a year visiting the main investors and bringing them up to date with the story. That prepares the ground for them to come back to the market again one day.

EUROWEEK: How difficult is that for a provider like you? If you've already got institutional investors to meet, are you doubling your workload by seeing retail investors as well?

Tyler, Severn Trent: We often have the materials prepared from talking to the institutional equity market and the institutional bond market. But over the last 18 months we focused on meeting with the broker market. And we found that of the private client brokers who are represented on our share register, the number of shares they represent has gone up. So there's been a beneficial effect from the work we've done with targeting that retail bond investor market in the equity base. A substantial section of the UK investor base now has better knowledge of our company.

EUROWEEK: How do others around the table feel that the retail bond market may develop in future?

Walmsley, London Stock Exchange: The natural progression of the market is that we would expect that investor base to widen out, and then potentially companies could come and issue in US dollars or euros. But I don't think we're there yet. This is predominantly a sterling market for the time being, and that's always been our focus in establishing it. We think we need to build out the UK investor base and widen that sterling pool of funding before it progresses to euro and US dollar.

Gilliam Walmsley,
LONDON STOCK EXCHANGE

Ruane, Investec: If you have a predominantly UK retail investor base, they want to have UK denominated assets on the bond side. These will often be the lower risk assets within their portfolio, so that's the bit that will help them on a rainy day. In equities, on the other hand, they're quite happy to go into US equities, European equities and Asian equities, and they tend to take more risks there. So at the moment we probably see less demand for retail bonds that are denominated in euros.

One development we'd like to see that has already been mentioned is the greater diversification of issuers. We do have a lot of financial and property names in the market, and it would be nice to see a few more non-financials.

Gordon, Killik: I agree. Diversification of the market is key to its development, or at least a very important part of its development.

Most people coming into this market are still probably looking for income, so will look for fixed coupon deals. But given where we are now with interest rates potentially rising, there may be some more interest in floating rate note perhaps, and maybe some linkers. But generally, I'd just like to see the market widening out and getting more names out there.

Coverdale, Lloyds Bank: Floaters might be a really interesting one. We've not seen anything like that yet, but I think there are investors out there who would be delighted to see that kind of development coming along. But from a structural perspective, it's probably steady as she goes — we don't want to overburden investors with complexity at this stage.

For example, we've thought about looking at bank tier two. What's happened this year with the Co-op

has raised some questions about that sort of space as a retail investor product. But it could be an interesting one, because it does open up yield for investors in a low yield environment.

Gordon, Killik: The interesting thing about that is that you do have investor participation on the secondary market for those instruments anyway. So while I don't think it should necessarily be precluded, I'm not sure what the wider appeal would be.

Ruane, Investec: We would find lower tier two capital very interesting. But it raises some issues — some people say this bond market should be very simple, it should be senior and it should be as safe as it can be. Other people argue that maybe it should be offering higher returns, with investors getting 8% for taking a bit more risk. If you can get the right sorts of investors that can understand those risks, well, maybe that's appropriate for the market too. I think we'd be happy with that, but we want to do what's right for everybody, rather than maybe a certain few investors.

Coverdale, Lloyds Bank: Yes, I think there's a limit to how racy you can get in terms of structures. We need to see more issuers and higher quality issuers. That's critical. The potential unwinding of the Funding for Lending scheme (FLS) towards the end of next year will hopefully encourage issuers to look away from the bank funding market, and see how they can diversify their funding.

Gordon, Killik: That's an interesting point. The FLS has played its part in keeping deposit rates low for savers, so that has created in itself more demand from investors looking for greater returns through the fixed income market.

EUROWEEK: Looking back to when this retail bond market was set up, what did you each hope that this market would achieve? And how has it matched up to your expectations?

Phil Shepherd,
PROVIDENT FINANCIAL

Shepherd, Provident Financial: We were keen for the diversification and to issue at smaller ticket sizes, and I think for Provident Financial it's met our expectations. We've been able to do four issues and established a strong presence in the market. However, the lack of new issues over the last 12 months has been disappointing.

Tyler, Severn Trent: For us, I suppose the first test was that we were happy with the bond that we got away last year. We saw this as a diversification play, not a replacement for our existing sources of funding. I think that if the interest rate dynamic changes there will be more issuers coming in, because it'll become more economically attractive. The only concern I have is that some of the documentary requirements that are out there will make it harder for first time issuers who aren't familiar to take the plunge and leave the world of bank debt. But it's still early days in a market that we think has still a long way to go.

Atkinson, London Stock Exchange Group: I would agree with that. From our point of view, whilst there had always been the desire to support ORB, we seriously considered the timing for our first transaction. Clearly there was sufficient momentum last summer to persuade us that there was demand for a larger issuance. And not only was the issuance successful, but the economics worked versus the institutional market at that time.

We were delighted with the success of the issuance and the sub-5% coupon. It's traded very well since, so I've been very happy with it. Like Severn Trent, we will continue to look at a number of markets for our borrowing sources, including the banks, because we desire flexibility and diversification in our funding arrangements.

We're an organisation with an increasingly euro denominated balance sheet, so developments into euros would be great for us. We looked at the Italian retail bond (the MOT) market last year, which is also owned by this group, but competing issuer yields in that market would have made it a very expensive issue at that time. We may possibly return to that market at some point.

But I still see lots of progress ahead of the ORB in terms of new issuance. What the market needs in my view is borrowers who are going to be repeat issuers — maybe not borrowers who will take large, institutional sized deals, but who will come back and tap the market from time to time. I think that would be very helpful.

Coverdale, Lloyds Bank: There are issuers who have maybe one institutional bond of £300m out there, who roll it every five or seven years. It would be good to see those types of names breaking that one issue up into three or four £75m pieces, to spread out their debt maturity profile and provide some ongoing issuance into the retail market.

Gordon, Killik: From an investor's perspective, there is a recognition of the importance of corporate bonds in a portfolio for diversification purposes and for income generation. Certainly the demand is there, and demographic trends are in favour of the market's continued development.

Walmsley, London Stock Exchange: We've been very encouraged by the success of the market. We shouldn't forget that it's a brand new market and a brand new investor base. It's a new distribution model in the primary market and in just a relatively short period of time — 3-1/2 years — a number of companies have raised a total of over £3.4bn. We are still looking to diversify and attract new companies to the market, and to build secondary market liquidity. Of course, we wouldn't expect companies to rely solely on the retail market, but we'd like to be one of the options that companies look at when they're financing, along with bank financing and the institutional markets. We think that the ORB has done well in terms of establishing itself as a valid option for borrowers to consider. ▲

Welcome to ORB

ORB, the Order book for Retail Bonds from London Stock Exchange, gives companies - from ambitious SMEs to large multinationals - access to the capital they need for growth. As the UK's only regulated retail bond platform, it enables businesses to access additional investors and an entirely new source of funding. With ORB, you can take the direct route to a high profile liquid market - and a wider investment audience.

To download the latest ORB guide and contact us, visit

londonstockexchange.com/orbguide

London Stock Exchange