Legal Expert Group Meeting
Minutes of the meeting held on: Thursday 9 July 2013 at 8:45am
Norton Rose Fulbright LLP, 3 More London Riverside, London SE1 2AQ

Present:	Tom Shaw (in the Chair)	TS
	Gary Thorpe (Deputy Chair)	GT
	Danette Antao	DA
	Simon Cox	SC
	Julie Keefe	JK
	Martin Kay	MK
	Hilary Owens	HO
	Donald Stewart	DS
	David Davies	DD
	Anthony Turner	AT
	Tim Ward	TW
	Kate Jalbert	KJ
In attendance:	Jaspal Sekhon (Minutes)	JS
	David Hicks	DH
	Paul Arathoon	PA
	Paul Kay	PK
	Danny Sullivan	DSu
	Gareth Morris, Canaccord Genuity	GM

ACTIONS

1. **Apologies**

Apologies were received from June Paddock, Chris Barrett, Mebs Dossa, Philip Lamb, Richard Beavan, Ian Binnie, Ross Bryson, Susan Hollingdale and Stephen Hamilton.

2. **Welcome to Gareth Morris, Canaccord Genuity Ltd, to talk about mid-cap bond market developments**

TS thanked GM for attending the meeting.

Key points from GM's talk:

- The factors which have led to the establishment of the retail bond market include the creation of the order book for retail bonds (ORB) trading facility on the LSE in 2010. In addition, increased volatility in the equity capital markets has led to investors looking at other forms of investments. Finally, as a result of the 2012 changes to the Prospectus Directive, the minimum unit for a wholesale bond is now €100,000. In contrast, retail bonds are traded in smaller units which has helped to attract investors.

- The markets began as a secondary market but since then it has become a primary market.

- To date £2.85bn has been raised for a wide range of companies ranging from the likes of National Grid and Severn Trent down to smaller issuers such as Alpha Plus. There are a broad range of bond issues both rated and unrated (although most are generally not rated).

- In terms of issue size, the LSE raised £300m whereas Provident Financial raised £25m. £50m is the benchmark figure for a fundraising. John Lewis kicked off the trend for "mini bonds" which are not listed as tradable instruments. Other examples include Hotel Chocolat and King of Shaves which raised small amounts of just a few million pounds. Some of these bond issues can be structured with payment-in-kind coupons which can be used to attract customers. For example Hotel Chocolat paid the coupon in chocolate and The Jockey Club paid the coupon in race track vouchers.

- However, investors are not always happy with the level of disclosure in mini bonds, particularly when compared with full retail bonds which are traded on the LSE. In contrast, mini bonds are marketed on the back of a financial promotion. GM's view is that whilst disclosure can be a hassle and there is a cost implication, issuers should also be mindful of brand and market reputation. GM thinks that regulators will take a much greater interest in this type of product especially as something will inevitably go wrong.

- The payment-in-kind bonds can lead to interesting tax consequences. With the Jockey Club bond, investors were taxed on the gross coupon of 7.5% which led to the coupon having an effective rate of 1.5%. This was not well disclosed in the marketing documents and there have been concerns expressed about misselling.

- The retail distribution review came into force in January this year. GM thinks this is a positive development and will increase standards.

- As regards bond funds, these tend to produce quite low returns due to low yields which are therefore likely to push investors into fixed income products. The fixed income market is incredibly deep and worth approximately £1 trillion. This effectively means that the £2.8bn raised so far in retail bonds is a drop in the ocean. One of the big obstacles to the market really taking off is the yield expectation of investors. Traditionally yields were approximately 5% which is unrealistic in the current environment and not cost effective for issuers.

- The typical term for a bond is 5 to 10 years. A 5.5 year bond is the ideal length of time for ISAs. The 5 year window ties in with the ISA requirements and the extra 6 months creates a secondary market.

- Retail bonds will normally include covenants and a negative pledge. A typical bond is unsecured, although some issuers have raised money on a secured basis.

- Another interesting development on ORBs is that the UKLA has carried out a review of prospectuses and is now pushing for a "plain English" approach. The trend is for prospectuses to be published and a separate booklet will be produced with a more straightforward presentation of information. GM would like to see this extended to the wholesale market.

- In terms of the scale of the listed market, there are 160 listed bonds on the ORB market. However, some of these are bonds that have been rolled-over. In terms of turnover, Canaccord turn over approximately £10-15m every week and across the market the turnover is approximately £50m.

- GM estimates that 85-90% of what Canaccord trades in is retail. Often they are trades in the region of £10,000.

- Recent issues have tended to be for smaller companies. Alpha Plus was a private company with a low EBITDA.

- TW noted that there are 3 QCA members who have issued retail bonds.

- The property sector is very popular amongst retail investors. Grafton, an Irish construction company, closed their book just yesterday.

- If listed companies have good market and analyst coverage, it will help to get the retail bond away in the market.

- Total costs for a typical retail bond issue are in the region of 1.75%. The arranger fees will be in the region of 1-1.5%. Lawyers' fees will be approximately £200,000 to £250,000 and accountants' fees are in the region of £50,000. In addition there will be other costs such as PR. The costs will be reduced if an issuer has recently completed an equity fundraising with a prospectus and the same documents can be substantially used for the retail bond.

- Canaccord Genuity, Investec and Numis are the main players. Lloyds, RBS and Barclays are also involved in the market but less so.

- The typical coupon rate is 5 - 6.5%. The lowest is 4.5% (LSE) and the highest is 7.5% (Provident Financial).

- Retail bonds are not generally rated but this is a hot topic at the moment. Cannacord's house view is that a rating is not mandatory but it is helpful, especially to attract wealth managers. That said, all wealth managers will have their own investment criteria. Retail banks will always push for an issuer to obtain a rating. Credit rating agencies are usually unnecessarily harsh on small cap issuers and will usually rate them as sub-investment grade. TW noted that S&P have come up with a new rating system mid-size corporates for private placements. GM noted that there is a growing private placement market in the UK which compares favourably with the US. However it is currently not used for retail bonds.

As regards future trends:

- The more retail bond issues that occur, the more investors will get involved and therefore increase liquidity in the market.

- A low interest rate environment is going to change the approach of investors.

- Due to an ageing population, people will de-risk by moving into fixed-income products as individuals near retirement age.

- On the issuer side, there has been a reduction of bank lending which has made it much harder for companies to raise money. Property companies have become popular for retail bonds because the banks were very over-exposed in this area and are reluctant to lend to such companies. This reflects a notable shift in the market.

- GM is keen to push retail bonds into different sectors and move away from the current focus on property companies.

- The big attraction is highlighting the differences with, for example, traditional bank debt. However, there is still not enough differentiation on cost just yet and biggest problem at the moment is the low yield environment.

TS thanked GM again for attending and GM left the meeting.

3. Approve the minutes of the previous meeting (23 May 2013)

The minutes of the last meeting were approved.

4. Current consultations and issues

a) Business Growth Fund

TW noted that he and TS had recently briefed some people at the Department for Business, Innovation and Skills (BIS) about the Business Growth Fund investing in small cap companies. The BIS people seemed receptive to this idea.

b) Market Abuse Regulation - Trilogue concluded and final text agreed

KJ noted that the final text is now agreed. The good news is that there is an exemption for SME growth markets from having to produce insider lists. If AIM and ISDX become SME growth markets, then companies on these markets will not have to produce insider lists. The Regulation is expected to be published at the end of 2013 and is likely to come into force in the first quarter of 2015. However, it is tied to MiFID's progress as well.

c) Transparency Directive - Amending Directive approved in Parliament

KJ noted that the Directive had been approved by the European Parliament. Listed companies will no longer be required to produce interim quarterly reports but certain sectors can be asked to do so by the competent authority. However, there needs to be strong justification and prior sign-off from ESMA. The British Government has been supportive of the proposals. The Directive is expected to be approved in October or November this year and will come into force in Q4 2015.

d) Packaged Retail Investment Products (PRIPS): key information documents

KJ was not sure about the current status. She had spoken to an official at the Treasury who was supportive of the QCA's views.

EuropeanIssuers had published a position paper making clear that they do not support the proposals. In contrast some parts of the French market do like the measure. This will be a topic for the Prospectus Directive review.

e) AIM/ISDX shares in ISAs

KJ noted that the feedback statement had been published. She is hopeful that the proposal will be in force hopefully by the end of this summer.

f) Removal of Stamp Duty on AIM/ISDX

KJ had attended a meeting at the Treasury to discuss this issue. They have decided not to do a formal consultation. Instead they will consult informally with market participants (including the QCA) about the need to define a "growth market".

5. Communications

a) Guest invitations

All members were invited to send suggestions of potential guests to KJ

All

b) Policy Briefing Update - 24 June 2013 (for information only)

Noted for information.

6. Review of actions from the last meeting (to the extent not already covered)

N/A

7. Any other business

N/A

Information for noting

- Consultation update - response submitted:

  - ESMA Paper: Draft Regulatory Technical Standards on specific situtations that require the publication of a supplement to the prospectus (response date: 28 June 2013)

- Next meeting

  - 8.45am Thursday 26 September 2013 (Venue: Speechly Bircham)

8. Actions

Action	Person	Timing
Send suggestions of potential guests to KJ	All	ASAP