Is the bond market ready for a retail influx?

Rhiannon Price considers whether the recent Financial Conduct Authority initiatives are enough to bridge the gap between bond issuers and retail investors.

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Vibrant capital markets bring together companies who want to access financing with investors who want to see their money grow. The simplest example of this is equity shares in a company listing on the public stock market, however debt in the form of bonds is just as important – for both companies and investors. Yet in contrast to equities that are easily available to retail investors, bonds are much harder to invest in directly for UK retail investors.

While retail investors can directly access shares via public equity markets, the lack of debt issued that is available to UK retail investors means the most common way of getting exposure to corporate debt is via bond funds. However a bond fund does not typically give the investor the same benefits as investing directly in a bond.

Unintended consequences

Until a few decades ago, UK retail investors typically accessed bond markets alongside institutional investors. The likely reason why this changed can be linked directly to the

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unintended consequences of regulatory changes – ironically, those laid out in the EU’s Financial Services Action Plan (FSAP) that aimed to remove barriers to raising capital on an EU-wide basis[2]. While much of this regulation was designed to encourage efficient markets by helping investors to better understand and compare the key features, risk, rewards and costs of different instruments – particularly structured products – difficulties in interpretation of broad definitions and an unwillingness to face any legal uncertainty about meeting regulatory requirements seem to have resulted in unintended consequences.

The effects of these regulatory changes were first felt following the implementation of the Prospectus Directive in 2005, and then continued with the introduction of the revision of the Markets in Financial Instruments Directive (MiFID II) and the Packaged Retail and Insurance-based Investment Products Regulation (PRIIPs) following the financial crisis.

Increased uncertainty

The number of companies issuing bonds admitted to the Official List in the UK that were accessible to retail investors reduced from 76 in 2004, to just 20 by 2022[3].

In a nutshell, as more consumer protection requirements were introduced, and uncertainty about whether and how they could or should be met increased, they acted as a disincentive for companies to issue bonds to UK retail investors at all. This had the effect of severely limiting the supply of bonds that retail investors could access and hold as part of a diversified portfolio. While previously market practice in issuance neither favoured nor excluded UK retail investors, there were gradually more and more reasons to exclude them.

If companies issued bonds as they had done prior to 2004, they and their advisors could be subject to some or all of the above regulation– or have to incur considerable expense to show that they were outside of the regulations or that an exemption applied.

It was therefore understandably easier to issue bonds to an exclusively institutional and professional investor target market, in high denominations to benefit from exemption for wholesale markets and exclude retail investors entirely. In addition to this, standard legal language was introduced to prospectuses, explicitly stating that they should not be marketed to retail investors.

Encouraging retail investors

Recognising this recently in the UK, the Financial Conduct Authority (FCA) has set in train a series of initiatives that are designed to make it more attractive to issue corporate bonds to retail investors. They have proposed changes to the prospectus regime to align requirements for non-equity securities to the current disclosure requirements for wholesale denominations, and new guidance for when certain (non-complex) low denomination corporate bonds issued by listed companies can be appropriate for the ‘mass market’. However our analysis suggests these do not go far enough in two important ways:

- The FCA’s approach of targeting particular groups of issuers and bond features for UK retail investors does not allow enough issuers to meet the regime criteria and does not target issuers that are likely to be open to issuing to retail investors as they do not match up with those bonds that retail investors have expressed interest in buying.
- The changes proposed thus far by the FCA do not affect an important element of the regulatory framework; the MiFID product governance regime. This would continue to hamper retail access to a significant portion of corporate bonds due to the target market obligations and the complex classification.

The key test of the FCA’s proposals will be how the issuer community reacts to them. Will they actually change how they issue corporate bonds so they are more accessible to retail investors?

Appropriate information

Our experience engaging with corporate clients is that they can certainly see and understand the merits of having a broader investor base, and indeed they query why this is more readily standard market practice in other jurisdictions.

However, other key matters, raised anecdotally, are of education and reputation. Issuers seek comfort that there is appropriate information and understanding of the bond market available to retail investors before their name is associated with issuing to retail investors. Liquidity in the institutional market vastly exceeds retail and as such regulatory, reputational and cost barriers need considering for issuers to have the confidence and impetus to broaden their investor base, particularly when only increases in liquidity may be marginal or difficult to predict. ■

References:
1. *Retail Access to Corporate Bonds, January 2025, available at: home.barclays/insights/2025/01/Retail-access-to-corporate-bonds*
2. *European Commission, Implementing the framework for financial markets: action plan, May 1999.*
3. *FCA Engagement paper 4: Non-equity securities, May 2023.*