Stock Market Review

The MFSA listing policies two years on

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On July 5, 2010, the Malta Financial Services Authority e-mailed a consultation document regarding proposed new Listing Authority policies to market participants, 14 of whom including stockbrokers, lawyers, auditors and banks submitted feedback to the regulator before the new policies came into force on August 16, 2010.

The policies' purpose was to formalise the setting up of the 'sinking fund' and to introduce a new requirement for prospective bond issuers (excluding banks and the government) to draw up a financial soundness report when applying for a listing of corporate bonds aimed at local retail investors.

Although the sinking fund had become a common feature in the many bond issues that came to the market in 2009 and the first half of 2010, the requirement for such a mechanism had never been formally included in any of the Listing Rules which were similar to those adopted by the Financial Services Authority in the UK and based on EU standards.

At the time of the introduction of the new policies, various members of the financial services industry, and lawyers and auditors who normally participate in assisting a company to launch a bond issue, had argued that these new policies could potentially have a negative impact on the issuance of new bonds. The new requirements aimed at issuing companies and their advisors seemed too onerous.

The most contentious and problematic issues were those related to the more stringent uses of the sinking fund assets and the list of duties of the sinking fund custodian.

The policies established that the advisors responsible for publishing the newly required financial soundness report on the issuing company had to include a statement in the report. The statement had to certify that if the proceeds from the bond issue were to be used to finance a specific project, and if "in the worst case scenario" the project was unsuccessful, the issuer would have sufficient funds from its existing operations to be able to honour its bond interest payments and repayment of capital upon maturity of its bonds.

Following several approaches made by prospective bond issuers, stockbrokers, legal advisers and auditors to the MFSA indicating that the new policies were stalling the new issuance market, the MFSA issued a further consultation document a year after the initial policies were introduced.

The consultation document of August 12, 2011, which then came into force on December 9, 2011, made a distinction between those bond issues where the minimum subscription amount is at least €50,000 and those with a minimum subscription of at least €10,000. In the case of a bond issue with a minimum subscription of €50,000, the issuer became exempt from the two new policies, i.e. the sinking fund and the requirement of a financial soundness report.

On the other hand, issuers structuring a bond with a minimum subscription of €10,000 became exempt only from the requirement of a financial soundness report but would still be required to set up a sinking fund. Companies wishing to launch a bond with minimum subscriptions of less than €10,000 would still need to adhere to both new policies.

Despite the revisions to the policies, only one non-exempt issuer has since launched a new bond, i.e. Corinthia Finance plc last February. The Corinthia financing vehicle, which partially rolled-over a bond which was about to be redeemed, opted for minimum subscriptions of €10,000.

Although the company was successful in raising the required funding, the amount of €7.5 million on offer was rather small when compared to most of the bond issues in 2009 and 2010 which ranged between €30 million and €40 million.

This offer attracted just over 600 applicants. However, another restriction imposing on new investors an obligation to retain at least €10,000 during the bond's lifetime rendered the security almost totally illiquid in the market.

Only two trades have taken place since the listing of the bonds on March 30. This is not a mere coincidence – it was widely expected by market participants in view of the new requirements which came into force.

The lack of the much sought-after new bond issues even after the revisions to the policies in December 2011 is not surprising given that these amendments only made reference to the distinction between issuers tapping the market with a minimum subscription of at least €10,000 and €50,000.

No changes were made to the Listing Authority policies for issuers who wished to target the wider audience with minimum subscriptions of less than €10,000. The various bond issues in 2009 and 2010 fell into this category.

This is where the problem remains and which needs to be addressed for the benefit of all issuers and investors alike. Investors are crying out for new bond investment opportunities and are having to resort to riskier investment propositions being presented to them, many of whom accepting these propositions without realising the risks involved.

It is unfortunate that the impact of the new listing policies has, in effect, led to investors taking greater risks with their money.

It is now widely accepted that the MFSA's new listing policies have made it very difficult for companies to offer new bond issues to the small retail investors (under €10,000) and as a result this brought the new issuance local bond market to a standstill.

On the other hand, the London Stock Exchange launched the Order Book for Retail Bonds in 2010 to cater for the growing demand for fixed interest securities by the small retail investing public. At the launch of this new initiative, the City Minister at the time had stated that "economic growth depends on individual businesses being able to raise funds necessary to operate and flourish". He further added that the ORB launched by the London Stock Exchange "will offer companies a new route to access capital that is vital for growth, benefiting the wider British economy".

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These views were replicated by one of the leading UK stockbrokers who argued that the growing demand by retail investors is driven by a desire to: (i) enhance the income on their savings; (ii) diversify their investments out of term deposits with banks; and (iii) reduce their overall risk element by rebalancing their investment portfolios and introducing increased fixed interest rate securities as opposed to equity. This applies very much also for Maltese investors.

The UK broker indicated that the preference for bonds by retail investors also reflects the trend that has been evident in Europe and North America. Retail investors are playing a more vital role in the development of global bond markets and this must be recognised by the authorities concerned when formulating new regulations.

As the UK sought to widen the opportunities for retail investors, the new listing policies in Malta had the opposite effect. So where have retail investors placed their savings as a result of the lack of new bond issues in the market? One of the primary beneficiaries from the lack of new local corporate bonds was surely the government. There was a significant increase in demand by retail investors for the various MGS issues that were launched over the past two years and one of the reasons must be the lack of other opportunities across the market.

Retail investors have also been channeling increasing amounts of money to the newer banks that have only recently entered the market offering substantially higher rates of interest when compared to those offered by the older-established local banks. While deposits at the traditional retail banks increased marginally, it is worth highlighting that the rate of growth of the deposits across the newer banks has been much greater.

One bank has amassed close to €380 million from local depositors in a very short period of time. The depositor compensation scheme launched in 2003, which is widely used in all marketing campaigns especially by the newer banks, is also contributing to the rapid growth in deposits with these newer banks.

However, funds are also increasingly being channeled to the international bond markets where the current volatility caused by the eurozone sovereign debt crisis has provided some perceived opportunities, albeit with higher risks attached.

These are mainly being availed of by some of the more sophisticated investors. Unfortunately, however, other less knowledgable investors have been enticed to gain exposure to the high yields being offered by some eurozone governments and related corporates at the centre of the crisis and many investors will most likely be losing some of their hard-earned savings over time.

It is unfortunate that the impact of the new listing policies has, in effect, led to investors taking greater risks with their money. Developments over the past two years have provided clear evidence of the negative impact of the revised listing policies on new bond issuance.

These policies need to be revisited by all the authorities and practitioners concerned to enable the new issuance market to start functioning once again and provide retail investors with what they deserve: less risky propositions than what is on offer as a result of the non-availability of new bonds.

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