



HM Treasury

Regulation of non-transferable debt securities (mini-bonds)

Consultation response

March 2022

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Contents

Chapter 1	Introduction	2
Chapter 2	Summary of responses	6
Chapter 3	Government response	11

Chapter 1

Introduction

- 1.1 Non-transferable debt securities (NTDS), commonly referred to as mini-bonds, are unlisted securities normally issued by companies to retail investors in order to raise finance. NTDS are ‘non-transferable’ meaning investors cannot normally sell their investment before the bond matures. The issuance of NTDS is, in general, not a regulated activity for the purposes of the Financial Services and Markets Act 2000 (FSMA), although the marketing of NTDS falls within the scope of the Financial Promotions Regime.
- 1.2 From 2015, there was a significant increase in the issuance of NTDS by companies who focussed on raising capital to invest in projects of a third party, rather than to invest in expanding their own businesses. London Capital & Finance plc (LCF) was a prominent firm acting in this market, and issued its own NTDS, which were bought by over 11,000 investors with a total value of more than £230m. LCF entered administration on 30 January 2019.
- 1.3 An independent investigation conducted by Dame Elizabeth Gloster¹ into the FCA’s regulation of LCF found that the FCA did not discharge its functions in respect of LCF in a manner which enabled it to effectively fulfil its statutory objectives. It also recommended that HMT should consider bringing non-transferable securities within the scope of regulation, setting out two potential options²:
- making the issuance of non-transferable securities a regulated activity; and
 - extending the scope of s85 FSMA to cover non-transferable securities³, so that public offers of non-transferable securities would require an FCA approved prospectus.
- 1.4 The government consulted on these options as they apply to NTDS from 19 April until 21 July 2021⁴. When considering these options in the consultation, the government took into account the risks to retail investors when investing in NTDS (reflected in the number of firm failures that have been seen historically) as well as the shared characteristics with other regulated financial services.

¹ The report can be found in full [here](#).

² These are presented in page 304 of the report.

³ Dame Elizabeth’s second recommendation included all non-transferable securities. HMT focussed specifically on NTDS when consulting, mainly as this was the type of non-transferable security that was issued by LCF.

⁴ The consultation can be found [here](#).

1.5 The following section recaps on the options presented in the government’s consultation. The rest of the document summarises the responses received and then goes on to outline the government’s response and next steps.

Option 1: Make the issuance of non-transferable debt securities a regulated activity

1.6 Under this option, the issuance of NTDS (where the proceeds are used to invest or lend to third-party businesses or projects⁵) would become a regulated activity. The consultation set out that this would not cover issues where an entity (such as a crowdfunding platform) acts as an intermediary between the issuer and the investor and is carrying out a regulated activity in doing so, but would instead apply primarily to the ‘direct-to-market’ issuance of NTDS.

1.7 If the government moved forward with this approach, firms wishing to carry on the activity of issuing NTDS would need to be authorised by the FCA for which they would have to meet minimum FCA standards⁶. Once authorised, the FCA would then be in a position to apply a broad range of requirements to NTDS issuers. The FCA’s financial promotion rules would continue to apply to promotions of NTDS (unless an exemption applies) and as an authorised firm the issuer would be able to communicate its own financial promotions without requiring another authorised firm to approve them.

1.8 The consultation set out two approaches to implement the option:

- creating a specific carve out from the exemption in Article 18 of the Regulated Activities Order 2001 (RAO) (which provides an exclusion from the regulated activity of ‘dealing in investments as principal’ for firms who issue their own debt securities) for direct-to-market issues of NTDS, where the proceeds are used to on-lend or invest; or
- extending the scope of the Markets in Financial Instruments Directive (MiFID) investment service, ‘execution of orders on behalf of clients’⁷ to cover NTDS.

1.9 The consultation presented the creation of a specific carve out from the exemption in Article 18 of the RAO as the government’s favoured approach to implement the regulated activity option.

1.10 Paragraph 4.16 of the consultation explained that, because regulation under this option would only apply to direct-to-market issues of NTDS, firms looking to issue NTDS may seek to use an intermediary (which would itself be regulated) to avoid the need to become authorised. The government set out its view that this would be an acceptable development of the market as the FCA would supervise the intermediary and thus have a regulatory grip over the issuance of the NTDS.

⁵ The measure would therefore not apply to firms issuing their own NTDS to fund their own expansion and refinance existing debt.

⁶ These conditions are outlined [here](#).

⁷ This approach was outlined in the Dame Elizabeth Gloster report.

Option 2 – Extending scope of the Prospectus Regulation to cover NTDS

- 1.11 Currently, the requirement to produce a prospectus only applies to ‘transferable securities’ (as defined by the Prospectus Regulation). This means that the requirement does not cover public offers of NTDS. Under this option as presented in the consultation, the scope of the Prospectus Regulation would be extended to include NTDS.
- 1.12 This change would mean any issuer wishing to offer over €8 million of NTDS to the public⁸ in the UK would be required to produce an FCA approved prospectus unless otherwise exempt. Potential investors would be able to review the prospectus before deciding whether to invest in the securities being offered. The issuer would have responsibility for the information provided in the prospectus and could be liable under FSMA to compensate any investors who suffered a loss in respect of any untrue or misleading information in the document.⁹
- 1.13 The consultation noted some drawbacks of Option 2; namely, that prospectuses are long and complex documents, typically used by those with significant relevant expertise in financial services. NTDS investors have been shown¹⁰ to struggle to digest all the information currently presented to them when deciding to invest in these products and so there is some doubt as to whether a prospectus document would improve their understanding or help investors make better decisions.

Option 3 – Rely on other HMT and FCA measures

- 1.14 The alternative to Options 1 and 2 as presented in the consultation was to not introduce any new regulation regarding the issuance of NTDS, and instead to rely on changes that have been, or are planned to be made to the UK’s financial promotions regime. The most relevant of these changes is the FCA’s ‘speculative illiquid security’¹¹ (SIS) mass-marketing ban, which was introduced as a temporary measure in January 2020 and made permanent in January 2021. This ban means that firms cannot promote securities (including NTDS) where the proceeds are used to on-lend or invest in other companies, property developments or projects to most retail investors, although firms are still able to market these products to high net worth or sophisticated investors where certain conditions are met.¹²
- 1.15 The consultation discussed that, although the FCA’s SIS ban effectively closes down the highest risk part of the NTDS market for ordinary retail investors, the restriction only addresses the marketing of these products and means there is very little, if any, regulatory oversight in the design, governance and functioning

⁸ Paragraph 4.20 of the consultation noted that if the requirement to provide a prospectus was extended to NTDS, the government would consider whether the existing €8 million exemption threshold for public offers of securities remains appropriate for NTDS.

⁹ See section 90 of FSMA.

¹⁰ Paragraph 4.22 of the consultation discusses this in more detail. See also [here](#) for research conducted by London Economics and YouGov into Non Transferable Debt Securities. See in particular page 57 of the report.

¹¹ The FCA’s definition of a speculative illiquid security can be found [here](#).

¹² See the FCA’s policy statement on the speculative illiquid security ban [here](#).

of these products. This is important, because the FCA SIS ban does not apply to promotions to professional investors, and is constrained in the way that it can be applied to high net worth and sophisticated investors, and it is unclear as to whether these investors are better placed to understand the risks presented by these products.

- 1.16 The government's plans to create a regulatory 'gateway', which an authorised person must pass through before it is able to approve the financial promotions of unauthorised persons was also discussed. This reform will mean that, where a financial promotion for the issue of an NTDS is approved by an authorised firm, that firm will have the necessary expertise to confirm that the promotion is fair, clear and not misleading, and complies with the FCA's mass-marketing ban for speculative illiquid securities.

Chapter 2

Summary of responses

- 2.1 The government received eight written responses to the consultation. These responses came from legal firms, and consumer and trade bodies. The consultation asked seven questions which have been grouped into four categories below for the purposes of this response:
- the issuance of NTDS as financial services activity and the regulation of NTDS;
 - regulating by making the issuance of NTDS a regulated activity;
 - regulating by extending the Prospectus Regulation to the issuance of NTDS;
 - reliance on current measures and alternative options.

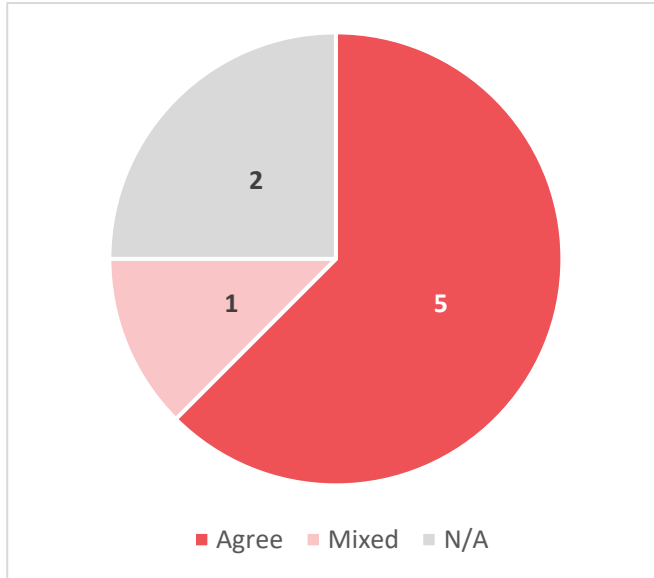
The issuance of NTDS as a financial services activity

- 2.2 The consultation asked whether the issuance of NTDS where the proceeds are used to on-lend or invest in the projects of a third party has the characteristics of a financial services activity (Question 1).
- 2.3 Five respondents agreed (see Box 2.A). One respondent said that the issuance of NTDS where the proceeds are used to on-lend had the characteristics of a financial services activity because the aim of on-lending is to make a profit through managing capital rather than through a 'real economy' business. Other respondents noted further types of financial services activity that the issuance of NTDS resembled such as fund management and credit intermediation.
- 2.4 One respondent noted that a more significant question is whether NTDS are issued by regulated financial institutions rather than whether they are used to on-lend or invest in third party projects. Another suggested that the interpretation of the term 'transferable security' (by HMT, the FCA and the courts) may have been overly literal and that some non-transferable debt securities should already be captured by the scope of MiFID and the Prospectus Regulation.¹
- 2.5 The same respondent suggested that there was no practical difference between a firm which uses the proceeds of an NTDS issue to on-lend or invest than one which is using the money to fund its own business activity. This respondent suggested a more important distinction for investors is between investment

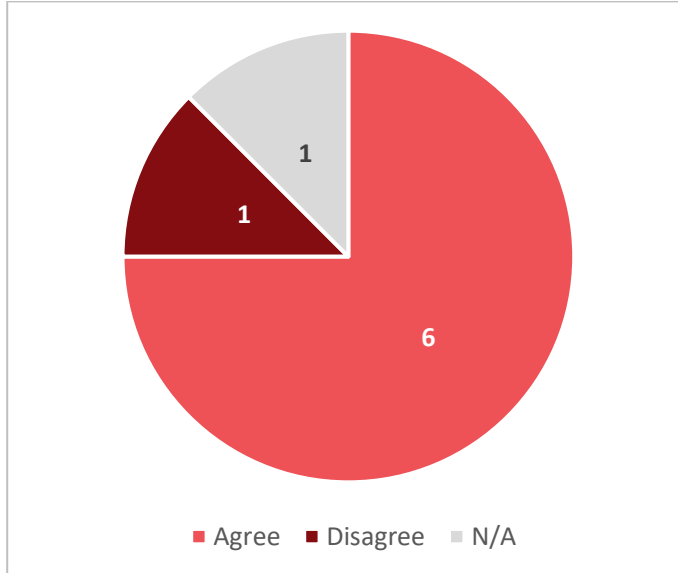
¹ This point is addressed in the Government Response section of the document (see paragraph 3.2).

strategies that are low-risk and those which are high-risk, which they suggested is often unrelated to whether the proceeds of an NTDS are used to on-lend.

Box 2.A: Do NTDS have the characteristics of a financial services activity?



Box 2.B: Should the issuance of NTDS be regulated in some form?



2.6 Questions 2, 3, 4 and 5 in the consultation discussed the two options for bringing NTDS into regulation. Six out of the eight respondents were in favour of some sort of regulation, either by making the issuance of NTDS a regulated activity or bringing NTDS into the scope of the Prospectus Regulation, illustrated in Box 2.B. The responses to the two options for regulation are explained in more detail in the following sections.

Regulating by making the issuance of NTDS a regulated activity

- 2.7 Questions 2 and 3 asked specifically if the direct-to-market issuance of NTDS should be made a regulated activity, and if so, by what means. A number of respondents noted the potential benefits of making the issuance of NTDS a regulated activity. Four responses noted that making the issuance of NTDS a regulated activity could increase investor protection. Others said that it could lead to firms issuing better-quality NTDS products. Other reasons respondents gave for making the issuance of NTDS a regulated activity were that it could increase investor confidence in NTDS and lead to improved understanding and oversight of NTDS by the FCA.
- 2.8 One respondent was in favour of increased regulatory oversight but was concerned that making NTDS a regulated activity could increase the FSCS levy.
- 2.9 Some respondents were against making the issuance of NTDS a regulated activity. As outlined in paragraph 2.4, one respondent suggested that NTDS are actually transferable and therefore should already be subject to the Prospectus Regulation. Another reason respondents gave against making the issuance of NTDS a regulated activity was that they considered it would be disproportionate. They noted that the NTDS market was in decline in favour of transferable securities, and further, that the public were becoming increasingly aware of the risks of NTDS following high-profile cases such as the failure of LCF. These respondents concluded that increased regulation for NTDS in isolation was not well-supported.
- 2.10 Respondents that took this view stressed that if HMT regulated the issuance of NTDS only there could be unintended consequences, such as an increased risk of regulatory arbitrage. Respondents raised concerns that some issuers could re-engineer their products (for example, to make them 'transferable') to prevent them from being caught by the regulatory changes while still posing a significant risk to consumers. These respondents advocated taking a more joined-up approach to the regulation of debt securities that avoids treating NTDS differently to other kinds of financial instruments.
- 2.11 Of those respondents that were supportive of making the issuance of NTDS a regulated activity, the consensus was that amending article 18 of the RAO was the most effective way to do so.

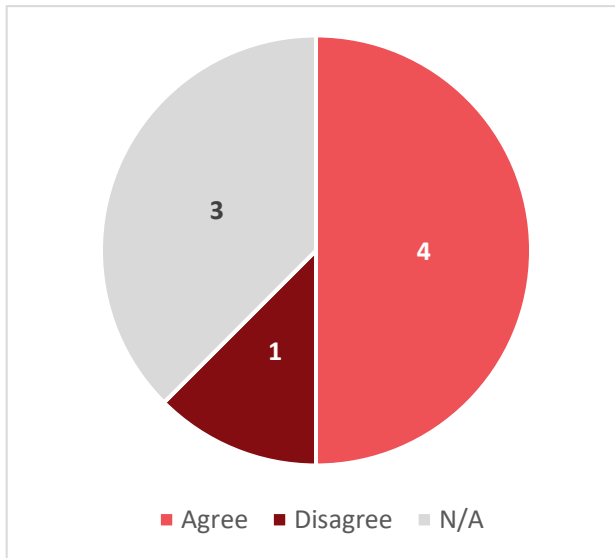
Regulating by extending the Prospectus Regulation to the issuance of NTDS

- 2.12 Two questions in the consultation focussed on prospectuses and NTDS. Question 4 asked if the provision of a prospectus would better inform retail investors when they are deciding whether to invest in NTDS. Question 5 sought views on the benefits and drawbacks of extending the Prospectus Regulation to the issuance of NTDS.
- 2.13 Generally, respondents were in favour of providing retail investors with more information about NTDS before investing (see Box 2.C). However, some answers questioned whether the prospectus document as currently formed was the

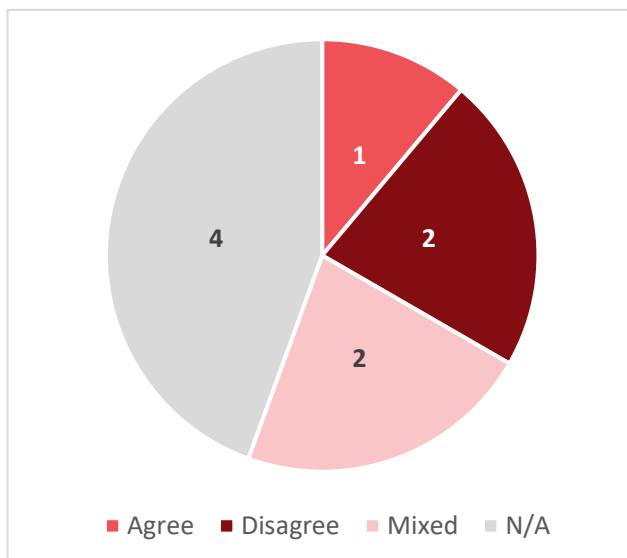
appropriate tool through which to provide this information (see Box 2.D). For example, one respondent said that the complexity of prospectuses means they are not accessible for retail investors.

- 2.14 Other respondents noted that products that are generally considered to be lower-risk for retail investors (such as transferable securities), require a prospectus. These respondents reasoned that if lower risk products generally require a prospectus then NTDS should too.

Box 2.C: Do you think investors in NTDS would benefit from more written information?



Box 2.D: Do you think the Prospectus Regime should apply to NTDS?



- 2.15 One respondent said that protections need to recognise the role of long-term customer relationships such as those between firms offering NTDS and retail investors. The respondent went on to say that improvements to protections around these relationships is key to encouraging more informed investors. This answer separately noted that they were broadly supportive of initiatives to reform the Prospectus Regulation.
- 2.16 Overall, respondents considered that investors would benefit from more information when investing in NTDS but they had concerns with applying the prospectus regime ‘as is’.

Reliance on existing measures and alternative options

- 2.17 The final consultation questions asked whether existing HMT and FCA measures were sufficient in respect of NTDS meaning that further regulation wouldn’t be required (Question 6), and if respondents had any other options that they would like HMT to consider (Question 7).
- 2.18 Five of the seven who responded to Question 6 disagreed that existing measures were sufficient with regard to the issuance of NTDS. Two responses were critical of the FCA’s SIS ban, suggesting that it captured firms that were low-risk while not solving problems exposed by high-profile firm failures such as LCF. These respondents suggested that the ban pushed firms to use other unregulated investments to raise finance. One suggestion given by these respondents was that a more proportionate approach might be to bring ‘speculative’ NTDS back under the Non-Readily Realisable Security (NRRS) regime², which would allow retail investors to continue to invest in NTDS where the proceeds are used to invest or lend to third-party businesses or projects, although still subject to some restrictions³.
- 2.19 Two respondents considered existing measures to be sufficient. As previously discussed in the context of answers to Questions 1 and 2, a minority of respondents suggested that the prospectus regime should already apply to NTDS. This minority considered this regime to provide the FCA with sufficient oversight of NTDS already.
- 2.20 On whether there are any other options that HMT should consider, one respondent suggested that another legislative option could be to specifically exempt bonds from Article 5 of the RAO (i.e. the regulated activity of accepting deposits) in accordance with Article 9 of the RAO (the exclusion for sums received in consideration for the issue of debt securities) only if they are transferable securities. However, the respondent reasoned that if the RAO were to be amended, changing Article 18 would make more sense in the context of other laws.

² See [here](#) for the FCA’s discussion paper on their financial promotions rules for high-risk investments, in particular, p.12 which discusses the NRRS regime.

³ See Conduct of Business Sourcebook (COBS), Section 4.7.7 – 4.7.10 for detail on the FCA’s NRRS regime, linked [here](#).

Chapter 3

Government response

- 3.1** The government welcomes the responses to the NTDS consultation. While there is a clear consensus to bring NTDS into regulation, the government recognises that a number of responses asked for a joined-up approach, that treats non-transferable debt securities consistently with other types of securities. Respondents also generally considered that investors would benefit from more written information when they were considering investing in NTDS, while noting that the prospectus document is likely not an effective way to provide this information.
- 3.2** As outlined in paragraph 2.4, one respondent concluded that NTDS should already be subject to regulation under MIFID II and the Prospectus Regulation. As set out in the initial consultation¹, the government does not take this view and notes that MiFID and the Prospectus Regulation do not apply to non-transferable securities.
- 3.3** Since the consultation on NTDS was launched in April 2021, work has progressed to carry out a fundamental review of the UK's prospectus regime, as recommended by Lord Hill's UK Listing Review². HMT launched a consultation on the UK prospectus regime in July 2021³. Chapter 8 of that consultation presented options on how the ability of unlisted⁴ (i.e. private) companies to offer securities to the public could be maintained and improved under a reformed prospectus regime. It questioned whether prospectuses (which companies must prepare and provide to investors when making issues of transferable securities to public over a threshold value of €8 million) are the right obligation for unlisted companies. It also raised similar issues with prospectuses as those raised in the NTDS consultation, for example it asked whether they are too long and detailed for use by retail investors. The Prospectus Regime Review consultation also presented evidence that showed that fundraisings by unlisted companies over the threshold are rare, indicating that the threshold to publish a prospectus is operating more like a cap.
- 3.4** The consultation suggested that, instead of preparing a prospectus, an unlisted company offering securities to public over a threshold amount would be required to make that offer via a firm authorised to carry out a new, bespoke regulated activity of operating a platform for the public offering of securities. The consultation noted that this would facilitate a package of appropriate

¹ See pages 10-12 of the NTDS consultation.

² See [here](#) for the UK Listing Review.

³ See [here](#) for the UK Prospectus Regime Review: Consultation.

⁴ Not admitted to trading on a regulated market or MTF.

investor protection measures to replace the prospectus obligation. As outlined in the government's response to the consultation⁵, the government intends to bring forward this policy, hereafter referred to as the 'new public offerings regime'.

- 3.5 The existing obligations under the Prospectus Regulation and Part VI of FSMA only apply to offerings of 'transferable securities'⁶. However, in light of the feedback received to the NTDS consultation that the government should seek to take a joined-up approach to the regulation of transferable and non-transferable securities, the government has considered whether the scope of the new public offerings regime should include offers to the public of non-transferable securities.
- 3.6 Including non-transferable securities within the scope of the new public offerings regime would mean that issuers of non-transferable securities (including NTDS) would be required to do so via a platform which would be regulated by the FCA. When considering the application of this proposal to NTDS specifically, this requirement would apply to all firms issuing NTDS and not just firms issuing NTDS where the proceeds are used to on-lend or invest in the projects of a third party, reflecting the fact that 'real economy' issues are currently captured by the prospectus regime. This proposal therefore had the potential to capture more firms than Option 1 as presented in the consultation.
- 3.7 The new public offerings regime shares some characteristics of 'Option 2' as presented in the NTDS consultation, given it will replace the obligation to provide a prospectus in order to issue securities and is focused on providing additional information to investors when deciding to invest. However, including non-transferable securities in the new public offerings regime addresses one of the key issues identified with Option 2 in the consultation, namely the fact that prospectuses are long and technical documents that are difficult for retail investors to understand. Instead, the new public offerings regime should ensure that investors receive specific and proportionate information about the products to make informed investment decisions.
- 3.8 Furthermore, the government is of the view that including NTDS within the scope of the new public offerings regime would have a similar effect in practice to making the issuance of NTDS a regulated activity (the favoured option as outlined in the consultation). This is because the new public offerings regime would make it a requirement to issue non-transferable securities via an intermediary (a public offer platform). The use of intermediaries by NTDS issuers is something that government explained would be likely to happen if the issuance of NTDS was made a regulated activity, given that NTDS issuers would look to avoid the need to become authorised (see paragraph 1.10).
- 3.9 Including non-transferable securities within the scope of the new public offerings regime also responds to Dame Elizabeth Gloster's recommendation to include non-transferable securities in the scope of regulation. This option would give the FCA greater role in relation to the regulation of the distribution of NTDS, which was a key concern of Dame Elizabeth's report.

⁵ The government's response to the consultation can be found [here](#).

⁶ This regulation is in Part VI of FSMA; see [here](#)

- 3.10 In summary, applying the new public offerings regime to non-transferable securities would allow the government to take a joined-up approach to the regulation of transferable and non-transferable securities; deliver on the Dame Elizabeth Gloster recommendation to bring non-transferable securities into regulation; and address issues identified in the NTDS consultation regarding the prospectus regulation option ('Option 2').
- 3.11 For this the reason, the government's preference at this stage is to include non-transferable securities within the scope of the new public offerings regime and to proceed with this option. However, there is still further work to develop this proposal to ensure it allows businesses to raise finance through the issuing of securities while ensuring appropriate consumer protection. Were issues to emerge relating to the preferred option, the government would return to exploring 'Option 1' as described in the NTDS consultation, to make the issuance of NTDS a regulated activity. As outlined in paragraph 4.25 in the NTDS consultation, the preferred route for enacting Option 1 would be to provide a specific exception to Article 18 of the RAO. While Option 1 does not have some of the potential benefits of our preferred option, such as creating a more consistent approach across different types of security issuance, we consider that it would still be effective in meeting the government's core objectives.

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