Cripps

No time to buy – mini-bonds

What are mini-bonds?

'Mini-bond' is a name given to a type of high-risk investment that is usually non-transferable debt securities (NTDS). They are created by a company issuing a bond note to an investor and paying an attractively high rate of interest in exchange for upfront capital. At the end of the period specified by the bond, the investor's money is due to be repaid in full.

Many companies turned to mini-bonds as a new way of raising capital after the financial crash of 2008. As institutional investors tightened their belts and banks became more cautious about issuing loans, mini-bonds offered a risky but practical way of raising capital for those companies willing to wager that their own growth would ensure they could keep up with the high interest rate payments to holders.

Crucially, an investor's return on a mini-bond depends on the proper running of the issuing company's business – if the company fails, you may get nothing back.

What is the risk?

For the consumer an immediate risk with mini-bonds is that they are illiquid so cannot be easily converted into cash. Their non-transferable nature means they cannot be sold on a secondary market; investors can be locked in until the bond matures and are usually unable to exit their investment early.

Mini-bonds are also unregulated by the Financial Conduct Authority (FCA). This means that investors will generally not have access to the Financial Services Compensation Scheme (FSCS) or the Financial Ombudsman

Service if something goes wrong.

This is compounded by mini-bonds' low place in the liquidation pecking order; holders are usually classified as unsecured creditors so they may only get a portion of their money back on liquidation only after those creditors with higher priority have been paid.

What has happened?

These risks were underscored by the highly publicised failures of several large issuers of mini-bonds. The most significant of these was London Capital & Finance (**LCF**), which was an FCA authorised firm whose main source of income was the issuance of mini-bonds. LCF went into administration in 2019 and at the point of failure 11,625 bondholders had invested around £237 million. Many of the bond holders were elderly, and lost hard-earned savings.

While they continue to investigate the circumstances surrounding the collapse of LCF, the FCA have introduced a permanent ban on the marketing of speculative illiquid securities, including mini-bonds, to retail investors.

What can an investor or insolvency practitioner do if an issuer becomes insolvent?

While there is normally no protection from the FSCS if the issuer is unable to repay the invested capital, there are still actions the investor should consider. If the investor received advice from (or purchased through) an FCA-authorised firm in connection with the investment in the failed mini-bonds, they should consider complaining to that firm if the advice was not in line with FCA regulations.

Issuing mini-bonds may have generated a large amount of short term income for the issuer. If the company fails, an appointed insolvency practitioner should investigate how that money was used and whether the conduct of the directors breached any of their legal duties.

If you would like to know more about mini-bonds, or the implications of an issuer's insolvency, please get in touch with our insolvency and restructuring team.

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