



TaylorWessing

Informal capital-raising consultation responses  
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Date  
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Our reference  
DJC

Your reference

Dear Sirs

**Informal capital raising and high net worth and sophisticated investors - consultation**

We attach our responses to this consultation.

Yours faithfully

**Taylor Wessing**

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## Consultation Questions Summary

*Q1: Are the current exemptions allowing appropriate numbers of high net worth and sophisticated investors to become certificated?*

No, the information which we receive from the industry suggests that the expense and difficulty of obtaining certification is such that take-up by business angels has been low.

*Q2: If no to question 1, is this posing a problem for smaller firms seeking to raise capital via unlisted equity and for investors? Please give examples where appropriate.*

Yes. The exemptions have, in effect, failed to increase the availability of capital for SMEs from business angels beyond the position which existed pre-December 2001. SMEs seeking to raise capital via unlisted equity from business angels are, in effect, forced to rely on other exemptions, where available, and, we believe on occasion to rely on an over-aggressive interpretation of the legislation.

*Q3: Do you agree that promotions should be allowed on the basis of a reasonable belief that an individual is either a certified high net worth investor or a certified sophisticated investor?*

Yes.

*Q4a: Should potential investors be able to self-certify that they qualify as high-net worth individuals?*

Yes. We consider this is essential in order to facilitate the availability of business angel finance to small businesses.

*Q4b: Do the majority of sophisticated investors already meet the high net worth criteria?*

No. We believe that many sophisticated investors, particularly those working in the area in which they might wish to invest, may not already meet the high net worth criteria. We consider that such investors should have the opportunity of investing without the undue expense of obtaining a certificate from a regulated firm.

*Q4c: If yes to Q4a, should the self-certification exemption replace or be introduced alongside the current high net worth exemption?*

We see no good argument for retaining the current high net worth exemption in these circumstances and, consequently, believe that the self-certification exemption should replace the existing current high net worth exemption.

*Q5: Should the net assets test for self-certification by high net worth investors be increased to £500,000, remain at £250,000 or be set at another level? Please give reasons and evidence for your choice.*

We are in favour of retaining the current levels. Once an individual's primary residence, rights under qualifying contracts of insurance and pension benefits are removed from the calculation, we believe that a surplus of £250,000 in net assets is an appropriate level for the protection of the consumer and that if the level were increased to £500,000, this would greatly reduce the number of people entitled to self-certify.

*Q6: Do you think a test for self-certifying as a sophisticated investor should be introduced alongside the current regime?*

Yes. The cost of obtaining a certificate from an authorised firm is too high, given the level of verification which firms, quite legitimately, consider is necessary. If self-certification is not possible for sophisticated investors, we anticipate that there will not be any significant change

in the take-up of this exemption. However, we are surprised to see that the proposed amended and new exemptions are limited to "individuals" as opposed to "persons" under the current exemption. We would suggest that the existing and proposed exemption should both be open to "persons" thus enabling body corporates and unincorporated associations to take advantage of them.

*Q7: Do you agree with the proposed criteria for sophistication? What changes do you suggest and why?*

We agree with the proposed criteria for sophistication in model 2 so far as they go, but would suggest that they be extended to include:

- venture capital and private equity firms (which by reason of available exemptions in the Regulated Activities Order may not be regulated and may not, therefore, be considered to be part of the "financial services and markets" industry);
- persons who work or have worked in the same area of business as the SME seeking business angel investment.

*Q8: Do you think self-certifying as a sophisticated investor without detailed criteria to test against should be introduced?*

No. Provided the criteria are extended in the way that we suggest we favour model 2.

*Q9: Out of models 1, 2 and 3, which do you think provides the most appropriate balance between investor protection and facilitating investment in SMEs and why? Please provide examples or supply evidence where appropriate.*

Model 2. We believe that model 2 provides the most appropriate balance between investor protection and facilitating investment in SMEs provided the criteria for sophistication are expanded in the manner that we suggest under question 7. To make the sophisticated investor exemption entirely subjective would, in our view, leave the door open for unscrupulous promoters to take advantage of consumers for whom the level of risk involved in business angel investment is inappropriate. This in turn might backfire on the industry and give it a bad name in the event that consumers are "talked into" making high risk investments which are inappropriate to their level of knowledge and understanding. By the same token, persons who understand the private equity/venture world or who have a strong knowledge of their own particular industry, should not be excluded from the sophisticated investor exemption and should be entitled to self-certify.

*Q10: Should amendments equivalent to those made to the Financial Promotion Order be made to the CIS Order?*

Yes. We can see no reason why equivalent amendments should not be made to the CIS Order.

*Q11: What other regulatory issues are proving a constraint on business angel investment?*

Cross-referencing will be necessary to ensure that article 50A is captured elsewhere in the Financial Promotion Order, the CIS Order and in other legislation where references are currently to article 50.

We believe that the words "wholly or predominantly" in relation to investments by high net worth individuals in collective investment schemes could be expanded. For example, a mezzanine fund within the definition of a collective investment scheme may not be able to say

that its investments are "predominantly" in unlisted companies even though investment in unlisted companies may be one of its principal objectives.

*Q12: Are there particular regulatory barriers preventing angel syndication?*

No. Any form of syndication carries with it the possibility that an unregulated collective investment scheme may be created with the result that its operator must be regulated. We suggest that consideration be given to amending the Financial Services and Markets Act 2000 (Collective Investment Schemes) Order 2001 to provide that the business angel syndicate is an arrangement which does not amount to a collective investment scheme. If this proposal is adopted, it would be appropriate to include participation in such a syndicate (to the extent that such participation involves a transaction in a controlled investment) in the lists of investments to which articles 48 and 50A of the Financial Promotion Order, and the equivalent articles in the CIS Order, apply.

*Q13: What regulatory constraints or costs impact on access to equity finance for growing firms?*

We believe that a model 2 approach, with the changes which we have suggested, will go a long way to reducing the regulatory constraints or costs impact on access to equity finance for growing firms whilst taking account of the balance which needs to be achieved to protect the consumer.

*Q14: Is there an under-provision of private sector intermediation in this area and, if so, what are the causes?*

We do not believe that there is an under-provision of private sector intermediation. To the extent that there is, it is likely to be caused by the need in most circumstances for the firm providing the intermediation service to be regulated.