

**INFORMAL CAPITAL RAISING AND HIGH NET WORTH AND
SOPHISTICATED INVESTORS:
CONSULTATION DOCUMENT, JANUARY 2004**

**RESPONSE FROM
ST HELEN'S CAPITAL PLC**

Background

St Helen's Capital plc is a corporate finance house, based in the City, which works with early-stage growth companies seeking to raise equity finance. We believe we are well-placed to comment on the above proposals. Our fund raisings usually fall between amounts of £100,000 up to £2m – the notorious 'Finance Gap' that Government is seeking to address.

In order to facilitate access to certificated private investors on behalf of the companies we are acting for, we established a 'Certification Process' during 2003. This process complies with all current regulation surrounding the exemptions for HNWIs and Sophisticated Investors. We have attached copies of the Certification Process for your information. We are also in process of creating an investor network for the purposes of raising small amounts of capital for early-stage and start-up companies. The members of this investor network will require to be certificated.

The feedback from investors who wish to become certificated in order to have sight of new investment opportunities, is similar. They find the current system unwieldy and overly-bureaucratic. The main concerns have already been correctly identified in the Consultation Document. As Government has realised, this is causing a low number of investors to become certificated, which is in turn affecting the ability of unlisted companies to secure early-stage funding.

We have detailed our responses to the questions raised and hope that Government finds this document of use. We would be happy to expand on any part of our submission, should Government wish.

St Helen's Capital believe it is vitally important to refine this process of certification that will allow companies to raise much-needed funding and investors to gain access to potentially lucrative opportunities – helping to build and nurture the enterprise culture in UK.

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

No. The experience of St Helen's Capital has been that the current system is very onerous and time-consuming, requires a great deal of administration on behalf of investors, and is relatively expensive in terms of professional fees. We have also spoken to a number of investors who are finding it difficult to find an 'authorised person' who is willing to certify them.

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.

Absolutely. The smaller firms that St Helen's Capital work with, find it incredibly hard to reach private investors. The certification process has actually made it more difficult, not less, since the introduction of new regulations has meant that we must seek to identify only those investors who are certificated. Investors are missing out on potentially lucrative investment opportunities, and companies are losing the opportunity to raise relatively small amounts of capital from private investors. For example: St Helen's Capital are currently working with a digital radio station seeking to raise £250,000. This is an ideal opportunity for private investors who may wish to invest amounts from £5,000. We have found it difficult to raise this money because we do not yet have a sufficient pool of

certified investors to talk to about this opportunity. The company has raised £100,000 from a single private investor who has radio experience.

It is also worth mentioning here that St Helen's Capital has an extensive network of private investors with whom we have almost daily contact. It is a source of frustration that we are unable to certify these investors as sophisticated, even although we can reasonably assume that they are because of the previous investments they have made. We are unable to certify them, and then send them details of a company we are working with. We understand why this legislation is in place, but have found it a barrier to introducing investors to suitable companies and vice-versa.

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 individual or a certified sophisticated investor?

We were unsure about the precise meaning of this question. We believe that investors will either be certificated, or not. Where does 'reasonable belief' come in? We also believe that companies should not be promoting their own share offers – that is the role of advisers such as St Helen's Capital and it is our responsibility to advise the company correctly so that share offers are promoted within the current regulations.

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

Yes.

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

Unlikely. In our experience, there are a great number of private investors in the UK who do not already meet the high net worth criteria, but who may be reasonably regarded as sophisticated. Level of investment knowledge is not related to level of wealth.

We can reasonably assume:

- high net worth investors are regarded as able to invest in these risky investments, irrespective of their investment knowledge, because we believe that if they lose all, or some, of the property invested it is unlikely to affect their financial wellbeing.
- Sophisticated investors, on the other hand, are reliant upon their investment knowledge and experience to make a sound investment decision.

We believe it is important to maintain this distinction.

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

Replacing the current exemption would simplify the process for all parties.

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 would recommend raising the level to £500,000 of net assets to be a high net worth individual. Our reason for this is because we believe that investor education is important to ensure that investors understand the risks involved, and can make an informed decision prior to investing. This will reduce the risks and eventually lead to greater investment success as investors learn to make better decisions. By raising the high net worth threshold, we are effectively forcing some investors to follow the sophisticated route to certification which we believe should contain some element of investor education to demonstrate knowledge and risk-awareness. However, it is important to note that it is the act of certification itself, rather than the threshold, that is important – it is the investor taking responsibility for his/her actions.

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

Absolutely. Our recommendation would be as follows:

To introduce a web-based test, based around, say, 200 questions, of which 50 are chosen at random for the investor to answer (this avoids people checking answers). There would be a downloadable workbook that investors would work through, prior to taking the test. The test would centre around risk-awareness, fundamental analysis of companies and the ability to make an informed investment decision. Questions would be agreed with the appropriate bodies beforehand to ensure that all interested parties were convinced that the test was able to accurately assess whether an investor is indeed sophisticated. The site could then automatically generate the required certificate. Investors could be given the choice of having their details distributed to private equity firms such as St Helen's. If this route is approved by Government, there will be many private companies willing to undertake this project. We believe that investors would pay a fee for the workbook, and to sit the test. This also helps to create a national register of certificated sophisticated investors which would be beneficial

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

The proposed criteria are good, and relevant and should be introduced alongside a web-based Sophisticated Investor test. We would also be pleased if the criteria were a little less restrictive and offered some flexibility, within reason. By having a web-based platform for investors to gain certification as sophisticated investors, we believe that this will increase the number of investors willing to look at early-stage and start-up funding propositions, although they may have less money to invest. The company may end up with a larger number of shareholders, with a smaller investment per head. This opens up the opportunity to a larger market.

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

We believe that there is probably some middle ground, but we would recommend keeping some form of criteria in place. The criteria detailed in the document – ie membership of certain bodies, working in financial services is appropriate. For people wishing to become certificated as sophisticated investors, and who don't fall into one of those categories, there should be an alternative means of testing knowledge and risk-awareness. For instance, a web-based exam that can be taken online.

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

Model 2. We feel strongly that Model 3 is a very dangerous path and leaves the door open to unscrupulous practices. It is open to abuse. Model 3 could lead to investors who are not sufficiently knowledgeable being incited to invest into businesses which are not appropriate for their risk level. Therefore, Model 2, with the addition of some form of knowledge test, would be the best route forward. Model 2 allows a certain flexibility, with the stated criteria. We would add some form of competence test to Model 2, allowing more investors the opportunity to become certificated as sophisticated. It is vital that a certain level of risk awareness is demonstrated by investors before they can be classified as 'sophisticated'.

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

Yes.

Note

The authors of this document are Tony Drury, Chairman of St Helen's Capital and Lisa Campbell, Marketing Director. Lisa ran a private investor training company for several years between 1997 and 2003. Training for Profit trained over 5,000 investors during that time (both through live workshops and online education) in many investment disciplines, including fundamental analysis and risk management. Her knowledge of the private investment market has been built up during this time and she is committed to training and education for investors. By having a pool of well-educated investors, the risks associated with investing can be reduced, resulting in greater success – both for the businesses and the investors.

Lisa now works with St Helen's Capital as marketing director.

CONTACT DETAILS:

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