

Informal Capital Raising Consultation Responses
Enterprise Team (4/N2)
HM Treasury
1 Horse Guards Road
London
SW1A 2HQ

19 April 2004

Dear Sirs

Informal Capital Raising and High Net Worth and Sophisticated Investors

Thank you for the opportunity to contribute to the debate about the role of investor certification. National Business Angels Network (NBAN) has wide experience of the informal investment market and seeks to present a consensual view of the issues facing the industry today.

NBAN has consulted with members of its network to establish views about the proposed changes to the certified investor regulations. It enthusiastically supports all measures to liberate the informal investment market and to encourage more investors to participate in it.

The overriding consensus is that simplification and ease of access to the informal venture capital market should be the guiding principle. This tenet should not be diluted in any way by vested interest.

Generally speaking certification is unwelcome by investors. It is perceived as having no benefits to investors in a market sector that is characterised by determined low levels of competence, poor investor services and little ambition to tackle the scalability issues needed to genuinely correct the tiny levels of success; 2% of known demand.

For this reason, given that most known operators in the sector are either FSA registered or exempted organisations, the NBAN position is very straight forward. Any progress towards a totally free market is welcome. If investor certification is to be maintained at all, it should be by way of self-certification. We see no point in maintaining differentiation between high net worth and sophisticated investors.

The operation of any scheme must be very straightforward. For instance, to claim certification as a high net worth Investor it could be necessary to certify that tax at marginal rate in excess of £50,000 (for example) was paid the previous year.

To claim certification as a sophisticated investor, it should be possible to certify awareness of the risk, membership of an approved investor organisation (network) and the retention of proper advisors competent in the sector.

I tabulate below our specific responses to relevant questions.

Q1: No

Q2: Yes this does pose a problem for smaller companies seeking to raise capital via unlisted equity but even more seriously, it poses a problem for investors. For instance it is difficult for a first time business angel to demonstrate sufficient sophistication for no apparent benefit.

Q3: We believe that promotion should be allowed on the basis that an individual who is registered with a business angel network, either public (exempted) or commercial (FSA registered) network will meet the present criteria as a high net worth or sophisticated investor.

Q4a: Yes, if certification can offer benefits to investors.

Q4b: Overwhelmingly yes.

Q4c: Self-certification should replace the current high net worth exemption.

Q5: We are content that the net assets test should still be subjected to £250,000 guidance even though self-certified.

Q6: No, although NBAN would be happy to promote a decision tree tool on its new website that helped potential business angels to measure their sophistication.

Q7: We are surprised that no banking professionals are deemed to be sufficiently expert in this field. The second bullet point seems too vague. The third bullet point - the investor with an average frequency of forty stock exchange transactions over a year is a wholly inadequate basis from which to judge the investment worthiness of an early stage or start up company. This qualification could be scrapped.

Q8: Yes to members of recognised business angel networks where those networks have proper investor induction programmes.

Q9: We prefer model 3 for investors who are registered with an approved network. We also see an opportunity here to break the inflexible parochialism of business angel networks by allowing investors to certify themselves on a central register with an opportunity for those investors to indicate any investment preferences that they might have. This will have the added benefit of improving liquidity in the market whilst protecting the commercial relationships of the investor with their own network. Thus, a benefit for certification could well be access to an intelligent choice of propositions that interest. Above all else, it is important to break the secrecy and selective way in which many intermediaries currently restrict investment choice to both their investors and investee companies.

Q10: Yes

Q11: The lack of consensus among business angel practitioners (business angel networks and other business angel centric intermediaries) does much damage to the liberation of the informal investment market. The lack of clear professional standards either actively policed by professional bodies or by the FSA in collaboration with NBAN is a major constraint.

Q12: For FSA registered commercial networks and exempted publicly funded networks, there have been no major regulatory barriers to angel

syndication. This may be because angel syndication and angel activity in general has been sorely hit by the recent investment downturn. We are sympathetic to the needs of the small number of angel syndicates that do operate professionally and believe that their registration as approved networks (see previous suggestions) could remove the problem. Failing this, FSA registration would seem to be a well-established and reliable alternative.

Q13: There is little evidence that the cost of registration *per se* impacts adversely on access to equity finance. More particularly the lack of coherent and reliable market practices reduce the prospects of success and vice versa increase the likelihood of failure for both investors and investees. Simplicity and clarity in codes of conduct, in codes of practice can do much to improve the performance of the sector. A lack of transparency in business practices and low level of investor services are far greater causes for the chronic under performance of intermediaries.

Q14: There is continuing under provision of private sector intermediation in this area. Its causes include:

- The poor professional reputation of some practitioners in this sector.
- Public sector networks often recruit their potential investees from non-credit worthy and poorly prepared entrepreneurs.
- The resistance of many practitioners to change; the delivery models for many practitioners have not changed for six or seven years.
- The lack of awareness of the need to treat investors as clients is a major problem for many public sector networks.
- Attempts to establish a reliable referral network by bankers to BANs has been frustrated by lethargy from within the banks and resistance by BANs to collaboration. However, the need remains as great as ever.

NBAN has been pleased to submit these thoughts on behalf of the industry and would be delighted to engage in further discussion should any of the above points merit your consideration.

Yours sincerely

Bernard Hallewell
Managing Director

