

7th April 2003

The Business Angels Bureau Ltd t/a Advantage Business Angels

Response to

HM Treasury Consultation Document - January 2004

Informal capital raising and high net worth and sophisticated investors.

A consultation document on proposed changes to the Financial Promotion Order

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

Answer 1. Our experience shows that the current exemptions have been totally ignored by both the Investors and the intermediaries as they are far too complex and people who would qualify are not bothered any way as they back their own judgment.

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.

Answer 2. It has certainly not helped as far as the smaller firm is concerned but the overall effect has been minimal. Investor reaction has generally been very negative. Business Angel networks still have to work extremely hard to complete deals. Most SMEs are not aware that the exemptions exist and the investors ignore them.

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?

Answer 3 Yes

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

Answer 4a
Undoubtedly, they are the best judge.

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

Answer 4b Not necessarily but many certainly do.

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

Answer 4c

No, provided the Investor is given clear guidelines at the time of self-certification he should be allowed to self-certify for both exemptions

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.

Answer 5

Such a figure is arbitrary, there will be plenty of people who will consider themselves capable of deciding whether to make an investment or not. It may be sensible to give them some general guidelines but different people with different circumstances will make their decisions in the light of their own circumstances. If a figure has to be included the it should remain at £250,000.

The Business Angel community is seeking to widen the appeal of private equity investment through syndication and thereby bring smaller investors into the net. This allows the Investor with modest amounts to test the water and spread the risk.

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

Answer 6

No, many Investors feel insulted that they are asked to prove that they are sophisticated investors when they have been doing it for many years. They have a natural resentment to any official interference in their investment decision making.

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

Answer 7 Once again the criteria suggested assumes that all Investors are idiots. The third criteria is far too complex and insults the intelligence of those who wish to make private equity investments. There is plenty of protection already in the general legislation to warn people of the dangers of making investment decisions without taking suitable advice.

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

Answer 8 It should be possible to provide simple broad guidelines to help advise potential private equity investors. The normal requirements for health warnings would

apply and may need to be extended marginally. Any further interference would not be helpful to anyone.

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.

Answer 9. From the point of view of the operation of an effective Business Angel Network option 3 would be the obvious choice. Investors are constantly reminded by networks of the risks attached to such investments and the whole culture of Business Angels screams that private equity investment is risky but can also provide high returns.

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

Answer 10 – Yes

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

Answer 11 Compliance generally, but now money laundering rules.....It is difficult to criticize money laundering rules. They should not be seen as a constraint on LEGITIMATE investment. Nor should 'compliance' really, but the overall impact is that there is no longer a sense of caveat emptor on the part of the investor and the 'nanny state' prevails. One of the major problems with these types of legislation is that they seek to try to protect the gullible and the innocent from exploitation by the criminal element. In reality the criminal will always find a way round any legislation. The effect on the legitimate operators is to create a stranglehold of bureaucracy and so-called protection for which stifles enterprise. As we incorporate more EEC legislation this will only get worse. Some fairly radical thinking needs to be applied to these thorny problems.

Q12: Are there particular regulatory barriers preventing angel syndication?

Answer 12 ABA would very much like to syndicate more deals but this is difficult because of the existing FSA legislation. Full registration is a highly expensive procedure both at application stage and on an on-going basis. Due diligence and the cost of compliance, in particular, Professional Indemnity cover and the professional costs associated mean that full registration is not a viable option.

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

Answer 13 The regulatory issues are cover above. Cost has to be a real issue also, but regulators cannot legislate for that, UNLESS the Government establishes a funded costs system for genuine SME investment. If they have a mission to encourage investment in SME, combining a relaxation in rules for genuine risk investment with a BL consultants

type funding structure – (say up to 75% of approved fees funded by central Gov through DTI et al) could prove very encouraging.

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

Answer 14. Yes almost a void, with one or two notable exceptions who are brave enough to try to steer a course through the troubled waters of Regulation and Compliance and the need to try to make a commercial return. There is little doubt that without the publicly funded networks there would be only a handful of private sector firms operating in this area. The Venture Capital companies continue to move towards bigger deals and the same is true of the private sector Business Angel networks. It is extremely difficult to make a commercial return on any fund raising activity below £500k. Once again compliance costs, due diligence, overhead costs all make it uneconomical.