

15 April 2004

Informal capital-raising responses
Enterprise Team (4/N2)
HM Treasury
1 Horse Guards Road
London
SW1A 2HQ

Dear Sirs

Informal capital raising and high net worth and sophisticated investors: A consultation document on proposed changes to the Financial Promotion Order (the “Consultation”)

I write on behalf of the Society of London Theatre (SOLT), the Theatrical Management Association (TMA) and the Theatre Investment Fund (TIF). SOLT and TMA are the trade associations representing the interests of theatre managers, producers and owners in central London and elsewhere in the UK respectively. TIF is a registered charity whose aims include encouraging greater investment in theatre productions. Our comments in response to the questions raised in the Consultation are made from the perspective of theatre producers seeking to raise finance for productions.

We welcome the general approach which lies behind the Consultation. Theatre producers continue to struggle to raise finance for productions and an element of this problem is the difficulty they have in communicating opportunities to invest to potential investors. It is believed that there are people who would like to invest in theatre productions but who are not aware of the opportunities or how to go about it. There is, however, a balance to be struck as theatre investment carries a degree of risk and is generally only appropriate for those wealthy enough to be able to accept a capital loss. Therefore, while a degree of liberalisation is to be applauded, the regime does need to be sufficiently stringent to ensure that promotions are not made without an appropriate degree of regulatory protection.

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

We are not aware of any theatre producer having relied on either of these exemptions since their introduction. At present the procedural problems in obtaining the necessary paperwork to demonstrate that someone is a high net worth investor, without disclosing the underlying investment, make the exemption very difficult to use in practice. In addition, the typical levels of

investment being made (£5,000 to £50,000 per person) mean that a request for a certificate of high net worth can seem bureaucratic and creates a disincentive to rely on the exemption.

There is a lack of authorised persons who are prepared to certify potential investors in theatre productions as being sophisticated. This is due to a combination of the limited numbers of appropriate authorised persons who themselves have sufficient knowledge of theatre investment; the absence of any incentive for providing certification; and the lack of any guidance as to what criteria or standards an authorised person must apply in determining whether someone is sophisticated. This could, at present, range from having provided someone with sufficient background information on the subject through requiring them to pass a test.

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.

Most theatre producers are seeking to raise capital via non-recourse participating debentures. The problems in using the current exemptions for high net worth and sophisticated investors mean that producers are usually faced with a choice between incurring the costs of having a document approved as a financial promotion by an authorised person or distributing material unlawfully. Given that the typical capitalisation of a play in the West End of London is between £100,000 and £300,000, the costs of having a document approved can mean that producers are incurring significant regulatory costs which are disproportionate to the funds which they are seeking to raise.

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 believe that this change is essential if the exemptions are to have any practical use, for the reasons set out above.

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

Yes. Given the levels of investment being sought by theatre producers, a request for a certificate from a third party seems unnecessarily bureaucratic. Given that high net worth is an objective test, there would seem to be little in the way of increased risk to investors if this change were adopted.

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

Given that the sophisticated investor exemption has not been extensively used in raising finance for theatre productions, it is not possible to comment.

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

It is difficult to see what need there will be for the existing exemption if the proposed new exemption were introduced (other than where there are different financial thresholds for each exemption), although presumably retaining its availability would do no harm.

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.

The present levels seem appropriate. Many investors in theatre productions invest sums as low as £1,000 to £2,000. The smallest sum which producers will typically accept is £1,000. This is especially the case with respect to new producers and those looking to finance tours of plays. Many investors will also want to spread their risk by investing smaller sums in a wider range of productions. With investments at this level, raising the net assets test would risk defeating the object of making it more straightforward and cost-effective for finance to be raised for new smaller ventures. The £250,000 threshold is proportionate, given the small sums which are often in question.

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

Yes, provided that it is based on objective criteria. It is assumed that the need for investor protection is a fundamental objective behind the financial promotion regime. Given this, if a potential investor is certifying that they fall within a category of people who, based on an objective standard, should be able to understand the risks associated with the investment opportunity which is being promoted to them, unapproved promotions should be allowed to be made to them.

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

Yes. No suggested changes.

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

No. This proposal risks promotions being sent to potential investors for whom they would be inappropriate. It would effectively place an undue responsibility on the promoter to warn the potential investor of the risks

involved and to monitor whether an investment is appropriate for a particular investor. If it were introduced without a separate self-certification exemption for sophisticated investors based on objective criteria, it could also mean that promoters who did not want to take the risk of relying on self-certification by potential investors without reference to objective criteria would not have available a narrower self-certification exemption on which they could rely.

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. This permits promotion to those who are equipped to understand the risks involved and avoids promotion to those who might be enthusiastic about theatre but can ill-afford to lose a capital sum and may fail to understand the degree of risk. Given that the written material which constitutes theatre financial promotions is generally relatively brief, it is important that potential investors are able to appreciate the significance of the information which is included. We believe that it is not in the best interests of the theatre industry for producers to be obtaining finance from individuals for whom investment of this nature is inappropriate. Introducing a subjective test for self-certification would push the balance too far in this direction and would risk exposing too many people to promotions which are not appropriate for them.

Conversely, it is also necessary to take into account the relatively small sums provided by many investors, as described in answer to Question 9 above. There is a risk of there being a disproportionate amount of regulatory protection where small sums of capital are being put at risk.

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

Very few producers raise finance using CISs, because of the associated cost of being regulated in order to operate a CIS. Nevertheless, the underlying nature of theatre investment which is raised via a CIS as opposed to via non-recourse participating debentures is the same and therefore it would seem logical if the same amendments were made to the CIS Order.

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

The issues surrounding promotion to high net worth and sophisticated investors rely on a producer having already identified a particular person as being a likely possibility for investment. Often the problem is in reaching the many people who would like to invest in theatre and can afford to do so. It would be helpful if producers were able to promote the possibility of investment more widely, for example by advertising in appropriate

publications, subject to there needing to be some further degree of protection, such as investors having to qualify as high net worth or sophisticated before being able to invest. This would effectively be a two step process which would permit an initial more generic promotion (which would not fall within the existing generic promotions exemption) but would then be followed up with a process which would ensure that the promotion is ultimately not allowed to impact on investors for whom the investment in question would be inappropriate.

Q12: Are there particular regulatory barriers preventing angel syndication?

Not specifically. Some syndicated schemes for theatre investment have been established. However, typically investors like to identify with the fact that their investment is in a particular production, rather than spread across several productions.

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

At present, the biggest cost for theatre producers seeking to raise finance is the expense of having financial promotions approved by an authorised person. There is also a limited number of authorised persons with the skills and experience to provide such approval.

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

Formal intermediation is little used in the theatre investment context and other than where producers are seeking to raise larger sums for big musical productions is unlikely to be cost-effective. As noted above, there can be a problem in identifying potential investors to approach. At the moment, because of the regulatory hurdles involved, it is difficult for producers to get their message to intermediaries who may be in contact with potential investors. It is also difficult for those who have the skills to do so, to undertake an intermediary function because of the need for FSA authorisation and the resulting costs.

We are grateful for the opportunity to respond to the Consultation. If you require further information, please do not hesitate to contact me.

Yours faithfully

Richard Pulford

Chief Executive

cc Mr Nick Salmon, Chief Executive, Theatre Investment Fund
Ms Maggie Saxon, President, Theatrical Management Association
Sir Stephen Waley-Cohen Bt, President, Society of London Theatre