

# Financial Services and Markets Legislation City Liaison Group\*

London Investment Banking Association  
British Bankers' Association  
International Swaps & Derivatives Association  
Futures and Options Association  
Investment Management Association  
International Primary Market Association  
Association of British Insurers  
Linklaters  
Clifford Chance LLP  
Freshfields Bruckhaus Deringer

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*Advance copy by e-mail: [informalcapital@hmt-treasury.gov.uk](mailto:informalcapital@hmt-treasury.gov.uk)*

Richard Price Esq  
Enterprise Team (4/N2)  
HM Treasury  
1 Horse Guard Road  
London SW1A 2HQ

Our Ref: MS/may10/COM76C/COM76Z

8 May 2004

Dear Mr Price,

## **HM Treasury's consultation document on informal capital raising and high net worth/sophisticated investors**

I am writing to you on behalf of the Financial Services and Markets Legislation City Liaison Group, an informal alliance of major City trade associations and law firms which works jointly on new legislation which affects the financial services industry. The Group's members are listed above.

The main purpose of this letter is to confirm that members of the Group have considered the Law Society's Company Law Committee's response to the informal capital raising consultation document and that we support the points made in that submission.

In addition, though, I have been asked to draw some drafting points and questions to your attention.

- *Model 2*

It is not clear why the "sufficient knowledge of the risks" test in draft Article 50A(4)(c)(ii) refers to the "financial year" immediately preceding the statement date rather than to a period of 12 months (cf Articles 50A(1)(b) and (4)(b)).

As regards the number of transactions test in draft Article 50A(4)(c)(ii), we are assuming that this does not cover investments made for the individual on a discretionary basis.

More generally, we would note that sophistication can be achieved through experience of different investments and through fewer transactions than are specified in Article 50A(4)(c), so we would be interested to know more about the Treasury's thinking on this aspect. (In particular, for example, the holding test only covers stocks and shares.)

- *Model 3*

The sufficient knowledge test in draft Article 50A(4) refers to the “requisite knowledge *and* experience” of the individual and we assume that *both* criteria are to apply. This has prompted us to consider whether the Treasury have considered using the “expertisation” formula used in FSA’s rules which refers to an investor’s experience and understanding”. (We also would be interested to know whether the Treasury have considered provisions which would allow this criterion to be assessed according to the expertise of an investor’s adviser.)

The proposed investor’s “statement” is in a prescribed form and we wonder whether the Treasury have considered allowing *additional* elements to be included so that the investor could state, for example, that he/she has the requisite knowledge and experience to understand that engaging in investment activities in respect of the investments may expose him/her to a significant risk of loss. (This point is potentially related to our comments below on the way the “reasonable belief” formula is used.)

- *Collective Investment Schemes Exemption Order*

We are not sure that the reference in the proposed statement to the risk of loss of “all the property I *have invested*” covers the not unusual case of an investor making a commitment to invest a certain sum overall but where the initial investment(s) only represents a part of that sum and further calls are made at a later stage.

- *Reasonable belief test as currently drafted*

We are not sure that the “believes on reasonable grounds” formula will work satisfactorily in practice. This is because as drafted Article 50A(5)(a) appears to require the person making the communication to make a judgement about the sophistication of the investor even though the self-certification statement has been received and even though the paragraph (6) requirements have been met (the person making the communication is required to believe on reasonable grounds that the individual receiving the promotion is a self-certified sophisticated investor, *but* there are *two* limbs in the definition in 50A(1) so that perhaps receipt of the statement is not sufficient). We would suggest that the test in 50A(5)(a) should be amended so as to create a presumption that an individual making a statement can be assumed to be a self-certified sophisticated investor except where the person making the communication is aware of circumstances that give him reason to believe that the statement may have been wrongly made for some reason.

We do not think that this approach would give rise to undue risk to investors given not least the safeguards contained in Article 50A(6) as regards the contents of the communication and, in particular, the indication to be provided of the requirements that must be met for self-certification.

## **Conclusion**

We would be pleased, of course, to discuss the issues covered in this submission with HM Treasury or to provide further information about any of the matters which members of the Group have raised if that would be helpful.

I am copying this to Marcello Casale because of the work that the Financial Stability and Regulatory Policy Team are taking forward on the Financial Promotion Order more generally.

Yours sincerely,

A handwritten signature in black ink, appearing to read "P. Beales". The signature is written in a cursive style with a large initial "P" and a stylized "Beales".

**Peter Beales**