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Dear Ms Engledow

Financial Services and Markets Act 2000 Two Year Review

This response is submitted on behalf of the British Venture Capital Association ("BVCA") and I apologise for the slight delay in its submission.

The BVCA represents the overwhelming majority of UK based private equity and venture capital firms. The BVCA has around 165 members who are invested in over 11,000 companies. Those 11,000 companies employ around 3 million people – equivalent to approximately 18 per cent of the private sector workforce.

The BVCA welcomes the chance to comment on the proposed changes to the Financial Services and Markets Act ("FSMA") secondary legislation set out in this consultation paper. The BVCA's responses to the specific questions in the consultation paper are restricted to the questions which relate to the sections of the Financial Promotion Order which most closely affect BVCA members; these are set out below.

However, the BVCA wishes to make two high level points in connection with the two year review.

The first is that the BVCA is extremely disappointed that HMT has chosen to exclude from the consultation exercise the issue of who is caught by the definition of "controller" in the FSMA. The current definition is extremely wide with the result that it may catch people who do not in practice have any control whatsoever over authorised firms. For example, on one reading of the relevant section a person is deemed to be a controller solely by virtue of the fact that he or she is married to a person who holds 10% of an authorised company's shares. To call such persons "controllers" is not proportionate, and does not achieve any practical benefit. Nor does it help the FSA to meet its statutory objectives. Therefore the BVCA urges HMT to re-consider its decision and to consult on amendments to the definition of "controller" in FSMA as a priority.



Secondly, the BVCA does not believe that the Financial Promotion Regime is working effectively in practice. Many firms and individuals do not appreciate the extent of the regime and are therefore breaching it unwittingly. Where firms and individuals do attempt to apply the rules it is extremely expensive in terms of time and resources. The BVCA recognises that consumers need to be protected and that regulation should attempt to achieve that goal. However the BVCA considers that in the context of transactions between businesses, and other circumstances where individual consumers are not at risk, businesses should be free to promote their products and negotiate their own terms without the substantial burden of the complicated rules imposed by the Financial Promotion Regime.

The rest of the submission responds to those specific questions in the consultation paper of particular relevance to BVCA members.

The Financial Promotion Order

Q19 Do you agree with the proposed changes to the Financial Promotion Order?

The BVCA welcomes the proposed change to article 43 expressly to include communications that are *directed at* members and creditors in addition to those that are *made* to such persons. The BVCA also welcomes the proposed extension to article 43 so that it includes communications made *on behalf of* a body corporate.

Q20 Are there any further changes to the Financial Promotion Order which you think should be considered?

The BVCA has responded separately to HM Treasury's consultation paper entitled "Informal capital raising and high net worth and sophisticated investors: A consultation on proposed changes to the Financial Promotion Order" and requests that the points made in that response be considered in this context also.

Article 69 - Promotion of securities already admitted to certain markets

Q21 Do you agree that the current article 69 of the Financial Promotion Order is too complex and should if possible be simplified?

The BVCA agrees.



Q22 Do you agree with narrowing the scope of the exemption but widening the circumstances in which it can be used and with applying fewer conditions to its use?

The BVCA welcomes the proposal to clarify article 69 of the current FPO to make it clear that the exemption applies both to promotions relating to issued shares and to promotions of shares *to be issued*. However, the BVCA does not consider that it is necessary to narrow the scope of the exemption so that it only applies to communications that relate only to "relevant investments" (i.e. those investments within paragraphs 16 and 17 of Schedule 1 to the draft amended order, and within paragraphs 19 or 20 in so far as they relate to investments within 16 and 17). The BVCA notes that the intention is to achieve the same coverage of investments as the exemption for communications to shareholders (article 43) but would argue that article 43 and article 69 are inherently different exemptions and that it does not follow that the two exemptions need to be identical as to the scope of investments covered. The BVCA does not consider that, in the context of the article 69 exemption (which is available because of protections afforded by virtue of the listed status of the issuer (i.e. an entity subject to detailed listing rules)) that it is necessary for investors to have the extra protection afforded by restricting the exemption to communications relating only to "relevant investments". It should be noted that the availability of article 69 is in any event subject to the satisfaction of conditions.

Q23 Do you agree with the proposed specific conditions for the exemption to apply?

The BVCA agrees with the proposed specific conditions for the exemption to apply and welcomes the fact that these have been reduced in number.

Sale of body corporate - proposed changes to the Regulated Activities Order**Q24 Do you agree that the exclusion in the Regulated Activities Order should be narrowed so that the "may reasonably be regarded" test will apply only in relation to a party who is acquiring or disposing of the day to day control of that body corporate and hence not to advice given to a party whose object is not acquisition or disposal or day to day control?**

The BVCA considers that the proposed narrowing of the exemption in this regard is unnecessary in view of the fact that, as the Treasury states, there does not appear to have been any consumer detriment in the application of the "may reasonably be regarded" test as currently drafted - i.e. based upon the object of the *transaction* rather than, as proposed, the object of "T" (as defined). The BVCA's overall view, therefore, is that no change is required. The BVCA's position, in more detail, is set out below.

As the Treasury states in paragraph 6.12 of its consultation paper, its rationale for narrowing the sale of body corporate exclusion arises from a concern that, as currently drafted, that exclusion



may enable *advice* on specific investments arising out of a wide range of takeovers to be given to shareholders without the protections provided by FSMA regulation (although, as mentioned above, the Treasury is not aware of there having been any consumer detriment in practice). It seems clear from the various comments that the Treasury makes in Section 6 of the consultation paper (and indeed the wording of Q24) that its primary - if not exclusive - concern relates to the perceived risk of *unregulated advice* being given in the context of private takeovers; and yet the scope of the exclusion that is proposed in respect of each of the other relevant regulated activities - i.e. dealing as principal, dealing as agent and arranging deals - would also be narrowed in the same way as regards the "may reasonably be regarded" test.

The BVCA cannot see any rationale for changing the existing "may be reasonably be regarded" test as regards dealing as principal, dealing as agent and arranging deals. The BVCA also remains of the view that there is no evidence of any consumer detriment having arisen out of unauthorised persons validly relying on the sale of body corporate exemption in the specific context of giving advice. However, if change were to be made to the sale of body corporate exemption in response to a perceived risk of consumer detriment, the BVCA would suggest that the proportionate approach would be:

- to retain, for dealing as principal, dealing as agent and arranging, the existing "may reasonably be regarded" test - i.e. by reference to the object of the *transaction*; and
- to adopt the revised "may reasonably be regarded" test as regards giving advice - i.e. by taking into account the object of "T", as the recipient of the advice, rather than the object of the transaction.

The BVCA also notes that the current definition of "T" (the relevant person(s) for the purposes of the proposed "may reasonably be regarded" test) includes a "group of persons acting together". Although this is obviously (and helpfully) a different concept to that of a "group of connected individuals" it is unclear as to the potential scope of the phrase. In its consultation paper, the Treasury helpfully refers by way of example to a group of companies working together as part of a takeover bid and also (of relevance to the BVCA) to the management team and institutional investors investing in a new company created to take over a target company in the context of an MBO. It would be helpful if these examples (and perhaps one or two others) could be included in the definition on the face of the statutory instrument by way of *non-exhaustive* examples.

Q25 Do you agree that the exclusion in the Regulated Activities Order should be narrowed so that the "may reasonably be regarded" test will apply only in relation to takeovers of small companies?

The BVCA does not necessarily agree that such a narrowing is necessary in that consumer detriment does not appear to have been identified as regards the manner in which the purposive test may currently be applied. However, the BVCA accepts that change in this regard is probably inevitable and that persons conducting regulated activities in relation to larger/listed companies will either have to rely on the "harder-edged test" or be suitably authorised.



Q26 Which option do you prefer as the definition of "small" company in respect of which the "may reasonably be regarded" test should apply? Do you have any other suggestions?

Subject to the response to Q25, the BVCA prefers option 2 - i.e. a company which is owned by no more than 50 persons or is an "unlisted company" (within the meaning of article 3 of the FPO). Option 3, relating to a company which is owned by no more than 50 persons or which is a "relevant unlisted company" would be unnecessarily restrictive, having the potential dramatically to reduce the availability of the sale of body corporate exemption (particularly if the definition which is currently found in article 63(1) of the FPO were to be used).

As is always the case with legislation which attempts to set an objective criterion for determining whether or not something satisfies a "size test", the 50 person threshold risks appearing somewhat arbitrary - and there may be many cases in practice when a company fails the size test but is nonetheless undeniably "small" and in respect of which investor protection is unnecessary. The BVCA notes that the concept of the 50 person threshold has been imported from the Public Offers of Securities Regulations 1995 (more as a matter of convenience than pertinence?) and that the Treasury refers in its consultation paper to *beneficial* ownership. This raises issues as to the extent to which, in determining whether or not a company is a small company falling within the definition of "BD", one has to take account of underlying beneficial interests where legal title is held by e.g. nominees or trustees. Determining ultimate beneficial ownership may not always be easy.

Given that Regulation 7(2)(b) of the Public Offer of Securities Regulations 1995 deals with a different exemption in a different context, the BVCA would suggest that the threshold in the context of the sale of body corporate exemption be raised to 100 persons. We believe that this would still enable the Treasury to meet its policy objective of ensuring that the acquisition or disposal in a small company for the purpose of obtaining day-to-day control is exempt from regulation.

Sale of body corporate exemption - proposed changes to the Financial Promotion Order**Q27 Do you agree that the exemption for promotions in respect of takeovers should be subject to the same conditions as those which apply under the revised RAO?**

In the BVCA's view it does not necessarily follow that the FPO sale of body corporate exemption should exactly mirror the RAO sale of body corporate exemption. In the context of venture capital transactions alternative FPO exemptions are not always immediately obvious - for instance, it is often impossible to say with any degree of conviction whether or not article 28 FPO (the "one off" exemption) is available - and the cost, both in terms of money and time, in getting financial promotions approved is often disproportionate to the investor protection benefits such approval supposedly bestows.

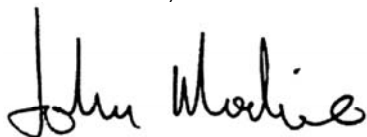


In the BVCA's view, it is important that there should be a clear distinction between the conditions that should be satisfied in relation to the **transaction** if the FPO sale of body corporate exemption is to apply and the scope of the exemption in relation to **communications** concerning that transaction. If either of the "harder-edged" test or the purposive, "may reasonably be regarded" test (as restricted to "small" companies - see our comments above in response to Q26)) is satisfied, the Treasury's policy objective (of ensuring that the acquisition or disposal of shares in a small company for the purposes of obtaining day-to-day control is exempt from regulation) should be met. The BVCA does not understand the need to further restrict the availability of the exemption by requiring that it will only apply if the *communication* is made to "S" or "T" as the case may be - in other words, if the transaction in question satisfies one or other of the conditions in paragraph (2) or (3) of draft article 69, why should the availability of the exemption then turn on the identity of the recipient of the communication? As the Treasury is aware, the financial promotion restriction is drawn in the widest possible terms and the industry and practitioners necessarily have to take a cautious view as to what may constitute a financial promotion. In the context of any particular transaction, therefore, there may be a number of communications which might be deemed to amount to "inducements to engage in investment activity" and, as mentioned above, getting financial promotions approved by authorised persons can be a costly and time-consuming exercise.

If there is a concern on the part of the Treasury that there may be recipients of a communication who would not fall within the definition of "S" or "T" as the case may be, but who would in the Treasury's view nevertheless require some kind of consumer protection, perhaps consideration could be given to incorporating a requirement to include warning "rubric" on the face of the document, including a recommendation to the effect that the recipient should seek independent advice.

If you have any questions about this submission please do not hesitate to contact me.

Yours sincerely



John Mackie
Chief Executive

