

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

21 April 2004

Dear Sirs

**CONSULTATION DOCUMENT – Proposed changes to the Financial Promotions Order**

We apologise for our late submission, but hope you will find our comments on your consultation document on the proposed changes to the financial promotion order of value.

Kingston Smith has been involved in attempting to raise capital for the SME sector for many years. We have championed organisations such as the National Business Angels Network, LENTA and others in order to promote a forum that would overcome the difficulties of raising small sums of equity capital.

Our client base is largely comprised of organisations directly affected by the current financial promotion order which has been responsible for an almost total decline in the raising of informal capital amongst them. Whether as investor or investee it is perceived that the difficulty and cost involved in trying to comply with the exemptions in a timely fashion is simply too onerous.

Whatever changes are ultimately made as a result of this consultation they must be simple to understand and contain simple tests to verify any status barriers for exemption.

In any event we believe the protection mechanisms for investors should only be triggered at the point of investment. Investees should retain appropriate evidence of eligibility to invest for a six year period which could be confirmed as having been received on registering a share issue at Companies House.

I set out in the attached appendix our responses to the specific questions included in the consultation document.

Yours sincerely

**STEVEN NEAL**  
**Partner - Corporate Finance Department**

## CONSULTATION QUESTIONS SUMMARY

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

No we do not consider that the current exemptions are allowing appropriate numbers to become certificated.

**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.**

Yes, the procedures are posing problems for small companies seeking to raise capital via unlisted equity and for investors. The legal compliance with the certification procedures in the documentation is causing the main problem thus increasing the cost of raising funds.

The uncertainty about the status of individuals that an issuer would like to approach and the time and effort required by an authorised person to diligently complete the process makes this legislation unworkable in the context of very small businesses and very small fundraising of less than £300,000.

**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?**

A test based upon a reasonable belief that an individual is within the exemptions is in our view too subjective a test of compliance without providing examples of criteria which are readily available in the public domain to test against thus allowing issuers to make that presumption. For example:-

a person who is shown at companies house to be a director and shareholder of a company that it's self has a net asset value greater than £500,000

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

We believe that investors should be able to self-certify.

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

It is our experience that anyone eligible for the category of sophisticated investor is also likely to meet the high net worth criteria.

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

The self-certification exemption should be introduced alongside a high net worth exemption.

**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.**

We think that there should be some variable tests dependent upon the size of the investment rather than merely increasing the limit for judging who is or who is not a high net worth investor. For example, if the limit remained at £250,000 we would suggest that an investor should not “risk” more than £62,500 whereas if he was a high net worth investor with £500,000 that limit should possibly be increased to £125,000 (ie. 25% of his “free” money in either case).

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

We do not think that an investor should self-certify himself as a sophisticated investor. This is a much greater risk in our perception than self-certification as a high net worth individual where the investor at least has to consider whether he has funds available which can be risked.

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

Please note above that we do not consider that there should be a separate exemption of “certified sophisticated investor”.

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

We do not think self-certifying as a sophisticated investor should be introduced and certainly not without detailed criteria to test against that certificate (see above).

**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.**

We believe that model 2 as amended by some form of testing as noted under Q4a and removal of the uncertainty as to who issuers can approach noted under Q2 above would provide a practical framework for the raising of informal capital in the SME context whilst allowing for a reasonable level of protection.

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

We agree that whatever changes are made to the Financial Promotion Order should be made also to the CIS Order in the manner proposed.

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

Almost all business angels have advisers who are fully aware of their obligations under the FSMA. As a consequence they are in the main reluctant to introduce their clients to investment situations. They are also very aware that they are unlikely to recover the full cost in relation to assisting a small issuer with an informal capital raising because of the time requirement to ensure that they comply with all the regulations.

**Q12: Are there particular regulatory barriers preventing angel syndication?**

We are not aware of any regulatory barriers just the practicalities and clashes in personalities that arise within smaller entities and the sometimes complex rules of the EIS scheme.

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

Our comments on the difficulties faced by authorised persons and the lack of benefit perceived by investors and consequently the value of this service is a severe restriction on activity levels.

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

There is a lack of intermediation participation particularly from accountancy practices who with less onerous regulation could help stimulate the very small start up end of the market.