Fraser MacLeod
HM Treasury
1 Horse Guards Road
London
SW1A 2HQ

By email: FinProms@hmtreasury.gov.uk

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Dear Colleagues

Re: Financial promotion exemptions for high net worth individuals and sophisticated investors

Introduction

We are writing on behalf of the British Private Equity and Venture Capital Association ("BVCA"), which is the industry body and public policy advocate for the private equity and venture capital industry in the UK. With a membership of over 750 firms, we represent the vast majority of all UK-based private equity and venture capital firms, as well as their professional advisers and investors. Between 2016 and 2020, BVCA members invested over £47bn into around 3,500 UK businesses, in sectors across the UK economy ranging from heavy infrastructure to emerging technology. Companies backed by private equity and venture capital currently employ over 1.1m people in the UK and 90% of the businesses our members invest in are small and medium-sized businesses.

We welcome the opportunity to provide our feedback on the consultation proposal for the financial promotion exemptions for high net worth and sophisticated investors.

Please see below our responses to the specific questions raised in the consultation paper.

BVCA responses to consultation questions

1. Do you agree that the exemptions should be retained?

Yes. The certified high net worth and self-certified sophisticated investor exemptions in the Financial Services and Markets Act 2000 (Financial Promotion) Order 2005 ("FPO"), the Financial Services and Markets Act 2000 (Promotion of Collective Investment Schemes) (Exemptions) Order 2001 ("PCISO") and their COBS 4.12 equivalents are of particular importance to start up to SME stage companies seeking investment from friends and family, seed and angel investors (Articles 48 and 50A FPO), and to fundraising by UK and EU based fund managers that raise venture capital to invest in UK based early stage companies, for both investment funds and co-investments (Articles 21 and 23A of the PCISO, COBS 4.12.4(2) and (9)). Feedback from our membership indicates that the certified sophisticated investor exemption that requires certification by an authorised person (Article 50 FPO and equivalents) is used infrequently.

We are concerned that the removal or material reduction in the scope of the certified high net worth and self-certified sophisticated investor exemptions would:

1. restrict an important source of capital for early stage UK companies and venture funds focussed on investing in UK SMEs (there is no obvious replacement for that capital); and
2. impact the growth of early stage innovative businesses and UK competitiveness as a location for founders to establish and scale up businesses.

2. **Do you agree with the objectives for reform? Are there other objectives the government should consider?**

We agree with the objectives for reform and would add three more:

1. Any changes should be evidence led, proportionate and balance (a) promoter obligations and consumer protection, and (b) the cost of compliance to promoters (both intermediary firms and company issuers) and the negative externalities of excluding a wider range of persons, from both the investor perspective (loss of access for UK based investors to certain investments and the reduction in their investible universe of asset classes) and the issuer perspective (reduction of a finite range of capital sources with no obvious replacements).

2. Any restrictions or obligations that erode UK competitiveness against competitor countries (particularly France, Germany and the US) should be justifiable and where they are necessary should be imposed progressively – particularly where they may erode the relative attractiveness of the UK as a location for founders of innovative, high growth businesses to set up, scale up and exit, and the related eco-system of seed funders, angels and venture capital funds.

3. Seek to simplify rules and to minimise cost and delay that could act as a barrier to fundraising, particularly the need for costly legal advice.

3. **Do you agree that the financial thresholds for high net worth individuals should be increased? At what value do you think the thresholds should be set? Please justify your answer.**

An increase in the high net worth individual threshold in line with inflation from 2001 seems appropriate; to an income threshold of £150,000 and a net asset threshold of £385,000.

Calibrating to the top 1% of earners and asset holders would not take into account the imbalance in wealth creation in the UK since 2001 particularly by age and geography.

4. **If you are a business (or trade body who represents businesses) who use the exemptions when promoting investments to investors, can you provide information on the investor profile of the investors who are promoted to within the exemptions? How would increasing the high net worth investor thresholds affect your ability to make communications to these investors?**

The high net worth and sophisticated investor exemptions are used to market a proportion of private equity and venture capital funds. Most private equity fund managers generally only market to per se or elective professional investors (under the MiFID definitions). The use of the exemptions is more common for venture capital fund managers who manage funds that invest in early stage high growth businesses; high net worth and sophisticated investors are an important source of capital for venture funds. In private equity and venture capital funds it is common for fund managers and investors to meet at least on an annual basis, and for relationships between successful fund managers and high net worth investors to endure over decades and multiple funds.

Venture capital funds commonly focus on a particular sector (for example, biotech, proptech or fintech) and often:

1. seek high net worth founders with knowledge and experience in the sector, who act as bell-weather investors whose investment may encourage other investors, and who may also assist with originating investment opportunities in early stage companies, developing portfolio companies through industry, trade and international contacts, and through co-investment; and

2. develop long-term symbiotic relationships with high net worth investors with an interest or experience in that sector, who will often invest in successive funds and coinvest in portfolio companies.

From feedback from our membership, increasing the high net worth thresholds to an income of £150,000 and net assets of £385,000 is unlikely to have a direct material impact on private equity fund raising, though increasing the net asset threshold to £900,000 could have a direct negative impact.

However, the exemptions are widely used by (a) early stage venture funds such as SEIS, EIS and seed-stage funds, and (b) UK companies to raise seed and early stage funding from friends and family, seed investors, angel investors and networks, and high net worth founders with knowledge and interest in the particular sector. So, of greater concern is the impact that increasing the thresholds is likely to have by reducing the availability of sources of capital for early financing rounds on innovative UK businesses, the funds that invest in them at an early stage or as they scale up, and the related eco-system that enables early stage companies to scale up. We therefore think it important that the likely effect at this level be scrutinised with care before increasing the thresholds.

5. **Do you agree that the assets in scope of the net asset calculation should remain the same?**

Yes. We agree that the existing net asset calculation should remain the same and that pensions, primary residence and related mortgage, and rights under a qualifying insurance contract should be excluded from the net asset threshold.

We would welcome consideration of a second, higher, net asset threshold that includes self-invested personal pension assets, to allow SIPPs to invest in a wider range of asset classes (for example, with an overall asset threshold of £1 million).

6. **Do you agree that the unlisted company criteria of the self-certified sophisticated investor test is no longer a reliable way of demonstrating sophistication, and therefore should be removed?**

We agree that investments in unlisted companies are more readily available than they were in 2005, and that a single investment in an unlisted company in the previous two years may no longer be appropriate. However, we do not think that is reason to entirely remove the exemption; knowledge and experience through investing in unlisted companies can result in and demonstrate an appropriate level of sophistication. HM Treasury's first proposed objective (at paragraph 4.7 of the consultation paper) is to ensure that thresholds for exempt investors are calibrated to reflect investors' experience. The level should be set at a number and frequency of investment that indicates an established behaviour and sufficient experience. Four material investments in unlisted companies in a two year period (or perhaps a higher number if investments are through a platform) seems appropriate. We think £5,000 would be a material investment amount. We would also welcome consideration of widening the types of eligible investments to include the types of investment to which the Article 50A FPO exemption itself applies, particularly to include collective investment schemes that invest in stock, shares or indebtedness of unlisted companies (see FPO 50A(8(d)).

7. **Do you have suggestions for other tests that could be included to demonstrate sophistication, and could be incorporated into the definition of a self-certified sophisticated investor?**

We would welcome consideration of education-based criteria. Relevant tertiary or equivalent education (for example, a degree in applied economics, a masters in business administration, or a masters in finance) and other qualifications (CFA, ACCA, CAIA) should demonstrate an appropriate level of sophistication. Industry-led initiatives also seem worth considering.

We would welcome review of the current two year limitation for the third and fourth criteria of the permitted sophisticated investor categories; that require a recipient to have worked, within two years, in a professional capacity in the private equity sector or in financing SMEs or been a director of a company with an annual turnover above a specified threshold. The two year period seems unnecessarily short and based on an overly pessimistic view that does not reflect the actual rate at which private investment skills and knowledge erode and experience becomes outdated – the fundamentals of investment analysis change incrementally over decades. For other regulatory precedent, see for example the second MiFID elective professional client

quantitative test that requires that a person has worked in the financial sector for at least one year in a relevant professional position, and that is not time limited. We think this approach could usefully be adopted. If HMT concludes a finite period is required, a longer period of ten years or longer would be appropriate.

8. **Do you agree that the fourth criteria of the self-certified sophisticated investor definition should be updated so that the company must have, or have had, a turnover of at least £1.4 million?**

   Yes, we think an inflation-adjusted increase to the size of company turnover for the fourth criteria is appropriate. Please see our response to question 7 in relation to the relevant period.

9. **Do you agree that a greater responsibility should be placed on firms to ensure that prospective investors satisfy the thresholds for categorisation as high net worth individuals or self-certified sophisticated investors?**

   A level of greater responsibility on promoters to ensure that prospective investors fall within the relevant categories seems appropriate and is in line with existing practice for private equity and venture capital fund managers. However, we think it important that:

   1. any obligation on persons that make financial promotions (whether intermediaries or company issuers) should not be greater than the current HMT proposal of "*reasonable belief*" that a recipient falls within a relevant category; and

   2. there should be a presumption that prospective investors provide truthful information, unless the information raises suspicions on its face (without the requirement for further due diligence).

10. **If so, do you agree that the emphasis of the "reasonable belief" be shifted so that the firm communicating the financial promotion must have a reasonable belief that an individual meets the criteria?**

    We agree the "reasonable belief" test and obligation to document that reasonable belief are appropriate. A simple principle is preferable to prescriptive obligations that could not fit the considerable range of financial promotions, persons making them, sectors and underlying assets. Specific concerns for particular sectors or practices could be dealt with by specific guidance from HM Treasury, that could be adjusted where necessary to increase its effectiveness. For example, protections that might focus on protecting vulnerable consumers from direct online sale of high risk investments are unlikely to impact industries where periodic face-to-face communications, and long term relationships between firms and investors are common, such as private equity and venture capital.

    To increase certainty for promoters and levels of compliance, and to reduce the need for costly legal advice about the practical application of "reasonable belief", we would strongly recommend guidance (from the FCA or HM Treasury) that includes a non-exclusive list of actions that would constitute reasonable belief and act as safe harbours, which could be industry-specific, and revised where necessary to reflect changing risks. The BVCA would welcome industry engagement on this from the FCA or HM Treasury, and would be delighted to make available representatives of private equity firms and other funds experts to contribute to any working group.

11. **Do you think there is a better alternative than placing greater responsibility on firms to ensure that prospective investors satisfy the thresholds for categorisation as high net worth individuals or self-certified sophisticated?**

    We agree with the proposal to require recipients to select the relevant criteria that applies to them. We do not think that the obligation on promoters (whether intermediaries or company issuers) should be greater than the current HMT proposal of "*reasonable belief*".

12. **If you are a firm who uses the exemptions, how would you establish a reasonable belief that a particular individual satisfied the relevant net worth or sophistication criteria? How would this compare to what you do now? If you envisage problems in establishing whether a consumer meets these criteria please explain why?**

From feedback from our members, it is common practice to establish eligibility from existing information held by the firm, public sources, subscription services, and information received from the individual, whether formally by written request or through discussions, or a combination of the above.

We do not think that in all cases all recipients should be required to explain how they meet the criteria but that they should be invited to do so. Investors are often concerned about confidentiality and data protection and often would not want to provide information they regard as sensitive before reviewing a possible transaction. So, if a recipient does not provide information, or provides limited information, there should not be an adverse inference.

If HM Treasury considers it essential to require response from recipients, summary or general responses or confirmation that the recipient has an income and net assets of at least the threshold levels (rather than s statement of a recipient's actual income or net assets, which recipients are likely to consider sensitive) should be sufficient. For example, rather than give actual numbers, a recipient might explain that they meet the income and asset requirements as they are a managing director of a well-known bank, a hedge fund founder or similar. We think it important that promoters should be entitled to rely on the information that they are provided with and to a presumption that it is true, unless aware that it is not true or the particular circumstances would indicate that further due diligence is required.

We are concerned that a forced requirement for recipients to state their actual income or net worth, or on promoters to obtain evidence of income or assets (for example bank statements, payslips or asset manager reports) would be counter-productive, would be seen as highly intrusive by many, would deter some high net worth investors, and would raise data protection issues. We think it should be sufficient for recipients to confirm that their income and net worth exceed the relevant thresholds, or to select from ranges, and think it prudent to include an option or range that allows recipients to confirm that they fall below the relevant threshold.

Similarly, while independent verification from a credible online or subscription service that an individual is a founder of a high-growth business, inherited considerable wealth, or is a partner or managing director of a successful firm or bank etc may be used, it should not be required.

13. **Do you agree that firms should be required to provide details about themselves in any communications made using the exemptions?**

We agree with the obligation that promoters should provide their full name, their address, contact details and Companies House or local registration equivalent. This would not be difficult for legitimate promoters to provide, forces a level of transparency that should assist recipients' due diligence, though we note would be of little protection in relation to, or help in exposing, fraudulent promotions.

14. **Do you agree that the investor statement should be updated to achieve greater engagement from investors and awareness of the regulatory protections they are losing in receiving financial promotions under the exemptions?**

We agree that the investor statement could be clearer and could set out in greater detail the regulatory protections and potential losses that could arise from investments. We think a standardised investor statement and format is important both for investor protection (so that the relative importance of items cannot be manipulated in a misleading or inappropriate way or to give undue prominence to particular aspects) and to reduce cost of transacting (to avoid costly legal advice).

15. **Do you agree with the proposed changes to the investor statements?**

    We agree that the investor statements should be updated. We would welcome statements that are clear, simple, in plain English, that do not assume knowledge of the UK financial promotions regime, and do not use jargon.

    As set out in our response to question 12 above, we do not think that in all cases all recipients should be required to explain how they meet the criteria but that they should be invited to do so, and that promoters should be entitled to assume that the information that they are provided with is true, unless aware that it is not true.

16. **Do you have any other suggestions for how the investor statement could be updated to ensure greater investor engagement, for example, to work more effectively as part of a digital journey?**

    We think it important that the statements can be completed and signed digitally, that pre-ticked options or pre-filled content should be prohibited, but that response fields that include a range of drop down options and an "other" allowing for data entry should be permitted.

17. **If you are a firm that uses the exemptions, do you envisage any issues with the proposed changes, particularly to require individuals to set out how they meet the exemption criteria? Please justify your answer.**

    See answer to question 12 above.

18. **Do you agree that the title of the 'certified high net worth individual' exemption should be updated to 'high net worth individual'?**

    We agree that "certified" should be removed from the name of the Article 48 FPO and Article 21 CIS Order exemptions, which would be consistent with the labels given to other exemptions.

    As "high net worth individual" or "HNWI" is widely used within financial services with a spread of meanings, we think it would be useful to use a label that would distinguish Article 50A / 23A eligible HNWIs from general HNWIs – we think "Eligible High Net Worth Individual" or similar could provide useful clarity. Though this would not be consistent with other labels in the FPO and PCISO.

19. **Are there any other ideas that you feel would deliver on the three objectives of these proposals, outlined in paragraph 4.7**

    No.

20. **The financial promotions regime plays an important role in protecting vulnerable consumers when investing. The government would welcome views from groups that represent vulnerable groups regarding any of the information presented in this consultation, and in particular on the proposals outlined in the preceding chapter**

    The BVCA would support proportionate measures to protect vulnerable consumers. Our member private equity and venture capital firms typically engage in active and at least annual dialogue with investors and do not seek capital from vulnerable consumers.

21. **If you are a firm or individual who relies on the OPE to provide or receive financial services from foreign jurisdictions, what effect would the proposed changes have?**

Our member firms typically have offices in the UK and are FCA authorised. Please see response to question 4 above.

Yours sincerely,

Tim Lewis, Chair, BVCA Regulatory Committee