

Informal capital raising and high net worth and sophisticated investors: Consumer Panel response to the consultation document on proposed changes to the Financial Promotion Order

Introduction

The Consumer Panel has a number of concerns about issues raised in the Consultation Paper and our response deals with these issues, rather than the individual questions set out in the Paper.

In particular the Panel believes that the Paper fails to take proper account of the risks to consumers which arise from these proposals. This is both a surprise and a disappointment. Without this balance of argument and on the evidence currently available, the Panel cannot support the liberalisation of the existing Financial Promotions Order on the basis of any of the options set out in the paper.

Consumer Interests

The Panel has been unable to identify any evidence of a significant and unsatisfied consumer demand for opportunities to invest in unlisted companies. Nor is the Panel convinced that, even if such a demand exists, the current certification requirements for high net worth and sophisticated investors are a major stumbling block for either potential investors or small companies wishing to raise capital. The arguments put forward in the Paper for the need for changes to the current regime are not compelling.

High net worth and sophisticated investors who choose to invest in unlisted companies without the benefit of regulated advice run the risk of losing their money without the possibility of recourse to the Financial Ombudsman Service/Financial Services Compensation Scheme. The Panel recognises that there will be investors who are competent to take these important decisions and to deal with the consequences if something goes wrong. However, there are others who will not be in this position. For example, given current property values in some parts of the UK, it is quite possible for a child inheriting its parents' former home to meet the definition of high net worth investor without acquiring any financial or investment expertise. So far as "sophisticated" investors are concerned, the Panel is pleased that firms adopt a cautious attitude to certification. The costs to the consumer of being wrongly identified as a sophisticated investor are high. We do not believe that there is any scope for relaxing the existing requirements for certification of sophisticated investors.

Self-certification

The Panel has reservations about the use of self-certification. In our view many investors will be susceptible to pressure from firms who need funding and could make decisions they

would later regret. Self-certification would, in effect, mean abandoning certification and the protection it affords altogether as the proposed "reasonable belief" criterion is unlikely to be effective in safeguarding consumers against unscrupulous firms. The Panel does not believe that this is justified. It is particularly strange to see proposals for changes to the regime in respect of high net worth investors in all three models, where the Treasury acknowledges that the current certification arrangements are relatively straightforward.

Options

We do not propose to comment in detail on the three options set out in the Paper. The Panel does not believe the case for change has been made and therefore we do not favour one option over another.

Cost Benefit Analysis

The paper does not contain a formal cost benefit analysis of each of the proposals. The Panel would be interested in the results of such an exercise, including the way in which the potential benefits and risks to consumers would be quantified.

Conclusion

The Panel does not support any of the options for changes to the financial promotions regime.

Financial Services Consumer Panel

14 April 2003