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HM Treasury **-UK Prospectus Regime Review**
Consultation Response from ShareSoc

We welcome this consultation paper.

ShareSoc is a not-for-profit organisation with over 8,000 members. We represent the interests of 5 million individual shareholders and 12 million individual investors in the UK. We are members of Better Finance who, together with our sister organisations in other countries represent individual investors throughout Europe. We are also members of the World Federation of Investors. ShareSoc Chair, Mark Northway, is also Chair of the World Federation of Investors.

These proposals are sensible. As the consultation paper itself states, the implementation of these reforms will encourage "broader participation in companies by removing disincentives to offer securities to narrow groups of investors, rather than the wider public". Companies Act 2006 S172(f) requires - directors to act fairly between shareholders. We believe these proposals are in line with the intent of that legislation.

The evidence is clear -When restrictions on company issuance were temporarily relaxed last year, there was a noticeable uplift in the amount raised by existing listed companies. More would certainly have been raised if it was not for the rule that any main market listed company issuing more than 20 per cent of its share capital is required to publish a prospectus.

We strongly support the removal of the €8m limit placed on the amount of new capital that existing listed corporates can offer to the public. We have campaigned to have this limit removed and are delighted that our arguments have been listened to.

We also strongly support the proposal to remove incentives to offer securities to narrow groups! (and disincentives to offer them to the wider public). This change should have the effect of taking all rights issues outside of the restrictions imposed by the public offering rules. Pre-emption rights of minority shareholders are important and need to be respected. We understand that this

proposal will enhance shareholder rights that have been allowed to be diminished in this area. This proposal will be particularly beneficial to smaller companies quoted on the Main Market and AIM listed companies.

These changes will serve the capital needs of listed companies and their shareholders in a simpler, cheaper and better way.

One point we wish to raise is whether legal claims like the Sirius Minerals class action claim (see https://www.sharesoc.org/campaigns/sirius/) would still be possible under the new proposals. I spent two hours today mainly discussing with counsel 'untrue or misleading statement' or any omission in the 2016 Sirius Prospectus document to raise funds and their 2017 Prospectus to transfer from AIM to the Main market. I am sure you will not want to discuss a specific case, and we would respect that, but we would like to understand the intentions of the proposals. It is our contention that investors have lost £1billion and have been misled by the information they received or did not receive in a timely manner. In my opinion, there is little doubt (in the terms of the man or woman on the Clapham Omnibus) that many individual investors were misled and there is also little doubt that many sophisticated investors knew the risks involved in this type of company and this type of project. Whether this or what can be proved in a court of law and whether litigation funding can be source to pursue a claim are critical points and any changes to legislation need careful consideration in this respect.

The document does not adequately address the impact (intended or otherwise) of the proposals on sophisticated individual investors[1]. Guarding unsophisticated consumers from harm is important, but the balance needs to be recognised and in many cases sophisticated investors' needs should be addressed separately to other investors.

Your second goal is to make regulation agile and nimble You plan to do this by delegating much regulation to the FCA. We challenge very strongly on this point. Was the FCA up to the job historically? Why should we believe it will be up to this new job in the future? What will the new FCA regulations look like? If the Treasury do not know what the aunt sally looks like, how can the Treasury be sure this is the way to go. We would prefer a more detailed explantion of the framework or likely frameworks. We cannot support a proposal if we do not know what it is.

Our initial reaction is that, based on recent experience, the FCA has hardly covered itself in glory. On the other hand, what other organisation could or should take on the duties that the Treasury is proposing to pass to the FCA?

We think the FCA should regulate AIM, rather than the LSE regulating that market. In our opinion, the LSE is conflicted in that it has a business interest in encouraging as many AIM listings as possible which conflicts with the requirement to vet the legitimacy of companies that list and the probity of their boards. We are also concerned about hot potatoes currently being passed between the FCA and LSE and things falling in between the cracks.

The proposed changes to the Prospectus Regime look sound. However, we have concerns about the context in which they (and probably other changes) are taking place. Post Brexit we have a huge opportunity to develop a clear strategy for the UK finance industry. The Prospectus regime is an important part of the bigger picture. We would like to see greater

[1] We have in previous consultations explain our views on sophisticated investors and how they should be defined. E.g. in our response to DP21/1 and to the FCA consultation on Consumer Investments. For your convenience we reproduce these previous comments in Appendix 1.

clarity on the bigger picture and a wider review and overhaul of the way that UK markets and the UK Financial Services industry works is needed. Clearly, that is going to be a long-term endeavour which will take years. But the starting point has to be some sort of plan and strategy.

We would be pleased to meet with you to explain further our responses.

Please treat our response as a public document. We will be publishing our response openly. Our response is not confidential. We are happy for you to list our organisation in your list of respondents and to publish our response. In our view, the more publicity our response gets, and the more it is read, the better.

Yours sincerely

Cliff

Cliff Weight
Director

List of questions and ShareSoc's Responses

1 Do you agree with our overall approach to reforming the UK prospectus regime?

Yes.

2 Do you agree with the key objectives that we are seeking to achieve?

Yes.

3 Do you have any views on the underlying purpose of a prospectus when seeking admission to a regulated market?

We think your proposal is OK.

4 Do you agree the FCA should have discretion to set rules on when a further issue prospectus is required?

Yes.

5 Do you agree the Government should grant the FCA sufficient discretion to be able to recognise prospectuses prepared in accordance with overseas regulation in connection with a secondary listing in the UK?

Yes, but clear labelling should apply, so investors can easily see if a prospectus is not prepared in line with UK regulation.

6 Do you agree with our approach to the 'necessary information test'?

Yes.

7 Do you agree the FCA should have discretion to set out rules on the review and approval of prospectuses?

Yes.

8 Do you have any comments on what ancillary powers the FCA will need in order to ensure admissions of securities to Regulated Markets function smoothly? (See list of potential powers in Annex A.)

No comments.

9 Do you agree with our proposed change to the prospectus liability regime for forward looking information?

One point we wish to raise is whether legal claims like the Sirius Minerals class action claim (see https://www.sharesoc.org/campaigns/sirius/) would still be possible under the new proposals. We recently spent two hours mainly discussing with counsel 'untrue or misleading statement' or any omission in the

2016 Sirius Prospectus document to raise funds and their 2017 Prospectus to transfer from AIM to the Main market. We would like to understand the intentions of the proposals and in particular whether there is any intention to strengthen or weaken the ability of individual investors to seek redress through the legal system.

It is our contention that investors have lost £1billion and have been misled by the information they received or did not receive in a timely manner in the Sirius case. In the opinion of many, there is little doubt (in the terms of the man or woman on the Clapham Omnibus) that many individual investors were misled and there is also little doubt that many sophisticated investors knew the risks involved in this type of company and this type of project. Whether this or what can be proved in a court of law and whether litigation funding can be sourced to pursue a claim are critical points and any changes to legislation need careful consideration in this respect.

10 Do you think that our proposed changes strike the right balance between ensuring that investors have the best possible information, and investor protection?

Yes, except that we have doubts about the ability of individual investors to seek redress through the legal system, see our answer to Q9.

11 Which option for addressing companies admitted to MTFs do you favour and why?

We prefer Option 2, because it is more comprehensive.

We think the FCA and not the LSE should be responsible for those parts of the AIM market that the LSE currently regulates. The LSE has not done a good job of regulating AIM. The LSE has inherent and inappropriate conflicts of interest, and, as a consequence, prioritises short term profits, of itself and those advisers to AIM listed companies, over the long term benefits of investors in AIM companies.

We approve of the idea in para 6.21 of improving liquidity of smaller companies on the Main Market and AIM by having intermittent trading focussed on trading windows. Liquidity and spreads of such companies is much worse than in the US and currently is driving investors into overseas markets. HM Treasury should be doing more to reverse this.

12 Do you agree there should be a new exemption from the public offer rules for offers directed at existing holders of a company's securities?

Yes.

13 Do you agree we should retain the 150 person threshold for public offers of securities and the 'qualified investors' exemption? Do you have any comments on whether they operate effectively?

Yes. We have separately responded to the FCA on our preferred definition of sophisticated investor, which would equate with your term 'Qualified investor'.

14 Does the exemption for employees, former employees, directors and ex-directors work effectively?

No comment.

15 Which option for accommodating the right of private companies to offer securities to the public do you favour?

We believe that there has been much misselling and consumer detriment through dodgy debt securities and crowdfunded issues (eg LC&F). We favour option 2 (certainly not option 3, status quo): if such securities have to be issued through a "platform" which is itself well-regulated and part of that regulation is that the platform must vet the legitimacy of the offers, and must check the qualification of prospective investors, consumer detriment should be reduced.

This would be better than requiring bulky & costly prospectuses, which go straight over the head of naive investors.

16 Which of the options above do you prefer? (Please state reasons)

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This would be better than requiring bulky & costly prospectuses, which go straight over the head of naive investors.

17 Do you have any further thoughts or considerations over how a new deference mechanism (Option 2) should operate?

No comment. We are not experts in the unquoted companies area and do not wish to comment on this question.

Appendix 1 Sophisticated Invesor – UKSA and ShareSoc views

We do not subscribe to the concept of a nanny state in respect of retail investors.

It should be the individual investor's responsibility to decide on their level of financial knowledge and to educate themselves accordingly.

Combined with this, as we have noted above, there should be an effective duty of care for advisers and platforms to provide appropriate products with clear transparent information and for individuals to choose based on their knowledge.

UKSA responded to the FCA Consultation on Consumer Investments and the definition proposed in that consultation response is reproduced below.

Extracts about Sophisticated Investor from UKSA response to FCA on Consumer Investments

Q23: What do you think about how the current high net worth and self-certified sophisticated investor exemptions are working in practice and the level they are set at?

We consider it essential for regulators to think separately about high-net-worth investors and sophisticated investors.

Overall, we consider the high-net-worth exemption to be fundamentally misconceived. See Q19 above.

An individual does not become more competent at assessing non-standard investment promotions simply because they have more money. Even if they have £100 million, it may have been acquired in a walk of life that did not require financial competence in order to be successful.

We recommend that the entire policy of enabling financial promotions that would otherwise be prohibited for the general public to be sent to individuals who have a particular level of wealth should be abolished.

The sophisticated investor exemption is conceptually different. The approach here is that if an investor has a sufficient level of knowledge/skills, they are able to evaluate financial promotions that would otherwise be prohibited for the general public.

At present the FCA has two distinct definitions, *"certified sophisticated investor"* defined in COBS 4.12.7 and *"self-certified sophisticated investor"* defined in COBS 4.12.8.

As previously, we have reproduced below those definitions for the benefits of other readers of this submission.

> *"A certified sophisticated investor is an individual:*

> *(1) who has a written certificate signed within the last 36 months by a firm confirming he has been assessed by that firm as sufficiently knowledgeable to understand the risks associated with engaging in investment activity in non-mainstream pooled investments; and*
>
> *(2) who has signed, within the period of twelve months ending with the day on which the communication is made, a statement in the following terms:*
>
> *"SOPHISTICATED INVESTOR STATEMENT*
>
> *I make this statement so that I can receive promotional communications which are exempt from the restriction on promotion of non-mainstream pooled investments. The exemption relates to certified sophisticated investors and I declare that I qualify as such.*
>
> *I accept that the investments to which the promotions will relate may expose me to a significant risk of losing all of the money or other property invested. I am aware that it is open to me to seek advice from an authorised person who specialises in advising on non-mainstream pooled investments.*
>
> *Signature: & Date:"*

The consultation document does not ask for comments about the *"certified sophisticated investor"* scheme. However we generally support it, as it has the advantage that it is the firm that is required to assess the investor and reach a conclusion regarding whether the investor is sophisticated. The FCA has laid down various requirements, and can sanction the firm if it carries out the assessment negligently or wilfully incorrectly.

The FCA seeks views about the *"self-certified sophisticated investor"* exemption. The definition is reproduced below.

> *"A self-certified sophisticated investor is an individual who has signed, within the period of twelve months ending with the day on which the communication is made, a statement in the following terms:*
>
> *"SELF-CERTIFIED SOPHISTICATED INVESTOR STATEMENT*
>
> *I declare that I am a self-certified sophisticated investor for the purposes of the restriction on promotion of non-mainstream pooled investments. I understand that this means:*
>
> *(i) I can receive promotional communications made by a person who is authorised by the Financial Conduct Authority which relate to investment activity in non-mainstream pooled investments;*
>
> *(ii) the investments to which the promotions will relate may expose me to a significant risk of losing all of the property invested.*
>
> *I am a self-certified sophisticated investor because at least one of the following applies:*

(a) I am a member of a network or syndicate of business angels and have been so for at least the last six months prior to the date below;

(b) I have made more than one investment in an unlisted company in the two years prior to the date below;

(c) I am working, or have worked in the two years prior to the date below, in a professional capacity in the private equity sector, or in the provision of finance for small and medium enterprises;

(d) I am currently, or have been in the two years prior to the date below, a director of a company with an annual turnover of at least £1 million.

I accept that the investments to which the promotions will relate may expose me to a significant risk of losing all of the money or other property invested. I am aware that it is open to me seek advice from someone who specialises in advising on non-mainstream pooled investments.

Signature: & Date:"

As a preliminary point, there is nothing wrong with self-certification as a concept.

For example, an investor may be able to self-certify that he has a degree in mathematics, is a chartered accountant, is a chartered tax adviser, and is also a member of the Association of Corporate Treasurers, and has been investing in quoted shares, warrants and options for over 30 years, and that for these reasons he considers himself as meeting the requirements of a sophisticated investor.

We would regard the giving of such a certificate, and the associated exemption, as appropriate.

The challenge is to come up with acceptable criteria suitable for general use.

We consider the existing criteria in the FCA Handbook as reproduced above to be seriously flawed.

(c) is the only criterion that involves some assessment of competence by a third party, since either the private equity employer or the bank which employ the individual to provide finance to small and medium enterprises must have assessed the competence of the individual.

The other criteria, (a), (b) and (d) involved no requirement for any kind of competence or knowledge. (d) is particularly inadequate since being the HR director of a small company running a grocery warehouse, with a turnover exceeding £1m p.a. could not conceivably be regarded as making the individual into a sophisticated investor.

Since relatively few individuals are likely to have existing formal qualifications that would clearly qualify them as sophisticated investors, we recommend that the FCA along with the industry develops a series of online tests that could be taken by individuals wishing to achieve sophisticated investor status.

A certain level of formality should surround these tests.

For example, the individual could be required to apply for testing, then be sent an access code by paper post, and be timed while sitting the test online. The risk would still remain of impersonation, with the individual seeking someone else to sit the test on their behalf. The FCA could either choose to accept that risk, or could make the test even more rigorous by requiring the test-taker to be video recorded by their laptop webcam while taking the test. This would almost certainly deter impersonation.

What matters is having the will to introduce rigorous standards. The principle of trust but verify should be followed. We also refer to our answer to Q 19 and our suggested requirement to make an additional certification on investment.