

Fundraising for your business: beware financial services

Nearly all owners and directors of companies are aware of the need to protect their business secrets, and would not dream of sending someone a copy of their company's business plan or other confidential documentation without making sure that the recipient has first signed a confidentiality agreement.

By contrast, few entrepreneurs who are looking to raise finance for their companies appear to have heard of a "statement of high net worth", let alone have any idea of the importance of making sure a potential investor signs such a document before being allowed access to information about the company. Many directors we come across – even relatively experienced ones – are surprised to learn of the need to comply with financial services regulations when they supply information about their companies to potential investors. This is the case even though the relevant regulations are far from new: the predecessor to the Financial Services and Markets Act 2000 (Financial Promotion) Order 2005 ("Regulations") came into force several years ago.

Despite its title, the Financial Services and Markets Act 2000 ("FSMA") applies to *all* companies, not just those that operate in the financial services sector. Although its main aim was to protect the public from the mis-selling of investment products or risky investment schemes, it is also relevant to any company that wishes to offer shares to potential investors.

The basic rule is that it is unlawful to "communicate an invitation or inducement to engage in investment activity" unless the content of the communication has been approved by a suitably qualified financial adviser authorised by the Financial Services Authority (which in many cases is likely to be prohibitively expensive). Because of the wide legal definitions of "communication" and "investment activity", this means that practically any information you give with a view to promoting your company or generating interest among potential investors will put you at risk of breaking the law. This applies not only to formal communications such as prospectuses, private placing memoranda, advertisements, business plans, presentations etc., but also to more informal situations – for

example, a conversation you may have with a potential investor you meet at a social event. Also, the restriction applies to private companies just as much as it does to public companies, and to communications to friends, family and/or employees just as much as communications to people you know less well.

Failing to comply with the law in this area can potentially have severe consequences. Not only is it a criminal offence to engage in unlawful "financial promotion", but significant civil liabilities can arise too. For example, if you persuade or encourage someone to become a shareholder in your company on the basis of an unlawful communication, and that person later comes to regret his investment decision, you may find that under section 30 of FSMA he is entitled to claim his money back and/or to claim compensation for any additional loss he has suffered. If the company cannot afford to repay the sums invested, then as a director of the company you could potentially find yourself personally liable to compensate the investor (or the company) on the basis that you were

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the one who caused the company to contravene the law.

Fortunately, the Regulations provide for a number of possible exemptions to the general rule against unapproved financial promotions. Many of these exemptions are quite complicated, and specific legal advice should be sought before trying to take advantage of any of them. However, the most common and straightforward of the exemptions is the one that applies to communications made to "certified high net worth individuals". If a potential investor is an individual who satisfies certain criteria regarding his net worth (broadly speaking, if his annual income is more than £100,000 or his net assets (excluding his main residence and certain life insurance and pension assets) amount to more than £250,000), he will be eligible to sign a statement of high net worth that will enable you to communicate certain investment-related information to him without breaching the restrictions referred to above.

In order to benefit from the protection offered by this exemption, it is important to note the following points:

- the statement of high net worth must be in the form required by the Regulations.
 - the potential investor must have signed the statement *before* you disclose any details about your company and/or the proposed investment.
 - the communication still needs to be accompanied by certain statutory warnings (which, in the case of oral communication, need to be confirmed in writing).
 - the exemption only applies to certain limited categories of investment (which includes shares or loan notes in private companies).
- In conclusion, try to follow these guidelines:
- always seek advice at the earliest possible opportunity before entering into any discussions aimed at finding potential investors (or which could be construed as an attempt to seek investors).
 - if it is not practicable to obtain a statement of high net worth from a

potential investor without giving him or her at least some indication of why you are requesting it, you should ensure that in your initial approach you disclose general information only and are not drawn into giving details that would enable the prospective investor to identify the company in relation to which you are seeking investment.

- if you think you may have revealed too much and may already be in breach of FSMA or the Regulations, seek legal advice as soon as you can so that remedial action can be taken to protect against any of the potential undesirable consequences set out above.



Richard Beresford
r.beresford@solnick.com

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