ADVISER ROUNDTABLE

INSIGHTS FROM EIS ADVISERS

MODERATOR: **JOHN SCHAFFER** INTELLIGENT PARTNERSHIP

ATTENDEES

JOHN SCHAFFER
INTELLIGENT PARTNERSHIP

STEPHEN JONES (SJ)
CLEAR SOLUTIONS

FAISAL SHEIKH (FS)
MONMOUTH CAPITAL

ANDREW TUSTIN (AT)
PARTNERS WEALTH MANAGEMENT

JOHN CORNELIUS (JC)
WARWICK BUTCHART

DENNIS HALL (DH)
YELLOWTAIL

WHAT SORT OF CLIENTS ARE YOU USING EIS WITH, AND WHAT'S THE PRIMARY DRIVER FOR USING IT?

JC: Mostly high net worth clients. We're probably looking at people with stakes above a million pounds.

The primary driver is capital gains tax deferral, and to enable clients to release funds as part of inheritance tax planning arrangements.

DH: The primary driver is that it's an itch clients want to scratch. Our portfolios generally have a smart passive approach – but there's an awful lot of clients who say, I think I want something else.

For clients who've got a substantial amount of money, who like a bit of complexity - they want to go up the risk ladder a little bit more. They like the idea of some tax relief, but for them, it's a little bit more of the thrill of investing.

SJ: We go all the way up from retail clients where they are investing quite a small sum, like £25,000. They might say - I want the opportunity as a speculative investment. But it goes from there up to people who are very high net worth.

The amount of clients using EIS is not quite single figures - but a very low proportion of our client bank has not had at least one discussion about them.

What I find interesting, we very recently acquired the CEO of a FTSE 100 company. He had only heard of EIS conceptually. He had no real practical understanding of it. When I was running through facets of EIS, he was saying, "why did I not know about this before?"

I think we, in the profession, think EIS is more widely known than it actually is.

WHAT ALLOCATION DOES EIS HAVE IN YOUR CLIENTS' PORTFOLIOS?

FS: All of our clients have net wealth of at least £10m. In terms of EIS allocation, it's typically below 5% of clients' net wealth, so it's really about helping them to access venture capital, which most of them are interested in. It may be because they're entrepreneurs.

When they get liquidity from their business, they'll often have an eye on putting money back into early stage businesses, so we can help them to access venture capital using competent and experienced managers with useful tax breaks. And generally speaking, it acts as a diversifier to other parts of their wealth.

SJ: It varies enormously. I was with a client recently who's got about £1.2m in a mix of VCTs and EISs. He's got about £4m in what I call mainstream investment portfolios. He now wants to allocate his whole portfolio into EIS and VCTs. He's not interested in mainstream portfolios.

He's got other wealth besides mainstream investment portfolios, including property and a company business. We have established beyond reasonable doubt that if he lost every penny in VCTs and EISs, he would still meet his lifetime cash flow requirements.

AT: I set a benchmark where I would not look to exceed an upper ceiling of 10% of a client's liquid investable portfolio in this kind of space. Then within that 10%, it would not be with a single provider, it would be in a portfolio of providers. I set a limit to every EIS that I recommend to a client.

EIS tends to be the surplus money in the pot where high net worth clients are looking to put a bit of sparkle and excitement into their portfolio - something different from a traditional growth portfolio with a DFM.

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This is not a situation where a client says, "I've got £100,000. That's all my money." - I wouldn't say, "Let's put £10,000 of that into an EIS for you because the tax breaks are really good."

The client would sign a high net worth client declaration to say:" I have liquid assets of this. I am capable of losing this amount of money without having an impact on current lifestyle or future income requirements."

HOW DO YOU COMMUNICATE AND QUALIFY THE RISKS OF EIS TO YOUR CLIENTS?

FS: What we're trying to communicate to clients is to think about EIS as a series of investments in individual small companies. Every single one of them could fail.

If you took every company in isolation, you could make a case for why it's not going to work out and could fail. Which then would only leave the loss relief in the absolute worst case.

Even then, we warn clients that in extremes, government regulation can change. We try to bring to life what it would mean for this to go badly wrong, rather than just saying, "oh, it's risky."

DH: Most of our clients would be classified as high net worth, but it's not suitable for all of them.

We just understand that when we talk to clients about risk profile, those people that are balanced tend not to want to experience a loss. We approach everybody that we think could afford a loss - but not everybody's comfortable with it.

It's not really us screening them out, we give them enough information for them to screen themselves out.

WITH THE CHANGES IN THE BUDGET, HOW HAS YOUR APPROACH TO EIS CHANGED?

FS: Our approach has not changed. We welcome the continued focus by the government on deploying genuine risk capital, that's the way we've always viewed it and positioned it with our clients. A primary driver of doing this investing is the venture capital side of things, not - "let's bank the tax relief as quickly as we can."

DH: It hasn't. Although the budget has increased the maximum amount that anyone can put into a particular account - we've never had anyone put in the maximum each year. I think the most I've ever had anyone put in at any one time is £250,000.

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— FAISAL SHEIKH, MONMOUTH CAPITAL

SJ: I am aware that quite a lot of advisers have decried the loss of asset-backed investments, but I don't care. To my mind, all it's done is clarify the picture. We always emphasise - this is a higher risk area, you can't guarantee returns, you shouldn't compare it to even the higher risks of mainstream OEICs.

ARE INVESTORS PREPARED TO TAKE ON THE RISK AND ILLIQUIDITY OF EIS, ESPECIALLY AFTER THE MOST RECENT BUDGET WITH THE CRACKDOWN ON CAPITAL PRESERVATION SCHEMES?

FS: The main way we address those particular risks is always making sure they have more than enough capital to cover several years of their likely expenditure, so that whatever happens with these particular investments, their lifestyle is not affected.

Secondly, we pay close attention to the different strategies employed by different fund managers, including such things as the expected number of years to a typical exit from any fund. We also encourage our clients to repeat EIS and other venture capital investments every year to build up a ladder of cash flows.

JC: We've always told our clients that EIS are higher risk funds. As part of the portfolio, we usually balance the risk by reducing the risk with other assets.

The fact that EIS has become more risky is more a case of reverting to what EIS should have been in the first place.

DO YOU FEEL THAT EIS IS UNCORRELATED FROM MAINSTREAM ASSET CLASSES?

JC: Certainly, because it's giving access to the sort of investments which we just could not access in any other way.

SJ: Ultimately, it's a business, which is why I don't think it can be completely uncorrelated.

AT: Yes, personally I do. When you're looking at true, young EISs where they're relatively small firms in niche particular areas, such as a company that's sponsored by Cambridge University doing research and development into new technology around batteries for cars, for example - the impact of whether the FTSE goes up or down today or tomorrow is going to have no real, immediate impact on that company.

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WILL ANY OF YOUR CLIENTS BE TAKING ADVANTAGE OF THE HIGHER INVESTMENT HEADROOM AVAILABLE ON KNOWLEDGE INTENSIVE COMPANIES?

FS: We have three or four clients who could take advantage of it, but I think only one or two will end up using a decent amount of it.

SJ: Not for our clients. Our clients simply don't put that amount in at any one time. Some of the big accountancy firms, or perhaps the IFAs who've got really ultra high worth clients could take advantage, but that's not our client bank.

Our clients are investing 25, 50, 75 thousand pounds at any one time. Some of them might go up to half a million.

DH: It's not going to make much difference at all. The bulk of our clients don't like knowledge-intensive companies anyway.

They like to invest their money in very tangible businesses and they want to invest into things they can touch and feel, to some extent. Or they want to be able to understand the company they're investing in. A lot of knowledge intensives don't allow them to do that.

HOW HAS YOUR USE OF EIS CHANGED OVER THE PAST TWO TO THREE YEARS?

JC: It's probably increased a little. I think there's possibly more awareness of inheritance tax liabilities. Especially from the next generation. Most of these drivers come from the next generation of people who are going to receive the inheritance.

AT: I've seen a much bigger interest since the impact of the changes in pension contributions. With the lifetime allowances being ratcheted down, clients have withdrawn significant pension assets to fund their children with a property purchase - because kids aren't going to be earning enough money, either in salary or in savings to be able to buy their first homes.

The knock-on effect of what high net worth clients can put into pension schemes has made them become more aware of alternatives, because they got used to getting that income tax credit as part for their tax exempt process. Clients were saying - "I can't do a pension anymore, or the contribution is so small it's almost meaningless. So what else can I do?"

HOW MANY EIS MANAGERS DO YOU WORK WITH, AND WHAT SPECIFICALLY DO YOU LOOK FOR IN A MANAGER?

JC: Actively, about half a dozen different managers. We do like to see somebody who's been doing these sorts of investments for a long time, rather than the new kids on the block.

FS: We work with around a dozen managers, although we've done detailed research on over 25 and counting.

We look at many factors you'd expect, such as governance, custodial arrangements, quality of reporting and so on.

Some of the wider factors that help us understand the role that the fund could play in a client's portfolio, are consistency of strategy and approach. We're a bit wary of funds that have switched from one type of investing to another over the years. Maybe that's unfair, but we want to see consistency.

We really like a core definition of the type of investment they make, whether that's sector-based or a question of size of company, or deal, or whether it's based on valuation metrics or a combination of factors. We like them to be very clear about that, so we can decide how much to allocate, or how much to advise our clients to allocate to that particular strategy - then clients know what to expect.

It's really helpful for us to know the likely number of years for a typical exit for that fund, so again, we try and introduce some diversification there so clients aren't tied to a particular exit environment.