Hot Topics in EIS Fund Due Diligence

5th March 2020

Panel Participants

- Luke Barnett - LB
- Ewoud Karelse - EK
- Kealan Doyle - KD

Summary Takeaways

1. *The establishment of trust between investors and EIS fund managers is crucial to the future of the EIS market*
2. *Transparency on fees is vital in establishing this trust*
3. *EISA needs to adopt Best Practices Guidelines on Fees*

Introduction

KD –

There were two things that inspired today's event, both of which occurred in Q4 2019. The first was my constant touring of the UK with some of Symvan's sales and marketing team during the second half of 2019, including a number of events with the Intelligent Partnership EIS Showcase. Symvan presented all over the United Kingdom and we met and had productive meetings with all sorts of wealth managers, family offices, financial planners, IFAs and HNW investors.

One of the things that struck me was how many of these investors approached EIS/VCT investing with a distinct sense of trepidation. Don't get me wrong – probably a majority of the investors that I met were enthusiastic venture capital investors who viewed funds like Symvan as the most interesting part of their client's portfolio. But the advisers that really stood out for me were the ones who seemed interested in what funds like Symvan had to offer, but really did not like EIS investing. The problem was simple – they recommended a few EIS investments for their clients every year, they did not make that much money from advising EIS to their clients, they were worried terribly about these investments 'blowing up' whilst possibly impacting on their PI fees, but their most suitable clients insisted on taking advantage of tax-efficient investments such as EIS and VCT.

This lead to the next stage of inspiration, which was the talk that I gave at Modwenna Rees-Mogg's EIS/VCT Forum in November 2019, which was directly inspired by the my recent experiences. The title of my talk was "*Trust But Verify*" and it attempted to deal with what I believe is the great disconnect between EIS fund managers and wealth mangers, namely trust. That day in November directly led to today's presentation because Ewoud was in the audience for that event, but crucially I had a robust conversation with Luke and Lauren Radford from Allenbridge after the event.

In my experience, it is very rare for an animated pub conversation to move to anything remotely practical but here we are today to discuss a number of these burning issues.

Transparency on Fees in the EIS Market

KD -

Ewoud, perhaps you can give us your thoughts on the much vexed issue of fees? What are the burning issues surrounding fees in the EIS market and tell us about transparency or the lack thereof?

EK -

For us as a MiFID firm, it is a requirement for us to show the impact of fees on the potential performance of the funds that we recommend to advisers. This is very easy to do with a Unit Trust, but it is really difficult to work out for an EIS fund.

There should be a standard for EIS fund managers in such a way as to allow clients to see the impact of fees and to present it in a way that is easy to compare between funds.

LB -

Our perspective as analysts is that there is an enormous diversity in the level and structure of fees in the market, whether investors or investee companies are charged etc.

But it is difficult to compare fees amongst EIS fund managers and some form of standardisation would be desirable. Perhaps EISA should provide some guidelines to fund managers to make comparisons easier for investors. At the moment, it is a free-for-all.

KD -

When we came into the EIS market in 2013, we found that there was a very confusing approach to fees. The EIS fund managers charged rather high fees to investors, but even then took a few years of AMC in advance. Moreover, they all added a lot of additional fees, but they all called them something different. But the real shocker was that they also charged the Investee Companies, but refused to say how much they charged, and it was almost invariably quite high. Even now, it is not really clear how much most EIS fund managers charge their Investee Companies. This brings us to an important question - do you think there should be some sort of audit of what EIS fund managers charge to Investee Companies?

EK -

Tilney is fully aware that EIS/VCT fund managers can sometimes be “naughty” but that is not the main question surrounding fees. We do not mind what the fees are

within reason, but we need transparency on what those fees are. How do you justify the level of fees that you charge?

We also need to know the impact of EIS fund manager conflicts. I have come across two managers who monetise 5 years of fees upfront. Some charge up to 30% of the money raised, and this is split between charging investors and investee companies. That is so painfull for the entrepreneur that I am not sure that this will be a good investment. And this will certainly impact negatively on the track record of the fund manager.

LB -

There is a case to be made for charging either investee companies or investors directly. But if a manager reserves the right to charge investee companies, the market needs to know what the manager is charging to the company. Let's disaggregate them and make it explicit what the fees are for. Allenbridge has asked fund managers to outline all of the fees that they charge to companies and what they are for.

KD -

Why not request that managers give Allenbridge a measure of the all-in costs that they charge to investee companies? Surely that would make your life easier?

EK -

I wish to say something controversial.

KD -

Well, that is why we are here!

EK -

Even more worrying for a lot of Tilney clients than lack of fund manager transparency is the role of HMRC. They have a track record of making retrospective changes to tax-efficient investing that can destroy investor confidence and trust in the sector.

KD -

If I can conclude on the fees question, do you think that it would be preferable to have some standard guidance or best practice from EISA on fees that are charged to investee companies?

As an EIS fund manager, I would have absolutely no problems if I were asked by Allenbridge or Tilney to outline every single fee that we charged to investee companies. Surely that would allow the analyst to drill down and ask the hard questions and make valid comparisons between fund managers.

LB -

When we ask that question, we get a lot of pushback. Many fund managers say that they cannot provide this information. They say that it is not possible to provide confidential, competitive or commercially sensitive information.

KD -

I can understand your point with some fund managers being unwilling to break down fees charged to companies in great detail, because there may be something commercially sensitive with some fees. But they surely should not have a problem telling you the aggregate total of fees charged?

LB -

I agree. Again, if we can encourage some sort of industry standardisation or for everyone to sign up to a charter, this would be very helpful for the EIS industry.

KD -

Your point ties in with what Ewoud says… If a fund manager charges more in aggregate fees, perhaps the fund manager could justify the fees by illustrating that they provide more value-added services to justify those fees.

Note: All participants agreed that EISA guidelines or best practice suggestions would be useful in helping to resolve the aforementioned issues.