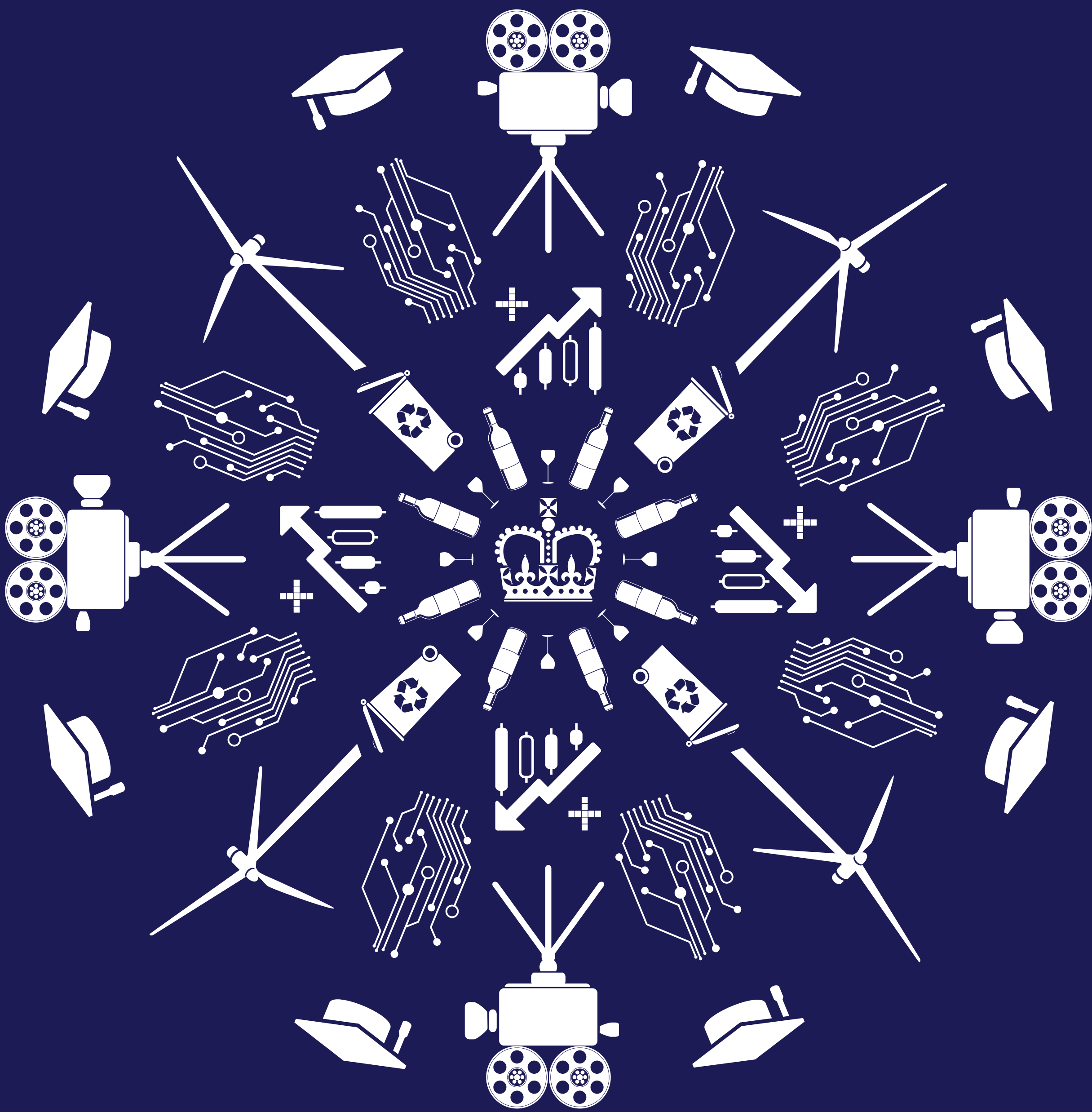
AiR 16/17

ALTERNATIVE INVESTMENT REPORT

VENTURE CAPITAL TRUSTS

INDUSTRY REPORT



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PUBLICATION

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FOREWORD

Welcome to the second edition of the annual VCT Industry Report

We know that advisers are increasingly interested in VCTs. It will be no surprise to any of our readers that our market research found that lower limits on the amounts that can be saved in pensions are starting to have an impact. Advisers looking for alternative tax efficient investments have naturally turned to VCTs.

We also know that the amount of funds raised through VCTs has continued to increase: from a low of around £200 million in 2008 to consistently raising £435 to £440 million over the last three tax years. However, this year is proving to be different. VCTs are still digesting the money they raised over the last few years, and the rule changes announced in 2015 mean that the universe of potential investments has shrunk. Therefore, fewer VCTs are raising, and most of those that are raising are seeking relatively small amounts.

What does this mean for advisers? Well, advisers who want to use VCTs for tax planning purposes this year will need to be quick – or perhaps more accurately, they will need to be prepared. Carrying out research and due diligence on providers and open offers, finalising investment panels and shortlists and identifying suitable clients early on will mean advisers can secure the investments they favour.

This report should form part of that preparation. It won't replace the product specific work that is required, but it will quickly bring readers up to date on the sector, the changes to the rules, issues to be mindful of, and which new offers are coming to market.

There's also a campaigning element to our work: we believe that by surfacing some of the issues that exercise advisers – such as transparency around charges for example – and collating data on them, we will make the market more transparent and consequently more responsive to what advisers want.

Taken together, the market update, adviser survey and industry analysis will all help advisers to develop an informed opinion on the VCT sector, and feel confident that their research has covered the whole of the market.

I hope you find the report useful and informative, and that it continues to be an important resource for you over the next twelve months.

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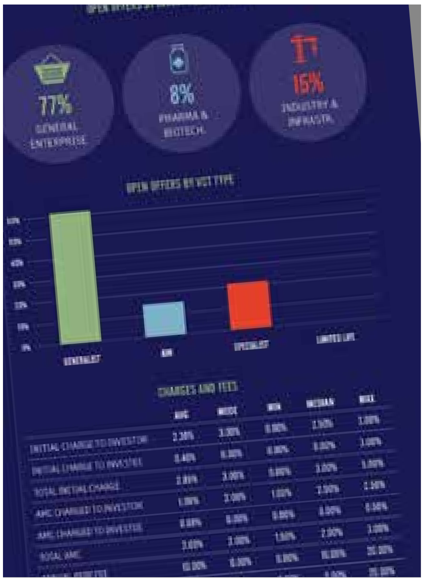
CONTENTS

INTRODUCTION

MARKET UPDATE

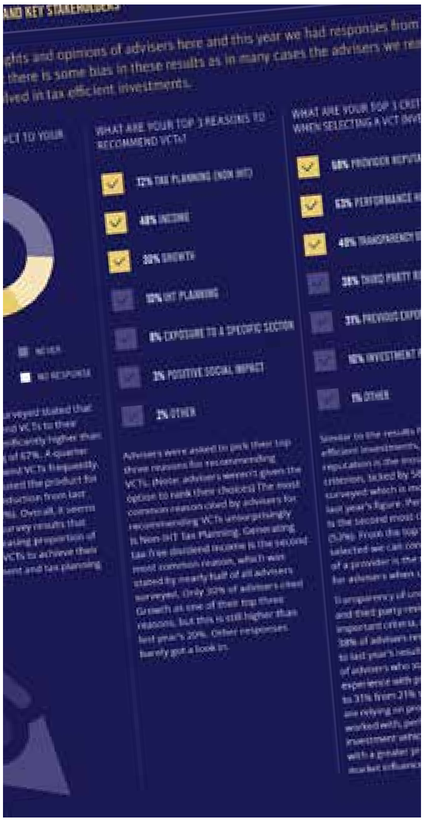


ADVISING ON VCTs

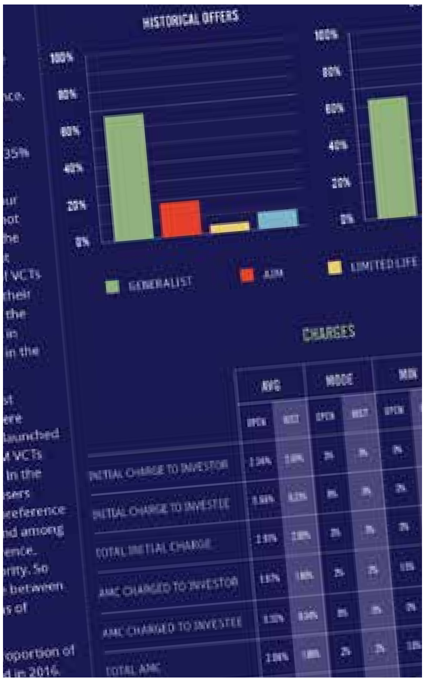
* Please note: unless otherwise stated, all charts and graphs have been provided by Intelligent Partnership

Intelligent Partnership is committed to the very highest professional standards as embodied by its accreditation and membership to these industry associations.

MARKET RESEARCH



INDUSTRY ANALYSIS



FINAL CONCLUSIONS

AMPS

OPENING STATEMENT

A WORD FROM THE ASSOCIATION OF INVESTMENT COMPANIES

Access to patient capital is vital for the UK's dynamic smaller businesses, and VCTs have been a natural home for patient capital since their inception over 20 years ago. The closed-ended structure provides the ideal vehicle for longer-term finance for companies, and the generous tax reliefs help offset some of the risks investors face in this sector.

VCTs boost the UK economy by providing vital finance and expertise and stimulating high levels of job creation. VCT-backed businesses have high levels of innovation and significant levels of exports, indicative of their potential value to the UK economy. Moreover, VCTs are good value for taxpayers, as our research shows that investee companies contribute more in tax than the cost of the initial tax relief.

In our recent survey of 409 companies that received VCT investment, we found that over 20,000 new jobs had been created across the country by these firms, with an average of 60 jobs per company since VCT investment. Where VCT investment had been in place for over five years the average increase in jobs was 103 per company.

In 2015, VCTs participating in our survey provided £225 million in finance to 115 smaller companies, split primarily between business services, digital, creative and information services and retail and manufacturing. It was also another successful year for fundraising, with VCTs raising £457 million in the tax year 2015/16, the third highest total ever and proof of their ongoing popularity.

Advisers are also getting increasingly familiar with VCTs and investment companies. Purchases of shares in investment companies by advisers have almost tripled since the RDR, and the average investment company is currently outperforming the average unit trust over one, three, five and ten year periods.

Reductions in the amounts that can be saved in pensions have also encouraged advisers to consider VCTs, with higher earners and those who are close to maximising their pension allowance looking for tax efficient alternatives. Upfront tax relief, and tax-free growth and income, mean that many advisers are turning to VCTs to supplement their clients' pension saving.

Furthermore, now that the sector has had time to digest the changes to the rules that were made last year to ensure ongoing compliance with European State Aid rules, we should be in for a period of regulatory stability. This will mean that VCT managers will be able to get on with what they do best: investing in dynamic small UK companies.

All of this means that there is a positive backdrop for the VCT sector. However, the signs are that fewer VCTs will be raising money this year than in the recent past, and demand might well exceed supply. Advisers and investors will need to be ready and prepared in order to secure the investment opportunities they want. Therefore we encourage advisers who are new to VCTs to read this report and make use of the educational materials on the AIC website, www.theaic.co.uk; and for advisers who are more familiar with VCTs, we think this document will provide a useful refresher and serve as useful reference material for the next twelve months.

LEARNING OBJECTIVES

We are required to state these in order to qualify as accredited for Structured CPD. By the end of the report readers will be able to:

- Describe how recent rule changes have impacted VCTs
- Identify the latest VCT offers raising money, and describe how this year's open VCTs compare with previous years' offers
- Benchmark current VCT offers against each other and against previous years, based on key investment criteria such as cost, target returns, liquidity and minimum investment levels, and be able to break this information down by VCT type and sector
- Explain what VCTs are to their clients
- List the different tax advantages that are available investing in VCTs
- Carry out due diligence and assess the potential risks and benefits of VCTs
- Identify clients and investment objectives where VCTs could be suitable

IAN SAYERS, Chief Executive, The Association of Investment Companies (AIC)

KEY FINDINGS

HIGHLIGHTS FROM OUR RESEARCH

COMPETITION DECREASES

with 25% fewer VCTs in 2015 raising the same amount of money as in 2014

SUPPLY

DEMAND

2016's demand for VCTs may well outstrip supply, leading to a capacity crunch

20,000 NEW JOBS

created by VCT-backed companies

38

VCT INVESTEE COMPANIES

on average more diversified than historical VCTs

RULE CHANGES

are having an impact. All VCTs launched this year are Growth & Income funds

£4,545

AVG MINIMUM SUBSCRIPTION

for 2016 VCTs raising funds in 2016, £103 less than the historical average

R&D

£181 MILLION

75% of VCT-backed companies had undertaken some form of innovation

2016's AVERAGE FUNDRAISING

is higher than historical VCTs, but max value is significantly lower

7/10 OF ADVISERS

believe that VCTs happily coexist alongside ISAs and pensions

VCT

ISA

PENSION

64%

OF ADVISERS

see their use of VCTs increasing over the next two years

1/3 CHARGE EXIT PERFORMANCE FEES

while only 13% of historical VCTs quoted the fee

82% OF ADVISERS

recommend VCTs to their clients

REPORT OVERVIEW

WHAT CAN READERS EXPECT?

This report has been written with advisers in mind. We want to provide our readers with a balanced and informative review of the current state of play in the VCT market, so the report will cover negatives as well as positives and therefore it is NOT sales or marketing literature.

The report comprises a summary of the VCT sector, an update on the market today, tips on how to advise on VCTs, an analysis of current investment opportunities, and surveys and interviews with both IFAs and investment providers to get a temperature check on how they perceive the sector. We don't expect readers to pick it up and read it from cover to cover (although we'd love it if you did). Instead we expect that most people will dip in and out of the report, picking out sections of interest and using it as a resource over the next twelve months whenever they are considering VCTs.

All of this content is CPD accredited, so by the end of the report readers will be better informed about VCTs and have the knowledge they need to approach the market with confidence.

Readers can expect to:

- Find out what their peers are thinking by reading the Market Research section. Intelligent Partnership surveyed 124 advisers to find out what they thought was good and bad about VCTs, and hosted a roundtable discussion to discover how some of the most active advisers use VCTs with their clients
- Use the Industry Analysis to help them benchmark open offers against each other based on key investment criteria such as costs, target returns, liquidity and minimum investment levels
- Evaluate the latest open offers in the market, and see how they compare to each other and to previous years
- Read our Manager Roundtable Discussion to see what the fund managers themselves have to say about the current state of play within VCTs, what impact Brexit might have on the market, whether advisers should be concerned about the recent legislative changes and whether there is enough capacity in the VCT market to meet demand
- Learn more about research and due diligence on VCT funds and client suitability in our special Advising On... section, which includes several client case studies.

We strike a balance between covering old ground for the benefit of new readers, and looking at new developments and interesting areas that we haven't covered before. New readers who want more depth on some of the basics, such as the benefits of a portfolio approach or how to carry out due diligence, should download copies of previous reports to find more detail.

ACKNOWLEDGEMENTS AND THANKS

We couldn't do this without the help and support of a number of third parties who have contributed to writing this report. Their contributions range from inputting into the scope, sharing data, giving us their insights into the market, providing copy and peer reviewing drafts. Some of them have inputted directly and some of them were good enough to share their thoughts and ideas over coffee or at various conferences and events.

So a big thanks to: Ian Sayers of the AIC, Gillian Roche-Saunders from BWB, Brendan Llewellyn from Adviser Home and all of the advisers who took the time to stop and chat after one of our events or who sent us feedback on the last report. Their input is invaluable, but needless to say any errors or omissions are down to us.

We have relied upon MICAP for the data we have based the report upon. MICAP are part of the same group of companies as Intelligent Partnership. We also carried out our own extensive desktop research, examining brochures, investment prospectuses, mystery shopping providers and crawling through the websites to verify their product data.

The report is made possible by our sponsors, who have contributed copy to the report on pages 62 to 69 and supported us by helping to meet production and printing costs.

So a big thanks to: Amati Global Investors, Beringea, Calculus Capital, Downing, Octopus Investments and Pembroke VCT.

KEY SECTIONS

EXECUTIVE SUMMARY

HIGHLIGHTS FROM OUR RESEARCH

1

ADVISERS ARE POSITIVE ABOUT VCTs

According to our survey, 82% of advisers recommend VCTs, up from 67% last year. A quarter of those advisers recommend VCTs “frequently”. 64% of advisers expected their use of VCT to increase over the next two years. When we followed up, most respondents cited lower pension limits as the driver for their use of VCTs.

2

THE RULE CHANGES ARE HAVING AN IMPACT

In last year’s report we described the rule changes to VCTs in detail. This year we are seeing the effect of those rule changes on fundraising. With a smaller pool of potential opportunities to invest in, and plenty of money left over from previous fundraising, it appears that the sector will raise less than the £430 to £440 million raised in each of the last three tax years. All of the VCTs that have announced fundraising so far have been growth focused VCTs: the more conservative funds with a business model based on supporting management buy outs are unlikely to raise money this year.

3

CAPACITY CRUNCH

You don’t need a master’s in economics to read the two points above and spot the difficulty: demand may well outstrip supply, leading to a capacity crunch. Advisers and investors who want to invest in VCTs this tax year need to be well prepared from the earliest possible stage in order to be ready to move quickly and grab the opportunities they favour. There’s a certain amount of this rhetoric from providers every year as they try and get their sales under way – “buy now while stocks last” – but this year it looks like it could be true.

4

VCTS ARE EFFECTIVE

The Government – in fact every government over the last few decades – is keen to support small businesses and sees the UK’s tax advantaged venture capital schemes as one of the keys to achieving that objective. Prominent politicians from both of the main parties have voiced their backing for the UK’s tax advantaged venture capital schemes. The evidence justifies this support: HMRC concluded in February 2016 that the VCT scheme was working as intended where it was used (“The Use and Impact of Venture Capital Schemes”, HMRC Research Report 355, February 2016).

*"VCTs boost the UK economy by providing vital finance and expertise and stimulating high levels of job creation." – **Ian Sayers, The AIC***

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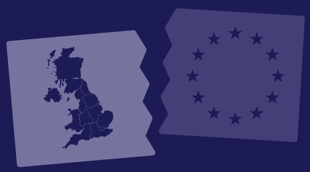


IT'S TOO SOON TO SAY WHAT THE IMPACT OF BREXIT WILL BE

On the one hand, Brexit might – and note it is only "might" – give the Government the opportunity to rewrite some of the changes to the VCT rules that were imposed by the EU. On the other hand, an economic slowdown or less access to EU markets might – and again, this is only "might" – have a negative impact on the UK SME sector. At this point in time, it's too soon to say anything definitive.

6

IS COMPETITION DECREASING?

There is a short term trend of fewer providers raising money, and the nature of VCTs means that investors inevitably favour established funds over new entrants as they can buy into an existing portfolio and income stream. If the trend continues, the balance of power in the market may shift to favour providers over consumers.

DEFINITION OF TERMS

INVESTMENT TRUST: A UK domiciled company formed with the express purpose of investing in other companies.

INVESTMENT COMPANY: As above, but domiciled outside the UK (for example, in the Channel Islands). The two terms are often used interchangeably.

VENTURE CAPITAL TRUST: A special type of investment company which primarily invests in earlier stage companies than most conventional funds, and has significant tax benefits for its investors.

All three are listed, closed ended funds, and therefore the share price is determined by demand for the shares and may be higher (trading at a premium) or lower (trading at a discount) than the value of the underlying investments (net asset value, or NAV).

Another major distinction of investment trusts/investment companies is that investors are shareholders in the trust (rather than customers of the investment manager, as is the case with OEICs and Unit Trusts), and their interests are looked after by a board of governors who appoint the investment manager.

OVERVIEW OF VCTs

WHAT'S CHANGED AND WHAT MIGHT THE FUTURE HOLD?

In this section we will provide an overview of VCTs and the latest changes to the rules around them. This year's report puts less emphasis on the tax benefits and history of VCTs as these were covered last year. Instead this edition focuses on new developments in the sector and updates on statistics of the market. Readers who want more depth on the "what" and "why" of VCT investments should refer to the 2015/16 VCT Report (available for download on the Intelligent Partnership website) which covered the background to VCTs in greater detail.

WHAT ARE VCTs?

A Venture Capital Trust (VCT) is a type of investment trust launched by the Government in 1995 to encourage investment into UK SMEs by offering investors Income Tax relief and favourable tax treatment on dividend payments and capital gains. However, investors are not the only beneficiaries of the scheme. What is perhaps more meaningful is the significant contribution that VCTs make to the UK economy by providing finance to smaller businesses. These small and medium sized enterprises (SMEs) would otherwise find it difficult to raise money from traditional sources such as banks; something that has been difficult since the financial crisis more than eight years ago.

Investors are shareholders in an investment trust, which is a collective investment overseen by an independent board and run by an investment manager who allocates the investment funds to small businesses on behalf of investors (the shareholders). They are governed by regulations that define the sorts of underlying investments they can make and are subject to UK Listing Authority rules.

TAX RELIEFS

There are three major tax reliefs:

- Income Tax relief of 30%
- Tax-free dividends
- Tax-free capital gains

The Income Tax relief is usually the most appealing benefit to investors. A £10,000 investment in a VCT would remove £3,000 off the investor's income tax and the relief is paid up front. The relief can also be claimed against both earned and unearned income (such as rental income from a property). Investors can purchase a maximum of £200,000 VCT shares per tax year to offset their Income Tax bill, meaning the maximum Income Tax relief one can achieve is £60,000 a year. More shares can be purchased in any given year, but an amount in excess of £200,000 would not qualify for Income Tax relief.

Readers should note that the Income Tax relief is only available on primary issues of VCT shares, and VCT investments have to be held for a minimum of five years. If the shares are disposed of earlier than the minimum five-year period, any initial Income Tax reliefs will be clawed back by HMRC.

The Income Tax relief can be claimed by completing the SA101 additional information form issued by HMRC along with the standard self-assessment form. The investor needs to enter the total value of the VCT investment on the form, and then the amount of tax they have to pay will be reduced accordingly.

Alternatively, investors who pay their tax by PAYE can request a change of their tax code by writing to HMRC, reducing the amount of tax they pay each month. Investors who do this will need to include their national insurance number, a P60 form if they have one and a copy of their VCT tax certificate.

Although there is an active secondary market for VCTs, purchases made on the secondary market will not qualify for Income Tax relief. However, shares purchased on the secondary market would count towards the £200,000 annual allowance and can still receive tax-free dividends and capital gains.

VCT TAX RELIEFS

RELIEF	RATE OF RELIEF	MIN. HOLDING PERIOD	RELIEF OF SECONDARY MARKET PURCHASES?
INCOME TAX RELIEF	30% of the value of subscriptions for newly issued shares in a VCT	5 YEARS	NO
TAX-FREE DIVIDENDS	Dividends are not subject to income tax and do not need to be shown on investors' tax returns	NONE	YES
TAX-FREE GROWTH	100% Capital Gains Tax exemption on disposals of VCT shares	NONE	YES

TYPES OF VCT

FOUR TYPES OF VCT

Depending on underlying investment, investment strategy and sector, there are four types of VCT provided by managers. Although all four types of VCTs are structured as investment trusts and are governed by the same set of rules, the investment metrics can be significantly different across different types. We will explore this in more detail in the Industry Analysis section.

GENERALIST VCTs

Generalist VCTs focus on investing in a broad range of unquoted companies. The management identify small companies looking for investment that they think have excellent growth prospects and this can be viewed as a private equity style investment. Their strategies can vary. Some invest in early stage companies, providing 'development' or 'expansion' capital and seeking high returns. Others will use a mixture of loans and equity, looking for more secure opportunities, or possibly asset backed opportunities, and sacrificing potential returns in exchange for lower levels of risk. Others simply look for larger, better established firms to invest in, with less risk and a more stable return profile.

LIMITED LIFE VCTs

Limited Life VCTs, also known as Planned Exit VCTs, aim to wind up and return cash to their investors soon after the five-year minimum holding period. These tend to be more conservative funds with a focus that is as much about capital preservation as it is about growth, and for this reason they may use loan notes in conjunction with equity investment.

AIM VCTs

As the name suggests, AIM VCTs focus on investing in companies that are listed on the Alternative Investment Market, the junior market to London Stock Exchange. These VCTs are closer to traditional stock market based funds. AIM VCTs are the most liquid and most diversified among the four types of VCT, with some AIM VCT managers holding 70 to 90 companies in their portfolios.

SPECIALIST VCTs

Specialist VCTs operate in the same way as Generalists, but focus on investing in niche areas where the management team has extensive experience. Specialist VCTs generally focus on a particular industry, with the most common ones being Media & Entertainment, Industry & Infrastructure and Renewable Energy. As Specialist VCTs are highly specialised in a certain area, they are generally less diversified than Generalist VCTs.

Readers should note that Generalist VCTs and AIM VCTs are not mutually exclusive to each other because AIM VCTs generally invest in a broad range of sectors (which are equivalent to the definition of Generalist VCTs). In addition, there are VCTs that hold both AIM companies and unquoted companies in their portfolios. For example, the Baronsmead VCT as at 31/3/16 had AIM traded investments of £63m and unquoted stocks of £53m.

WHY CONSIDER VCTs

POTENTIAL BENEFITS

Obviously the tax benefits associated with VCTs provide a great incentive for investing, but as with other tax efficient investments the investment case doesn't stop at tax reliefs (and shouldn't start there either). Supporting UK small companies, gaining venture capital exposure and diversification benefits all contribute to a strong investment case for VCTs.

SMALL COMPANY INVESTING

There is a strong investment case for investing in smaller companies. Despite the risks, these companies have greater potential to generate much higher percentage returns than established corporations as their business models are untested and often undervalued, so there are more opportunities for investment managers to identify bargains that can then turn into household names.

GROWTH

Small companies can offer significantly higher returns than quoted companies in the mainstream market. From November 2015 to November 2016, Generalist VCTs have generated a total return of 5.6%, excluding income. Over the same period, AIM VCTs have generated 6.9%. Although these figures are comparable to the FTSE 100 and FTSE AIM All-share indices, of course investments made through VCTs benefit from the additional tax reliefs that effectively enhance the total returns.

INCOME

In addition to capital gains, many VCTs are focused on generating income for their investors. The average target dividend yield is about 5p per share invested, higher than that of most mainstream funds. For many VCTs, the majority of the total return comes from income. As income on VCTs is not taxed, there is also a considerable level of return that can be generated from reinvesting income. Investors are basically exposed to tax-free compounding.

DIVERSIFICATION

Historically, smaller companies have shown they do not move in lockstep with values of larger companies. Instead of moving closely with the economic cycle that larger companies do, smaller companies' performance tends to lead or lag the economy for a period of time. It is also worth noting that while VCTs' share prices correlate with the markets, the NAV of VCTs and their dividend payments do not. This means investors can potentially add extra diversification to their existing portfolios by investing in smaller companies.

SUPPORTING UK PLC

The next reason for investing in smaller companies is less about the investment merits for investors and more about the contribution to the wider economy. Small business is a crucial part of the UK economy, accounting for 99.3% of all private sector businesses, and employs a total of 15.7 million people, representing 60% of all private sector employment in the UK. The combined annual turnover of SMEs was £1.8 trillion in 2016, 47% of all private sector turnover in the UK.

VCT investment is an important part of that picture. According to the AIC, VCTs provided £225 million of funds to 115 SMEs in 2015. 44 of those investments were provided to companies that raised VCT finance for the first time, while the rest (71 deals) were 'follow-on' investment. VCTs have successfully helped to fill the SME funding gap, which is commonly estimated as being widest where funding between £2 million and £10 million is sought. VCT investments ranged between £50,000 and £5 million in 2015. Over 20,000 new jobs have been created and on average £1.19 million has been spent on R&D by VCT backed businesses. 75% of companies supported by VCTs have undertaken some form of R&D as a result of their investment.

KEY FACTS

6/10

PEOPLE ARE EMPLOYED BY SMEs

20,000

NEW JOBS HAVE BEEN CREATED THANKS TO THESE SMEs

£1.19 million

AVERAGE SPENT ON R&D. 75% OF VCT BACKED COMPANIES HAVE UNDERTAKEN R&D

VCT investments effectively promote SMEs, research and innovation. Without venture capital schemes like VCTs, many small businesses in the private sector would not be able to grow.

IN SUMMARY

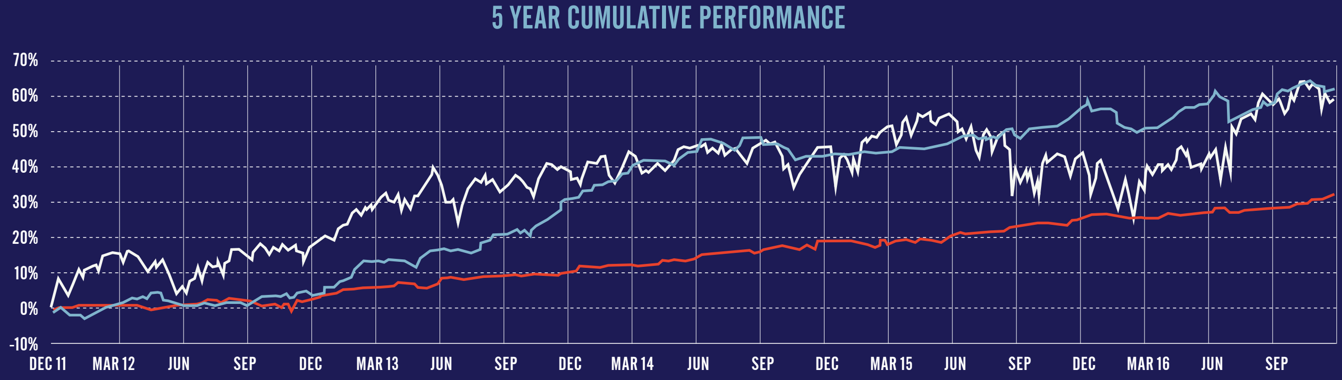
The following is a list of benefits that come with investing in smaller companies:

- Higher growth potential than mainstream assets
- Income
- Economic growth and job creation
- Diversification.

Overall, there are several benefits that justify investment in smaller companies. Holding VCTs allows an investor to benefit from the above advantages that small companies offer and also provides generous tax reliefs. That said, investing in smaller companies is inevitably perceived as more risky than mainstream equity and bond funds. We will examine the risk of VCT investments in more detail in Section 3.

PERFORMANCE

FTSE 100 VS VCTs



CUMMULATIVE PERFORMANCE	1M	3M	6M	1Y	3Y	5Y	10Y	SINCE LAUNCH
FTSE 100	-2.5%	-0.1%	13.2%	12.5%	14.1%	59.7%	61.1%	1,456.8%
IT VCT AIM QUOTED	-1.3%	2.9%	3.0%	4.5%	24.1%	62.7%	4.0%	8.6%
IT VCT GENERALIST	1.1%	3.4%	4.7%	6.0%	19.8%	32.6%	17.1%	19.3%

DISCRETE PERFORMANCE	0-12M	12-24M	24-36M	36-48M	48-60M
FTSE 100	12.5%	-3.1%	4.7%	18.9%	17.6%
IT VCT AIM QUOTED	4.5%	8.6%	9.3%	25.4%	4.6%
IT VCT GENERALIST	6.0%	5.1%	7.5%	7.8%	2.7%

ANNUALISED PERFORMANCE	1Y	3Y	5Y	10Y	SINCE LAUNCH
FTSE 100	12.5%	4.5%	9.8%	4.9%	9.3%
IT VCT AIM QUOTED	4.5%	7.4%	10.2%	0.4%	0.4%
IT VCT GENERALIST	6.0%	6.2%	5.8%	1.6%	0.8%

SOURCE: FE TRUST NET

The graph shows the five-year cumulative performance of FTSE 100, AIM VCTs and Generalist VCTs respectively. From the graph we can see despite the fact that investing in smaller companies is riskier than investments in mainstream asset classes, VCT investments can deliver solid returns and can even be less volatile than the FTSE. Among the three indices AIM VCTs have had the highest level of growth (62.7%), followed by FTSE 100 (59.7%) and VCT Generalist (32.6%).

By a simple eyeball analysis we can conclude that FTSE 100 has the highest degree of volatility while the VCT Generalist sector shows the most steady growth out of the three.

Although historical performance is not a reliable predictor of the future, it does show that the performance of VCTs is comparable to mainstream investments.

All of the figures above do not include any tax relief.

→ WHO IS IT FOR? – RISK PROFILE/SUITABILITY

In general, clients who are suitable for VCTs will need a high tolerance for risk. While some VCT opportunities are more risky than others, all VCT investments should be considered as carrying the potential for capital loss. For this reason, suitable investors should already possess a well-diversified portfolio of mainstream assets and have a need for tax planning.

Lack of liquidity can be another major issue with VCTs. Although secondary markets exist for VCTs, shares often need to be sold at a discount to their NAV in order to realise cash quickly.

SMALLER COMPANY INVESTING

RISKS AND VCTs ADVANTAGES

VCTs are an established tax advantaged venture capital scheme that encourage investment into smaller UK companies. The generous tax advantages offset some of the risks of investing in smaller companies.

SMALLER COMPANY INVESTING AND VCT ADVANTAGES

	POTENTIAL RISKS OF SMALLER COMPANY INVESTING	VCT ADVANTAGES
HIGHER GROWTH	They can be more reliant upon a small number of customers	Tax-Free Growth
DIVERSIFICATION	They can have less capital available to withstand a downturn in their fortunes	30% Income Tax Relief
CAN ACCESS INCOME	They can take a long time to bring new initiatives to fruition and become profitable	Tax-Free Dividends
SUPPORT UK PLC	Where they are listed on AIM, they can experience significant share price volatility	VCTs are listed on the Main Market of the LSE

Recent changes to pension limits have led some advisers to seek out VCTs as an alternative to pensions (see previous AiR reports on tax efficient investments for more details) and this, combined with growing awareness of VCTs and the still-ongoing adaptation to life after RDR, has made VCTs more popular.

However, recent changes to the rules that govern VCTs have had an impact on the composition of the market and – potentially – on the sector's capacity for new investment. We look at some of these issues in the next section.

VCT KEY POINTS

- VCTs have performed well over the last five years
- Investing in smaller companies can provide additional sources of growth, income and diversification within a conventional portfolio
- VCTs can be placed into four broad categories: Generalist, AIM, Specialist and Limited Life
- There are three tax reliefs available for VCT investors: 30% income tax-relief, tax free growth and tax-free income
- Suitable clients will have a high tolerance for risk

MARKET UPDATE

DEVELOPMENTS IN VCTs

FUNDRAISING SUCCESS

This section discusses developments in the VCT sector. Several major changes were made to the scheme last year and we examine how the industry has responded.

FUNDRAISING SUCCESS TO DATE

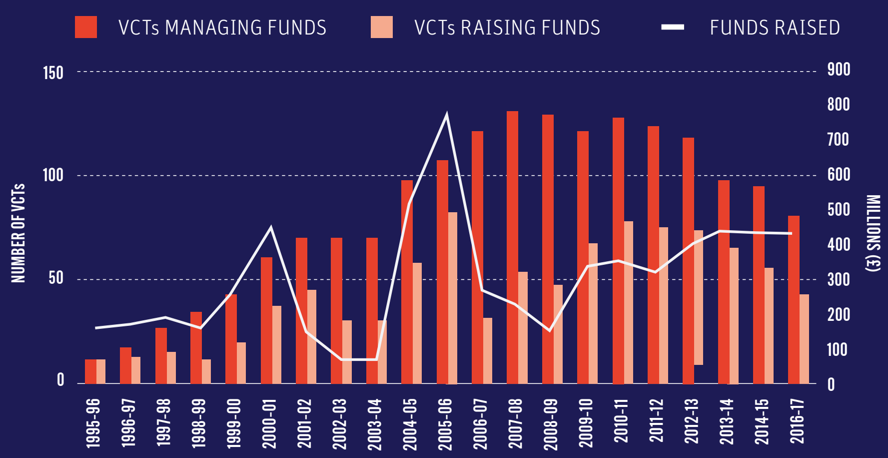
HMRC STATISTICS

Every year HMRC releases statistics on the fundraising of VCTs. The latest issue was released on 20 October 2016. The document provides statistics on the amount of funds raised by VCTs, the number of VCTs raising funds and the number of existing VCTs managing funds.

Looking at the latest available data at the time of writing (the October 2016 issue), we can see that in total VCTs have raised £6,375 million since inception in 1995. In 2015–16, the amount of funds raised was £435 million, the same as the amount raised in 2014–15. However, the number of VCTs raising funds has been falling significantly in recent years, dropping from 66 in 2013-14 to 43 in 2015-16. This means the market has become more concentrated, with some VCTs merging with others and some VCTs being wound up.

If this trend continues the market could eventually be dominated by a few big players and could even potentially be harmful to investors as providers will have more pricing power. Investee companies may also face stricter terms and conditions on their investment. We would like to see some new entrants into the market, either from existing providers or brand new market participants. However, the dynamics of the market mean there are barriers to new entrants: investors inevitably prefer to participate in a top-up of an existing VCT with an established portfolio and income stream as opposed to something new and unknown.

No. OF VCTs VS FUNDS RAISED



	FUNDS RAISED	No. OF VCTS RAISING FUNDS	No. OF VCTS MANAGING FUNDS
2013/2014	£440m	66	97
2014/2015	£435m	57	94
2015/2016	£435m	43	80

SOURCE: HMRC STATISTICS (OCTOBER 2016)

Since 2014 the amount of funds raised has remained flat and we believe it is likely to have been impacted by the rule change that restricted enhanced share buy backs from April 2014. Enhanced share buy backs allowed VCT investors to sell their current shares to VCTs after the five-year minimum holding period and re-invest in the same VCT at the same time.

The graph shows two peaks in the VCTs' fundraising history, in 2000–01 and 2005–06 respectively. The first peak coincides with the dot com bubble, which collapsed in 2001.

The second peak was in 2004–05 and in that year the rate of Income Tax relief was doubled from 20% to 40% so clearly the record amount of funds raised in that year was a result of the generous Income Tax relief! In 2006–07 the amount raised fell dramatically from £780 million in 2005–06, to £270 million as the tax relief was revised downward to 30%.

The global financial crisis in 2007-08 had also had a negative impact on the VCT industry before the fundraising started to recover in 2009-10.

The number of VCTs managing funds was 12 in 1995–96 when the scheme was first introduced, increasing to a peak number of 131 in 2007–08. Since 2010–11 the number of VCTs managing funds has been decreasing, dropping from 128 to 80 in five years. This again shows that although the market is expanding, the number of suppliers is declining, so the average size of each VCT is becoming higher.

The amount of funds raised was £458 million in the 2015–16 tax year according to the AIC, £23 million higher than the same statistics by HMRC. HMRC explains the discrepancy with AIC industry figures as arising due to differences in the methodology and assumptions used to compile the figures. In particular, AIC figures exclude enhanced share buy-backs.

VCTs' IMPACT

VCTs AND THE ECONOMY

THE ROLE OF VCTs IN THE ECONOMY

It's worth taking some time to examine if VCTs are fulfilling their objective of helping to finance smaller companies.

ASSESSING THE FUNDING GAP FOR SMEs

Funding to the SME sector has broadly improved over the last 8–9 years since the financial crisis, as there are more alternative ways to raise finance other than traditional bank loans, but barriers to accessing finance and lack of awareness of financial options are still undermining SMEs' growth potential.

Prime Minister Theresa May stated in the her speech at the Confederation of British Industry that while the UK ranks third in the OECD for start-up support, it lags behind in 13th place for the number of SMEs that manage to scale-up.

According to the British Bankers' Association, business applications for loans and overdrafts are at their lowest rate since 2014, which has resulted in a £1bn funding gap. David Cameron, the former Prime Minister, stated that "there is a £1 billion gap between the total funding UK businesses receive and the amount they need to realise their ambitions for growth".

Although a significant funding gap still exists in the SME sector, there have been some encouraging signs and improvements. According to the Albion Growth Report 2016, which surveyed more than 500 businesses, access to finance ranked 7th in terms of importance compared to 4th two years ago. And for companies with more than five employees the ranking falls further to 13th. This shows SMEs are less constrained by lack of finance than they have been in the recent past.

That said, the overall picture doesn't tell the whole story as certain sectors are still having trouble with access to finance. Only 9% and 11% of companies in the construction and retail sectors successfully raised finance.

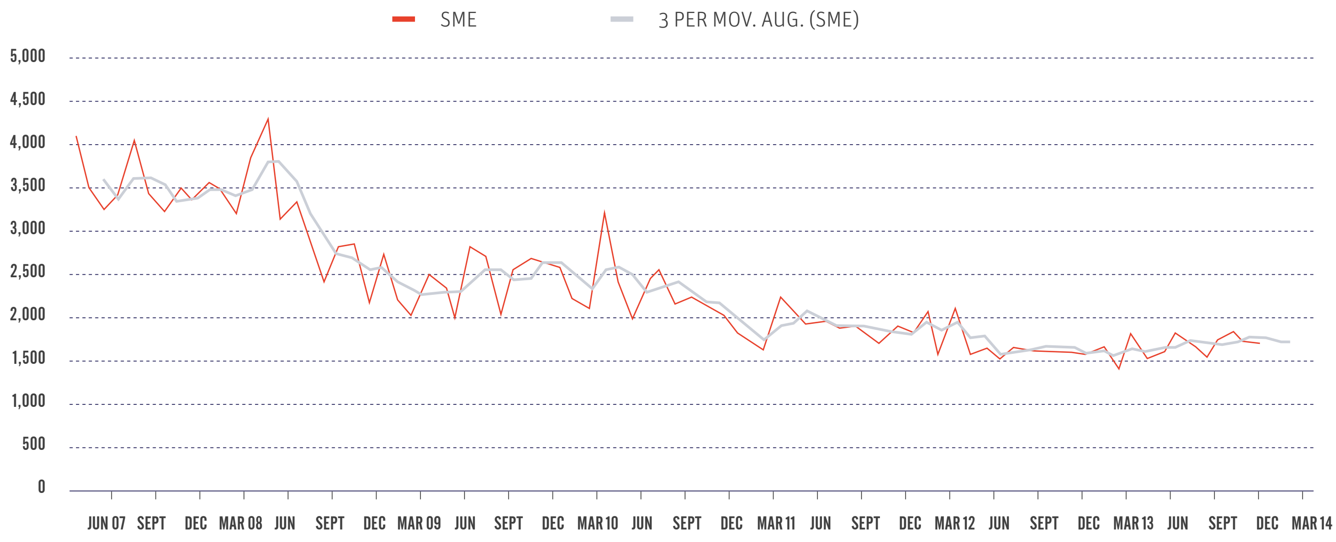
Another healthy trend in the SME sector is that the appetite for equity based investment has continued to rise this year. The proportion of SMEs willing to consider investment specifically from a venture capital or private equity investor has increased from 11% to 13% this year and the number of SMEs that hold an optimistic outlook about venture capital is double those that hold a pessimistic outlook. However, despite the rise this is still a very low number and suggests that businesses are either not as ambitious as they could be, or are not aware of the benefits of raising money by selling equity.

Therefore, with the funding gap still in existence and more business owners looking for alternatives, we think there is an important role for VCTs to play, and the industry should do more to raise awareness among entrepreneurs.

VCTs AND THE FUNDING ESCALATOR

Businesses go through a series of development stages as they grow and are often accompanied by different types of funding at each stage. The funding escalator model shows the different sources of finance available at different stages of the business life cycle. The escalator is an inter-dependent system; any gaps in the provision of particular types of finance will have knock-on effects, restricting the business from reaching the next stage of development.

GROSS LENDING TO SMEs IN THE UK (£ MILLION)



SOURCE: THE BRITISH BUSINESS BANK

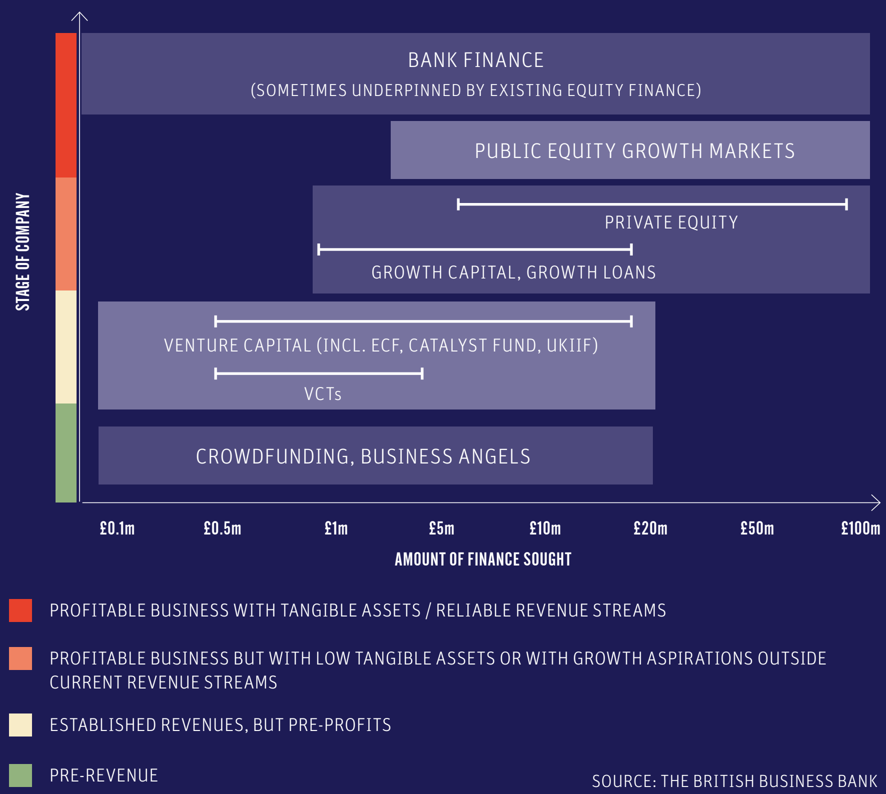
"During 2015 alone VCT-backed companies spent £181 million on research and development (R&D) and the average amount dedicated to R&D was £1.19 million per company."

The chart shows that VCT investments are made to companies that have established revenues but are yet to generate profits. In addition, VCT investments come after EIS investments and before private equity, so investee companies with VCT investment generally have slightly lower risks than those receiving funding through EIS and SEIS.

The size of VCT investments can range from £0.1m to £20m, reflecting the broad range of companies VCTs can support as a result of changes in rules. From 6 April 2012, VCT qualifying holdings were extended to companies with up to 250 full time equivalent employees and gross assets of up to £15m before investment and £16m after investment.

What the diagram shows very succinctly, though, is that VCTs play an important role as a step on the funding escalator for small business.

STYLISED FUNDING ESCALATOR



SOURCE: THE BRITISH BUSINESS BANK

VCT-FUNDED COMPANIES

According to the October 2016 edition of the AIC's "Feeding the Fledgling Economy" report, the top sectors supported by VCTs received £114 million, invested into 50 companies. The top four sectors that received the greatest support were:

- Businesses services
- Digital, creative and information services
- Retail
- Manufacturing.

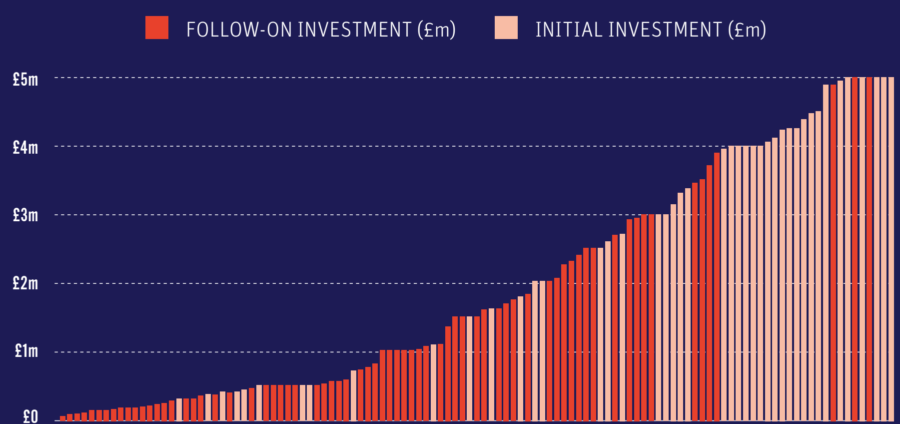
In the sub-section above we have noted that the retail sector is one of the sectors that struggle when it comes to raising traditional finance, but it is one of the sectors that received the most support from VCTs. Hence, we can see the importance of these alternative finance options.

Other sectors that received significant levels of investment in 2015 included health and social care, financial services and information technology.

In 2015, VCTs provided £225 million of funds to 115 SMEs. 44 investment transactions (£113 million) were in companies receiving VCT funding for the first time, while 71 deals provided further finance to companies that had received VCT funding previously.

VCT managers are particularly interested in innovative companies. Recent research by HMRC found that 75% of SMEs supported by venture capital schemes had undertaken some form of innovation as a result of their investment. During 2015 alone VCT-backed companies spent £181 million on research and development (R&D) and the average amount dedicated to R&D was £1.19 million per company.

VCT INVESTMENTS IN 2015 (RANKED BY SIZE)



SOURCE: AIC, FEEDING THE FLEDGLING ECONOMY, OCTOBER 2016

> *"Over 20,000 new jobs reported in VCT-backed businesses and HMRC's research states that 71% of SMEs had grown employee numbers since VCT (or EIS) investment."*

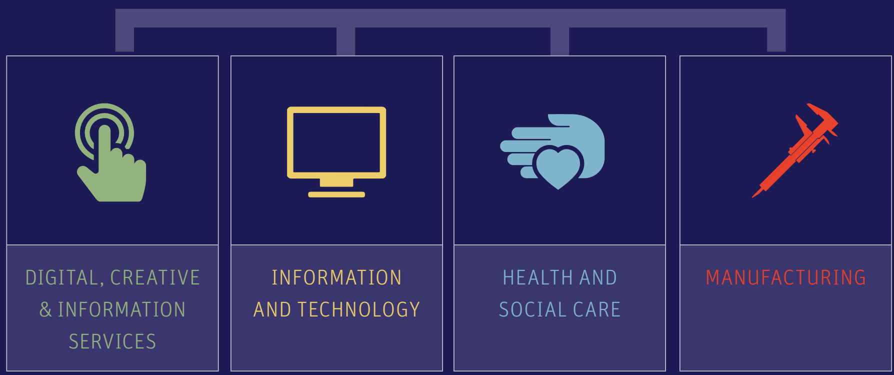
This year marked a significant level of exporting activity from VCT-backed SMEs. In a survey conducted by the AIC, 194 companies reported exports with a total value of £1.2 billion, which represents 40% of their total sales. This further proves why SMEs are a key part of the UK economy and why it is important to enable them to realise their full potential.

VCTs have also made a positive contribution to job creation. Over 20,000 new jobs reported in VCT-backed businesses and HMRC's research state that 71% of SMEs had grown employee numbers since VCT (or EIS) investment. The average number of increase in headcount is 60 among VCT-backed businesses. 26% of jobs created were in each of London and the North, making them the top two regions by number of jobs created. The South East follows that with 19% of total jobs created in the region.

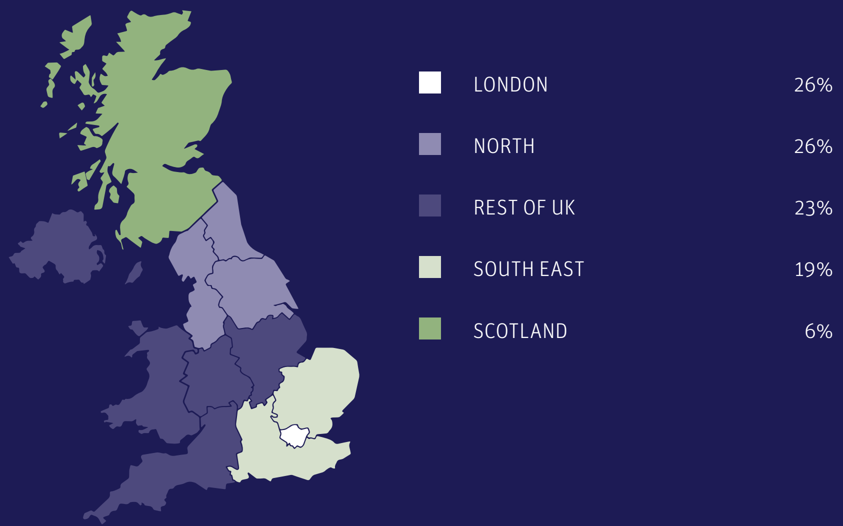
SCALE-UP COMPANIES

The number of UK start-ups is now not only well above the European average, but is hot on the US's heels, too. Estimates suggest an amazing figure of 600,000 new businesses launching each year for the past three years in the UK. But then there are the darker statistics: fewer than 3% of start-ups survive for a decade or enjoy a single year of high growth. OECD data shows that Britain is near the bottom of the table for the percentage of businesses that grow to more than 10 employees after three years, and this is a problem. Ignoring this issue could endanger the UK start-up revolution and hamper UK productivity. The British Business Bank's assessment is that there remains a need to stimulate a greater volume of scale-up businesses and SME exporters to counteract the UK's lagging productivity.

TOP SECTORS SPENDING ON R&D



DISTRIBUTION OF JOBS CREATED



SOURCE: AIC, FEEDING THE FLEDGLING ECONOMY, OCTOBER 2016

The picture isn't entirely negative: there are 22,470 companies that are achieving more than 20% average annual growth in turnover over a three-year period and with an annual turnover between £1 million and £20 million. And whilst they make up less than 1% of UK companies, they create one in every three new jobs. But statistics like these show how much more high growth small businesses could contribute if we could fund them: it is estimated that just 1% of additional scale-ups could add £225 billion to British GDP by 2034.

Close to a quarter of these firms find it difficult to secure the funding they need on acceptable terms, with 75% of these firms saying this is a significant barrier to their growth, and four out of five of those businesses surveyed by CEBR (Centre for Economic and Business Research) in 2015 weren't making use of facilities such as VCTs and EIS.

"Strategic planning, industry insights and contacts are all crucial factors to a growing business and VCT managers can offer support in all of these areas."

INVESTEE COMPANIES CASE STUDIES

ANTECH

AnTech Limited is a specialist oil and gas engineering company that both manufactures products and provides services for directional coiled tube drilling.

In February 2016, Calculus Capital made a £2.35 million investment in AnTech to provide working capital for the anticipated growth in the services business.

BLACKSTAR

Blackstar Amplification designs and manufactures innovative guitar amplifiers and associated products for the UK and international music instrument market. Based in Northampton, Blackstar has established a global brand on a catalogue of 50+ products, each of which has received industry acclaim.

Foresight VCT invested £2.5 million as of June 2015; the investment has significantly improved the company's operating efficiency and margins.

EVE SLEEP

Eve set out to create the most comfortable mattress in the world at a price that's fair for everyone. The mattress combines a high-density foam base, a mid layer of high-resilience comfort memory foam and a memory foam top layer. They are so confident everyone will love their product they offer all customers a 100-night sleep trial. By selling only online and cutting out the traditional retail middle man, they are able to sell their mattress at a third of the price you would pay for a premium mattress on the high street.

The company received funding from Octopus Titan VCT in 2015 and another round of funding of £6.9 million from Octopus Ventures, DN Capital and Channel 4. Today EveSleep is selling in seven countries, employing over 50 employees and won the 2016 Growth Champion of the Year award at the Growth Investor Awards.

THE GP SERVICE (GPS)

The GP Service (GPS) is an innovative platform that brings patients, doctors and pharmacies together. The platform allows patients to consult doctors via online assessment questionnaire or through their video chat function. All doctors on the platform are UK-based and registered. After the initial consultation, patients can then choose to collect their treatment from any Partner Pharmacy through the service.

The company is backed by Maven VCTs, which invested £2.5 million in May 2016. The fund will be used to stretch the company's activities into more regions of the country and develop additional services.

THIRD BRIDGE

Third Bridge provides private equity firms, hedge funds and strategy consultants with the information that they need to understand the value of their investment opportunities. The company was founded in 2007 in London and it now employs over 250 members of staff and has offices in North America, Europe and Asia.

The ProVen VCTs, managed by Beringea, invested £3 million in the company in 2012. The investment has enabled the company to expand overseas and strengthen its senior management team.

"Strategic planning, industry insights and contacts are all crucial factors to a growing business and VCT managers can offer support in all of these areas."

HELP BEYOND INVESTMENT

To expand their business activities SMEs need much more than financial support. Strategic planning, industry insights and contacts are all crucial factors to a growing business and VCT managers can offer support in all of these areas.

Besides investment there are a number of ways that VCT managers can support their investee companies to realise their potential.

- **Senior management:** VCT managers can help SMEs select the most suitable and competent management, which start-ups often struggle with and can overlook.
- **Operation:** VCT managers are more experienced at running businesses from various industries, they are able to enhance operating efficiency, optimise administration, and reduce unnecessary costs as well as provide legal and financial expertise.
- **Business insights:** SMEs are often focused too much on research and development and it makes perfect sense as they are challenging existing competitors. However, the danger is that they can overlook the power of sales and marketing. VCT managers can solve this problem by encouraging investment in effective marketing campaigns and pairing investees up with great marketing teams.
- **Network:** This can be reaching out to new customer segments, experts in specialised fields or opening up connections to prepare for the next round of fund-raising.

HELP ON PLANNING AN EXIT

Exit is arguably the most important stage in an investment transaction and many managers would examine potential exit options even before investing in a company, so a good VCT manager would have the network and experience required to ensure a smooth transaction to the next buyer.

Typically, a manager can exit from an investment through the following routes:

- **Initial Public Offering (IPO):** Under an IPO the investee company lists on a stock exchange to allow its shares to be bought and sold on the open market and the share price will be determined by buying and selling activities on the marketplace.
- **Mergers & Acquisitions (M&A):** M&A might give investors an opportunity to swap their holdings of one company for shares in another.
- **Share Buyback:** Under this form of exit, the company would buy back the company's shares from investors at a fixed priced determined by the investors and the management.
- **Trade Sale:** A majority of shareholders agree to sell their shares to another company.
- **Voluntary Liquidation Resolution:** Common with Limited Life VCTs, to enable them to distribute capital back to investors as soon as the minimum holding period is achieved.

SCALE-UP COMPANIES (STATS)

600,000

NEW BUSINESSES LAUNCHING EACH YEAR FOR THE PAST THREE YEARS IN THE UK

22,470

COMPANIES THAT ARE ACHIEVING MORE THAN 20% AVERAGE ANNUAL GROWTH IN TURNOVER OVER A 3 YEAR PERIOD

1/3

NEW JOBS ARE CREATED BY THOSE 22,470 COMPANIES

2016/17 FUNDRAISING OUTLOOK

OPEN OFFERS

2016/17 is likely to prove to be a very slow year for fundraising: many VCTs are still digesting cash raised in previous years (VCTs raised over £450 million in 2014/15) and the new rules (discussed below) have shrunk the pool of potential investments.

The highest target fundraise is £30 million lower than last year's highest figure (£100 million) and this year's mode target fund-raise (£8 million) is also significantly lower than the historical figure of £20 million. The median value remains unchanged from last year at £20 million.

This is happening at a time when demand is high due to lower limits on pension saving, so we are witnessing a capacity crunch in the market. VCTs that are raising are likely to hit their targets quickly. As the demand is outstripping the supply in the VCT market, investors must act quickly in order to avoid disappointment.

"It is difficult for VCTs to justify further fundraising to shareholders given so much cash on the balance sheet and limited proof to show they can employ the funds they are already holding," John Glencross, CEO of Calculus Capital.

VCTs RAISING MONEY (OPEN VCTs)*

	MANAGER	MINIMUM SUBSCRIPTION	TARGET FUNDRAISING	TARGET DIVIDENDS	VCT TYPE	INVESTEE COMPANIES	INVESTEE COMPANY TYPE	STRATEGY	SECTOR
ALBION VCTS PROSPECTUS TOP UP OFFERS (16/17)	Albion Ventures	£6,000	£24m	6%	Generalist	60	Seed/Early/ Later Stage	Growth & Income	General enterprise
AMATI VCT 1 & 2 TOP UP (16/17 & 17/18)	Amati Global Investors	£3,000	£8m	6%	AIM	60	AIM Listed	Growth & Income	General enterprise
CALCULUS CAPITAL VCT PLC (17/18) – D SHARE OFFER	Calculus Capital	£5,000	£8m	4.5%	Generalist	20	Later Stage	Growth & Income	General enterprise
DOWNING VCT FOUR VCT PLC – GENERALIST SHARE CLASS	Downing	£5,000	£20m	4%	Generalist	11	Early/Later Stage	Growth & Income	General enterprise
DOWNING VCT FOUR VCT PLC – HEALTHCARE SHARE CLASS	Downing	£5,000	£10m	4%	Specialist	11	Early/Later Stage	Growth & Income	Pharmac. & biotech.
FORESIGHT SOLAR & INFRASTRUCTURE VCT	Foresight Group	£3,000	£20m	5%	Specialist	Not specified	Project Based	Growth & Income	Industry & Infrastructure
FORESIGHT VCT	Foresight Group	£3,000	£30m	5%	Generalist	Not specified	AIM Listed	Growth & Income	General enterprise
HARGREAVE HAL AIM VCT 1&2 (16/17 & 17/18)	Hargeave Hale	£5,000	£25m	5%	AIM	80	Later Stage	Growth & Income	General enterprise
OCTOPUS APOLLO VCT PLC	Octopus Investments	£5,000	£20m	5%	Generalist	25	Early/Later Stage	Growth & Income	General enterprise
OCTOPUS TITAN VCT (16/17)	Octopus Investments	£3,000	£70m	5%	Generalist	55	Early/Later Stage	Growth & Income	General enterprise
PEMBROKE VCT B SHARE 2016/17	Oakley Investment Managers	£3,000	£15m	3%	Generalist	25	Early/Later Stage	Growth & Income	General enterprise
PROVEN GROWTH & INCOME VCT (16/17 & 17/18)	Beringea	£5,000	£30m	5%	Generalist	30	Early/Later Stage	Growth & Income	General enterprise
TRIPLE POINT INCOME VCT – E SHARES	Triple Point	£5,000	£15m	5%	Specialist	N/A	Project Based	Growth & Income	Industry & Infrastructure

* DEFINITIONS OF THE TERMS WE USE IN THE TABLE AND THROUGHOUT THIS SECTION CAN BE FOUND IN THE INDUSTRY ANALYSIS SECTION

"VCTs offer attractive tax breaks as well as access to a wide-ranging portfolio of growth focused investments across a variety of sectors." – ***John Glencross, Calculus Capital***

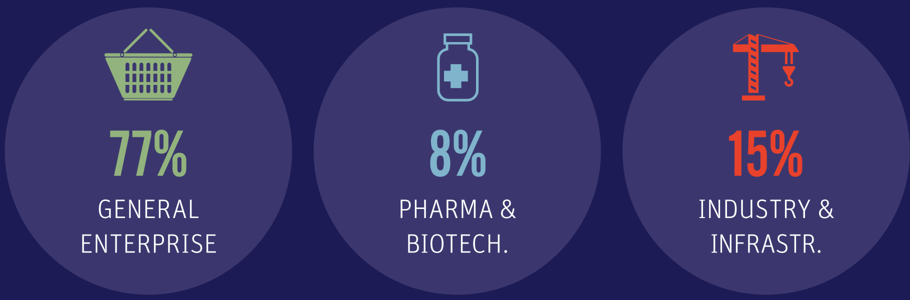
MARKET COMPOSITION

At the time of writing there are 13 VCTs that are raising funds, all of which have a Growth & Income investment mandate. 77% of open VCTs do not have a sector bias and invest in General Enterprise; the sectors Industry & Infrastructure and Pharmaceuticals & Biotechnology represent 15% and 8%, respectively.

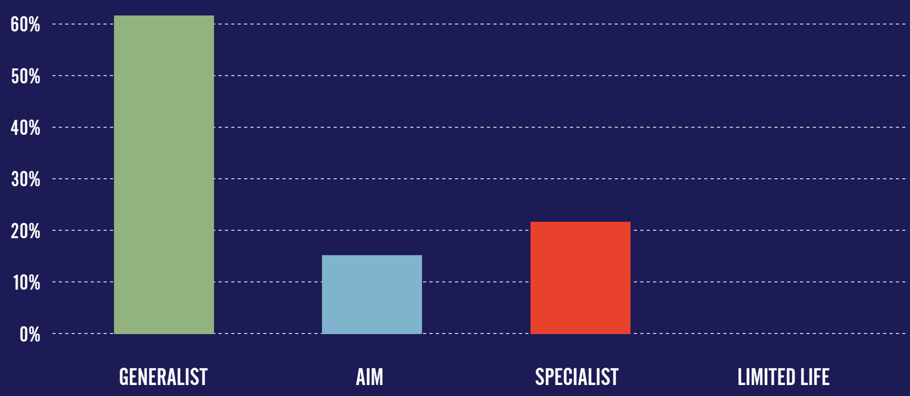
Compared to offers launched in the past, this year's VCTs have more similarities than differences. There have been 11 launches in total since April 2016, all of which have Growth & Income as their investment strategy.

AIM and Generalist VCTs contribute to 15% and 62% of open offers, respectively. There are no Limited Life VCTs available in the market at the time of writing. 23% of open offers are Specialist VCTs.

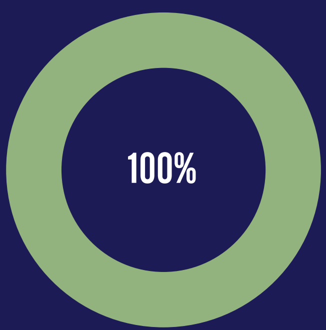
OPEN OFFERS BY INVESTMENT SECTOR



OPEN OFFERS BY VCT TYPE



OPEN OFFERS BY INVESTMENT STRATEGY



- CAPITAL PRESERVATION
- CAPITAL PRESERVATION & GROWTH
- CAPITAL PRESERVATION & INCOME
- GROWTH & INCOME

CHARGES AND FEES

	AVG	MODE	MIN	MEDIAN	MAX
INITIAL CHARGE TO INVESTOR	2.38%	3.00%	0.00%	2.50%	3.00%
INITIAL CHARGE TO INVESTEE	0.46%	0.00%	0.00%	0.00%	3.00%
TOTAL INITIAL CHARGE	2.85%	3.00%	0.00%	3.00%	5.00%
AMC CHARGED TO INVESTOR	1.96%	2.00%	1.50%	2.00%	2.50%
AMC CHARGED TO INVESTEE	0.08%	0.00%	0.00%	0.00%	0.50%
TOTAL AMC	2.03%	2.00%	1.50%	2.00%	3.00%
ANNUAL PERF FEE	10.00%	0.00%	0.00%	10.00%	20.00%
EXIT PERF FEE	6.15%	0.00%	0.00%	0.00%	20.00%
ANNUAL PERF HURDLE	22.40%	3.00%	0.00%	3.00%	100.00%
EXIT PERF HURDLE	77.00%	100.00%	3.00%	100.00%	105.00%
INITIAL DEAL FEE	0.00%	0.00%	0.00%	0.00%	0.00%
EXIT DEAL FEE	0.00%	0.00%	0.00%	0.00%	0.00%
ANNUAL ADMIN FEE	0.37%	0.00%	0.00%	0.00%	3.25%

"Compared to EIS investments, VCTs are more diversified."

A target dividend is stated by all currently open VCTs; the range is between 3% and 6% with an average of 4.81%.

The minimum subscriptions range from £3,000 to £6,000, much lower than the level of minimum subscription quoted in a typical EIS investment. It shows how VCT investment is not only suitable for high net worth and sophisticated investors. The average minimum subscription is £4,308, so VCT investments can also be held by retail investors whose needs and risk tolerance match what VCTs can offer.

There is a diverse range of sizes among VCT investments, as shown by the target fundraises. The smallest fundraising target is £8,000,000, which is approximately one tenth of the largest but there is no correlation between a VCT's target fundraise and other characteristics.

Compared to EIS investments, VCTs are more diversified. We use the target number of investee companies quoted by the manager as the measure for diversification. The average number of investee companies held by a VCT is 38, while the most diversified VCT aims to hold 80 companies in its portfolio.

TRENDS IN NEW LAUNCHES

Important changes were made to VCTs in response to revised EU State Aid rules. In particular, the Government imposed limits on the age of qualifying companies and introduced caps on total investment a company can receive from Venture Capital Schemes. Arguably the most important change is the restrictions on acquisition finance, even if the target company is carrying on a qualifying trade. The final rule change effectively bans VCTs from financing management buyouts. Many VCTs that followed a strategy of funding management buyouts are not raising funds this year.

The impact of changes in rules on new launches is mirrored in our data. The average target number of investee companies has increased from 37 to 38 per VCT. Previously, the least diversified VCT has only three investments in its portfolio, while the figure is 11 for VCTs launched this tax year. However, readers should note that there are various reasons why a VCT would have a low target number of investees.

OCTOPUS WITHDRAWS FROM EIS TO FOCUS ON VCT

The largest EIS manager, Octopus Investments, has withdrawn from the EIS market and stopped raising further EIS funds.

At the time Octopus commented: "The latest changes to the EIS and VCT legislation demonstrate the government's focus on helping early stage UK companies, which our VCTs are well positioned to support. It feels like it's the right time for us to focus on growing our VCTs rather than expanding our EIS products."

This is the biggest change in response to the legislation we've seen so far, and it's interesting that it has come from the biggest player in the market. Other providers have responded to the changes by launching more specialist EIS funds focused on growth and investing in non-contentious assets, but this is the first time we've seen a deliberate tilt away from EIS towards VCT.

Among VCTs launched in 2016 Octopus Titan VCT has the highest fund-raising target, which is more than double the second highest. It also has the lowest minimum subscription so we speculate Octopus VCTs will be a popular product in the market and become fully subscribed quickly.

OPEN VCTs INVESTMENT METRICS

	AVERAGE	MODE	MIN	MEDIAN	MAX
TARGET DIVIDENDS	4.81%	5.00%	3.00%	5.00%	6.00%
MINIMUM SUBSCRIPTION	£4,308	£5,000	£3,000	£5,000	£6,000
TARGET FUNDRAISE	£22,692,308	£20,000,000	£8,000,000	£20,000,000	£70,000,000
DIVERSIFICATION	38	60	11	28	80

THE IMPACT OF POLICY CHANGES

SUMMARY OF THE RULES AND RECENT CHANGES

The most recent changes to the rules governing the qualifying criteria for companies receiving VCT investment were made in two Budget statements in 2015. These changes were primarily made in order to ensure ongoing compliance with EU State Aid rules. The rules, both pre and post the final 2015 Autumn Statement and subsequent Finance Act, are summarised below for reference.

The changes were introduced to ensure that the tax-advantaged schemes continue to support economic growth and provide value for money for UK taxpayers. However, it is not intuitive how these changes can serve these objectives.

The arbitrary seven-year age limit doesn't seem to serve any logical purpose. It penalises firms with long R&D periods, or firms that have traded on a small scale for a number of years but then identified the potential to grow. However, it is true that the special rules for knowledge intensive companies, and exemptions from the age test, are provisions to try and mitigate the impact of the rules.

The cap on total investment penalises firms where there is a need to raise very substantial amounts of working capital to finance a long term development programme before investors see a profit, or where expensive tangible assets need to be acquired in order to commence business.

And the size of a company's workforce will be a reflection of the type of trade carried out by the business, not an indication of its stage of development and how easy it can access finance.

Removing or amending these rules could let more capital flow to where it is needed – plugging the equity gap for SMEs for helping to create jobs. At the moment, the rules are putting a brake on economic growth.

RULES FOR VCT QUALIFYING COMPANIES

		PRE NOV 2015	TODAY
MAX. AGE		No limit	7 Years unless total investment represents more than 50% of the company's turnover over the preceding 5 years and the company is using the funds to enter a new product or geographic market, or it received previous risk finance within its first 7 years.
LIFETIME CAP*		No limit	£12m
ANNUAL INVESTMENT LIMIT		£5m	£5m
EMPLOYEE LIMIT (FTE)		Fewer than 250	Fewer than 250
KNOWLEDGE INTENSIVE COMPANIES	MAX. AGE	N/A	10 Years unless total investment represents more than 50% of the company's turnover over the preceding 5 years and the company is using the funds to enter a new product or geographic market, or it received previous risk finance within its first 10 years.
	LIFETIME CAP	N/A	£20m
	EMPLOYEE LIMIT	N/A	Fewer than 500 FTE
USE OF VCT MONEY FOR ACQUISITIONS OF BUSINESS		Allowed	New rules to prevent EIS funds being used to acquire existing businesses or part of a business (including intangible assets that have already been used in a trade).
GROWTH AND DEVELOPMENT TEST		No requirement	Requirement that all investments are made with the intention to grow and develop a business.

"The rule changes have meant some head scratching in some quarters about deployment of funds."
*– **Andrew Wolfson, Pembroke VCT***

POST BREXIT CHANGES?

Immediately after the new rules were announced The Association of Investment Companies (AIC), the British Venture Capital Association (BVCA), the Enterprise Investment Scheme Association (EISA) and the UK Business Angels Association (UKBAA) all began a joint lobbying effort to try and soften some of the changes.

This effort is ongoing, and when the UK exits the EU (at the time of writing the exact format that Brexit will take is very unclear) then it is possible that there will be more scope to make changes to how these tax advantaged Venture Capital Schemes are organised. However, in order to access the single market and operate freely as it has done since 1973, the UK may still have to comply with EU rules on a variety of issues, which could very well include State Aid.

AUTUMN STATEMENT

The outcome of this lobbying effort remains to be seen, but the 2016 Autumn Statement did bring about some clarification and technical changes to the rules that govern follow on funding for VCTs, suggesting that HMRC is listening and responding to the industry. The Chancellor also announced that HM Treasury would lead a review into the barriers preventing access to patient capital. The announcement may potentially open the door to reversing some of the more restrictive new rules governing EIS and VCTs.

However, the Chancellor has decided not to go ahead with the introduction of increased flexibility for replacement capital within the VCT scheme. The Treasury said: "The government will not be introducing flexibility for replacement capital within the tax-advantaged Venture Capital Schemes at this time, and will review this over the longer term."

Ben Yearsley, Investment Director at Wealth Club, says the move away from amending replacement capital rules is partly down to the fact that most of the VCT managers have "moved on" from the banning of MBOs last year, which had dominated the VCT industry.

BREXIT: TIMING AND PROCESS

Article 50 of the Lisbon Treaty sets out the formal legal process for any member country to leave the European Union. The process should take two years. To date, Article 50 has never been used and because the likelihood of it being required was thought to be minimal, it's a rather vague, very basic five-point plan.

Theresa May stated at the Conservative Party conference of October 2016 that Article 50 will be invoked no later than the end of March 2017. Assuming that is when Article 50 is activated, two years from this date takes us out to March 2019: this, to us, seems like the current best guess for when we can expect the UK to formally withdraw from Europe. After this, there will be no way back unless there is unanimous consent from all other member states.

In the meantime, the Great Repeal Bill introduced by the Government will repeal the European Communities Act, so that, from the date the UK formally leaves the EU, EU law will no longer be applied to Britain. However the body of existing EU law will be converted into British law. This is intended to "give businesses and workers maximum certainty as we leave the European Union." And the consensus view is that it's virtually certain that there will be no legal changes to items which touch on EU agreed legislation until the actual exit.

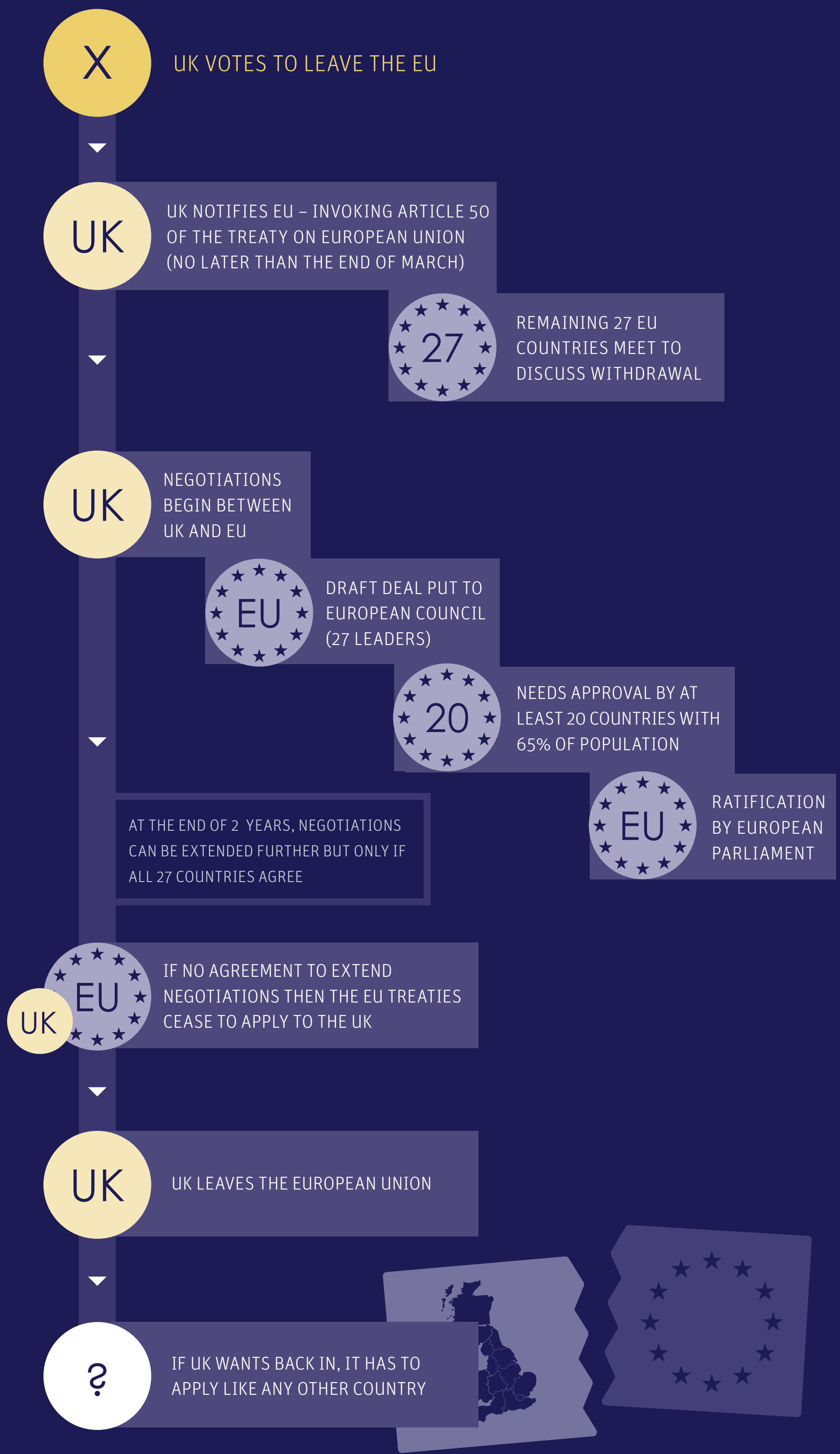
Once the UK formally notifies the EU that it is withdrawing under Article 50, the country will lose its power to participate in the discussions of the European Council or in decisions concerning it. However, the UK will carry on taking part in other EU business as normal.

Note that the two-year time frame for exit negotiations doesn't include the timeline to negotiate the framework agreement for future relations with the EU. Once the UK exits, the time required to regularise commercial relations could be fairly elastic; the Swiss signed their first framework agreement with the EU in 1972 and are still negotiating to deal with particular issues as they go along and the Lords EU Committee has said trade deals between the EU and non-EU states take between four and nine years on average.

At the point of exit, it will then be up to the Government to review and adjust any EU imposed legislation as it sees fit. Nevertheless, it will be important to take into account how any adjustments might affect the Government's upcoming negotiations to access the EU single market: much of this type of legislation is designed to keep the European playing field level, so changes that tip the balance too much in favour of the UK are unlikely to be tolerated.

"It's encouraging to see that those on the coal face of providing financing to smaller companies, are clearly indicating that the EU Referendum result is having no discernible negative impact on demand for development and expansion capital." – ***Jason Hollands, Tilney Bestinvest***

STEPS TO UK LEAVING THE EUROPEAN UNION



SOURCE: BBC

IMPACT OF BREXIT?

A survey of VCT groups by Tilney Bestinvest revealed that managers see little if any impact on demand for financing from UK smaller companies as a result of the Brexit vote. The survey includes response from 17 VCT management groups. 44% of VCT groups surveyed claim they saw no impact on demand for VCT financing from businesses, while 31% believe the Brexit vote will lead to an increase in demand for VCT financing.

Jason Hollands, Managing Director of Tilney Bestinvest, commented: "It's encouraging to see that those on the coal face of providing financing to smaller companies, are clearly indicating that the EU Referendum result is having no discernible negative impact on demand for development and expansion capital..."

Although there is no immediate impact on VCTs following the Brexit vote, the industry in general (64%) is expecting to see a lower level of fund-raising this year after having achieved a record amount of £458 million in 2015/16.

VCTs launched so far this year all have a Growth & Income strategy and in general they have lowered their fund raising targets, however we believe these trends are not a result of the vote but changes in rules announced last year.

INCREASES IN DIVIDEND TAX AND REDUCTIONS IN DIVIDEND TAX CREDITS

From 6 April 2016, the notional 10% tax credit on dividends was abolished. Instead, a £5,000 tax free dividend allowance has been introduced and dividends above this level are now being taxed at 7.5% (basic rate), 32.5% (higher rate), and 38.1% (additional rate). This could hit business owners hard when extracting funds from their company, particularly those who

*"It's too soon to say what the impact of Brexit will be." – **Daniel Kiernan, Intelligent Partnership***

have increased the amount of cash held on their balance sheets to offset risks of a financial downturn.

After the £5,000 allowance, the new rates represent dividend tax rate increases from 0% to 7.5% for basic rate taxpayers, 25% to 32.5% for a higher rate taxpayer and for additional rate taxpayers, from 30.56% to 38.1%. A possible solution? Business owners could consider investing some of the money extracted into a VCT to generate an income tax credit of 30% together with investment growth to offset the dividend tax payable.

Of course for investors who are looking for tax free dividends, perhaps because they are now paying more tax on their investment income than previously, VCTs are really the only option.

SOCIAL VCTs

In Budget 2015, the Government announced details of the design of a new Social Venture Capital Trust (Social VCT) scheme. The scheme was designed to encourage investment in companies that invest in social organisations. It will be similar to the Venture Capital Trust Scheme for indirect investment in commercial companies. However, there has not been any timescale committed on the proposed scheme, with the Government advising that they "will legislate for Social VCTs in a future Finance Bill".

TAX RATES PRE AND POST APRIL 2016

	TAX RATE (PRE APRIL 2016)	TAX RATE (POST APRIL 2016)
BASIC RATE BAND	0%	7.5%
HIGHER RATE BAND	25%	32.5%
ADDITIONAL RATE BAND	30.56%	38.1%

KEY POINTS

- Social VCTs have been mooted, but the concept has not advanced in the last 12 months
- VCT managers see little impact on the demand for finance from UK smaller companies as a result of Brexit
- Proposed changes to allow the use of replacement capital will not go ahead in the near future
- The majority of open VCT offers target Growth and Income

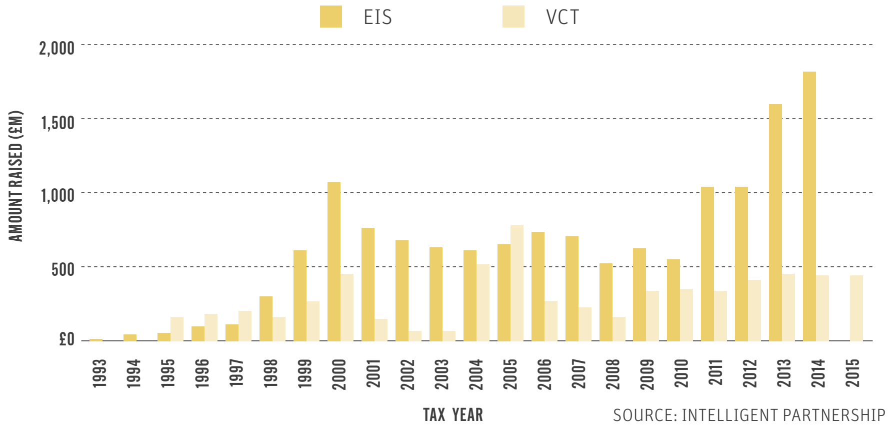
VCT vs EIS

COMPARING THE UK'S TWO LEADING VC SCHEMES

DIFFERENCE BETWEEN VCT AND EIS

VCT and EIS are similar in a number of ways as they are both tax advantaged investments designed to support UK small businesses. However, there are some important differences between the two that anyone who's interested in tax efficient investments should know. First, although both investments offer investors 30% Income Tax relief upfront, the minimum holding period for keeping the relief permanently is five years for VCTs, whereas it's just three years for EIS. Second, dividend income from VCTs is not taxed whereas income earned on EIS investments is subject to income tax. Finally, although VCTs' minimum holding period is two years longer than EIS, investors can expect to find a greater degree of liquidity in the VCT market, as there is a secondary market.

VCT VS EIS FUNDRAISING



SOURCE: INTELLIGENT PARTNERSHIP

FUNDRAISING TOTALS TO DATE

According to HMRC's statistics EIS have raised almost £14.2 billion funds for 24,620 companies since it was launched in 1993–94. In 2014–15, 3,265 companies raised a total of £1,816 million of funds under the EIS scheme.

In contrast, the total amount of funds raised by VCTs since its inception in 1995 is £6.4 billion and in the 2013–14 tax year 57 VCTs raised a total of £435 million. The same amount of funds was raised by 43 VCTs in the 2015–16 tax year.

Between 1995 and 1997 VCTs had raised more funds than EIS, before the trend reversed in 1998. The amount of funds raised by VCTs exceeded EIS again in 2005 when the level of Income Tax relief went up to 40% for VCTs. Since 2006, EIS funds have largely outpaced VCTs in amount of funds raised.

VCTs offer the same level of Income Tax relief as EIS and have lower minimum subscription levels in general, so why is the sector not attracting as much capital as its close counterpart?

We speculate that (to date) investors favour EIS investments for two main reasons:

- a greater investment cap
- a wider range of tax reliefs.

The maximum amount of investment an investor can make in a year in VCTs is only one-fifth of that of EIS, so it is intuitive that the total amount of funds raised through VCTs is a fraction of that from EIS.

There are more tax reliefs offered by EIS than VCTs. In particular, loss relief is available to EIS investors so if EIS shares are disposed of at a loss, the loss can be set against other capital gains or against Income Tax in either the year of disposal or the previous year. Furthermore, EIS investments would qualify for 100% IHT relief via BPR after a holding period of two years.

VCT vs EIS

	VCT	EIS
INCOME TAX RELIEF	30%	30%
MINIMUM TERM	5 YEARS	3 YEARS
MAXIMUM ANNUAL INVESTMENT ELIGIBLE	£200,000	£1M (PLUS £1M CARRY BACK)
DIVIDENDS	TAX EXEMPT	TAXED
CAPITAL GAINS	TAX EXEMPT	TAX EXEMPT
CGT DEFERRAL	NO	YES
LOSS RELIEF	NO	YES
IHT RELIEF	NO	100% AFTER 2 YEAR HOLDING PERIOD

"For people looking for an alternative to pensions, the main benefit is that VCTs provide regular, tax free dividend income and typically the income yield offered by VCTs is 5%."

VCT ADVANTAGES

However, in light of the changes made to pension allowances and dividend taxation it is worth highlighting some of the major advantages of VCTs over EIS.

TAX FREE INCOME

For people looking for an alternative to pensions, the main benefit is that VCTs provide regular, tax free dividend income and typically the income yield offered by VCTs is 5%. Since tax free income is the main feature associated with VCT investments, virtually all managers return cash back to investors, making them an effective tool when income is your client's primary investment objective. Furthermore, given the recent changes in dividend taxation mentioned above, VCTs may become a solution for a broader range of investors. And bear in mind the point we made earlier – tax free compounding can be a powerful driver of returns.

TRANSPARENCY

VCTs are investment companies listed on the London Stock Exchange so they are obliged to report regularly. It is much easier to assess a VCT's historical performance than an EIS. For example, the AIC publishes monthly performance data on VCTs including their current prices, NAVs and total returns etc.

LIQUIDITY

The level of liquidity an investor can get from the VCT market is higher. There are several ways to realise cash from VCT investments. Many VCT managers provide a buyback facility to allow investors to sell their shares back to the manager when liquidity is needed.

In addition, there is a secondary market for VCT shares where the price is determined by supply and demand in the marketplace. Although it can sometimes be difficult to sell VCT shares on the secondary market and shares often trade at a discount to their NAV, the secondary market gives investors an opportunity to release their capital in case of emergency.

Furthermore, Limited Life VCTs, which aim to wind up and return cash to their investors soon after the five-year minimum holding period, is another form of liquidity that cannot necessarily be found so easily in the EIS market these days.

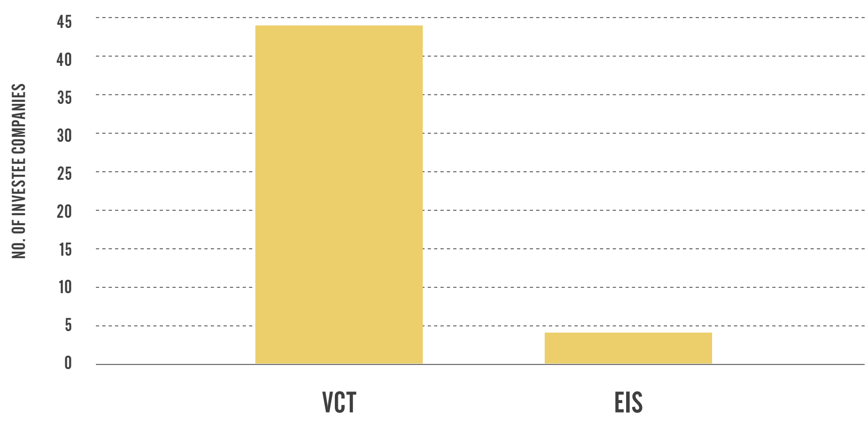
DIVERSIFICATION

VCTs' underlying investments are generally more diversified than EIS. About 90% of VCTs don't have a sector bias and invest in the General Enterprise sector, which consists of companies producing general products and services. In general VCTs also hold a greater number of investee companies than EIS. Our research reveals that the average target number of investee companies among open VCTs is 44, while it's 6 for open EIS. In particular, AIM VCTs can hold as many as 80 companies in their portfolios. It's also worth noting that VCTs can invest in debt as well as equity, and can have up to 30% of their portfolio in non-qualifying investments (typically cash and gilts). Of course these features are another source of diversification for VCTs.

"A VCT is a much larger collection of EIS companies than an EIS fund. As such, compared with an EIS, it provides greater diversification, should be more liquid, is generally larger and is listed on the main stock exchange."

– Tony Mudd, St. James's Place

AVERAGE NO. OF INVESTEE COMPANIES HELD BY OPEN OFFERS



REGULATORY UPDATE

Regulation of investments is in a bit of a holding pattern at the moment: we know that MiFID II (Markets in Financial Instruments Directive) implementation has already been postponed until 3 January 2018 to take account of 'the exceptional technical implementation challenges faced by regulators and market participants.'

On 8 December a delay to PRIIPs was confirmed by the European Council. The rules will now come into effect on 1 January 2018, and ahead of this, new guidance on the part of the rules causing the controversy is expected to be published around February 2017.

PRIIPS will require any investment structured as an Alternative Investment Fund to produce a prescriptive, three page Key Information Document (KID). The intention is to make more information transparent and available on a consistent basis so that investors can compare like with like, even across different asset classes. One possible positive is that this may have the effect of making tax-efficient investments more mainstream.

In the meantime, the UK retail investment industry has been digesting the FCA's consultation papers on the forthcoming regulations and in particular what will be designated "complex products", the rules around the disclosure of charges and the governance of product distribution. In particular it is expected that product manufacturers will need to clearly identify a potential target market and type of client whose needs, characteristics and objectives will be met by any new product.

The FCA has limited latitude in how to apply MiFID II in the UK: most of the decisions have been taken at European level. So far three consultation papers have been released, with the third published in September 2016, focusing on the everyday conduct of business rules that firms must follow. It proposes:

- new requirements for full disclosure of costs and charges
- new guidance on the responsibilities of providers for treating customers fairly
- expanding existing suitability and appropriateness requirements.

The extension of telephone recording requirements will apply to all MiFID firms and the FCA is considering applying it to financial advisers because, "based on information from the Financial Ombudsman Service the majority of complaints about investments centre on the conversations that happened when they are sold...We believe that the taping regime is a valuable means of gathering evidence in the context of market abuse and related regulatory breaches, and that these provisions are just as relevant to the activities of non-MiFID firms." (CP16/29)

The FCA is also proposing measures to essentially bring advisers and arrangers who choose to be exempt from MiFID (article 3 firms) into the regulatory regime of MiFID firms. It is required by Europe to apply "at least analagous rules" to article 3 firms and as such much of the lighter touch regime for financial advisers and corporate finance firms will disappear. Rules such as client classification and conflicts of interest will now apply equally. Additionally, a 4th MiFID II consultation paper will be released by FCA in early 2017 and the potential size of the issues to negotiate has prompted trade bodies to advise those involved to ensure they give themselves plenty of time to prepare for the 2018 implementation.

There will be a new knowledge and competence regime that requires more individuals to meet qualification and experience requirements. Advisers who only deal with professional clients, and individuals who provide information about investments without going as far as providing advice, will find that they need to do more in order to be seen as competent to undertake their role, and those not yet competent will need to be supervised.

On the advisers' side FAMR (the Financial Advice Market Review) was published in March 2016 and perhaps did not go as far as many were expecting or hoping. Much of what it recommended seemed to be further reviews and consultations, once again putting the industry into a holding pattern. However, it did propose a new definition of advice, which could clear up some of the ambiguity around "restricted" and "independent" advice and perhaps open the door to some form of simplified advice.

Finally, the FCA also carried out a thematic review of adviser due diligence, published in February. Director of life insurance and financial advice Linda Woodall said: "Research and due diligence is one of the three pillars of getting advice right", which is why we have returned to this issue. Firms clearly want to get this right and all firms, regardless of size or type, can carry out good research and due diligence. "However, there are still improvements firms need to make and we'd encourage all firms to look at our findings and ensure that they are challenging themselves to ensure they're delivering quality due diligence for their clients."

The regulator found firms of all sizes and type were able to assess the nature of the investments they recommend and their risks and benefits – the emphasis was very much that this is one of advisers' key responsibilities to their clients.

"Research and due diligence is one of the three pillars of getting advice right." – ***Linda Woodall, FCA***

We suspect that the majority of advisers operating in the alternative investment market will already have very strong procedures in place to ensure that this happens. So, overall, for once there has not been much change driven by the regulations in the market over the last 12 months – however, there is a lot of potential change hanging over both alternative investment providers and advisers in the future.

Overall however, there is little here for VCTs – and advisers who recommend them – to worry about this tax year.

CONCLUSIONS: MARKET UPDATE

The evidence suggests that VCTs certainly address the funding gap for UK SMEs, and play an important role in the funding journey of smaller companies. They've been successful in raising and deploying funds (although they are overshadowed by EIS in this respect), and most have achieved solid returns for their investors, even without considering the tax relief. More investors and advisers are considering VCTs than ever before, particularly in the light of lower limits on the amounts that can be saved in pensions.

However, this year looks like there will be a reduction in the amounts that VCTs raise. Having enjoyed several good years of fundraising many VCTs already have cash to invest. In addition, the new rule changes mean that there is a smaller pool of potential investments for VCTs to make. For these reasons, VCTs are raising less money (if they are raising at all) this year. Coupled with increased demand, this means we are witnessing a capacity crunch in the VCT market, and advisers and investors who are keen to purchase VCT shares this year will have to move fast.

Of the funds that are raising, they are all growth and income funds. The more conservative VCTs with capital preservations are constrained by the new rules.

It is also significant that there are fewer providers in the market. We've noted that it's difficult for new entrants and while we don't think this is a big issue at the moment, it is one that's worth keeping an eye on. If these conditions continue – lower levels of competition coupled with more money chasing fewer investment options – we think the balance of power in the VCT market will tilt in favour of providers over investors.

KEY POINTS

- MiFiD II and PRIIPS will now both be implemented in January 2018
- VCTs are likely to raise less money in the 2016/17 tax year than they have in the previous three years
- Despite raising less money than the EIS scheme, research from the AIC suggests that VCTs are used more widely by advisers
- Tax free income, more information on the underlying portfolio, greater levels of liquidity and greater levels of diversification are all possible benefits of VCTs when compared to EIS qualifying investments.

ADVISING ON VCTs

CONSIDERATIONS FOR ADVISERS

VCT CHARACTERISTICS

Because of their risk profile and tax benefits, VCTs are not going to be suitable for everyone. Investing in VCTs requires a relatively high level of tolerance for risk and capacity for loss and it's more suitable for investors who have maxed out their pension and ISA limits. But due to their unique features, VCTs can be used in a number of ways to suit various investment objectives. This section will take a look at the merits of investing in VCTs and issues and concerns that advisers would have when recommending VCT investments to their clients.

RISK AND RETURN: A QUICK REFRESHER

Investments into small and medium sized enterprises are always going to be deemed high risk. It is important to understand the risks associated with VCT qualifying investments in a general sense, and we will examine those risks here. However, each individual VCT investment opportunity will have its own unique risks and, therefore, each opportunity must be individually assessed.

INVESTMENT RISKS

The reasons for this include:

- They can be more reliant upon a small number of customers
- They can have less capital available to withstand a downturn in their fortunes
- They can take a long time to bring new initiatives to fruition and become profitable
- They can have very limited or no trading record and proven management history
- Where they are listed on AIM, they can experience significant share price volatility.

These risks can be offset, to some extent, by skilful stock selection and sufficient diversification, by identifying project based opportunities where outcomes are less uncertain, by investing in asset rich opportunities where the assets can provide some degree of capital protection, or by a combination of all three of these strategies.

VCTs can use gearing (borrowing money to invest), and this can magnify risks (as well as returns), although very few VCTs use much gearing.

LIQUIDITY

Although VCTs are listed investments, liquidity can still be problematic. VCTs' shares are not widely traded and they often trade at a discount to their NAV. VCT managers do offer share buyback schemes to enable divestment, but these are usually at a discount to the underlying asset value and are not guaranteed. They typically offer to buyback shares at a 5% discount.

Some VCT funds are positioned as 'limited life' or 'planned exit' and have an objective of winding up as soon after the five-year minimum holding period as possible, however this is still subject to being able to successfully dispose of the qualifying investments (without there being any arrangements in place to sell the assets from the outset).

TAX RISKS

In order to qualify for the tax reliefs, VCTs must follow a number of rules. These rules govern the types of investment that they make, how much cash they can retain within the fund and how quickly they have to deploy any funds they raise.

If the VCT were to breach any of these rules they may lose their approved status and investors would run the risk of having their tax relief withdrawn and clawed back by HMRC.

SECONDARY MARKET

It's worth considering the potential of the secondary market for shares in VCTs. A strategy of purchasing shares at a discount to NAV, locking in free tax income and hopefully tax free gains as the discount narrows, is tempting.

However, most investors (and most providers) focus on the primary market because of the Income Tax relief on offer.

Unlike EIS investments, a secondary market exists for VCT investors who want to liquidate their investment. The market also allows new investors to purchase shares in mature VCTs. However, readers should note that secondary market purchases count towards the permitted annual investment limit for Income Tax relief (even though secondary market purchases do not qualify for this relief). This means an investor cannot claim Income Tax relief on more than £200,000 worth of VCT shares a year, including both newly issued shares and secondary market purchases.

BUYING AT A DISCOUNT

Very often, demand for VCT shares on the secondary market can be low because investors prefer to subscribe to new issues to obtain the Income Tax relief. Therefore VCT shares tend to trade at a discount to the NAV of the fund.

Purchases of shares on the secondary market don't qualify for the Income Tax relief, but are still free from Income Tax and Capital Gains Tax. Therefore, an advantage of buying VCT shares at discount is that when (if) the shares start trading at a price closer to the NAV you will get a better return than the performance of the underlying assets alone, and any returns obtained will be tax free.

In addition to taking the advantage of buying at discount, another benefit of using the secondary market is that investors who want to acquire VCT shares are not tied to the timing of VCT fund raisings. The secondary market is open any time, unlike new share issues, which tend to be seasonal and only last for a certain period of time. Advisers can find information on secondary market opportunities on London Stock Exchange's website where the current price, monthly

"The purpose of buybacks is to offer exit opportunities to investors."

number of trades are recorded and published. In addition, the website also provides historical price data and archives new stories of listed VCTs. However, there are no services offering detailed commentary on the secondary VCT market and making recommendations or providing reviews (as far as we know).

BUYBACK POLICY

Most VCTs have a share buyback policy. The purpose of buybacks is to offer exit opportunities to investors. It's generally not easy to gauge the depth of the genuine secondary market for VCT shares, but it is probably safe to say that it is limited, so the buyback policy is vital for the functioning of the market. Buybacks take the form of either the VCT operating as the buyer of last resort for a market maker, or by dealing with investors directly. In fact, buybacks are probably the most common way to exit.

Buyback policy is also a way for VCTs to manage discounts on their shares. Most investment trusts offer to buy shares back at an agreed level of discount, often 5%, giving shareholders some protection if the discount is any deeper than that.

However, buybacks are not guaranteed and if lots of investors rush to exit at the same time, the policy may be suspended.

SECONDARY MARKET AND VCT PROVIDERS

The secondary market is also an effective way to achieve liquidity for VCT investors and many VCT managers support the secondary market in order to make the sector more appealing to investors. However, the merits of secondary market purchases are also underplayed by many VCT providers, who prefer to emphasise the tax advantages of buying new shares (and of course secondary market activity does little to directly help VCTs raise funds or charge fees).

TARGET BUYBACK DISCOUNT OF OPEN VCT OFFERS

	OPEN OFFERS	TARGET BUYBACK DISCOUNT
ALBION VENTURES	ALBION VCTS PROSPECT US TOP UP OFFERS	5%
AMATI	AMATI VCT 1 & 2 TOP UP (16/17 & 17/18)	5%
CALCULUS CAPITAL	CALCULUS CAPITAL VCT PLC (17/18) – SHARE OFFER	NO GREATER THAN 10%
DOWNING	DOWNING FOUR VCT PLC – GENERALIST SHARE CLASS	0% BUYBACK DISCOUNT
DOWNING	DOWNING FOUR VCT PLC – HEALTHCARE SHARE CLASS	0% BUYBACK DISCOUNT
FORESIGHT	FORESIGHT SOLAR & INFRASTRUCTURE VCT	10%
FORESIGHT	FORESIGHT VCT	10%
HARGREAVE HALE	HARGREAVE HALE AIM VCT 1 & 2 (16/17 & 17/18)	5%
OCTOPUS	OCTOPUS APOLLO VCT PLC	5%
OCTOPUS	OCTOPUS TITAN VCT (16/17)	UP TO 5%
PEMBROKE	PEMBROKE VCT B SHARE (16/17)	NO MORE THAN 5%
PROVEN	PROVEN GROWTH & INCOME VCT (16/17 & 17/18)	UP TO 5%
TRIPLE POINT	TRIPLE POINT INCOME VCT – E SHARES	10%

STATISTICS ON SECONDARY MARKET

	APR	MAY	JUN	JUL	AUG	SEPT	OCT	NOV
AVG VALUE TRADED (£)	186,297.24	93,005.65	126,655.99	117,647.41	83,464.81	186,276.95	114,828.28	117,081.06
AVG VOLUME	266,897	14,4710	201,211	167,936	124,287	272,697	201,370	197,166
AVG TRADES	14	17	11	10	11	12	11	12

This table presents some statistics on the trading activity of VCTs on the secondary market from the beginning of the 2016 tax year to present. Clearly, the scale of the VCT secondary market is not comparable to that of mainstream assets. For example, the number of trades in a month is less than 20 on average for VCTs, whereas a company share can trade tens or hundreds of thousands times over a month. Therefore, advisers should note that there is a limitation on how many VCT shares can be bought or sold on the secondary market at one time, and more importantly how much liquidity can be archived from there.

CLIENT CASE STUDIES

SOME FINANCIAL PLANNING IDEAS

INCOME TAX REDUCER

VCT investors are potentially able to claim a reduction in their Income Tax bill of 30% of the cost of the VCT shares they have purchased, up to the permitted maximum of £200,000 worth of shares in any tax year. The reduction will be applied to the investor's Income Tax bill in the same tax year as the shares were issued. For example, a client who purchased £200,000 of VCT shares would be entitled to claim up to the maximum £60,000 of Income Tax relief (£200,000 x 30%).

Some important points to note:

Firstly, an investor's overall Income Tax liability cannot be negative (i.e. it is not possible to claim relief on tax that hasn't been paid or isn't due to be paid). If the client in the example above only paid £30,000 of Income Tax, £30,000 of that potential relief would be lost (£60,000 - £30,000). In this case the client could instead have invested £100,000 in VCT shares and reduced their Income Tax bill to zero.

Secondly, the minimum holding period to retain the Income Tax relief is five years. If an investor was to dispose of their shares prior to the end of the five-year period, HMRC will clawback the Income Tax relief. HMRC will clawback Income Tax relief by raising a special assessment for the tax year in which the relief was obtained.

Note: Transferring the shares to a spouse or civil partner within the five-year period would not trigger a clawback of Income Tax relief, but transferring the shares to any other third party would do so. There is no clawback if the disposal or transfer is a result of the investor's death.

To qualify for Income Tax relief the client must subscribe, pay for and be issued brand new shares in a VCT. Secondary purchases, either purchased on an exchange or arranged privately, do not qualify for Income Tax relief.

TAX FREE INCOME

Dividends issued by VCTs are exempt from Income Tax and investors who receive exempt dividends do not have to show them on their tax returns. There is no minimum holding period for this relief, and it applies to both subscriptions for newly issued shares and purchases of shares in the secondary market. However, the exemption from income tax on dividends is subject to the permitted maximum.

A client with a £250,000 portfolio of VCTs that yielded 7% would be entitled to £17,500 tax free income annually (provided that no more than £200,000 of VCT shares had been purchased in any single tax year).

TAX FREE GROWTH (DISPOSAL RELIEF)

Disposals of VCT shares are not subject to Capital Gains Tax. There is no minimum holding period for this relief, and it applies to both subscriptions for newly issued shares and purchases of shares in the secondary market. However, disposal relief is subject to the permitted maximum.

Assume a client purchases £50,000 of VCT shares and then sells them for £75,000 six years later. Conventional shares would have attracted £5,000 CGT (ignoring any annual allowances), but shares in VCTs are CGT exempt.

However, losses made on disposals of VCTs cannot be used to offset gains made elsewhere when calculating an investor's total annual CGT liability.

DEFINITIONS

Share price: The price you actually buy and sell at

Net asset value of a share (NAV): The value of all the investment company's assets, less any liabilities it has, divided by the number of shares. Share price can deviate from the NAV as investment company shares are traded on a stock market, so at any point in time share price is determined by the buying and selling activities on the market at that point. The difference between share price and NAV is known as a discount or premium

Discount: Buying shares at a price less than the NAV

Premium: Buying shares at a price more than the NAV

DUE DILIGENCE & SUITABILITY

ISSUES TO CONSIDER

The FCA's thematic review of February 2016 focused on due diligence and, as well as understanding the nature of the investment and the risks and benefits, the regulator stressed the importance of assessing the provider to establish whether it's appropriate to entrust them with client assets. So instead of the usual due diligence requirements (see previous reports), this year we'll look at some specific items to examine.

Examining the product provider doesn't just mean considering its size and strength, the levels of assets under management and market share. Recent adjustments to qualifying trades and legislative shifts towards growth capital mean that past performance may be a less relevant measure of a manager's skill. If their experience is in a field that has now been removed from VCT eligibility, such as renewables or management buy outs, or if they have turned to growth capital but have few investment credentials in that area, advisers need to know.

Involvement with growth capital investments generally requires a close working relationship between the investee company and the VCT. The manager should positively influence and oversee the development of the investee and this should be part of the terms of the deal – for example, the manager might insist upon a seat on the board.

The manager's past experience is also likely to govern its access to deals and the sectors in which it has consistent deal flow. Bearing in mind the predicted supply and demand imbalances, advisers must be satisfied that managers are in a position to quickly and sensibly deploy all of the funds they raise. Deals made that are outside of the manager's normal risk parameters or investment mandate should raise a red flag. Cash drag, under diversification, overpaying just to get a deal and higher risk profiles are all possible consequences of unsatisfactory deal flow.

Specialist independent research and reviews are available to assist advisers. But advisers must not overly rely on these resources. FCA rules stipulate advisers need to be confident that the underlying processes third party researchers use are sufficiently strong and robust enough for compliant advice. Independent research should be used as a tool that highlights potential areas of concern, allows advisers to make meaningful comparisons and saves time. The adviser is then left to come to their own conclusions about the product/manager, and to undertake their own additional research where they feel it necessary.

The FCA rules on suitability reports, recently reiterated in the Financial Advice Market Review report, require that they:

- Specify the client's demands and needs;
- Explain why the firm has concluded that the recommended transaction is suitable for the client having regard to the information provided by the client; and
- Explain any possible disadvantages of the transaction for the client.

Since investment in SMEs and young companies is considered high risk by the regulator and the FOS because of the potential for failure being higher than larger companies, VCT suitability reports must reflect this, no matter what mitigations are in place. Good research and due diligence held on file provide evidence of why the product has been recommended as the most suitable for the client.

For clients with an attitude to risk at the lowest end of the spectrum, there is little prospect of justification of a recommendation of VCT. However, some with lower attitudes to risk but also an identifiable need for tax mitigation may be deemed suitable provided the case is clearly made as part of the suitability assessment. This will include full details of the client's tax position, including tax calculations showing the current position and the forecast benefits after the tax reliefs are obtained. Information that the tax reliefs can be withdrawn as well as an awareness from the client that it is possible to lose capital invested should also be provided in writing and be part of the suitability file.

For this reason, it should be demonstrated that suitable investors have surplus capital to maintain their standard of living without the funds earmarked for VCT investment. This means a full record of the client's existing assets to show what capital is available and the status of the client's portfolio prior to the recommendation. And, because of the statutory holding period to qualify for the tax reliefs, there should be no requirement for income or access to their funds during the term of the investment as well as an understanding that even after the expiry of the five-year period, there may still be a substantial element of illiquidity, or that the client will have to sell shares at a discount to the NAV.

TYPES OF VCT

PROS AND CONS

Although all VCTs have the same structure and their investments are governed by the same rules, there are many different types of VCT with different objectives and different risk and return profiles. In this section we'll look at four main types of VCT.

	PROS	CONS
GENERALIST VCTs: Predominantly investing in unquoted companies (excluding companies on AIM) across a broad range of sectors.	• More influence on investee companies	• Lower liquidity
AIM VCTs: Predominantly investing in companies issuing shares on AIM (Alternative Investment Market).	• Greater liquidity • High diversification • Publicly available information on investee companies	• Managers are not the dominant shareholder
SPECIALIST VCTs: Predominantly investing in a specialist sector, for example technology or healthcare.	• Specialist skills and technical knowledge	• Can be less diversified
LIMITED LIFE VCTs (PLANNED EXIT): Predominantly investing in lower risk assets with a view to winding the VCT up as soon after the minimum holding period as possible to qualify for the Income Tax relief.	• Exit shortly after qualifying holding period is over • Liquidity from a different perspective	• Potentially lower returns yield due to debt investment

OVERCOMING THE PII OBJECTION

PII OBJECTION IN FOCUS

When advisers start to recommend VCTs for the first time, they must notify their current Professional Indemnity Insurance (PII) providers and make sure their cover is appropriate. If they don't include VCT advice in their range of services an IFA cannot remain independent; there's no exemption from the requirement for IFAs to consider all products simply because they cannot obtain cover. Higher premiums making cover unaffordable or the total lack of suitable cover would leave an adviser with two options: self-insurance or to become a restricted adviser.

The FCA is aware of the current problems which smaller firms experience in obtaining adequate PII at an affordable price. According to some insurers, this is because the potential total premiums in the market for PII for personal investment firms may be significantly less than the sector's total annual redress liabilities. As a possible contributor to barriers to firms entering the advice market, as something which is harmful to competition and the robustness of firms, and something that leads to greater reliance on the FSCS, the FCA is considering whether to look further at the professional indemnity insurance (PII) market in relation to the suitability and availability of cover for smaller advice firms.

There are pros and cons to all VCTs:

- The FCA has focused on adviser due diligence in 2016, and it is arguable that more due diligence is required for alternative investments such as VCTs
- Many VCT managers offer a buyback service, typically at a 5% discount to NAV, providing an exit for investors
- There is a secondary market in shares in VCTs, and there may be some benefits to making purchases on the secondary market. However, secondary market purchases do not qualify for Income Tax relief.

CONCLUSIONS: ADVISING ON VCTs

According to our survey (see the following section) many advisers are using VCTs. However, by their very nature, they are unlikely to be something advisers are recommending week in, week out for their clients. They are only used with the right clients, in the right circumstances: for investment and tax planning purposes.

This in itself presents advisers with a challenge: deemed as risky investments, advisers need to spend more time and take more care with VCTs, even though they, for most advisers, only represent a small portion of business. And as we mentioned earlier, demand for VCTs is likely to exceed supply this year, and advisers need to move fast to invest in opportunities they favour. We think that means starting research into the market early, identifying suitable options and completing due diligence, forming an investment panel or a shortlist and then starting the conversation with suitable clients. This might seem like a lot of work for what will be a small amount of total assets under advice, but we think it is an area where advisers are able to demonstrate a lot of added value.

In short, advisers need to be clear in their minds about the value they can add for their clients by investing in alternatives and saving tax, something clients are less likely to be able to do for themselves.

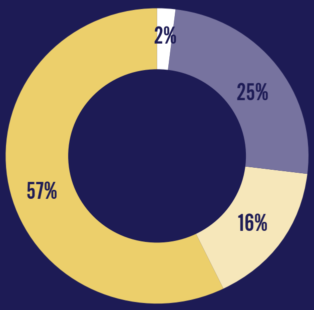
MARKET RESEARCH

ADVISER SURVEY

VIEWS FROM ADVISERS AND KEY STAKEHOLDERS

We gather the thoughts and opinions of advisers here, and this year we had responses from 124 advisers. Note that there is some bias in these results as in many cases the advisers we reach out to are already involved in tax efficient investments.

DO YOU RECOMMEND VCTs TO YOUR CLIENTS?



- FREQUENTLY
- NEVER
- SOMETIMES
- NO RESPONSE

82% of advisers surveyed stated that they do recommend VCTs to their clients. This is significantly higher than last year's finding of 67%. A quarter of them recommend VCTs frequently. 16% have never used the product for their clients, a reduction from last year's figure (23%). Overall, it seems clear from our survey results that there is an increasing proportion of advisers using VCTs to achieve their clients' investment and tax planning objectives.

WHAT ARE YOUR TOP 3 REASONS TO RECOMMEND VCTs?

- 72% TAX PLANNING (NON IHT)
- 48% INCOME
- 30% GROWTH
- 10% IHT PLANNING
- 8% EXPOSURE TO A SPECIFIC SECTOR
- 3% POSITIVE SOCIAL IMPACT
- 2% OTHER

Advisers were asked to pick their top three reasons for recommending VCTs. (Note: advisers weren't given the option to rank their choices). The most common reason cited by advisers for recommending VCTs, unsurprisingly, is Non-IHT Tax Planning. Generating tax-free dividend income is the second most common reason, which was stated by nearly half of all advisers surveyed. Only 30% of advisers cited Growth as one of their top three reasons, but this is still higher than last year's 20%. Other responses barely got a look in.

WHAT ARE YOUR TOP 3 CRITERIA WHEN SELECTING A VCT INVESTMENT?

- 58% PROVIDER REPUTATION
- 53% PERFORMANCE HISTORY
- 49% TRANSPARENCY OF UNDERLYING ASSETS
- 38% THIRD PARTY REVIEWS
- 31% PREVIOUS EXPERIENCE WITH PROVIDER
- 10% INVESTMENT PROCESS
- 1% OTHER

Similar to the results for other tax efficient investments, provider reputation is the most cited selection criterion, ticked by 58% of advisers surveyed, which is more than double last year's figure. Performance history is the second most cited criterion (53%). From the top two criteria selected we can conclude that quality of a provider is the most crucial factor for advisers when choosing a VCT.

Transparency of underlying investments and third party reviews are other important criteria, cited by 49% and 38% of advisers, respectively. Compared to last year's results the proportion of advisers who stated previous experience with provider has increased to 31% from 21%, showing more advisers are relying on providers they have worked with, perhaps through other investment vehicles. Clearly, providers with a greater product range and market influence have an advantage.

"Seven in 10 advisers believe that VCTs can coexist alongside ISA and pension as they offer additional benefits, such as diversification and ability to achieve higher returns."

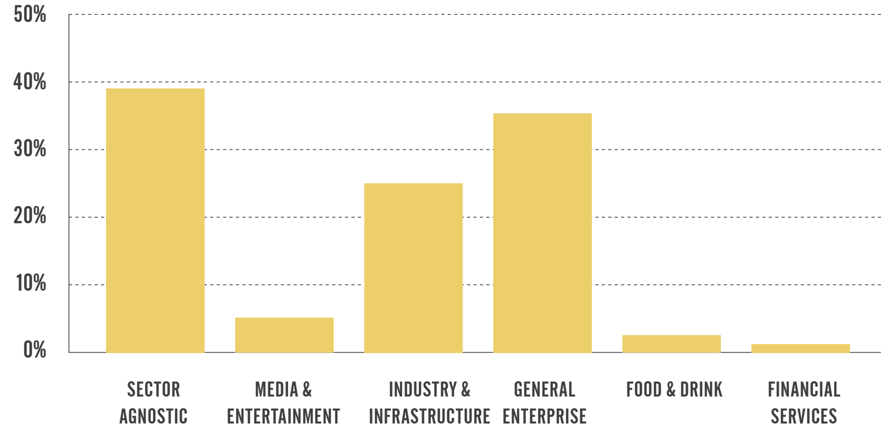
WHAT ARE YOUR TOP 3 CONCERNS WHEN SELECTING A VCT INVESTMENT?

- **55%** INVESTMENT RISK
- **40%** COMPLIANCE & DUE DILIGENCE
- **39%** LACK OF LIQUIDITY
- **35%** EXIT RISK
- **25%** SUITABILITY
- **17%** LACK OF TRANSPARENCY
- **9%** HMRC CHALLENGE
- **7%** NO TRACK RECORD
- **6%** OTHER

Over half of advisers cited investment risk as one of their top three concerns with VCT investments. This figure is a lot lower than last year's 90%, perhaps showing there has been improvement in advisers' understanding of the asset class. Compliance & due diligence (40%) and lack of liquidity (39%) are the second and third top concerns; both figures are higher than last year. This may be linked to the FCA's 2016 thematic review, which highlighted its concerns with adviser due diligence. Suitability (another issue on the FCA's current agenda) is also a key concern.

Only 17% of advisers surveyed felt uncomfortable with lack of transparency in the VCT market, despite the result for the previous question, where 49% of advisers picked transparency of underlying investments as a selection criterion.

WHAT ARE YOUR PREFERRED SECTORS WHEN SELECTING A VCT INVESTMENT?

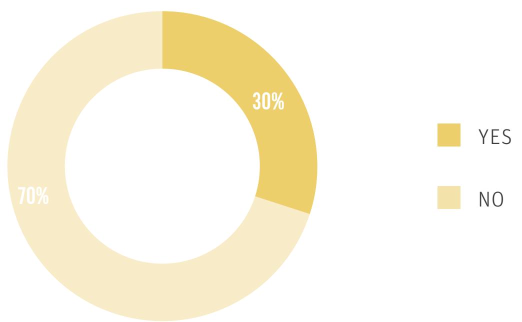


Most advisers are sector agnostic (39%), which may indicate that advisers recognise providers' ability to choose the right investments across sectors. 35% of advisers surveyed prefer investments in the General Enterprise sector, which covers products and services from various industries without bias (and therefore is pretty much the same as being sector agnostic).

Industry & Infrastructure is the most cited specialised sector by advisers. We can speculate that advisers who are particularly concerned about investment risk would give higher preference to investments that can preserve capital and the 'asset-backed' nature of investments in Industry & Infrastructure could suit their needs. 55% of advisers who favour Industry & Infrastructure also indicated that Investment Risk is one of their top three concerns.

Readers will find in the next section that VCTs launched in 2016 seamlessly match with advisers' preference, with most of them investing in the General Enterprise sector, and the rest in Industry & Infrastructure and Renewable Energy.

ARE VCT INVESTMENTS ONLY APPROPRIATE ONCE BOTH ISA AND PENSION LIMITS HAVE BEEN MAXIMISED?



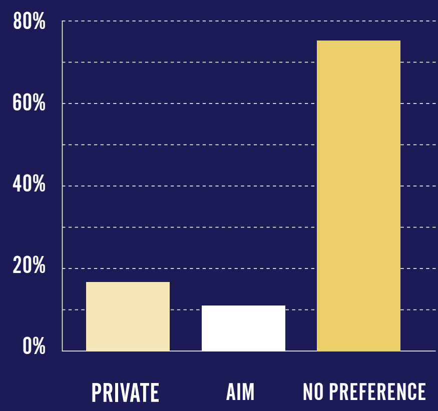
Three in 10 advisers agree with the statement that VCT investments are only appropriate once both ISA and pension limits have been maximised, while the majority believe that VCTs can coexist alongside ISAs and pensions as they offer additional benefits, such as diversification and ability to achieve higher returns.

"64% of advisers believe that they will be using more VCT investments for their clients' financial planning in the next two years."

DO YOU SEE YOUR USE OF VCTs INCREASING OR DECREASING OVER THE NEXT TWO YEARS?

64% of advisers believe that they will be using more VCT investments for their clients' financial planning in the next two years; the figure is double last year's 33%, showing the increasing popularity of VCT investments. Although 7% of advisers indicated that they would decrease their use of VCTs, this is lower than last year's finding of 9%.

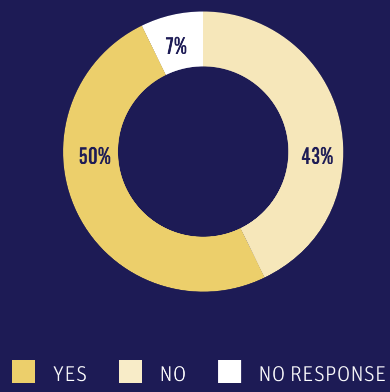
WHAT ARE YOUR PREFERRED SECTORS WHEN SELECTING A VCT INVESTMENT?



Of those advisers who recommend VCT investments to their clients, 72% have no preference with regard to investee company type. Private company VCTs are more popular among advisers who expressed a preference.

11% of advisers prefer AIM VCTs and we noted that 75% of advisers in this group highlighted lack of liquidity as one of their top concerns. This may suggest that advisers who need a greater level of liquidity are more likely to consider AIM based VCTs. In contrast, among advisers who prefer private company VCTs only 23% stated lack of liquidity as a concern.

ARE ONLY HNW/SOPHISTICATED CLIENTS SUITABLE FOR VCT INVESTMENTS?



This question continues to split advisers. Half of the advisers who recommend VCTs think that they are only suitable for HNW clients (slightly lower than last year's 56%).

43% believe VCT investments can be suitable for ordinary retail investors and, looking more deeply into the data, one third of advisers in this group recommend VCT investments frequently to their clients. In addition, over half see their use of VCTs increasing in the next two years. Hence, we can see that the asset class is gradually becoming more recognised and more common among ordinary retail investors, although the capacity crunch we are experiencing may put the brakes on this.

Interestingly, minimum subscription levels are lower this year which may show that VCT providers are responding to this notion.

In addition to the questions above, we have also asked advisers to provide general comments on the market. The 10 most frequently requested changes by advisers are listed on the right.

To be honest, none of these ideas strike us as unreasonable. We also think that a great deal of progress has been made on many of these issues over the last few years. But there is still room for improvement.

- LOWER CHARGES
- MORE TRANSPARENCY
- EASIER TO RESEARCH AND FOLLOW
- CLARITY ON SALE OF ASSET
- CONSISTENT CONTENT FOR COMPARISON
- EXIT TRACK RECORD
- MORE PROVISION (MORE CAPACITY)
- MORE DUE DILIGENCE INFORMATION
- MORE SECTORS
- FEWER SEASONAL OFFERS

ADVISER ROUNDTABLE

INSIGHTS FROM ADVISERS

MODERATOR: **DAN KIERNAN** INTELLIGENT PARTNERSHIP

We held a roundtable discussion with a handful of experienced advisers and investment professionals who use VCTs, to get a more qualitative view of how advisers perceive the VCT market.

ATTENDEES

CHRISTOPHER GREEN
ST JAMES'S PLACE

MATTHEW WOODBRIDGE
BARCLAYS WEALTH MANAGEMENT

FAISAL SHEIKH
MONMOUTH CAPITAL

DAN KIERNAN
INTELLIGENT PARTNERSHIP

FIRSTLY, WHAT SORT OF CLIENTS DO YOU USE VCTS WITH, AND WHAT SORT OF INVESTMENT OBJECTIVES ARE YOU TRYING TO ACHIEVE? WHAT'S THE PRIMARY DRIVER FOR USE OF VCTS, IS IT DIFFERENT FOR DIFFERENT CLIENTS?

● We are focused on our Private Bank customers who are typically High Net Worth individuals who have maximised their pension contributions and therefore are looking for a tax-efficient alternative with strong investment performance.

● We're very similar. Most of our VCTs are for people that for one reason or another are either capped or have just got lifetime allowance problems. They're people who are retirement planning. VCTs, with the tax relief and the tax free dividends, can give clients what I think is an incredibly effective retirement plan – provided obviously that they can accept the risk that comes with VCTs. So that's our main group now. It has changed, it used to be people that were just tax planning, but now, because of the £40,000 and even in a lot of cases £10,000 contribution limit on pensions, people are running out of the ability to contribute to them so VCTs very nicely address that.

● High net worth entrepreneurs are our typical client base anyway, and as a rule, we don't discuss VCTs with clients that have not signed a self-certified sophisticated investor statement or a high net worth investor statement. In terms of the investment objectives or the objectives for using VCT, it's quite often for diversification, and as part of sensible tax planning.

HAS YOUR USE OF VCTS CHANGED OVER THE LAST TWO TO THREE YEARS? ARE YOU USING MORE OR LESS VCTS, OR ARE YOU USING VCTS FOR DIFFERENT REASONS? WHAT HAS BEEN THE DRIVING FORCE BEHIND ANY CHANGE?

● Yes. It's going up significantly year on year at the moment. And as long as the Government continue to tinker with the rules on pensions, given what I've already said, I think yes it will continue to increase.

● Yes, for us the big change, probably the same as for everybody else, has been pension changes and the lower limits on what can be saved into pensions. So we're using VCTs more often now. It's also been down to increased awareness and adviser training as well though. We've put a significant amount of time and effort into educating our advisers about VCTs, and they are now more confident about recommending them.

● While we acknowledge the reduction in annual pension contribution limits for top rate taxpayers, we do not see this is as a sufficient reason to allocate more to VCTs and so our usage is more or less unchanged. The nature of the underlying investments in VCTs compared to what is typically the case with pensions is very different. Furthermore, with a tightening of the rules on qualifying companies to encourage VCTs to deploy genuine growth capital, in our view it is more important than ever to consider allocation to VCT primarily in the context of investment objectives, rather than focussing too much on tax reliefs.

WHAT ARE THE BIGGEST RISKS WITH VCTS IN YOUR VIEW? HOW MUCH DO THESE RISKS CONCERN YOU, AND HOW DO YOU QUANTIFY AND EXPLAIN THEM TO CLIENTS? DO YOU HAVE ANY STRATEGIES TO MITIGATE THE RISKS?

● Changes to the rules on the tax relief is a risk. Not just in terms of potential change to the rules, but also in terms of how the managers cope with any changes, and how advisers can assess the managers' strategy if there is no meaningful track record. They may have invested on one basis, last year, but now rules have changed and your money is deployed into different strategies this year...

CHRISTOPHER GREEN

MATTHEW WOODBRIDGE

FAISAL SHEIKH

DAN KIERNAN

Liquidity is another big risk; there is only limited scope for buy backs, so the question is what happens if everybody tries to liquidate in a downturn? These are some of the biggest risks we see and focus upon in the VCT sector.

● I think it's really vital with the VCTs that people understand that they are stepping away to a great extent from what they would normally think of as conventional investment – a bond or unit trust or ISA. I think it's really critical they understand that they have moved into a new arena. And I appreciate that some of the very big VCT funds, the likes of Octopus, they reduce risk and volatility by experience and size, and also by their stock picking. But nonetheless it wouldn't take much for VCTs' performance to start disappointing people if they haven't fully been made aware that this is not like a managed fund.

And that's what does worry me about the way that some of them are being sold. They're being sold off the back of tax relief, tax free dividends and tax free growth. Well it might suddenly appear to be a little bit unwise if the VCT involved suddenly tanks and the [investors] haven't been put in a position of really understanding that they've moved into a sophisticated investment area.

So we do try and make as much effort as possible to really research the companies we're going into. And we aim to demonstrate in really practical terms, in both our documentation and in discussions when we're sitting with the client, to make sure they appreciate that this is a risky investment in the true sense of the word. But we do everything we can to mitigate as much of that risk as we can by our recommendation and with diversification at our end as well.

● Liquidity mismatch. Although VCTs are listed, there is no genuine liquid secondary market for most of them. Clients must remain in control of how and when they realise these investments and avoid being in the position of a forced seller.

HAS YOUR PERCEPTION OF THE RISKS INVOLVED CHANGED SINCE LAST YEAR'S BUDGET WHICH INTRODUCED TIGHTER RULES FOR VCTS, WITH A RENEWED EMPHASIS ON GROWTH COMPANIES AND EARLIER STAGE INVESTING?

● It has increased the relative attractiveness of certain VCTs which happen to have exposure to an existing set of investments which pre-date the rule changes. They can therefore offer a slightly different risk profile to those entirely caught by the new rules.

● Obviously when the new rules were first thrown at us it was, oh dear, are we almost trying to kill this sector off by legislation? But actually again, talking to the providers we use, they have all taken very good and reasonable steps to make sure that as far as is possible they've taken on board the new rules and kept the risk as low as is possible.

I think in a way it's a good thing in as much as it's obviously a risk loaded investment anyway, so the message hasn't changed. It's kind of like talking to a client about exactly the same thing but just with a new set of rules. We haven't changed what we stress to clients, that this is a potentially volatile investment.

HOW MANY VCT MANAGERS DO YOU TYPICALLY WORK WITH? WHAT ARE YOU LOOKING FOR IN A MANAGER, AND WHAT DO YOU THINK THEY COULD DO BETTER?

● We work with a small number of what we regard as high quality managers. We're not looking for just a representative sample of the market; what we want to do is to take a view on, for example, their investment strategy, their track record, size and experience of the team and then select those who we think are the very best and who fit our needs.

● I think certainly from the point of view of the bigger providers we're quite happy with what they do, we like the way they approach potential investment opportunities and we look for them to really have good ongoing contact with the companies that they're investing in. And to do proper research, because again, and this possibly applies more to the EIS world rather than the VCT world, we did get feelings some providers were almost just looking around at what the competition were doing and then finding similar start-up companies and throwing those the money in the hope that it could be the same as something that happened a year ago. That might be an unfair criticism but that's how we felt about some of them.

I don't think that, certainly for the companies that we use on the VCT world, I don't think that's an issue. I think they are doing good ongoing due diligence and they are having a proper relationship with the investee companies which is why there's been an awful lot of successes. And also I think maybe the timescale of VCTs lends itself to investment much better, because they're not looking to turn a quick profit. They're able to say well, look, we got a five or six year run on this as opposed to the EIS world which is well, we know we're going to have people banging on the door after three years and one week, looking to get their money out.

So there's nothing particular that I would want to change, certainly for the companies we use. We don't use literally the whole of the market, because I think there's too many very small providers out there and we tend to try and stick to

*"Talking to the providers we use, they have all taken very good and reasonable steps to make sure that as far as is possible they've taken on board the new rules and kept the risk as low as is possible." – **Christopher Green, St James's Place***

the bigger ones because, whilst track records aren't everything, you can judge a lot by the successes and failures that they've had. Sometimes a pattern emerges and you think well, maybe some of the successes are built on pure luck whereas the failures tend to represent the fact that they're not doing their job properly. So rather than spend lots and lots of time talking to them, we'd move away from them and what we're really looking at is good, solid, strong investment strategies over that medium to long term.

● Key considerations for us include a long and consistent track record; a history of executing investment strategy as planned without too much deviation or pivoting – so, we don't like to see managers who used to be doing one thing, say, early stage tech investing, and now they're also doing other sectors. There needs to be a strong rationale for that.

We need to see strong governance and adherence to industry standards of disclosure. They need to have a commitment to proactive and clear client communications.

● In terms of what could be done better, I think they could communicate with investors better - for example around the timing of share allotments, and information on mergers and what they mean for clients. When there are proposed VCT mergers, clients are sent large complicated documents through the post that are not user-friendly. I would also like to see better communication on performance for investors.

HOW HAVE YOU FOUND THE ADMINISTRATION OF VCT INVESTING? HAS COORDINATING THE VARIOUS FORMS TO CLAIM THE RELIEFS BEEN CHALLENGING? HAVE YOU ENCOUNTERED ANY ISSUES WITH THE TIMING?

● I think it is much better and easier then EIS, but there are still issues with timing and communication as stated above.

● It's fine for us because we're quite a specialised business in the sense that we're a wealth manager looking after entrepreneurs that generally have a net worth of over £3 million. We have a relatively small number of clients that we look after on a very bespoke basis.

OUR PREVIOUS MARKET RESEARCH HAS INDICATED THAT ACCURATELY QUANTIFYING RISK, CHARGES AND PERFORMANCE (BOTH PRIOR TO INVESTMENT AND ON AN ONGOING BASIS) HAS BEEN A CHALLENGE FOR ADVISERS. WHAT ARE YOUR THOUGHTS ON THESE ISSUES?

● Well, charges are difficult to understand, the managers need to explain what they are charging for and why the charges are high relative to other investments. And there is also wide dispersion of charging structures. It can be hard to make comparisons.

On explaining the risks, some managers are very good – they might include examples that show that performance can be lumpy, where the investor may not get a dividend for three years and then get a large one in year four, so don't invest if your requirement is for annual income. Those kinds of examples are great, but some managers just place a list of generic risks in the back of the brochure, which is not so helpful.

LOOKING AHEAD, WHAT CHANGES WOULD YOU LIKE TO SEE IN THE VCT MARKET? DO YOU HAVE ANY CONCERNS FOR THE FUTURE, AND HOW DO YOU SEE YOUR OWN USE OF VCT CHANGING OVER THE NEXT 12 MONTHS?

● I would like to see a period of no more rule changes! A period of stability would be very welcome.

One issue that I do have is that it's a difficult market to break into. There are big barriers to entry, and it prevents competition.

● I agree with Matthew about rule changes. I should emphasise that we support the tenor of the changes both to VCT and EIS schemes, in terms of attempting to direct more genuine growth capital into smaller companies, rather than some of the rather contrived situations we have seen in the past. However, a period of stability would be welcome.

● I don't foresee any particular clouds on the horizon, I'm reasonably positive. From the point of view of the VCT world I think we've got some really good managers out there. I think there are… from talking to them and seeing what they're doing there's plenty of good opportunities, they just need the people on board to make sure they find them and then do the deals. So I'm really quite positive about the VCT market and have been for a couple of years now, they're really strong. I see it as a serious move forward, particularly in the high net worth world.

The Government – via legislation – have forced us all to look at other [tax efficient] avenues, and actually what a lot of us have done is discover this world that we used to dip into now and then for the odd speculative investor, but we didn't have it on top of our list. Whereas now, allowing for the client understanding and being able to take the risk, I think we've got a big business opportunity in VCTs.

THANK YOU FOR YOUR TIME AND FOR SHARING YOUR THOUGHTS WITH US.

INDUSTRY ROUNDTABLE

MARKET DISCUSSION

MODERATOR: DAN KIERNAN INTELLIGENT PARTNERSHIP

ATTENDEES

SHANE ELLIOTT
BERINGEA, FOR PROVEN VCTs

JOHN GLENCROSS
CALCULUS CAPITAL

KOSTAS MANOLIS
DOWNING

STUART LEWIS
OCTOPUS INVESTMENTS

ANDREW WOLFSON
PEMBROKE VCT

DAN KIERNAN
INTELLIGENT PARTNERSHIP

We held a roundtable discussion with a handful of fund managers who run VCTs to get their views on the current and future state of play within VCTs.

HOW HAVE THE LAST 12 MONTHS BEEN FOR YOUR FIRM? HAS BUSINESS BEEN GOOD? WHERE HAVE YOU SEEN INFLOWS COMING FROM, AND HAS THIS CHANGED FROM PREVIOUS YEARS AT ALL?

● We have seen strong investor inflows to our Calculus EIS and VCT funds; in particular we have seen an increase into our VCT which we feel reflects the changes in pension regulation and increase in appetite for tax efficient investing and specifically VCTs. We receive inflows from direct investors as well as advised investors and I wouldn't say the split has changed dramatically from previous years.

Portfolio company deal flow continues to be consistent despite Brexit and other factors. In 2016 we saw over 500 deals come through the door, totalling over £1.4bn in value. So we're very happy with how things have gone over the last 12 months.

● We've had a good year. It is very difficult to get into the generalist VCT market and we were the first new one in 10 years when we launched four years ago. We now have the required presence to raise significant funds.

Certainly the tailwinds at the moment are in our favour in terms of demand and supply, and we've engaged with Kin Capital, who were with us last year, to act as promoter. They are introducing us to a lot more of the IFAs and we're now doing conferences, events and we're getting out there a little bit more rather than relying on high net worth wealth managers. We are getting involved more with the IFA market and the more traditional VCT investors, and we feel we've got a very credible story to tell those people.

● Well, it's been a record year for fundraising into our VCTs – we managed to raise over 30% of the VCT market in the 2015/16 tax year. We continue to see adviser interest in VCTs grow, driven by a number of factors. Policy changes around pensions and buy-to-let have led to an increased appetite for complementary retirement planning options. This increased interest from advisers led to an industry record fundraise of £100 million into Octopus Titan VCT. As a business, we are big believers in the value of financial advice and the mix of our VCT inflows continues to reflect this.

I must also say that we saw very strong investment performance over the last 12 months, including a number of high profile portfolio company exits to industry heavyweights such as Microsoft and Twitter. The growth of our portfolio companies has led to strong demand for follow on funding from the 50 companies already in Titan – hence the big fundraising again this year. So all in all a very positive year!

● It's been a very strong year for the Proven VCTs and Beringea. We have made six new investments, seven follow ons, and exited seven businesses. The IRR on equity investment exits was 46%, and 12.5% on venture debt exits.

Dealflow has been consistently up two times on last year, we believe in large part due to stronger PR and marketing efforts and an expanding team. Approximately 40% of deals seen in 2016 came from corporate finance, which is somewhat different from the last few years, where we saw a stronger skew from direct introductions and other VCs.

The remaining 60% of dealflow comes from various sources, including direct, other VCs and portfolio companies.

● 2016 was a good year for new business for Downing, with a number of new initiatives being launched and excellent fund-raising into our established products. Given the recent changes in VCT/EIS investment rules we decided to restrict

"Given we have been growth cap investors since inception, our investment strategy hasn't really been impacted by the new rules." – **Shane Elliott, Beringea**

fundraising in these areas to ensure a realistic deployment programme in line with deal flow. Downing will only raise funds for which deal pipeline is evident, so we feel that we've been sensible in that area. Our inflows have been coming from Downing's established and widening support base of IFAs. We feel we've been sensible, and we're positive about the outlook for the future.

WHAT CHALLENGES HAVE YOU BEEN RESPONDING TO AND WHAT CHANGES HAVE YOU MADE TO YOUR BUSINESS? HOW DO YOU SEE THE 2016/17 "FUNDRAISING SEASON" GOING? HOW ARE YOU POSITIONING YOURSELF FOR THE NEXT 2–3 YEARS?

● Of course the primary challenge has been the changes to VCT/EIS investment rules as I just mentioned. This has required a change of focus on the investment front and the recruitment of additional team members to help drive this development. But interestingly, in that context, the 2016/17 "fundraising season" looks very promising for VCTs as the impact of ongoing restrictions to pension funding have driven investors to look at alternative tax-efficient products to help fill the gap. VCTs can fit well as a supplement to restricted pension funding.

● Yes, following changes to the VCT rules, we have had to turn down some businesses looking for funding, although this has been limited and doesn't seem to have impacted our ability to put money to work. More importantly, we have doubled the size of the investment team in the last 18 months, including adding more junior resources to allow the senior partners to close more deals.

We have made strong, consistent returns by investing in growth businesses, which means slightly later stage than true venture, and we intend to stick to our knitting for the next 2–3 years. In fact fundraising for 2016/17 has been our strongest to date.

● Well, for us, we see it going well. We are one of a handful of VCTs not impacted by the rule changes which most investors understand – we do not have to change our investment strategy which has generated good performance to date. Since launching in late November we've certainly seen a far greater take up from IFAs who haven't directed their clients towards us before, so that looks very positive. We are confident of having a successful fundraise this year.

● I think the changes to VCT legislation did unsettle the advisory market initially, but it seems demand has bounced back stronger than ever, driven by the significant changes to pensions and buy-to-let I mentioned earlier.

In addition to the legislative changes, growing concerns that the next two decades could see significantly lower returns from traditional investments thanks to low interest rates, high levels of inflation and currency concerns mean that advisers and their clients are increasingly looking to 'alternatives', such as VCTs, to meet their clients' planning needs.

We've continued to invest in our fund management teams as well as other parts of the business to support this growth in VCT demand and support our existing customers. This year we've launched the first ever monthly contribution VCT, so investors can lock in their investment needs early before capacity dries up, even if they don't have the cash to invest immediately.

Like last year, we expect our VCTs to fill up before their scheduled close dates, so we are worried about investors who may have left the planning until the very end of the tax year and risk missing out.

ANY CHALLENGES?

● One challenge is that we see that a lot of advisers easily confuse or interchange VCT and EIS – so a lot of our focus is on adviser education. VCTs and EIS are incredibly different in terms of structure, investment, risk profile and liquidity. It may be because they're grouped together in the financial press, when in fact they are very different and will meet the needs of different types of client and client objectives.

JOHN, HOW ABOUT CALCULUS?

● Yes, like many other funds we have had to deal with, firstly the complexity of new EIS/VCT rules, secondly the slow HMRC response times and thirdly the poor quality of guidelines given to inspectors in applying the new rules.

However, materially, we have not had to change our investment strategy in response to new regulation, and if anything our focus on growth and development aligns well with the rules. Our position as a growth and development investor also sits well with clients who want to invest within the spirit of the rules – i.e. targeting investment into areas where the Government perceives there to be a real funding gap.

So, like the rest of the market, our deployment rate was a little slower in the first half of 2016 due to the new EIS/VCT rules bedding in, but our completed pipeline of investments was strong in the second half of 2016, with a growing number of opportunities and profitable realisations.

We feel positive for the 2016/17 fundraising season and have already made significant progress with our VCT target raise, and we expect to reach capacity before the final close date.

SHANE ELLIOT

JOHN GLENCROSS

KOSTAS MANOLIS

STUART LEWIS

ANDREW WOLFSON

DANIEL KIERNAN

For the foreseeable future, we will be keeping our focus on backing good quality management teams behind companies with proven, successful products and revenues. We target more established businesses with growth potential, across a diverse range of different sectors. We will continue to focus on achieving capital growth from our investments, underpinned by thorough due diligence and risk management processes. This growth will help to support the VCT target regular annual dividend of 4.5% of NAV.

WHERE ARE YOU INVESTING? HOW STRONG IS YOUR DEAL PIPELINE AND WHAT ARE THE MOST INTERESTING AND EXCITING AREAS?

● We are continuing to invest in all the same target sectors and types of transaction as before the rule changes, including asset-backed deals. However, we have increased our focus on earlier-stage growth capital opportunities. Our deal pipeline is as strong as it has ever been, but to achieve this we have had to invest in more dedicated origination resources, including and the hiring of half a dozen additional investment team members last year. Therefore, transacting in the post rule-changes environment is still strong but I expect it to be less efficient from a manager's cost perspective.

● As we are sector diverse in our approach, we invest in a range of areas including technology, healthcare, environmental services, sports and leisure, hospitality, business and support services.

Our pipeline of deals that have progressed past agreed 'Heads of Terms' stage is strong and the number of prospective deals through the door is up versus the same period last year, substantiating that there are a plethora of good businesses out there requiring funding.

In December, we finalised investments in the leisure, technology and environmental services sectors, although we had been working on each of these for some months.

● That's an easy one for us! The vast majority of the funds we raise this year will be used for follow on investments into the existing portfolio. That means that we are investing in known companies that have already shown they can use our VCT funds to expand and prosper.

● This question really gets to the heart of why Pembroke are here, because we haven't changed our rationale at all – we were set up originally to fund the pipeline of opportunities we had coming in through Oakley Capital office, even before we established a VCT. Oakley Capital are a Private Equity firm with over $1.5bn under management. Peter Dubens, the founder of Oakley Capital, has a network with some of the UK's leading businessmen so we have always had a lot of new entrepreneurs coming to us for advice and for funding. That means we've got a fantastic pipeline.

We remain focused on consumer brands, in the premium sector across health and fitness, hospitality, media and technology and fashion and accessories. We tend to steer clear of pure digital offerings. We like things that people can buy, can touch and feel, can get on a shelf at Waitrose or Tesco or from a department store. And we continue to see a large number of opportunities.

We tend not to back pre-revenue opportunities, so the onus is very much on whether someone can go out there, create a product, develop it, set up a supply chain, take it to market. We then evaluate how big we think that market is and how much we can help them reach more of it.

Because in the space that we operate, which is really companies who have around £1 million of turnover, the banking sector is still shying away from these companies, and we can't see anything in the near future that's going to change that. So, we're providing funding for growth, just as VCTs were originally set up to do in 1995.

SHANE, HOW ABOUT BERINGEA AND PROVEN?

● Well, as I mentioned, dealflow is up two times on last year. We are a generalist investor, but with a focus on three key areas: Business services and software; digital media; and the consumer sector. Sectorally, we see SAAS [Software as a Service] businesses and media such as digital video as interesting areas. Trend wise, many of the businesses we are focusing on are taking advantage of more commercial aspects of machine learning, artificial intelligence, and internet of things.

WHAT CHANGES HAVE YOU MADE IN RESPONSE TO LAST YEAR'S BUDGET AND THE TIGHTENING UP OF THE RULES ON WHERE YOU CAN INVEST? HAS THE RISK PROFILE FOR VCTS CHANGED NOW?

● Well, over the past four or five months, I've been approached by four other VCT players who are having to change their investment strategy and are wanting to buy into our pipeline. I think that pretty much says it all! Although some people say 'we are changing our strategy'… it's not just a statement that is required, it's a whole culture change throughout the fund, after all how do you turn round from an MBO [Management Buy Out] style business, into one that is investing in growth?

They are very different skillsets. Who do the

"Advisers and investors now regularly tell us that the greater limitations placed on pensions have encouraged them to consider other tax-efficient investments such as VCTs." – **John Glencross, Calculus Capital**

founders want as their investors? They want people who are going to help them grow. You could argue the risk profile has changed but VCTs are going back to what they were originally designed to do.

So I think the changes on the whole were for the good, but I can understand those that have concerns over deployment of funds. Having to deploy cash without a strong pipeline of opportunities could increase the risk profile of each investment.

WHY IS THAT?

Well, some of the funds that we have seen, that have looked at specific investments that we were early stage backers of, in my view, are looking to overfund these opportunities. They want to overfund it with clever structures – basically an interest-charging structure rather than a straight equity deal. That could be funds trying to do more of what they used to be doing, MBO style: a loan going out, getting it off the funds books, into a company, and charging an interest rate on it. It is not growth investing the way I look at growth investing.

I do think it is something advisers should look at; what is the structure of the deal, and is it going in as equity or is it a convoluted loan structure that is masquerading as an equity investment?

WHAT ABOUT OCTOPUS, STUART?

Our VCTs have been focused for some time on investment strategies that fall exactly where the Government wants the investment to go. This means we aren't having to change strategies, recruit new teams, throw away track records etc.

The one area we are being cautious on now is the fund-raising into our AiM VCTs. The 'age of the company' rule in particular is slightly reducing the proportion of AiM offerings that qualify under the new constraints, so we aren't raising much new money while we wait and see how the AiM market settles down.

Our investment strategy is similarly unaffected – we have always been a growth investor. However, the initial uncertainty surrounding the interpretation of the new rules did disrupt the speed of receiving advanced assurance whilst the regulators digested the changes. In addition, the costs of tax and legal advice for deals have increased. But the risk profile of our VCT has not changed.

But I agree with Andrew, for the general market, the tightening of the rules has dramatically affected those VCT providers that focused on MBOs or operated in the 'limited life/capital preservation' sector. These VCTs will have to recruit or retrain teams if they wish to invest in accordance with the new rules.

Given we have been growth cap investors since inception, our investment strategy hasn't really been impacted by the new rules. We have developed an internal VCT checklist that is completed as an initial assessment for new businesses to assure we don't spend time on things that won't qualify, and review again in detail before closing any new deals to assure we are not in breach. We don't see our risk profile changing significantly.

On a different note, Downing has continued to expand its non VCT/EIS offering and we are quite excited about the Downing Crowd platform that we launched last year, which has already completed around £20 million of senior secured debt transactions.

As far as VCT funds are concerned, one could say that the risk has increased if a manager does not react to the rule changes. Downing has hired more dedicated resource to capture a fair share of the smaller pool of qualifying transactions and to choose and structure deals at appropriate risk levels. In addition to that, we are quite excited by a new partnership we have formed with Bioscience Managers which has underpinned the recent launch of the Downing FOUR VCT plc Share Healthcare Class. This fund will utilise the expertise and strong track record of Bioscience Managers to pick attractive investment opportunities in UK healthcare and medical technology unquoted companies, which is a niche space that offer a lot of opportunity if you have the right expertise.

OUR PREVIOUS MARKET RESEARCH HAS INDICATED THAT ACCURATELY QUANTIFYING RISK, CHARGES AND PERFORMANCE OF VCT INVESTMENTS HAS BEEN A CHALLENGE FOR ADVISERS. WHAT ARE YOUR THOUGHTS ON THESE ISSUES?

It is always our aim to be as clear and transparent as possible. We focus on providing easy to understand documentation and timely communications to enable IFAs and investors to make an informed investment decision. We recently redesigned our documentation after having requested input from investors and advisers; the response has been that they are now even easier to navigate and digest. Our investor relations team is always on hand to help with any queries. And our diversified approach to portfolio construction leads to reasonable consistency in long term performance.

I think the most challenging aspect of monitoring VCTs is that advisers have to explain to their clients that while they are quoted, the share price on the screen is irrelevant. The quoted market price doesn't take into account the dividend yield, nor the tax relief claimed, amounts which are unique to each

SHANE ELLIOT | JOHN GLENCROSS | KOSTAS MANOLIS | STUART LEWIS | ANDREW WOLFSON | DANIEL KIERNAN

investor's own situation. The share price is an indicator of what the shares would get if sold on the secondary market and whilst there is a small secondary market for VCTs, it's very unusual as the buyer of secondary shares would not benefit from the upfront income tax relief. Inevitably, this drives down the price in the market. But this doesn't matter, because clients would normally utilise the buyback facility offered by the Board of the VCT. It's very important for advisers and investors to check the buyback policy of the VCT and their history of facilitating buybacks, before investing.

So, it's the NAV investors need to focus on, both in terms of assessing the performance of the VCT but also the value the client should be able to get should the client wish to sell after the initial five-year holding period.

However, once the focus is on NAV, and the dividends paid, it is fairly easy to compare historical performance. I would suggest performance over five years is most relevant because that is the required holding period.

On costs, the costs of running the VCT aren't difficult to determine. The Prospectus will lay out the initial costs of the offer as well as the ongoing costs.

But, yes, risks are much more difficult to assess. Superficially, a VCT that invests in early stage companies – like Titan – would appear to be higher risk. But investing in Titan gives you access to 50 companies immediately, so there's your diversification, and many of those were early stage companies when investment started many years ago but they are now well established, profitable companies. It is arguably much more risky to invest in a VCT that will now have to do early stage investing for the first time, particularly if the offer is a new share class where you won't even get access to the previous investments.

● Yes, I agree with Stuart. Advisers have become accustomed to having daily price feeds and risk profiling tools for mainstream products such as OEICs.

Understandably they have looked to apply these same criteria to products that really do not fit into the same mould; but firstly they are not priced daily priced – although a secondary market exists for VCT shares – and secondly they are not analysed for risk by the main proprietary systems. And additionally, the wide differentiation of offers available also means that meaningful comparisons between them are difficult to make. This has meant that considerable weight has been put on the independent reviewers who have the resource and access to get under the bonnet of these products. This seems a sensible approach and IFAs that are willing and able to embrace this different approach will be in a position to advise their clients in an area that is becoming of increasing interest to them.

When it comes to charges, it is important that focus is not simply on the Initial Charge and Annual Management Charges as these products can have multiple charging mechanisms that may give different names to what is effectively the same thing.

A simple approach is to put all charges into one of three buckets – irrespective of what the charges are called: So I would suggest bucket one is all one off charges – such as the Initial Charge, Dealing Fees in and out, Exit Charges and Arrangement Fees. Bucket two could be all the ongoing charges – the Annual Management Charge, Annual Administration Charges and any Monitoring Fees. Finally, bucket three should be any fees related to performance and this should also include deferred AMC linked to return.

Advisers should also note that charges to underlying businesses, while not direct to the investor, ultimately impact returns and so they need to be factored into the equation.

● On charges, we are very lucky to be part of a much larger private equity fund manager, which helps us fund our ongoing costs. That means we can cap the total expense ratio (management fees and admin costs) at 2% and that is ALL we charge (i.e. no portfolio company fees are paid). I have seen a number of deals where there are excessive non-exec director fees, there are monitoring fees, there are deal fees, there are transaction fees, there are arrangement fees...

When doing an MBO deal, that might be relevant, because the company can generally afford it out of profits. Where investing in a growth opportunity, where the companies are generally going to be marginally or not yet profitable, I see it as the fund investors paying the fund manager a higher fee. That's the reality.

We don't do that. Again, I think advisers should look out for fees charged to portfolio companies, but sadly on the whole it's not very clear in the literature.

We see fees as being something that is very relevant, and we see our value to investors in our performance. Therefore, our success should be based on our performance, not on hidden fees.

WHAT CHANGES WOULD YOU LIKE TO SEE IN THE VCT MARKET? DO YOU HAVE ANY CONCERNS FOR THE FUTURE, AND HOW DO YOU SEE THINGS DEVELOPING OVER THE NEXT 12 MONTHS?

● I would like to see better recognition of VCTs/EISs in the role they play in filling the funding gap that exists

*"VCTs can fit well as a supplement to restricted pension funding." – **Kostas Manolis, Downing***

for small UK businesses, providing much needed finance. We regularly come across small businesses that are early stage in nature and cannot raise finance as they are caught by the new rules – for example, it's a small, historic share transaction or a company that was over seven years old and that was bought for a negligible sum but has contaminated the group. We believe there is some fine tuning required if we are to be able to help genuinely small businesses that deserve support.

If alternatives were available, there would be no demand from business for VCT and EIS funds, but this is very clearly not the case.

We would like to see the time it takes HMRC to review VCT clearance applications reduce as it currently causes significant delays to investment processes. HMRC's recent approach of requiring finalised legal documents together with the clearance application (as opposed to submitting a headline structure at the start and finalised documents later in the process when they are ready) also creates delays and frustration for entrepreneurs raising funds. It will also be interesting to see how the Government reacts following Brexit and whether the business-friendly noises we are hearing translate into a relaxation of the rules to help fuel economic growth.

● I would like to see more obligation on VCTs to repay capital on exits. At the moment it is allowable to retain capital invested from realisations and continue to fundraise. My concern is that if funds have too much money, it becomes that much more difficult to invest the money prudently. It goes without saying that fees are calculated as a proportion of NAV, financially benefiting managers who retain capital.

My concern is that the industry gets considered to be higher risk because of the amount of money that's flowing around in it, instead of flowing back to investors.

The other thing that I think I would like to see would be an HMT change that would allow individuals to decide how they're going to deploy their tax-efficient money split between EIS and VCT, rather than to have it capped at £1 million and £200,000 respectively. I would like to see a tax-efficient amount of £1.2 million, and left up to the investors to decide how they're going to deploy that.

● Well, as the other guys have said, in some respects, the VCT changes are positive for the industry as more VCTs which have historically focused on buyouts or fixed returns will be shifting to growth capital over the next 12 months, and entrepreneurs will again see VCTs as a key source of venture and growth capital.

However, our view is that a number of the changes are too restrictive and will end up excluding strong, early stage growth businesses, and therefore we would like to see some restrictions eased, especially the ability to provide some level of cash out and the 7-year rule.

● My wish is for no more legislation changes. Investors like certainty so a few years without any major changes would be welcome.

In the medium term I would like the Government to re-open discussions on Social VCTs; I think there is an appetite for that both from investors and worthy causes.

● I would like to see a more sensible interpretation of the 'growth and development' rule by HMRC. I feel that HMRC is currently going beyond the legislation in its guidance to Inspectors and HMRC should apply the new rules as Parliament intended. For example, confirming that raising funds to, in part, cover expenditure relating to commitments already made such as rent, or paying existing employees, is permissible under HMRC's interpretation of funds being used for growth and development.

But overall, we see little likelihood of change in the next 12 months, either in regard to legislation, or the general market. We expect the demand for VCTs to continue to outstrip supply in the next 12 months.

MANY THANKS TO YOU ALL FOR GIVING YOUR INPUT.

CONCLUSIONS

MARKET RESEARCH: CONCLUSIONS

First, advisers' use of VCT investments is growing and many of them expect to see their use of VCTs increase in the near future. As there are fewer VCTs raising funds in the market this year, the survey result makes the anticipated "supply crunch" a more probable trend.

Non-IHT tax planning is the top reason for advisers to use VCTs for their clients, followed by income and growth. We can conclude that advisers are using the scheme in a way that the investment is design for and are understanding the asset class better.

The quality of a provider is the main criterion for advisers when selecting VCT investments, as investment risk remains as the most cited concern. There is also a significant proportion of advisers that are concerned about compliance and due diligence issues.

Most advisers have no preference on investment sector and underlying investee company type. But advisers who are concerned about liquidity tend to invest clients' money in AIM VCTs.

Seven in ten advisers believe that VCT investments can be used even before pension and ISA limits have been maximised, and 43% believe VCT investments are also suitable for some retail investors. These results demonstrate that the asset class is being more widely recognised in the retail investment market.

KEY POINTS

- Tax planning is the most commonly cited reason for recommending VCTs
- 82% of advisers we surveyed reccomend VCTs, and the majority (39%) are sector agnostic
- Three in ten advisers think that VCTs are only suitable once ISAs and pensions have been maximised
- 64% of advisers think that their use of VCTs will increase in the next two years
- Advisers are split on whether VCTs are ever suitable for ordinary retail investors

INDUSTRY ANALYSIS

TERMINOLOGY

DEFINITION OF KEY TERMS

This section takes a look at the current market of Venture Capital Trusts. The analysis is based on data obtained from the MICAP platform and is correct as of November 2016.

Our intention here is to give advisers data on key investment metrics – such as costs, minimum subscriptions and target returns – so that they have a reference point when reviewing the market for VCT investments and can understand the levels of returns to expect and at what prices. We start by giving some clarification on the terminology we will use:

OFFER STATUS	
OPEN OFFERS	VCTs that are raising money at the time of writing
2016 OFFERS	VCTs that launched in the 2016/17 tax year (after April 2016)
HISTORICAL OFFERS	VCTs that launched in previous tax years (everything before April 2016)

INVESTMENT STRATEGY	
CAPITAL PRESERVATION	Investments exploiting an asset, either a physical asset or the rights to an intangible asset
CAPITAL PRESERVATION & GROWTH	Investment into asset backed trading companies
CAPITAL PRESERVATION & INCOME	Investments exploiting an asset typically with contractual income streams that will allow it to pay an income to investors
GROWTH	Investment into trading companies for long term capital growth
GROWTH & INCOME	Investment into trading companies for long term capital growth and income

INVESTMENT SECTOR	
ENERGY GENERATION	Generating energy, typically from renewable sources (including wind, solar and hydro), clean sources (including anaerobic digestion) or other sources (including diesel powered generators)
GENERAL ENTERPRISE	Providing general products and services, or an investment with no sector bias
INDUSTRY & INFRASTRUCTURE	Operating in the diversified manufacturing, cars, heavy equipment, aerospace, roads and business services areas
MEDIA & ENTERTAINMENT	Making films, producing theatre productions, printers and disseminators of news etc.
RENEWABLE ENERGY	Generating energy from renewable sources, including wind, solar, tidal and biomass

VCT TYPE	
GENERALIST	The most common type of VCT. Usually broad-based and invest in a range of unquoted companies in a wide variety of sectors and can be in various stages of development
AIM	This type of VCT invests in companies listed on the Alternative Investment Market (AIM), the junior market to the London Stock Exchange
SPECIALIST	Specialist VCTs have a sector bias and invest in one sector or industry
LIMITED LIFE	These VCTs typically aim to exit and distribute assets back to investors after 5 to 7 years and are designed to bear lower risk and generate lower returns than other VCTs

OVERALL MARKET

CHANGES AND DEVELOPMENTS

The industry analysis begins with looking at the composition of the market for VCT opportunities. We will examine the market by grouping products by their investment strategy, investment sector and VCT type.

We will show our readers developments and changes in the VCT market by comparing our statistics on new launches to offers introduced to the market in the past.

There are 65 VCTs recorded in our register in total. 13 of those are open to new investments while the other 52 are closed. Eleven VCTs launched after April 2016 and all of them are still raising money, so there are two open VCTs that launched prior to this tax year.

MARKET COMPOSITION BY INVESTMENT SECTOR

82% of 2016 VCTs do not have a sector bias and invest in the General Enterprise sector, while the rest invest their funds in the Industry & Infrastructure and Pharmaceuticals & Biotechnology sectors. Historically, there has always been more VCTs investing in the General Enterprise sector. The chart shows over 90% of historical VCTs invested in the General Enterprise sector and Industry & Infrastructure only represented 3% of the market in the past.

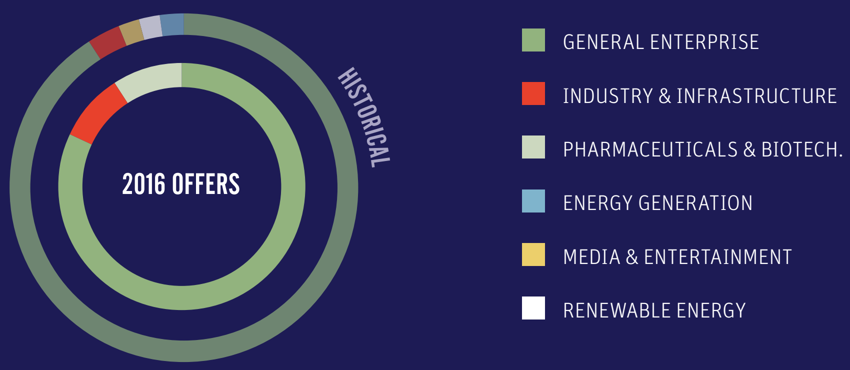
In the section above we saw that Industry & Infrastructure is advisers' second most preferred sector after General Enterprise, in line with what the adviser survey suggests they prefer, and there are a fair number of VCTs in this sector that are still raising funds.

The Renewable Energy and Energy Generation sector each had 2% market share before disappearing from the market due to the ban on Venture Capital Schemes from investing in renewables. The other 2% of historical VCTs have invested in the Media & Entertainment sector.

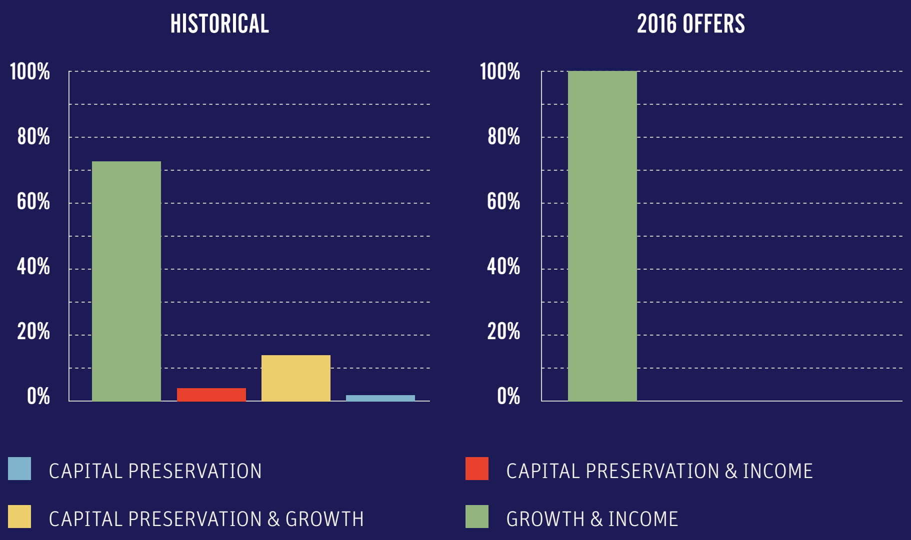
OPEN OFFERS

	NUMBER OF OFFERS	OPEN OFFERS
HISTORICAL	54	2
2016 OFFERS	11	11

MARKET COMPOSITION BY INVESTMENT SECTOR



MARKET COMPOSITION BY INVESTMENT STRATEGY



Unlike EIS and BPR investments, which can follow a diverse range of investment mandates, the Growth & Income investment strategy dominates the VCT market. However, it is hardly a surprising observation given the recent rule changes designed to encourage VCT managers to invest in more risky growth opportunities, and the fact that VCT dividends are tax free. In addition, 78% of advisers surveyed said they recommend VCTs for either Growth or Income, so we think it should be fairly simple for advisers to find VCTs that match their needs in this respect.

More than a quarter of all historical VCTs have capital preservation as their primary or partial investment objective. There has only been one purely capital preservation VCT ever launched in the market (and that was a Limited Life VCT).

"Our VCTs have been focussed for some time on investment strategies that fall exactly where the government wants the investment to go." – ***Stuart Lewis, Octopus Investments***

MARKET COMPOSITION BY VCT TYPE

The most common type of VCT is Generalist. Two thirds of all VCTs are Generalist, investing in unquoted businesses with no sector preference. This again matches with advisers' preference; as 39% of advisers surveyed are sector agnostic and 35% prefer General Enterprise.

At this point we'd like to remind our readers that a Generalist VCT is not equivalent to a VCT investing in the General Enterprise sector. Except Specialist VCTs, all other types of VCT can have General Enterprise as their investment sector. In fact, all of the Limited Life VCTs and AIM VCTs in our register deploy their funds in the General Enterprise sector.

Limited Life VCTs is the smallest segment of the market and there haven't been any Limited Life VCTs launched in 2016. The proportion of AIM VCTs has remained at 18% in 2016. In the previous section, 72% of advisers indicated that they have no preference on investee company type and among those who did state a preference, private company is the majority. So there is again no divergence between demand and supply in terms of investee company type.

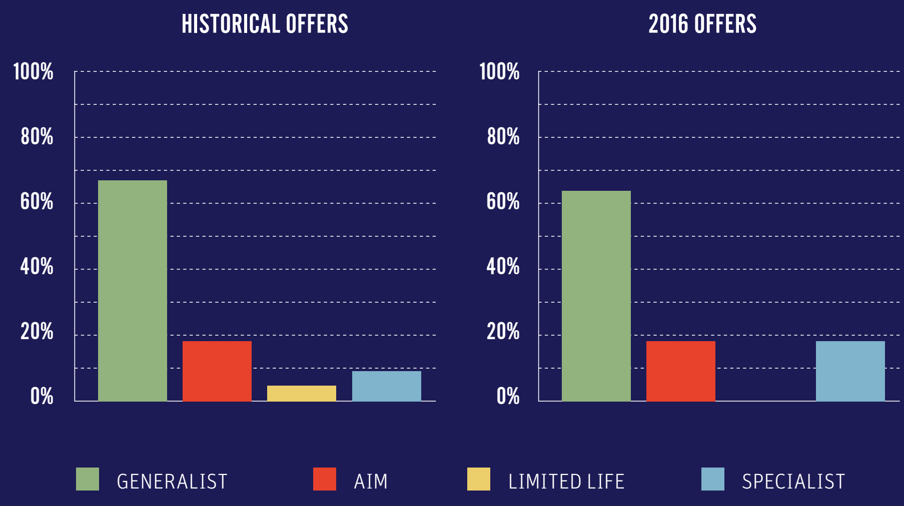
We can also see that the proportion of Specialist VCTs has doubled in 2016.

CHARGES

Initial Charge and Annual Management Charge are the most common fees charged by managers. Both fees can also be charged to investee companies, but for the sake of our analysis we will focus on the total (Initial charge to investor + Initial charge to investee).

The average Initial Charge for 2016 VCTs is 2.36% whereas it's 2.86% for historical VCTs. In addition, the range for Initial Charge narrowed

MARKET COMPOSITION BY VCT TYPE



CHARGES

	AVG		MODE		MIN		MEDIAN		MAX	
	2016	HIST	2016	HIST	2016	HIST	2016	HIST	2016	HIST
INITIAL CHARGE TO INVESTOR	2.36%	2.69%	3%	3%	0%	0%	3%	2.75%	3%	5.5%
INITIAL CHARGE TO INVESTEE	0.55%	0.23%	0%	0%	0%	0%	0%	0%	3%	5%
TOTAL INITIAL CHARGE	2.91%	2.86%	3%	3%	0%	0%	3%	3%	5%	7%
AMC CHARGED TO INVESTOR	1.97%	1.89%	2%	2%	1.5%	0%	2%	2%	2.5%	3.5%
AMC CHARGED TO INVESTEE	0.10%	0.04%	0%	0%	0%	0%	0%	0%	0.5%	2%
TOTAL AMC	2.06%	1.89%	2%	2%	1.5%	0%	2%	2%	3%	4%
ANNUAL PERF FEE	12%	10.71%	20%	20%	0%	0%	20%	15%	20%	20%
EXIT PERF FEE	5.45%	2.64%	0%	0%	0%	0%	0%	0%	20%	20%
ANNUAL PERF HURDLE	22.4%	42.25%	3%	100%	0%	3.5%	3%	6.5%	100%	100%
EXIT PERF HURDLE	69.3%	86.56%	N/A	100%	30%	3%	100%	100%	105%	105%
INITIAL DEAL FEE	0%	0.08%	0%	0%	0%	0%	0%	0%	0%	3%
EXIT DEAL FEE	0%	0%	0%	0%	0%	0%	0%	0%	0%	0%
ANNUAL ADMIN CHARGE	0.37%	0.12%	0%	0%	0%	0%	0%	0%	0%	3.25%

"It's great to see VCTs return to their original purpose: funding high growth companies to help secure the UK's future." – ***Andrew Wolfson, Pembroke VCT***

significantly this year. Initial Charges of historical VCTs range from 0% to 7% compared to 0% to 5% for 2016 VCTs.

The average AMC increased in 2016 to 1.97% from 1.89%. Similar to the Initial Charge the range for AMC has also narrowed from 0% to 4% to 1.5% to 3%. Readers are reminded that AMC is charged regardless of manager performance, so it can add up to a considerable amount after several years.

In comparison to EIS, the level of Initial Charge and AMC stated by VCT managers is higher, but it doesn't necessarily mean that investing in VCTs is more expensive. The key difference in fee structures between the two asset classes is that most EIS managers charge an Exit Performance Fee, which is less common among VCTs. Our data shows less than 10% of VCT managers charge an Exit Performance Fee.

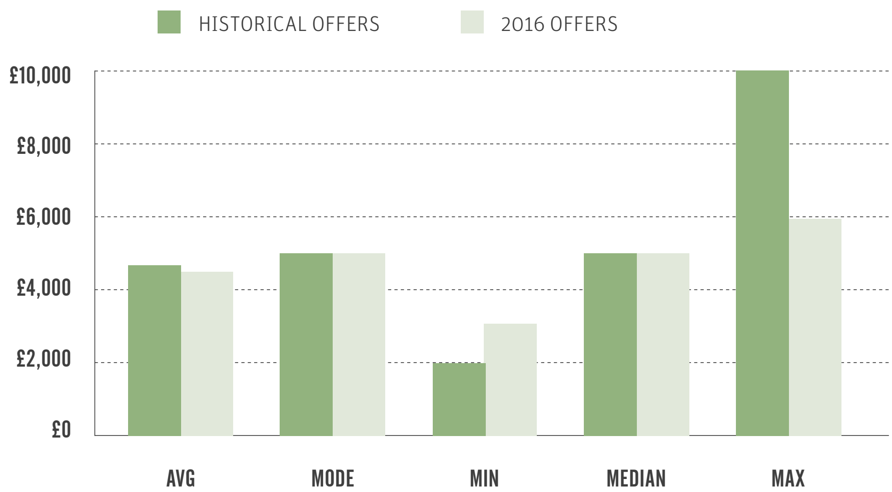
In contrast, an Annual Performance Fee is more common with VCT investments. 28 out of 54 (6 out of 11) historical (2016) VCTs stated an Annual Performance Fee, with 20% being the mode. A few managers charge a 5% or 10% Annual Performance Fee.

Managers who charge an Annual Performance Fee usually specify an Annual Performance Hurdle so that the performance fee is only payable when the hurdle is met. Therefore, it is important for advisers to investigate whether a hurdle has been appropriately set and whether a performance fee is justified.

TARGET DIVIDEND

The average level of target dividend increased slightly from 4.90% to 4.94% as there were historical VCTs that do not distribute income (those with target dividend of 0%). 5% is the most common level of target dividend the industry offers, quoted by almost 40% of the VCTs in our register.

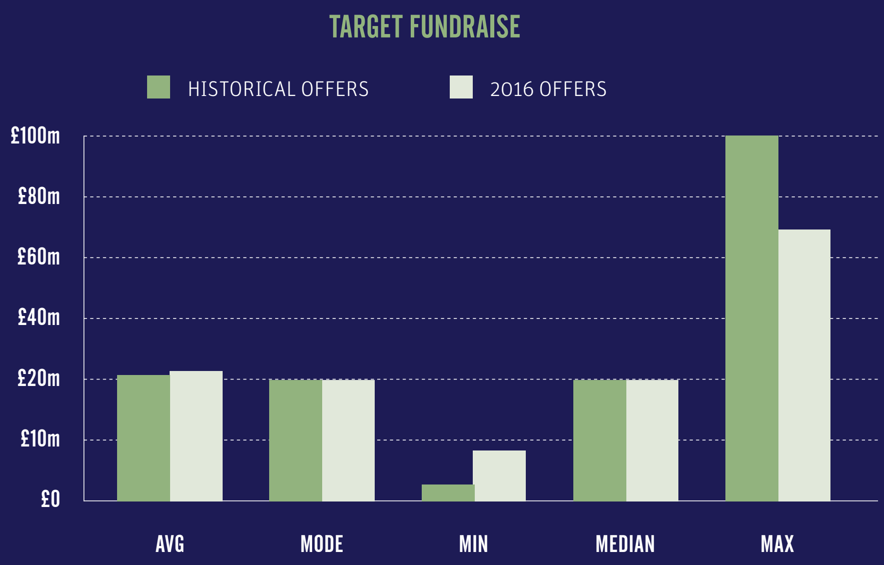
MINIMUM SUBSCRIPTION



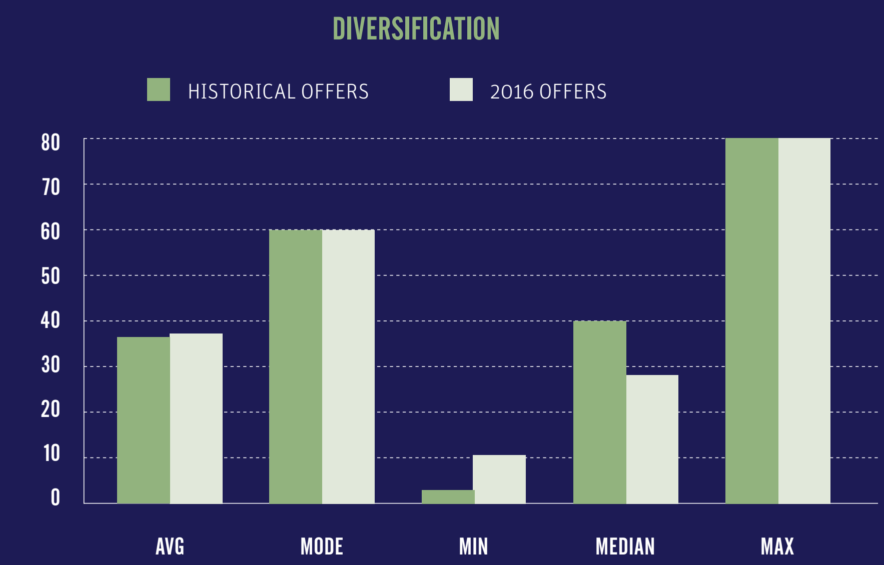
This year's average minimum subscription is 4.4% lower than last year's figure, which is what we have expected, as VCT managers are slashing their fund-raising targets, so it is natural to lower their minimum subscription levels at the same time. The mode is £5,000 regardless of investment strategy. Although the min increased to £3,000 from £2,000 in this tax year, the max dropped by £4,000 from £10,000 to £6,000.

While comparisons between EIS and VCT are interesting (and something our readers request), it is important to note that the range of charging structures, investment horizons and level of returns makes it difficult to make apples to apples comparisons.

> *"We cannot observe any significant imbalances between what advisers need and what providers offer."*



Surprisingly, the average target fundraise of 2016/17 VCTs is slightly higher than the average of historical VCTs, contrary to our expectation of a lower value as a result of the recent changes. However, the table shows that this year's max target fundraise is £30 million lower than last year's £100 million. Some managers have merged their VCTs in response to the changes which may explain why the average value didn't fall down. For example, Baronmead has merged four of its VCTs into two.



We also take a look at the level of diversification in the VCT market. We will use target number of investee companies as a measure. The statistics are in line with our expectations, with VCTs launched in the 2016 tax year being more diversified than historical VCTs. The average number of investee companies increased from 37 to 38. Among historical VCTs the minimum diversification is merely three investee companies, while the least diversified 2016 VCT has 11 investments in its portfolio. Since VCT managers are forced to focus on growth investments they must at the same time expand the number of companies in their portfolios to mitigate the risk, which explains why the level of diversification is rising among new VCTs.

CONCLUSIONS: INDUSTRY ANALYSIS

It is clear that the rule changes on qualifying companies had an impact on the VCT market, as shown in market composition, minimum subscription and diversification. All new VCTs launched this year follow the Growth & Income investment strategy, and the levels of minimum subscriptions stated by new offers are lower than they used to be. We expect these trends to continue and to observe more clear shifts in these measures in the coming years.

Advisers' preference has generally been met by providers in terms of investee company type and investment sector and we cannot observe any significant imbalances between what advisers need and what providers offer – other than the anticipated mismatch between supply and demand overall.

The average Initial Charge and AMC of VCTs are higher than EIS. VCT managers generally don't charge an Exit Performance Fee, but our data reveals that an incentive fee on exit is becoming popular among new VCTs. Annual Performance Fees have been more common with VCT managers.

However, as the fee structures can vary so much between individual offers and between the EIS and VCT sectors, making meaningful comparisons between the two can be tricky.

MANAGERS IN FOCUS

DISCLAIMER

Some of the managers have included some performance information in the following pages. As always, past performance is not a reliable indicator of future performance.

This document is for professional advisers only, and it is not to be relied upon by retail investors. The value of an investment, and any income from it, can fall as well as rise, so investors may not get back the full amount they invest. Tax treatment depends on individual circumstances and may change in the future. Tax reliefs depend on the portfolio companies maintaining their qualifying status. The shares of the smaller companies could fall or rise in value more than shares listed on the main market of the London Stock Exchange. They may also be harder to sell. These products are not suitable for everyone. Any recommendation should be based on a holistic review of your client's financial situation, objectives and needs. Neither Intelligent Partnership nor the managers offer investment or tax advice. We recommend investors seek professional advice before deciding to invest.

BERINGEA

BERINGEA

BERINGEA PROVEN VCT

ABOUT BERINGEA

ProVen VCTs are managed by Beringea, an award winning, specialist venture and growth capital firm which manages nearly £200 million of VCT assets.

Beringea has over 25 years' experience of managing investments in unquoted companies and has managed the Company since it was launched in 2001. Beringea is part of an international fund management group which manages more than $500 million of venture capital assets.

The investment management team comprises 12 executives, who have more than 85 years' combined experience of making equity and debt investments in SMEs.

Once an investment has been made, Beringea uses the experience of its investment management team to add as much value as possible to the investee company. It also monitors all investments closely to ensure that any problems are identified at an early stage, so that appropriate action can be taken swiftly if necessary.

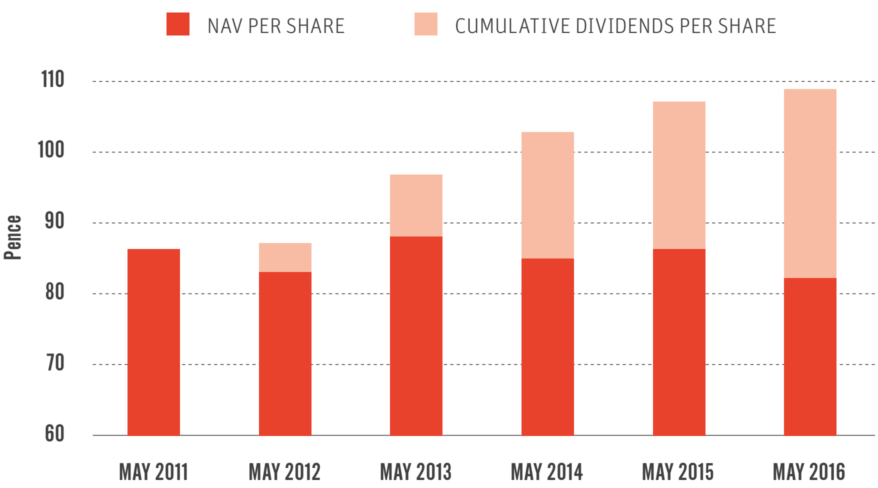
OUR PROVEN VCT

The principal investment strategy of PGI VCT is to identify a number of small and medium sized UK private companies with the potential to grow rapidly and to provide them with the capital and management support they need to be able to take full advantage of this potential. In return for this capital, PGI VCT will take a shareholding in the company, allowing it to benefit from future increases in the business's value.

Rapidly growing SMEs make attractive acquisition targets for larger companies looking for ways to boost their own rate of growth. A sale to a larger business is, therefore, the most frequent means by which PGI VCT achieves profitable disposals of successful portfolio companies. Any profit made on an investment will then be available to be paid out to shareholders as a dividend in line with the company's dividend policy.

PERFORMANCE OF PGI VCT OVER THE LAST FIVE YEARS

The Total Return performance of the Ordinary Shares over the last 5 years (to 31 May 2016) is shown in the chart below:



CASE STUDY:

THIRD BRIDGE

Third Bridge

Third Bridge Group is a provider of primary research services to professional investment firms and their advisers, including hedge funds, private equity and mutual fund managers and management consultants. Third Bridge Group helps its clients to make important investment decisions by connecting them to authoritative market intelligence provided by industry specialists.

Third Bridge Group was founded in London in 2007 and then quickly expanded into international markets, opening a New York office in 2010, followed by offices in Hong Kong, Beijing and Mumbai. The company grew rapidly from its inception.

PGI VCT invested £2.1 million in Third Bridge Group in November 2012, alongside ProVen VCT, to support further international expansion and the development of additional research products. The company recently moved into larger offices in both London and New York to accommodate its growing workforce.

CALCULUS CAPITAL

CALCULUS VCT OFFER

ABOUT CALCULUS CAPITAL

Calculus Capital have been investing in small UK companies for over 17 years, making us a trusted choice for VCT investors. Having created the UK's first approved EIS Fund in 1999, Calculus are pioneers of the tax efficient investment space and we've been managing VCTs since 2005.

We are known in the market for our strong performance, delivering regular dividends to our investors. We believe our solid track record is down to our robust due diligence processes and highly experienced investment team. The core team has been together since inception, and we have brought significant further talent on board over the years.

As a growth investor, we are focused on providing capital to established businesses which are looking to grow and develop. We invest across a wide range of sectors; from technology to healthcare, leisure and hospitality to biotechnology. Put simply, we seek to back impressive management teams behind proven businesses.

AGRI-SCIENCES	2%
ALTERNATIVE ENERGY	4%
BIOTECHNOLOGY	2%
BUSINESS & PROFESSIONAL SERVICES	9%
CONTENT MANAGEMENT SOFTWARE	2%
DIGITAL MARKETING SOFTWARE & SERVICES	2%
DIVERSIFIED FINANCIALS	2%
ENERGY EQUIPMENT & SERVICES	5%
HEALTHCARE EQUIPMENT & SERVICES	5%
INTERNET	2%
MANUFACTURING	2%
MARKETING	2%
MATERIALS	4%
MEDIA	2%
OPERATIONS PERFORMANCE MANAGEMENT SOFTWARE & SERVICES	2%
PHARMA SERVICES	9%
PHARMACEUTICAL DRUG DEVELOPMENT	2%
PLATFORM BPO	2%
RESTAURANT & FOOD SERVICES	7%
SPECIALIST ENGINEERING	9%
SPORTS, TRAVEL & LEISURE	5%
TECHNOLOGY HARDWARE	5%
TRADITIONAL ENERGY	9%
TRANSPORTATION	5%

OUR VCT OFFER

We are pleased to be offering a top up to the Calculus VCT, which will target an annual dividend of 4.5% of NAV. The Calculus VCT will invest alongside our EIS Funds, providing access to larger deals into more established companies which are further along in their growth trajectory.

At Calculus, we believe that investing in these more established companies means failure rates are lower and the time to exit is shorter – enabling us to pay regular dividends. We are active in a diverse range of sectors and target companies with the following characteristics:

- Strong management teams
- Recurring revenues and a strong balance sheet
- Profits or a clear path to profitability
- Clear route to exit
- Can achieve our target IRR of 20%.

The key objective for each of our investments is capital growth, alongside robust investment and monitoring processes to manage risk. We are 'hands on' investors, and usually take a seat on the board, driving value creation and guiding our companies through to a successful exit.

SECTOR SPLIT: INVESTMENTS / EXITS

*Data as at November 2016, includes all investments and exits across Calculus VCT and EIS Funds

CASE STUDY:

GENEDRIVE

WEBSITE	www.genedrive.com
LATEST INVESTMENT	£2.5m
DATE	July 2016
SECTOR	Healthcare Equipment & Services

Genedrive, previously called Epistem, is a Manchester based biotechnology company commercialising its expertise in adult stem cells in the area of infectious diseases. Their ground breaking product Genedrive® is a next-generation Point of Care molecular diagnostic system providing a low cost, rapid and accurate diagnostics platform for the diagnosis of infectious diseases such as Tuberculosis (TB) and Hepatitis C.

Since our initial investment, the company's headcount has increased from 2 to 86 people, revenues have grown to over £5 million, a new CEO has been appointed and a new US laboratory has opened. The company also recently launched Genedrive® in the Indian market to test for TB and antibiotic resistance. Genedrive gained further financial support from the US Department of Defence and the Bill and Melinda Gates Foundation. More recently, the company's research and development team achieved CE marking for the Hepatitis C test in anticipation of phase 1 launch in the EU in 2017.

Genedrive is an investment in both the Calculus VCT and EIS Funds.

DOWNING

DOWNING FOUR VCT

Downing

ABOUT DOWNING

The VCT is managed by Downing LLP. Our origins date back over 30 years and we are an experienced manager of VCTs, with over £200 million under management (of a total £700 million under management as at 30 November 2016). Since 1986, more than 35,000 investors have helped us raise over £1.7 billion that has been invested into UK businesses across a range of sectors, including renewable energy, care homes, data centres, children's nurseries, early-stage technology and satellite earth stations.

We know that a successful business needs a strong team behind it, so we look for management teams with the appropriate skills with whom we can build a long-term relationship. We take the time to get to know them, their business and their aspirations, and work alongside them to achieve success. Once invested, we offer support in a variety of ways to help businesses grow and often have a representative on investee companies' boards to maintain oversight.

OUR VCT OFFER

In December 2016, Downing FOUR launched two Offers for the new Generalist and Healthcare Share Classes, which are seeking to raise up to £20 million and £10 million, respectively. The Share Classes aim to build portfolios of investments to support the growth of small UK businesses and healthcare companies while offering investors access to VCT tax reliefs.

The Generalist Share Class aims to provide attractive returns to investors by investing in a portfolio of growth companies, at different stages in the business life cycle. The Healthcare Share Class aims to provide attractive returns to investors by investing in a portfolio of healthcare companies. The focus will be on development and expansion funding for innovative healthcare and biomedical businesses. Downing has appointed BioScience Managers Pty Ltd as our healthcare investment adviser.

In addition, we are pleased to offer a new monthly standing order option, allowing investors to subscribe a regular amount in the VCT, in addition to the usual lump sum offer. As annual and lifetime pension limits continue to be restricted, VCTs may provide an attractive supplement to retirement income through tax-free dividend payments.

Our new VCT share classes have recently opened. Set out below are two example investments that illustrate the type of investments we will be seeking to make.

CASE STUDY 1: FIRSTCARE

FirstCare

The example below for the Generalist Share Class was an investment made by Downing ONE VCT in 2007.

Revenue generating pre-profit – FirstCare

FirstCare is an absence management solutions company helping businesses track and reduce the number of absences among their employees. They maintain the UK's largest database on absences covering c.180,000 employees and recording c.12 million absences. Since Downing's investment, FirstCare has merged with their main competitor, reached profitability and is now expected to expand globally.

(SOURCE: FIRSTCARE)

CASE STUDY 2: ADHERIUM

adherium

Our Healthcare Share Class' investment adviser is BioSciences Managers Pty Ltd and an example of one of their previous investments is set out below.

Adherium

Adherium Limited is a company seeking to tackle medical non-adherence (the failure to follow a prescribed medical plan). Through their smart personal medication monitoring system and products, Adherium helps patients manage and track their chronic respiratory conditions. Their SmartinhalersTM synchronise with the app and secure online database to provide reminders and information, improving medical adherence in children by 180%. Adherium was successfully listed on the Australian Securities Exchange in August 2015. They have conducted 22 clinical trials across six countries. The company has received US FDA 510(k) clearance and their CE Marking, allowing for greater international market access.

(SOURCE: BIOSCIENCES MANAGERS)

Please note that past performance is not a reliable indicator of future performance.

OCTOPUS INVESTMENTS

octopusinvestments

OCTOPUS TITAN VCT

ABOUT OCTOPUS INVESTMENTS

The best companies and products make your life simpler, not harder. Why should financial services be any different? When Octopus was founded in 2000, we wanted to build an investment company that put its customers first, by solving real life issues. We also wanted to be fully accountable, honest and upfront about how we managed investors' money.

Today we manage more than £6 billion on behalf of tens of thousands of retail investors, institutions and charities (source: Octopus Investments, Dec 2016). And we've built market-leading positions in tax-efficient investments and smaller company financing.

Having launched our first VCT in 2002, today we are the UK's largest provider of VCTs as well as investments that qualify for Business Property Relief (source: Tax Efficient Review, 2016). We offer a range of VCTs to suit different objectives. These include: Octopus Titan VCT, Octopus Apollo VCT and Octopus AIM VCT and AIM VCT 2.

OUR VCT OFFER

With over £300 million in assets under management, Octopus Titan VCT is the largest Venture Capital Trust (VCT) in the UK (source: Association of Investment Companies, Dec 2016). It targets high levels of capital growth for its many investors.

Octopus Titan VCT is managed by the Ventures team at Octopus, who have a combined investment experience of 150 years, bringing together a wide range of backgrounds. This VCT is currently open for investment with a share offer of up to £70 million, with the potential for a further £50 million.

The VCT currently targets a regular annual dividend of 5p per share, with the potential for additional special dividends if portfolio companies are sold for a significant profit. For example, a 5p special dividend was paid in early 2016 following the sale of portfolio company SwiftKey to Microsoft and the sale of Vision Direct to Essilor, the global market leader in contact lenses.

Please note that the value of an investment, and any income from it, can fall as well as rise. Investors may not get back the full amount invested. Tax treatment depends on individual circumstances and may change in the future. Tax reliefs depend on the VCT maintaining its qualifying status. VCT shares could fall or rise in value more significantly than shares listed on the London Stock Exchange. They may also be harder to sell. This advertisement is not a prospectus and investors should only subscribe for shares on the basis of information contained in the prospectus, available at octopusinvestments.com.

CASE STUDY:

TAILS.COM

tails.com

The UK dog food market is worth £1.6 billion, online sales of pet supplies are growing and a fifth of pet owners are already feeding their dogs according to specific diets. Tails.com takes advantage of these opportunities by tailoring deliveries of food with the ideal nutrition and quantity for each dog.

With easy-to-manage online ordering and free ongoing deliveries, the company continues to perform well, now feeding over 40,000 dogs and growing revenue by 5x in the 12 months to July 2016.

Individual portfolio example is for illustrative purposes only and should not be considered as a recommendation to invest. All information sourced from tails.com, July 2016 (for latest prospectus).

Issued by Octopus Investments Limited, which is authorised and regulated by the Financial Conduct Authority.

TITAN VCT FIVE YEAR PERFORMANCE

YEAR TO 30 APRIL	2012	2013	2014	2015	2016
ANNUAL TOTAL RETURN	2.7%	33.8%	9.6%	11.4%	7.2%
ANNUAL DIVIDEND YIELD	1.9%	38.3%	5.6%	5.4%	9.2%

PEMBROKE VCT

OAKLEY INVESTMENT MANAGERS

ABOUT OAKLEY INVESTMENT MANAGERS

The Pembroke VCT is managed by Oakley Investment Managers LLP, part of the Oakley Capital group of companies; a privately owned asset management business with over $1.5 billion assets under management. Founded in 2002, Oakley Capital seeks to be a best-of-breed entrepreneurially-driven UK investment house comprising private equity, venture capital, corporate finance and fundraising.

Pembroke VCT and its management have maintained a strategy of investing in growth businesses since 2013, and through their experience and the connections of the wider Oakley group benefit from a preferential view of investment opportunities in Pembroke's chosen sectors. This means a healthy pipeline of promising companies with no changes to our strategy required as a result of the November 2015 regulatory changes.

OUR PEMBROKE VCT

Pembroke VCT offers investors a tax efficient way of participating in the success of high growth companies in four key consumer markets: Health & Fitness, Hospitality, Apparel & Accessories and Media & Technology, addressing the core aims of the Government's VCT programme. Investors gain immediate exposure to 19 companies in a well-diversified portfolio with net assets exceeding £35m. Approximately 50% of our investments are later stage and profitable, 50% are revenue-generating but pre-profit. New investments are planned at the rate of 3–5 per year.

The fund aims at steady growth through a range of investee company maturities, alongside an annual dividend target of 3p per share. Investors in Pembroke have seen total returns of 28% over three years, 2013 to 2016. Alongside balanced investment objectives, Pembroke offers the lowest TER in the VCT industry, charging no fees to investee companies so subscribers' funds are used purely to grow their investments.

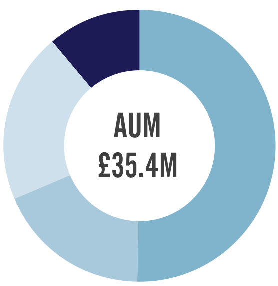
CASE STUDY:

BLAZE

Founded in 2012 by Emily Brooke, Blaze designs products which enhance bike safety. Their flagship product, the Blaze Laser Light, in addition to its consumer applications, is now fitted to the entire fleet of 11,500 Santander bikes in London. Now in discussions with New York, Paris and Sydney cycle schemes, Blaze has successfully expanded its offer to the global cycle hire market to include advanced logging capabilities, enabling scheme operators to analyse usage and predict maintenance needs.

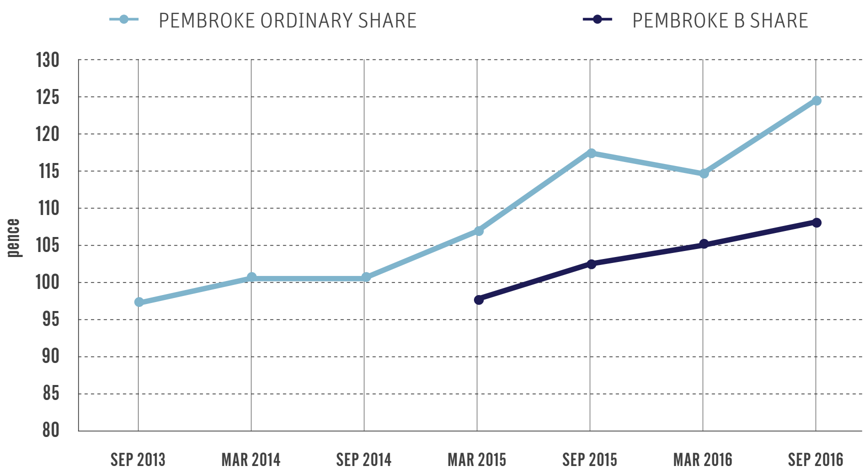
Having increased its team size from 6 to 11, Blaze raised a further £4.5 million in summer 2016 from a private office at a significantly increased valuation, enabling it to scale its design, marketing and sales activities. This has allowed its current 'Burner' front and rear LED lights to be complemented by a variety of new products now in the pipeline for 2017 launch.

PORTFOLIO SECTOR ALLOCATION BY VALUE



HOSPITALITY	50%
APPAREL & ACCESSORIES	18%
MEDIA & TECHNOLOGY	21%
HEALTH & FITNESS	11%

TOTAL SHAREHOLDER RETURNS



All figures as at 30 September 2016

VCT COMPARISON

VCT INVESTMENT OPPORTUNITIES

	PROVEN GROWTH & INCOME VCT PLC (PGI VCT)	CALCULUS VCT
MANAGER	Beringea LLP	Calculus Capital
DESCRIPTION OF OFFER	The offer is targeting returns which are greater than those available from investing in a portfolio of quoted companies, through the Company's established strategy of investing in a portfolio of carefully selected small and medium sized private companies with the potential for rapid growth. Investors in the Offer will be buying into ProVen VCT's existing diversified portfolio of companies. The funds raised will be used to enable the company to make further investments in companies which the manager believes have high growth potential.	Calculus VCT plc will invest in established unquoted companies across a diverse range of sectors. The current raise of £4 million is for a Top Up Offer. The focus is both capital appreciation and income generation, with a target yield of 4.5% of NAV per annum. Calculus Capital, the Venture Capital portfolio manager, was co-founded by John Glencross and Susan McDonald and has been investing in UK SMEs for over 17 years.
YEAR FOUNDED	2001	1999
TYPE OF VCT	Generalist	Generalist
AUM (TOTAL/VCT)	£170m/£71.8m in PGI VCT (as at 31/08/2016)	£133m/£5.6m
LAUNCH DATE	21 Sep 2016	28 Nov 2016
INVESTMENT OBJECTIVE	Growth & Income	Growth & Income
TARGET FUNDRAISE	£30m + up to £10m over allotment	£4,000,000
TYPE OF FUNDRAISE	New Ordinary Share Offer	Top Up
TARGET RETURN / YIELD	5% target dividend yield	4.5% of NAV annual dividend
5 YEAR CUMULATIVE RETURN	Increase of 26% between 31 May 2011 and 31 May 2016	n/a
MIN INVESTMENT	£5,000	£5,000
INITIAL FEE	3% advised, 5.5% execution only/non-advised	3% (advised/execution only) or 5% (direct)
AMC	2% of NAV	1.75%
PERFORMANCE FEE (IF APPLICABLE)	20%	20%
OTHER FEES	Annual running costs capped at 3.6% of net assets – expected to fall to 2.5%	Cost cap of 3.4% of the gross amount raised

VCT INVESTMENT OPPORTUNITIES

	DOWNING	OCTOPUS TITAN VCT
MANAGER	Downing LLP	Octopus Investments Ltd
DESCRIPTION OF OFFER	Two share class offers: A Generalist Share Class with no sector bias. Qualifying investments will focus on revenue-generating growth companies and opportunities that have tangible assets in the business to secure the investment against in order to manage risk. Non-qualifying investments will mainly comprise funds managed by Downing's Public Equity team and cash deposits. The Healthcare Share Class aims to provide attractive returns to investors by investing in a portfolio of healthcare companies. The focus will be on development and expansion funding for innovative healthcare and biomedical businesses.	Octopus Titan VCT is a generalist VCT and the largest in Europe. The portfolio features around 50 early-stage companies operating in many different sectors, making it a great way for investors to get broad exposure to this part of the UK economy. The new share offer aims to fund new investments as well as additional investments into existing portfolio companies. Titan is targeting an annual regular dividend of at least 5p per share. In addition, the VCT will aim to pay dividends when there are significant gains from the realisation of portfolio holdings.
YEAR FOUNDED	1986	2000
TYPE OF VCT	Evergreen	Generalist
AUM (TOTAL/VCT)	£700m/Over £200m	£6.1bn/£611m
LAUNCH DATE	08 Dec 2016	Titan launched in 2007, New Share Offer 23 August 2016
INVESTMENT OBJECTIVE	Growth & Preservation	Growth & Income
TARGET FUNDRAISE	Generalist: £20m Healthcare: £10m	£70m with over allotment facility of a further £50m
TYPE OF FUNDRAISE	New Share Issue	New Share Issue
TARGET RETURN / YIELD	Target dividends of at least 4% p.a. from year four onwards	5% annual dividend plus special dividends
5 YEAR CUMULATIVE RETURN	n/a	Refer to brochure
MIN INVESTMENT	£5,000 p.a. or £500 p.m.	£3,000
INITIAL FEE	2% (Non-execution), 4% (Execution only)	3% (2% for existing VCT investors)
AMC	2% Generalist and 2.5% Healthcare	2%
PERFORMANCE FEE (IF APPLICABLE)	20% of all dividends paid if the total return exceeds the hurdle. The hurdle is £1.00 per share up to 31 March 2020, £1.03 per share at 31 March 2021 and will rise by 3p p.a. thereafter	Performance fee of a maximum of 20% on all future gains above the current high water mark
OTHER FEES	Refer to the Prospectus for full details	Fees to investee companies not to exceed 1.5% of total amount invested by Octopus

PEMBROKE VCT B SHARE OFFER
Oakley Investment Managers
Pembroke is a capital growth-oriented VCT offer with a focus on post-revenue branded consumer and leisure investments. Established in 2013, it invests across four key sectors: health and fitness, hospitality, apparel and accessories, and media and technology. With a maturing portfolio of growing brands, it offers investors a mixture of growth and dividend yield along with the lowest TER in the generalist VCT category.
2013
Generalist
£1.3bn in wider Oakley group, £35m in VCT at 30 Sept 2016
Ordinary shares: 2013 B shares: 2014
Growth & Income
£25m
New Share Issue
Target dividend of 3p/share (yield of 2.7%), total return target of 6-9% p.a.
5 year returns n/a (launched in 2013) 3 year returns 27.8%
£3,000
2% advised, 5% execution only
2%
20% over hurdle of 3% p.a.
None: no deal, director, company management or governance charges

PROVIDER DIRECTORY

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FINAL CONCLUSIONS

REPORT CONCLUSIONS

SUMMING UP AND LOOKING AHEAD

1 DEMAND FOR VCTs IS GROWING

Our survey suggests that more advisers are using VCTs than previously. Anecdotal evidence based on conversations with advisers and the number of incoming enquiries Intelligent Partnership and MICAP receive also support this conclusion.

2 TAX, DIVERSIFICATION AND THE ABILITY TO ADD VALUE ARE THE REASONS WHY

Follow up analysis confirms that the reasons for this are what most readers would expect: lower limits on the amounts that can be saved in pensions, an increase in wealthier clients with income tax bills they would like to reduce, adviser focus on tax planning as a way of adding value for clients post RDR and smaller company investment as a diversifier.

3 SUPPLY IS LIKELY TO BE LOWER THIS YEAR

After several years of successful fund-raising, it seems that many VCTs are choosing not to go looking for new funds this year, especially now that the changes announced in the 2015 Budget have come into force. There is a smaller universe of potential investments for VCTs, and more conservative managers who supported management buy-out with their funds are having to rethink their strategy.

4 THEREFORE ADVISERS MUST BE READY TO INVEST

Reduced supply means that advisers who do want to use VCTs for their clients this year will need to prepare in advance. Research and due diligence, panel selection and shortlisting should all be completed quickly, so that when VCTs do open, advisers can move fast. There's a certain amount of this rhetoric every year from the industry as part of the annual marketing effort, but this time it is more pertinent than usual.

5 RULE CHANGES ARE REFLECTED IN THE DATA

All of this year's launches have been for VCTs that target Growth and Income. This has always been the most popular VCT sector, but so far this year there are no VCTs targeting Capital Preservation. The number of VCTs that charge exit performance fees is also ticking up (from a low base) and the number of underlying investments they target is also on the increase – perhaps a reflection of the focus on growth as managers seek more diversification to reduce risk.

LOOKING AHEAD

Although the EIS sector typically raises twice as much as the VCT sector, AIC research suggests that more advisers use VCTs than EIS.

And even though this year is likely to be a thin year for VCT fundraising, we wonder if VCT fundraising will begin to catch up with EIS. The drivers we have discussed throughout the report – pension changes and wealthier clients looking to reduce their income tax bills – remain in place. These are the same drivers for EIS, but EIS might be too risky for many investors. VCTs, with their listed status and greater levels of transparency and liquidity (although we must not over egg those benefits), might appeal to a growing cohort of investors with tax planning needs, but no appetite for EIS.

More money chasing fewer VCT fund-raising efforts, coupled with high barriers to entry for new managers, could shift the balance of power in the market and place too much power in the hands of the managers at the expense of consumers. We don't see any evidence of this yet, but if providers think they can get away with charging more than costs could creep up. We'll keep an eye on this in the future. It would be great to see more offers from more providers in the market next year.

VCTs have served the SME community well, as the evidence in the report demonstrates. They support growth, research and development and help to create jobs. They play an important part in raising funds and have an important place on UK SMEs' "funding escalator", often making investments of between £500,000 and £1 million, where many companies can struggle to secure funding. Over 20,000 new jobs have been created and on average £1.19 million has been spent on R&D by VCT backed businesses. 75% of companies supported by VCTs have undertaken some form of R&D as a result of their investment. These are compelling statistics and show the value of the VCT scheme to the wider UK economy.

APPENDIX I

USEFUL ORGANISATIONS & RESOURCES

The Association of Investment Companies (AIC)

The AIC is the trade body for closed-ended investment companies. The organisation provides an online platform which allows advisers to compare investment companies and review historical performance information.

WWW.THEAIC.CO.UK

London Stock Exchange (LSE)

Readers can find useful information on VCT shares from LSE's website, including bid and offer prices, key fundamental ratios and an interactive chart facility that supports simple technical analysis.

WWW.LONDONSTOCKEXCHANGE.COM

FE Trustnet

FE specialises in the collection, validation and distribution of fund and equity prices, and factsheet information. In addition to key statistics, the company provides a custom charting facility which advisers can use to make comparisons between VCTs and against a benchmark.

WWW.TRUSTNET.COM

Morningstar

Morningstar is a leading provider of independent investment research. The company provides data on nearly 540,000 investment offerings, including VCTs. Its website offers key statistics such as a VCT's total assets and market capitalisation, as well as data on returns and dividend payments.

WWW.MORNINGSTAR.CO.UK

MI Capital Research (MICAP)

MICAP is a provider of independent due diligence and research into the alternative investment market. As well as being a research tool, the MICAP Fund-Finder enables investors to Search, Compare and Select investment opportunities suitable for their investment needs.

WWW.MICAP.COM

HM Revenue & Customs (HMRC)

HMRC's website provides statistics and information about VCTs, including official statistics on the number of VCTs and amount of investment raised. More importantly, readers can find HMRC's internal manual on VCTs, which includes all the information on tax reliefs and qualifying criteria.

WWW.GOV.UK

APPENDIX II

POLICY CHANGES TIMETABLE

VCT POLICY CHANGES

2004-2005

FROM 6 APRIL 2004, THE MAXIMUM INVESTMENT QUALIFYING FOR INCOME TAX RELIEF INCREASED FROM £100,000 TO £200,000. CAPITAL GAINS DEFERRAL RELIEF IS NOT AVAILABLE.

2006-2007

FROM 6 APRIL 2006, THE MAXIMUM GROSS ASSETS OF QUALIFYING HOLDINGS DECREASED TO £7 MILLION BEFORE INVESTMENT TO £8 MILLION IMMEDIATELY AFTER INVESTMENT. THE RATE OF INCOME TAX RELIEF REDUCED TO 30%. THE HOLDING PERIOD FOR SHARES HELD BY VCTS INCREASED FROM THREE TO FIVE YEARS.

2007-2008

FROM 6 APRIL 2007, VCT QUALIFYING HOLDINGS WERE LIMITED TO COMPANIES WITH FEWER THAN 50 FULL TIME EQUIVALENT EMPLOYEES AT THE TIME SHARES WERE ISSUED. FROM 19 JULY 2007, COMPANIES MUST HAVE RAISED NO MORE THAN £2 MILLION IN ANY 12 MONTH PERIOD UNDER ANY OR ALL OF THE TAX-BASED VENTURE CAPITAL SCHEMES.

2009-2010

MONEY RAISED SHOULD BE WHOLLY EMPLOYED WITHIN TWO YEARS OF THE ISSUE OF THE RELEVANT HOLDING OR, IF THE ISSUE TAKES PLACE BEFORE COMMENCEMENT OF THE INTENDED TRADE, WITHIN TWO YEARS OF COMMENCEMENT.

2011-2012

THE REQUIREMENT THAT THE TRADE BE CARRIED ON WHOLLY OR MAINLY IN THE UK WAS REMOVED, AND REPLACED WITH A REQUIREMENT THAT THE ISSUING COMPANY HAVE A PERMANENT ESTABLISHMENT IN THE UK. RESTRICTION THAT PREVENTED A VCT INVESTING MORE THAN £1 MILLION PER ANNUM IN ANY SINGLE COMPANY REMOVED.

2012-2013

FROM 6 APRIL 2012, VCT QUALIFYING HOLDINGS WERE EXTENDED TO COMPANIES WITH FEWER THAN 250 FULL TIME EQUIVALENT EMPLOYEES AND GROSS ASSETS OF NO MORE THAN £15 MILLION BEFORE INVESTMENT AND £16 MILLION AFTER INVESTMENT. THE ANNUAL INVESTMENT LIMIT FOR COMPANIES WAS INCREASED TO £5 MILLION, AND THAT SUM MUST TAKE ACCOUNT OF EIS AND SEIS INVESTMENT.

2014-2015

FROM APRIL 2014 VCTS CAN NO LONGER RETURN SHARE CAPITAL TO INVESTORS WITHIN THREE YEARS OF THE END OF THE ACCOUNTING PERIOD IN WHICH THE VCT ISSUED THE SHARES. AT BUDGET 2014 THE GOVERNMENT ANNOUNCED THAT COMPANIES BENEFITING FROM RENEWABLES OBLIGATION CERTIFICATES (ROCS) AND/OR THE RENEWABLE HEAT INCENTIVE (RHI) SCHEME WILL BE EXCLUDED FROM VCTS.

2014-2015

FROM APRIL 2014 A MEASURE WAS INTRODUCED TO PREVENT INVESTORS REFRESHING INCOME TAX RELIEF ON INVESTMENT INTO VCTS BY DISPOSING OF VCT SHARES AND REINVESTING THE PROCEEDS IN NEW SHARES. THE LEGISLATION ALLOWED NEW INVESTMENT INTO VCTS TO STILL BE ELIGIBLE FOR INCOME TAX RELIEF. HOWEVER, INVESTMENTS THAT ARE:

- CONDITIONAL ON A SHARE BUY BUY-BACK, OR WHERE A SHARE BUY-BACK IS CONDITIONAL UPON THE INVESTMENT; OR
- MADE WITHIN A SIX MONTH PERIOD OF A SALE OF SHARES IN THE SAME VCT, WILL NOT QUALIFY FOR INCOME TAX RELIEF.

2016-2017

FROM 6 APRIL 2016, VENTURE CAPITAL TRUSTS (VCTS) WILL NO LONGER BE PERMITTED TO MAKE ANY NON-QUALIFYING INVESTMENTS WHICH ARE NOT ONE OF THE LIQUID INVESTMENTS. CHANGES WERE MADE IN 2015 ON QUALIFYING COMPANY CRITERIA TO ENSURE THAT THE VCT RELIEFS CONTINUED TO COMPLY WITH EU STATE AID.

CPD AND FEEDBACK

NEXT STEPS AFTER READING

CLAIM YOUR CPD

Intelligent Partnership has achieved accredited status for AiR from the CISI, CII and PFS. Members of these professional organisations represent the majority of the insurance, investment and financial services industry.
Readers of the industry report can claim one CPD hour towards their CISI, CII or PFS member CPD scheme for each hour spent on the report. The CPD hours claimed should reflect the length of time spent studying the material.
The review process included an assessment of the technical accuracy and quality of the material against CPD Accreditation standards. Achieving the recognised industry standard afforded by these organisations for this report, and our training, demonstrates our commitment to delivering only balanced, informative and high quality content to the financial services and investment community.
In order to obtain CPD and meet accreditation standards, readers must complete a short questionnaire and provide feedback on the report. This includes 12 multiple choice questions to demonstrate learning and a feedback form to assist in the compilation and improvement of future reports.

To claim CPD please visit:
Intelligent-partnership.com/cpd

PROVIDE FEEDBACK

Intelligent Partnership actively welcomes feedback, thoughts and comments to help shape the development of this industry report, with a particular interest in the topics readers would like to be covered in more detail in interim and future annual reports.
This report is produced on an annual basis and is compiled through the conducting of research and surveys with providers, promoters and practitioners within the alternative investment industry. Greater participation, transparency and fuller disclosure from industry participants should help foster best practice and drive out poor practice.
Feedback can be given on the website or via email:

Intelligent-partnership.com/feedback
Reports@intelligent-partnership.com

Participation and feedback are gratefully received.

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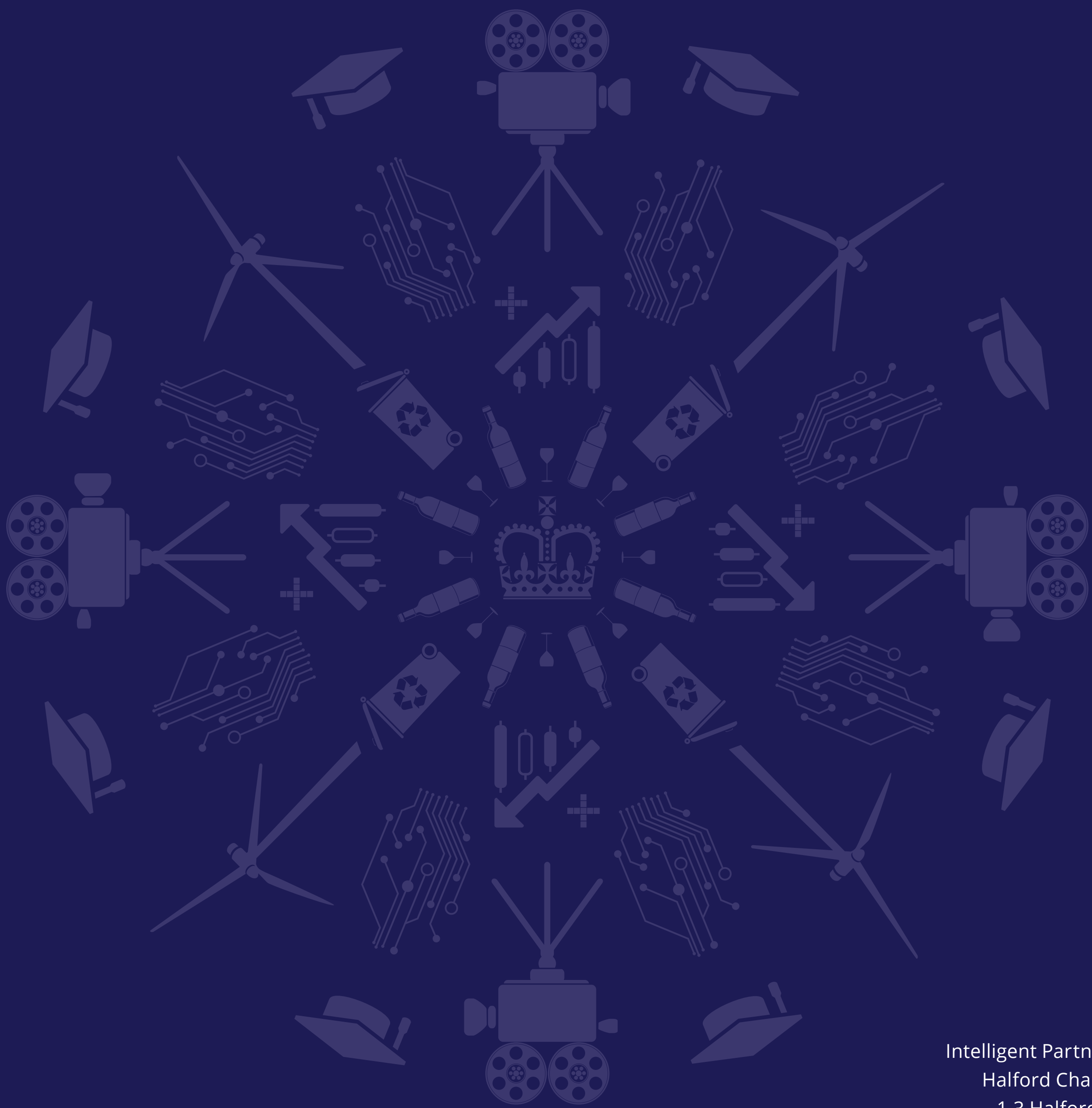
PUBLICATION

The information has been compiled from credible sources believed to be reliable, however it has not been verified and its accuracy and completeness are not guaranteed.

The opinions expressed are those of Intelligent Partnership at the date of publication and are subject to change without notice.

"We know that advisers are increasingly interested in VCTs. It will be no surprise to any of our readers that our market research found that lower limits on the amounts that can be saved in pensions are starting to have an impact. Advisers looking for alternative tax efficient investments have naturally turned to VCTs." – **Guy Tolhurst, Managing Director, Intelligent Partnership**



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