THE PARAPLANNERS

Our perspective on Nova Cofoundery SEIS & EIS Fund focussing on the SEIS element

INTRODUCTION

We're often asked by financial advice practices and professionals to help them and their clients by undertaking research and analysis of a scheme as part of their suitability process.

As paraplanners, we really enjoy immersing ourselves in a 'deep dive' into a proposition; not only because it helps advisers and their clients fully understand what's involved, but because we think – to offer valuable insights – it's vital to keep on top of the latest innovations in financial products and services too.

Because financial services are in a continuous state of evolution and change. And that's certainly true of the SEIS market.

So when **Nova Capital Growth (Nova)** asked us to prepare a technical review of the **Nova Cofoundery SEIS & EIS Fund (focussing on how the SEIS element functions and referred to as 'Nova Cofoundery SEIS'),** written from a paraplanner's perspective, we relished the challenge.

And apart from providing us with details of the SEIS, and answering lots of questions, we have enjoyed the freedom to craft this review however we wanted without input from Nova.

What follows is is our own – independent – analysis. We have prepared a technical review and also a deployment guide which offers guidance for advisers and paraplanners who are considering recommending an SEIS as part of a portfolio.

This document is for financial advice professionals only. It is not a recommendation or endorsement and provides information and analysis only.

Further information is available from Nova at https://invest.novagrowthcapital.co.uk.

SUMMARY

Investment Vehicle	Seed Enterprise Investment Scheme (SEIS)
Fund Name	Nova Cofoundery SEIS & EIS
Investment Objective	To invest into a cohort of 10 early-stage companies alongside Nova Cofoundery Limited who will mentor each company with the aim to reduce the rate of failure and improve the chances of success when investing in the knowledge intensive industries
Fund Type	Open Ended, FCA Regulated, Unapproved Fund
Sector & Market Cap Focus	Early start-ups, Finance, Market Services, Health, Manufacturing, Information Technology, Communication & Media
Tax Benefits	Income, Capital Gains, Inheritance Tax, Loss Relief
Target Return	A minimum return of 38.5p in the £1 if the fund fails in full and a targeted return after three years of c£1.72 for each £1 held by investors in the fund
SRRI Risk Level	6 out of 7 (High Risk)
Subscription Levels	Minimum is £10,000
Term for Investment	Minimum holding period of 3 years, with a total expected term for investment of 6 years.
Costs	No initial charge to the investor, 2% annual management fee and 20% performance fee if the fund value grows to 150% of the sum invested
Application Process	Applications can be made via post or registering and following an online process
Further Information	https://invest.novagrowthcapital.co.uk

BACKGROUND

This is a due diligence document for the Nova Cofoundery Seed Enterprise Investment Scheme (SEIS). Its objective is to provide UK advice professionals with analysis and commentary on the Nova Cofoundery SEIS fund and strategies for deploying an SEIS fund within a client's wider investment portfolio.

NOVA COFOUNDERY SEIS

The Nova Cofoundery SEIS is an Open Ended Alternative Investment Fund (AIF) which launched in 2018. The fund invests into a pool of companies alongside the Nova Cofoundery Enterprise Investment Scheme (EIS) into early stage companies.

The SEIS fund was launched as Nova identified from their 12 year investment experience that early stage technology companies potentially offer an attractive investment opportunity to UK investors. Nova's objective is to try and increase the survival rate of these companies by enrolling them in a mentor programme which provides organisation, structure, knowledge, financial support, and guidance to help them navigate the early years of inception.

Investing in early stage companies is inherently risky. Nova has identified that a viable structure to attract capital for these companies is to utilise the tax advantages of an SEIS and EIS investment vehicle. The structure of these vehicles will help reduce the risk to the investor and ensure Nova engages with suitable investors who have the willingness and ability to invest into these styles of companies for the duration of the investment.

"A short survey of the SEIS marketplace in December 2020 identified c. 17 companies offering a managed fund SEIS solution. These funds fall into one of two categories: investor funds and engagement/mentor funds."

SEIS Market Sample Survey 2020, The Paraplanners

WHAT IS AN SEIS?

SEIS are UK domiciled investments which launched in 2012/13 following a government initiative to assist new and early stage companies attract investment capital. The SEIS was designed to complement the existing tax advantages available via EIS and Venture Capital funds (VC). An SEIS is focused on early stage companies whose objective is to grow and develop over the long term. Early stage companies will employ the investor capital to develop their businesses and products.

A SNAPSHOT: THE SEIS MARKETPLACE

Since SEIS launched in 2012, c. 12,040 companies have received over £1bn of investment. SEIS are either a standalone company or a portfolio of companies managed by a team of professionals.

A short survey of the SEIS marketplace in December 2020 identified c. 17 companies offering a managed fund SEIS solution. These funds fall into one of two categories: investor funds and engagement/mentor funds. [1]

Investor funds aim to identify potential investment opportunities and then leave the company or entrepreneur to manage their own business; whereas the engagement and mentor funds work alongside the business or entrepreneur to increase the chance of building a successful business and reduce the risk of failure.

In a survey conducted on six out of the 17 managed SEIS available, c. 50% had some form of early stage business engagement, although we note the level and depth of this was not known and the general industry trend has been to adopt a hands-off approach. [1]

The average size of investment for investors who claimed Income Tax relief into an SEIS in 2018/19 tax year was c£10,000 or less. Investments in excess of £25,000 accounted for 60% of the total amount invested in SEIS. The majority of companies received a sum in excess of £50,000; whilst the maximum they can ever receive from the SEIS is £150,000. The HMRC estimate is that in the 2018/19 tax year c. 7,480 investors claimed Income Tax relief following an SEIS investment.

The Information, Technology and Communication sectors received the majority of investment in 2018/19, with c34% (c£55m) invested. This sector's business activity includes software, cyber security, programming, communications, data hosting, publishing, motion picture, television production, sound recording and music publishing. [2]

The next four largest sectors (professional, scientific, and technical, admin and support services) attracted c40% of the investment capital (c£66m), and between them the 5 sectors account for c74% of all SEIS investment.

Geographically, early stage companies that are registered in London and the South East dominated 71% of all SEIS investments in the last tax year, although geography does not necessarily indicate the centre of gravity for a firm's trading activity.

Early stage companies must be 'qualifying' to receive SEIS status from the HMRC; although as many companies are start-ups, lone entrepreneurs or simply an idea, they can apply for 'Advance Assurance' from the HMRC to begin fund raising activities. Not all companies apply for this.

SEIS have tax year subscription limits for investors with the maximum investment sum being £100,000; they also have eligibility requirements and are designed for experienced and High Net Worth (HNW) investors and should be held as part of a wider diversified investment portfolio.

The sums that are expected to be invested into the SEIS sector (as of May 2020 relative to previous years) has been forecast to see a slight decline (investment levels previously ranged from c. £155m to £162m) and are forecast to fall to c. £144m. The 2020 health crisis and its economic impact could reduce funds raised in 2020/2021. To put this into context, between 2008 and 2011 the sums invested into an EIS declined during and following the Global Financial Crisis. [3]

SEIS TAX BENEFITS

An SEIS has the following tax advantages:

50% Income Tax Relief: SEIS attract Income Tax relief at a rate of 50%. This means an investment of £50,000 would attract tax relief of up to £25,000. Please note:

- You cannot claim a higher level of Income Tax relief than the tax that you have paid (so if the SEIS generates tax relief of £15,000 and the investor only paid £10,000 Income Tax, they can only claim £10,000 Income Tax relief).
- SEIS must be held for a minimum of three years to qualify for the tax reliefs (if a business fails before three years for genuine reasons, then HMRC has confirmed the tax reliefs are not withdrawn). [4]
- The maximum subscription is £100,000 per tax year.
- Investors have up to five years to claim the tax relief.

- Tax relief can be claimed via the tax return, paid directly to the investor, or employed to reduce the Income Tax liability directly via the HMRC.

Income Tax & Contribution Carry Back: The carry back facility allows the investor to treat shares as if they were acquired in the previous tax year (assuming the investor has a subscription allowance available); this allows them to potentially contribute a maximum of £200,000 spread over two tax years.

This feature allows the investor to reclaim the Income Tax paid in the previous tax year.

CGT Re-investment & Disposal Relief: Gains arising on the disposal of any asset which are reinvested into an SEIS where the investor has received Income Tax relief are eligible for CGT re-investment relief. This relief enables an investor to allow 50% of the gain to be exempt from CGT. The maximum amount of relief that can be claimed by the investor is £50,000 (the disposal and the investment must both be made in the same year and the SEIS must be still be held when the gain has arisen).

If disposal relief is due the investor will not have to pay Capital Gains Tax on a gain on the disposal of SEIS shares. The following conditions have to be met:

- They must have held the SEIS shares for at least three years
- They must have received SEIS Income Tax relief in full on the whole of their subscription for the SEIS shares and none of the Income Tax relief must have been withdrawn
- Investors may not have to pay Capital Gains Tax on a gain on their disposal of the SEIS shares, even if they did not receive Income Tax relief in full on all their SEIS shares, provided they received some Income Tax relief. In this case, to qualify for disposal relief, none of that Income Tax relief must have been withdrawn and the only reason they did not receive Income Tax relief in full was that their claim reduced their Income Tax liability to nil.

Inheritance Tax: If the investor holds the SEIS for a minimum of two years and it is retained until death, then the investment is not liable to Inheritance Tax.

Please note if a beneficiary receives the SEIS shares on death they do not receive any tax reliefs and they would be liable to any CGT that might be payable.

Loss Relief: If the SEIS investment performs poorly, or its value falls to zero, then the investor can claim loss relief on the investment and offset this against their Income Tax liability.

Loss relief is granted based on the highest rate of Income Tax they pay and calculated from the sum lost after accounting for any Income Tax relief previously paid. For example, if after accounting for Income Tax received, the investor was a higher rate taxpayer and had generated a £20,000 loss, 40% of this loss (£8,000) could be offset against their Income Tax liability.

Loss relief when combined with Income Tax relief can minimise the impact of losses that an investor may experience. Loss relief can be reclaimed against CGT or Income Tax, even if the business fails within three years.

Please note: **The SEIS tax benefits are dependent upon the individual circumstances of the investor and the SEIS remaining a ‘qualifying investment’.**

SEIS Investor Eligibility: To be eligible to invest into an SEIS the investor must be:

- Age 18 and UK tax resident.
- Either individually or with associates, have a substantial, interest in the company receiving the investment.(A ‘substantial interest’ means controlling the company, or possessing more than 30% of the

company's share capital or more than 30% of the voting power in the company, or being entitled to more than 30% of the company's assets in a winding-up. This does not apply, subject to certain conditions, at any time when the only shares issued are the original subscriber shares). For this purpose, an 'associate' includes a spouse or civil partner, lineal ancestor or descendant, a business partner, or certain persons with whom they have connections via a trust.

- The SEIS must be purchased with cash.
- Invest no more than £100,000 into SEIS in a single tax year.

SEIS Company Eligibility: To be an eligible and remain a compliant SEIS the business must be:

- Independent and unquoted before beginning SEIS.
- Must trade in a qualifying sector and have less than 25 full time employees.
- Have no more than £200,000 of gross assets at the time the shares are issued.
- To have been trading for less than two years.
- The maximum SEIS investment in the business over a lifetime is capped at £150,000.

NOVA COFOUNDERY SEIS

The Nova Cofoundery SEIS is located with the Nova Group holdings, which is the 'Group', under which Nova has two operating firms.

- Nova Growth Capital Limited, provides the "Nova Cofoundery SEIS and EIS fund" product.
- Nova Cofoundery limited. This is the operational centre of the business, which employs in excess of 100 staff to work as founders with the early stage businesses, select investment opportunities and manage deal flow.

Nova Group Holdings Limited was previously Galactic HQ Limited prior to 2015. The management and employees have longevity in the marketplace, having previously invested into early stage and fledgling companies for over 10 years. Historically they worked with 'Angel Investors' and more recently SEIS and EIS funds such, as DeepBridge and Capital.

In 2018 Nova took a strategic decision to restructure and launch their own SEIS and EIS offering to improve the money flow into the early stage company business opportunities they had identified, to de-risk their underlying business model, remove partners' funding dependency and improve the management process for the early stage companies and the risks associated with investing in these businesses.

The Nova Group's core unique selling point is that Nova Growth Capital Limited via the SEIS and EIS will co-invest alongside Nova Cofoundery Limited to help 'incubate' and 'nurture' the early stage company's business. This approach has been adopted to reduce failure rates as a result of early stage companies lacking business skills, management experience, financial resources, upscaling too quickly or losing key employees.

MANAGEMENT TEAM

The Nova Cofoundery SEIS is an 'engagement and nurture' fund and so it is important to understand the experience and skill set of the individuals involved in management of the business and delivery of this strategy.

We have identified they should be suitably qualified or experienced in the following areas:

1. Experience of managing early stage companies in the Information, Communication and Technology Sectors.
2. Have direct experience of working in the Information, Communication and Technology Sectors.
3. Experience of Information, Communication and Technology business operation.
4. Experience of Investment Management.

Key members of the team are:

Chief Executive Officer, **Andy Davidson,** who has a breadth of experience in launching, managing, and taking a business to exit. His key experience is evidenced as follows:

- He cofounded a large number of technology companies over a 20 year period, raising over £5m in capital for these. He also continues to retain a directorship across a number of them.
- Sentric Music is a success story of his. Following a total investment of £50,000 in 2008 and 2009, the company exited in 2017 and 2020 with x30 and x60 multiple of the original investment.

- In 2017 the Sunday Times listed him as one of the UK's top 100 disruptive entrepreneurs.

Nova describes Chairman, **Paul Morrissey**, as an experienced technology entrepreneur. His notable key skills and experience are evidenced as follows:

- He is a chairman in four other firms across a range of sectors – Lucid Games, Tubedale Films, Stagereel Films and A&M Wealth Management.
- In 2010 he was awarded a Professorship by the School of Mathematics and Computing at Liverpool John Moores University for his work surrounding University technology 'spin-out' companies.
- In 1989 he founded his own business, the Tubedale Group, which is an international telecommunication, project management, software development and integration business.

Olivia Greenburg is the Chief Growth Officer at Nova and she heads up the business mentor and product management teams. Olivia has a wealth of experience in establishing and delivering digital business strategy, innovation, transformation, and operations as evidenced as follows:

- Over a 14 year career at Amaze, a European digital marketing, technology, and commerce consultancy, she worked with global brands and occupied key roles as Transformation Consultant, Programme Manager and Operations Director.
- As Operations Director she managed teams across four offices to deliver a portfolio valued at over £10m.
- She has worked as an independent Digital Consultant.

Darren Gowling is the Chief Investment Officer (CIO) at Nova. He is an experienced investment and operations director who started his career in fund management; his key experience is evidenced as follows:

- He has 11 years of experience in Fund Management; initially beginning his career with early stage VC firms, before moving to the fund management firm Alliance.
- He has held five positions as a director working with early stage companies or university early stage businesses, that focused on financing, deal flow, investor opportunity identification and crowdfunding.

Jeremy Westhead is the Chief Financial Officer (CFO) at Nova. He is an experienced Financial Officer who started his career at PWC; his key experience is evidenced as follows:

- He has 14 years of experience as a Financial Officer.
- His responsibilities have been over his career – internal monitoring and reporting, FCA compliance, taxation, fund transactions, technology and systems, risk management and insurance, property management and external reporting.
- He is a member of the institute of Chartered Accountants and an Oxford University graduate.

Jason Rogers is the Chief Operating Officer at Nova. He has a wealth of experience in with overseeing the day-to-day administrative and operational functions of Nova and reporting to the management team; his key experience is evidenced as follows:

- He has six years of experience as a Bond and Swaps trader.
- He designed and built key operational systems at an asset management firm over a period of four years.
- He has six years of experience in an operations role in his last two positions. His duties included, strategic decision making and reporting, design and implementation

of a governance framework and operational responsibility for the following - compliance, legal, technology and HR.

Investment Adviser: Sapphire Capital Partners LLP. The role of Investment Adviser is deferred to a specialist firm, Sapphire Capital Partners LLP, a business whose experience is evidenced as follows:

- £60m of funds under management, 350+ SEIS, VCT, EIS HMRC applications and over 100 companies invested into.
- Sapphire Capital Partners Ltd has over 10 industry awards – including best fund manager – with 10 years of experience.
- Headed by Boyd Carson who has 30 years accounting and corporate finance experience.

"Extensive range of services and very active in engaging with the industry"

EISA 2020 [5]

2020 Awards: Nova won the 'Best New Product or Service' and 'Industry Rising Star' in the 2020 Growth Investor awards and was a runner up in the 2020 Best Industry SEIS Manager and Industry Game Changer awards.

INVESTMENT PHILOSOPHY

Nova Cofoundery Limited, which co-invests with the Nova Cofoundery SEIS, aims to identify companies within the technology market segment offer a potential investment opportunity.

This is because portfolio companies in Nova Cofoundery are growing, on average, at a rate of 36.5% year on year; however, investing in these is risky as 92% of the technology start-ups typically fail within three years.

To tackle this failure rate and to capture this potential return and manage the risks of investing, Nova developed (over a 10 year period) the 'Cofoundery' investment model which aims to address 80% of the most common reasons for technology early stage company failures.

Nova's research suggests failure is primarily accounted for by the following five major errors:

1. Building something nobody wants.
2. Having the wrong cofounders.
3. Hiring the wrong people.
4. Failing to execute sales and marketing.
5. Other

The 'Cofoundery' investment model tackles these issues by establishing an operational partnership between the start-up business and the team at Nova to provide each business with operational support and also guidance on product development and deployment.

This partnership Nova has identified will help to reduce business costs and provide the start-up business with access to business management experience and knowledge, whilst allowing Nova to manage the risks of investing by developing relationships with each business, which in turn improves their portfolio data analytics and understanding of future capital requirements.

Nova's investment model is designed to provide an operational structure and mentorship to aid the business decision making, business management and product development and deployment. It is essentially

"Nova understands the skills required by a cofounder team and can fill the gaps in the founder's capabilities. This way the cofounder team is known to the Investment Manager and importantly if the cofounder team does not feel they can work with the founder then the opportunity is deselected by Nova."

Nova Growth Capital Limited 2020 [6]

a process of applying 'Stewardship' to help the early stage businesses navigate the potential problems that can lead to failure.

NOVA COFOUNDERY BUSINESS OPERATION: DEAL FLOW AND OPPORTUNITY SELECTION

Nova sources potential candidates from the general marketplace by attracting them to enrol onto a digital e-learning mentor programme via digital marketing channels and professional relationships with Venture Capital Firms, Hospitals and Universities.

Nova Cofoundery Limited employs an on-line mentoring programme to screen and filter potential investment opportunities by identifying candidates using a process based on 'signal markers'. Signal markers are essentially 'factors' that Nova's own research has identified as being 'descriptors' of potential start-up business success.

An example of this is 'founder market fit'. If they understand the applicant is an expert in their field from their LinkedIn profile, then there is a much greater chance of success. [7]

Once suitable candidates are identified, Nova establishes direct contact to continue the due diligence process. Nova aims to see c. 25 opportunities per investment and employs the Berkus valuation model in the assessment process.

Examples of eligible investment opportunities are innovative software development, new medical technology applications, or fin-tech and edtech. [7]

"Examples of eligible investment opportunities are innovative software development, new medical technology applications, or fintech and edtech."

Nova Growth Capital Limited 2020

This selection process allows Nova to understand the time scales and the quantity and quality of their Deal Flow and the opportunities they have six to 12 months in advance. This helps them negotiate terms with businesses and generate funds for investment. Once a founder firm or individual has been identified Nova invests £300,000 and target a nine-month duration for launch. This approach ensures they understand how many companies they are starting over the next 12 months

Business Mentoring. The mentoring programme employs a methodology that Nova developed over a period of 10 years; it focuses the following:

1. Identify and gap fill any weakness in experience and knowledge.
2. Educate and focus the business on the product lifecycle and the end user problem.
3. Provide a secure source of funding to ensure capital is available to support the business growth.
4. Access expertise as required to reduce operational costs.
5. Build a relationship with the business in order to better understand its needs, key people and to ensure successful implementation of the programme.
6. Provide cash flow assistance to aid the retention of key workers, knowledge, and expertise.

The mentoring programme is delivered by a staff in excess of 160 people and via sub-contracting services. [7]

What type of business will the SEIS invest In?
The SEIS will invest into a diversified portfolio of a minimum of 10 companies that exhibit some or all of the following qualities:

1. Significant market potential with clear and demonstrable consumer or commercial need or demand.

2. A problem-originated solution that has the potential to create new market segments or displace current market offerings.
3. Companies that utilise a technology-driven platform and/or an innovative approach to meet a newly-identified, existing market or consumer demand.
4. Knowledge-intensive opportunities that possess a clear and realistic path to the delivery of a minimum viable product or prototype.
5. A clearly defined strategy aimed at creating and protecting intellectual property.
6. Passionate, energetic, and experienced founders.
7. A clear exit strategy to be implemented within five to six years with an alignment of founder interests with shareholders.

SEIS PORTFOLIO RISK MANAGEMENT

The SEIS and EIS will invest into a diversified portfolio holding c. 10 early-stage knowledge-intensive companies.

Nova estimates that c. three to six of these companies will be successful, with the majority of failures occurring in the early years and underlying returns being driven by the surviving businesses. Nova believes that holding 10 companies provides a level of diversification large enough to reasonably mitigate the risk of failure across the whole portfolio.

"In a sample we conducted of eight SEIS providers the number of companies expected to be held (on average) ranged from seven to 10; this provides evidence that Nova's diversification approach is similar to standard practice in the observed sample."

SEIS Market Sample Survey 2020, The Paraplanners

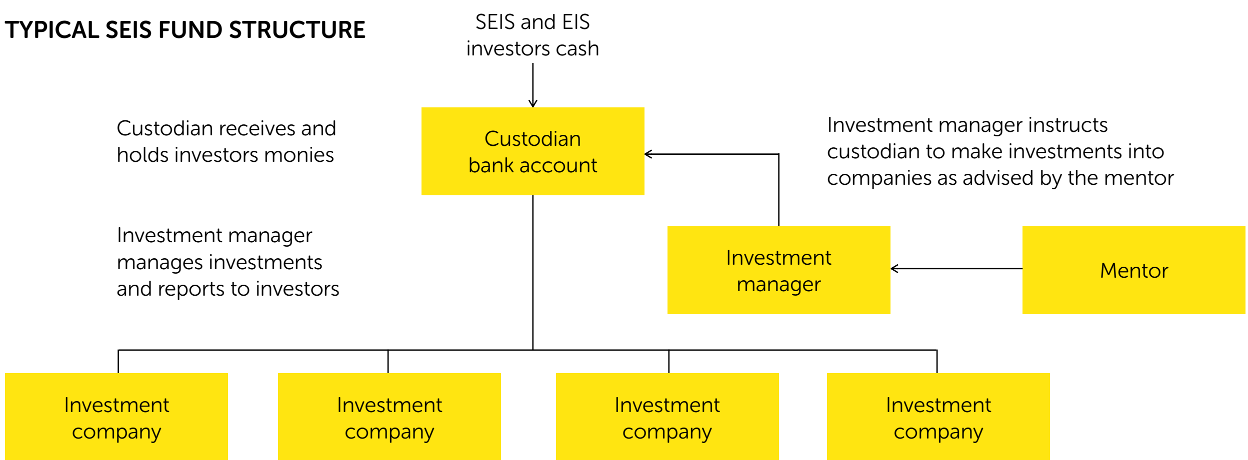
In a sample we conducted of eight SEIS providers the number of companies expected to be held (on average) ranged from seven to 10; this provides evidence that Nova's diversification approach is similar to standard practice in the observed sample. [1]

Nova will structure sector exposures so the portfolio will never have more than 25% invested within a specific sector in any given year and Nova has commented that the portfolio is rarely concentrated to this level.

Investor risk is reduced by using the tax advantages offered by the SEIS.

Nova estimates they will review at least 25 opportunities before making an investment, reducing risk via their early stage screening and due diligence process. Nova estimates this process allows them to identify more opportunities, increasing this from one out of 100 to four out of 100.

TYPICAL SEIS FUND STRUCTURE



Source: Sapphire Capital Partners [8]

Nova believes this approach helps support deal flow so the SEIS and partner funds have available investment opportunities, and it allows them to consider 1,000's of opportunities and ensure the deal pipeline has a nine to 12 month lead time so opportunities are available for investment and deal flow maintained.

SEIS risk score KIID: The Cofoundery SEIS fund has been rated by Nova as risk level six on the SRRI (Synthetic Risk and Return Indicator). See diagram below.

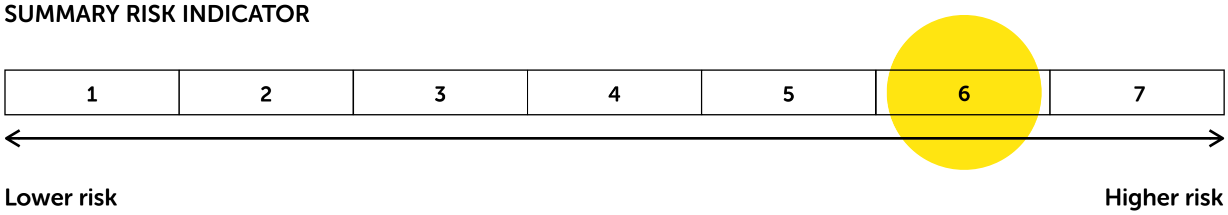
To provide relative comparison we contrasted this risk score to UK managed retail funds with the same six SRRI score. The survey confirmed the fund's risk score would rank it at the second highest level of risk, similar to global equity funds (large and small cap). [9]

The expected price volatility of the risk level 6 SRRI score is that it will range from c15% to c25% [10].

To put this into context for the investor, assuming a mid-range return of 5%, the dispersion of returns is expected to fall 75% of the time within two standard deviations of the average return; this is forecast to be at a lower bound of -45% to -25% and upper bound of +35% to +55%, with returns falling three standard deviations above and below these upper and lower levels 25% of the time. [9]

The expected risk and return range employed the Chebyshev Inequality to determine upper and lower return band probability (which is a probability theorem that provides a 'general' rule to determine the number of observations that lie around the mean) [11].

SUMMARY RISK INDICATOR



Client Protection

- SEIS are not covered under the Financial Services Compensation Scheme (FSCS).
- The Custodian, Mainspring Fund Services, is regulated and authorised by the Financial Conduct Authority (FCA), reference number: 591814. Mainspring was founded in 2010 and supports over 45 VC and start-up firms and has recorded a profit in the last two tax years.
- The Nova Cofoundery SEIS and partner funds are audited by its FCA regulated investment adviser Sapphire Capital Partners LLP (FCA ref: 565716) annually. Sapphire Capital Partners LLP has won numerous Enterprise Investment Scheme Association (EISA) awards over the last five years including best Fund Manager 2017 and best SEIS Tax Adviser 2020.
- Loss relief is available to the investor at their highest marginal tax rate should the SEIS underperform. Accounting for the Income Tax relief paid previously to an investor, any losses incurred would potentially have between 20% to 45% deductible from these losses which an investor can offset against their income or CGT tax liability in the year claimed. This offers a level of protection to

"In a sample of eight providers offering SEIS funds, Nova was an outlier in that it offered a short minimum investment term for investment at three years; most funds had a minimum term of five to seven years."

SEIS Market Sample Survey 2020, The Paraplanners the investor, especially if the full sum invested is lost.

- Professional Portfolio Management. By accessing the specialist services of the team at Nova, the investor can delegate the portfolio selection and management to a team of professionals.
- Medium Term Duration – the expected duration for investment is between three to six years with a minimum term of three years due to SEIS constraints; having a shorter investment horizon reduces the risk of experiencing an extreme event, although this also limits the time an investor will have to generate their return or recover losses should the underlying SEIS holdings experience a risk based event.
- In a sample of eight providers offering SEIS funds, Nova was an outlier in that it offered a short minimum investment term for investment at three years; most funds had a minimum term of five to seven years.
- The fund is 100% owned by Nova Growth Capital Limited. The Nova Group's financial statements are difficult to assess as they do not provide an insight into the potential success of the SEIS as they are new entrants.

Investment providers do go bankrupt, but as a measure of reassurance the investor should look to Nova's industry and management team experience and their longevity (10 years) in the market-place. In a survey of eight SEIS firms, Nova – alongside three others – had the second longest tenure in the sector. [1].

HISTORIC PERFORMANCE

The Nova Cofoundery SEIS has been in-force for only two years and so there have been no exits since launch, as the minimum holding period is three years to access the SEIS tax benefits.

The fund targets a return (including tax relief and excluding the impact of fees) of £1.72 for each £1 held by investors

"Investment providers do go bankrupt, but as a measure of reassurance the investor should look to Nova's industry and management team experience and their longevity (10 years) in the market-place. In a survey of eight SEIS firms, Nova – alongside three others – had the second longest tenure in the sector."

SEIS Market Sample Survey 2020, The Paraplanners

The Nova Group companies have experienced four exits over three businesses, between 2017 and 2019, with exits ranging from a multiple of x3.11 to x60 for each £1 invested. The total sum invested of £400,000 generated an exit amount in excess of £3.5m+.

Nova states that they expect at least 40% to 70% of the companies in each cohort to fail in the early years, with the returns being generated by the remaining companies.

In a survey of five SEIS providers we identified that they had target return multiples which ranged from circa x1.7 to x3. The performance data from the EISA website for SEIS and EIS confirm that the centre of gravity for exits will tend to sit around the x2 multiples or below for every c20 investments made. [5]

The nature of early stage companies (regardless of the experience available to support them) makes it inevitable there will be business failures and therefore the investor should not focus on 'past performance' when making an investment decision, but the tax opportunities the SEIS can provide. The tax relief should be the primary return mechanism, whilst the potential protection from the loss relief should also help minimise any losses.

We surveyed c. 100 exits from SEIS funds and identified that:

- c. 40% generated a loss of more than 95% of the sum invested

- c. 21% returned less than the original investment
- c. 10% returned 100% of the original investment
- c. 39% generated a return of more than 100% (of which 36% generated returns above 150%, with the middle 50% of the data generating an average return of c. 129% to c. 212%) [1]

COSTS

The fund has two fees that an investor will pay:

- An annual charge of 2% (taken annually); no adviser trail fees are paid.
- A 20% performance fee called a Success Fee charged at exit from the fund or company when the total return is more than 150% of the original investment e.g. if your return is 150%, Nova will take 20% of the funds returned.
- The investee companies pay the Nova 5% deal fee upon receipt of the funds and from this 3% can be paid as an initial advice fee to the adviser. This fee can be waived or rebated to the client to increase the sums invested.

In a survey of eight SEIS providers, only one firm levelled an initial charge, with initial fees generally being charged to the investee company i.e. the early stage company. Of these, 43% of firms charged a 2% annual fee and two levelled all annual fees on the early stage company.

This indicates that the Nova charges are broadly in line with industry standard practices and offer competitive value for money.

The Nova performance fee hurdle rate of 150% sits at the highest level – alongside two other providers from a sample of six companies we surveyed, this indicates that the investor will receive more of their investment back before the performance fee is levied. This shows the performance fee hurdle rate is good value for the investor.

"In a survey of eight SEIS providers, only one firm levelled an initial charge, with initial fees generally being charged to the investee company (i.e. the early stage company); of these 43% of firms charged a 2% annual fee and two levelled all annual fees on the early stage company."

Investment Research 2020, The Paraplanners

ADVISER OPERATION & IMPLEMENTATION

Eligibility: The fund is available for a UK tax-payer that is looking to reduce their tax liability to Income Tax, Inheritance Tax or CGT who is interested to invest in early stage companies.

Applications can be made directly by the client or the adviser on an advised or execution only basis. All adviser applicants must fulfil the FCA Conduct of Business Rules Sourcebook (COBS) suitability rules.

https://www.handbook.fca.org.uk/handbook/COBS/9/3.html

Execution only investments can be made by clients via an adviser subject to compliance with the COBS appropriateness rules (COBS rule 10) to high net worth individuals (COBS rule 4.7.7.(2)(a), certified and self- certified sophisticated Investors (COBS rule 4.7.7(2)(b) and (c) and restricted Investors (investing only 10% of their assets in non-readily realisable securities: COBS rule 4.7.7(2)(d).

Subscriptions

A minimum of £10,000 per investor.

Online access: Nova has a client/adviser facing online portal which details the deployment dates, sums invested, tax reliefs available and associated documentation. These details can be exported as a CSV or PDF file
The online portal is easy to navigate and includes the Memorandum Information (MI),

detail of the investment approach, the key risks to the investor and supporting information.

It also provides additional independent commentary on the Nova Group, the CEO, pre and post fund track records and impact of Nova on company survival rates to complement your research.

This is available from the investor dashboard under the Reviews section on the Nova client login.

To access, register here:

https://invest.novagrowthcapital.co.uk/

Closure date: The fund is open ended (called 'evergreen') and so it is always open for investment, although different deployment dates will close off the various tranches (cohorts) for investment.

Application process: You can apply online by registering on the Nova website and completing an online application client suitability form at the following address.

https://novagrowthcapital.co.uk/

You can complete the application form and client suitability form and send them, with the subscription cheque, to:

Nova Growth Capital Limited
Studio N
44 Simpson Street
Liverpool
L1 0AX

Minimum term for investment: To be eligible for tax relief the shares must be held for a minimum of 3 years.

Tax vouchers: You cannot claim your SEIS relief until you are in possession of the tax certificates (called SEIS 3 forms).

The tax voucher for the SEIS investment (SEIS3) should be available to the investor at the end of October in the tax year following the investment; although please note this is not guaranteed.

Adviser remuneration: The investee companies pay the Nova 5% deal fee upon receipt of the funds and from this 3% can be paid as an initial advice fee to the adviser. This fee can be waived or rebated to the client to increase the sums invested

Valuations and statements: A contract note is issued by post when Nova buys or sells an investment on the investor's behalf.

A formal portfolio valuation and portfolio review is sent twice per year, or more regularly if the adviser or client wishes.

A consolidated tax voucher is issued at the end of each tax year.

Documentation is accessible via the online portal.

Client & Adviser Support: Nova has confirmed they support documentation in an alternative format (such as braille).

Instant messaging and telephone support for the client and adviser is available via the website.

Website: The Nova Cofoundery SEIS web address is:

https://novagrowthcapital.co.uk/

FINANCIAL ADVISER SEIS DEPLOYMENT

This section aims to provide information, guidance, create further discussion, raise points of consideration and a general commentary on how an SEIS might be included in a client's investment portfolio established by a Financial Planner or Adviser:

CLIENT SUITABILITY

Below are some areas of consideration when assessing client suitability; clearly, they are not exhaustive:

Client Type: SEIS (and tax advantaged investments in general) are predominately designed for HNW clients who are experienced investors with a tax liability. They must have a good capacity for loss and be UK domiciled.

If the client has a relationship with the SEIS or firms it invests into, then please see the start of this due diligence document for additional eligibility criteria.

KNOW YOUR CLIENT

Key areas the Financial Planner should consider:

Client economic circumstances and objectives: All financial planning should start with an understanding of a client's economic position, objectives, knowledge and experience and assets. For SEIS investing a greater focus should be on the following:

"Detailed and personalised. The client was at the heart of the recommendation"

EISA 2020

- Does the client have an income, CGT or IHT tax situation they would like to mitigate?
- Is the client selling a business or do they have Lifetime Allowance (LTA) concerns?
- Do they have suitable cash assets in an emergency fund that are easily accessible to support expenditure (especially events that may require large sums, such as home repairs, medical emergency etc)?
- Does the client have 'investable' wealth already diversified across other financial products?
- Does the client have a good level of secure income or employed income to support regular expenditure?
- Does the client have liabilities?
  - Can the funds being invested be deployed to repay these?
  - Is the liability suitably protected for repayment in the event of death or ill health ?
  - Is the liability an excessive drain on asset wealth or a call on future income (especially if it extends into retirement) ?
- Is the client looking to cap the growth on the estate for IHT or reduce the value of the estate for IHT?
- Can the client hold the investment until death for IHT planning?
- Has the client maximised the use of their annual personal tax allowances?
- What is the term the client will commit the investment for? An SEIS must be held for a minimum of three years to access tax reliefs and the Nova SEIS investment strategy is focused towards a three to six year period.

- What access requirements does the client have for the investment ?
- Does the client have a specific sector they wish to invest into and will this 'clash', over-expose them within their existing portfolio or be in an area from which their employment income is generated?
- Has the client an existing provider in mind and how was this provider selected?
- Whose tax position will drive product selection ?

  Key things to consider:

  - What will the client's tax position be at the start, duration and termination of the investment and how does this impact product selection?
  - Is the investment intended for a third party and whose tax situation will drive product selection (client, beneficiary, third party)?
  - Will the third party need immediate access when ownership is passed to them or do, they want to retain the investment?

Attitude to risk: Any ATR assessment conducted using suitable software should be viewed as an initial point for discussion, with the adviser complementing this and making their own assessment based on the client's psychology, decision making approach, economic circumstances, knowledge and experience and their capacity for loss.

Key points to consider:

- What is the client's knowledge and experience of financial products and how is this evidenced by their history of ownership and the purchase of these?
- What is the client's investment experience and understanding of risk as evidenced by their history of ownership and their behaviour, feelings, and thoughts during market corrections or in trending positive markets?

Client health, assistance and third party involvement:

- Does the client need assistance when making the financial decision due to:
  - Ill health
  - Medical condition (poor eye-sight, disability)
  - Recent trauma
  - English is not their primary language
- Do they have any health needs that will need funding in the medium term?
- Is there to be a beneficiary or do they have support from other professionals – legal and accounting? How should they be involved in the conversations and decisions communicated to them?

PORTFOLIO CONSTRUCTION

The goal of modern portfolio construction is to optimise the asset class weights to maximise the return generated for the lowest level of risk relative to an investor's risk preferences.

Unfortunately, when we try to extend this approach to account for early stage companies, we struggle to model the risk and return relationship relative to traditional asset classes because the return or price data for these businesses is generally non-existent or difficult to source.

Micro Caps - A Market Spotlight: A good starting point to understand the nature of micro caps and alternative investment companies is to look to the wider marketplace and consider the risk and return characteristics of two risk indices which we can employ as 'proxies' for fledgling and micro-cap companies – these are the FTSE Fledgling and FTSE AIM indices (see **Figures 1 and 2** on the next page).

By using these risk indices as potential descriptors of return it allows us to understand the 'general' characteristics of micro-cap and

Figure 1 / **15-year 12-month rolling averages**

Index	Total return	Sharpe ratio	Risk	Correlation	Max drawdown	Worst month
FTSE All Share	6.45	0.59	13.55	N/A	-10.52	-15.07
FTSE AIM All Share	5.52	0.46	17.43	0.70	-16.02	-28.27
FTSE Fledgling	12.79	1.43	13.75	0.69	-11.80	-24.36

Figure 2 / **Market corrections**

	12 Months - 2007 Financial Crisis		12 Months - 2020 Health Crisis	
Index	**Total Return**	**Risk**	**Total Return**	**Risk**
FTSE All Share	-32.24	21.35	-10.29	24.70
FTSE AIM All Share	-61.14	36.09	14.87	34.85
FTSE Fledgling	-41.14	23.30	5.87	35.26

All data source: Morningstar Office, ex-post monthly total returns, rolling 12 months, one month step

alternative small cap investing and put them into the context of modern quantitative portfolio management.

We can 'generally' conclude the following:

- The FTSE All Share Index has a strong influence on the strength and direction of the returns generated in these indices as evidenced by the strong linear correlation score of +0.69/70.
- Further research identified the indices had an average R2 (coefficient of determination) relative to the FTSE of c50. This indicates the return generation process in each index was not solely generated by the price movement relationship to the FTSE All Share; this informs the investor that holding exposures to these styles of companies will diversity your UK equity position in the portfolio.
- The FTSE Fledgling annualised total return was substantially greater (by +5.82%) than the FTSE All Share. This indicates (in the long run) the investor could potentially be financially rewarded for holding this UK equity asset class sub-sector.
- Both indices displayed a substantially higher level of return dispersion (risk) and peak to trough drawdowns during extreme risk based events relative to the FTSE All Share; thus they are historically high risk.
- The correlation and R2 analysis suggested these companies will have a strong systematic (market risk) and high level of company specific risk (unsystematic risk).
- Additional research identified that both the indices displayed a propensity to have an earlier recovery after a severe market correction relative to the FTSE All Share; this was evidenced by higher total returns and positive skewness in the first few years after an extreme event.

RISK MANAGEMENT STRATEGIES

As mentioned throughout this document early stage company investing is risky and therefore advisers may want to consider the following strategies – or a combination of these – to reduce risk and to determine the correct portfolio weightings for their clients:

Tax relief mapping and loss optimisation: The driving force behind product choice should be a client's economic situation and the tax benefits an SEIS can provide.

To minimise the potential for loss, the sum to be invested should aim to maximise the tax relief returned.

For example:

Client A is a 40% higher rate taxpayer with a £12,000 Income Tax bill in 2020. They aim to recover 100% of this sum and invest £24,000 into an SEIS, which returns £12,000 to offset against their Income Tax.

The SEIS investment fails and £24,000 that was invested is lost in full.

The client has already received a return via Income Tax relief of £12,000 via their tax return.

From the £24,000 which has been lost (after accounting for the previous Income Tax relief received), they can claim 40% loss relief on the balance of £12,000 (from the £24,000 that was lost in full). This is a sum of £4,800, which can be offset against their CGT or Income Tax bill.

Maximising the tax relief and loss relief in this strategy ensures that if the full investment is lost the client will have returned to them c. £16,800, c. 70% of the original investment, leaving them with a £7,200 loss.

PROVIDER AND SECTOR DIVERSIFICATION

Modern portfolio theory informs us that interrelationships (covariance and correlation) between the asset classes returns series within a portfolio will reduce risk. Despite having no early stage returns data we can, at a 'high level', employ the same approach with our SEIS investment to potentially reduce risk as follows:

Diversify by provider and fund

- Spreading a client's wealth over a range of SEIS, EIS and VC providers will reduce operational risk, especially should the product provider fail or experience a technical issue which could impact the client's return.
- Investing across a portfolio of EIS/SEIS funds will expose the client's wealth to a range of different investment strategies. Please note a concentrated portfolio will generate the highest returns and so it is important they are not over diversified.
- Historically – between 2017/19 – the Information, Technology and Communication sectors attracted the most investment. It is important to diversify a client's sector exposure if they are investing across multiple funds or tax advantaged products. Other popular sectors are Manufacturing, Retail Trade and Repairs, Professional, Scientific, Technical, Admin and Public Services.
- Adjusting portfolios for geographic exposure is much harder. This is because despite the London and South East bias in the SEIS sector, the base of operations for a business does not indicate the centre of gravity for its trading activity.

"Good holistic approach taken and healthy fund diversification"

EISA 2020

Product diversification and duration mapping: One approach is to blend tax advantaged products to reduce the risk to the client and maximise the tax relief they can access. In recent years since the introduction of the 'risk to capital condition', companies raising funds via an EIS for the first time has declined [3], and these funds now focus on the longer term growth and development of a company.

To reduce risk the adviser can employ a ladder investment approach, weighting the sums to invest relative to the term for investment and maturity of the product provider and underlying companies held. As funds mature in the riskier shorter term SEIS, these can be re-invested or crystallised.

Figure 3

Term	Time	Sums to Invest	Product	Fund Type Bias
Short to medium duration	3 to 6 years	20%	SEIS	Start ups
Medium long duration	5 to 10 years	30%	EIS/VCT	Developing/New blend
Long duration	10 years +	50%	EIS/VCT	Developing/Maturing
	Total	100%		

For example: A client has a desire to invest over 10 years to reduce CGT and/or reclaim Income Tax. They adopt the approach show in **Figure 3** (above) and invest the smaller sums into a riskier shorter term SEIS, with the long term investments focused on more mature companies.

Phased Investment: Investors who wish to commit capital but are concerned about markets, could phase their money over differing time periods to capture different market regimes and access alternative products and funds.

To reduce risk, investors could commit smaller sums to shorter term, higher risk, and larger sums to longer term more mature investment companies. But why?

- A shorter term for investment, would potentially generate a return quickly and reduce the probability that the investment will experience a risky market regime.
- In contrast an investment held for a longer time period will most likely encounter a wide range of market regimes, increasing the probability of experiencing a market correction. By weighting the greater sum of money to funds with a longer term for investment and a higher level of exposure to firms with greater maturity, the investor is thus hoping that the more established companies business model can 'weather' any storm, whilst a longer time horizon ensures they can be held through extreme events into periods of recovery.

For example, assuming a £75,000 investment is phased over two years – with £50,000 invested in year one (**Figure 4**) and £25,000 in year two (**Figure 5**) – will result in the total exposure shown in **Figure 6** (on next page).

Figure 4 / **Year 1**

Sum Invested	Weight	Product	Fund Style	Tax Relief	Max Tax Relief £
£10,000	20%	SEIS	Early Stage	50%	£5,000
£15,000	30%	EIS	Early/Developing	30%	£4,500
£25,000	50%	EIS	Developing/Maturing	30%	£7,500
£50,000	**100%**				**£17,000**

Figure 5 / **Year 2**

Sum Invested	Weight	Product	Fund Style	Tax Relief	Max Tax Relief £
£10,000	20%	EIS	Early/Developing	30%	£3,000
£15,000	30%	EIS	Developing/Maturing	30%	£4,500
£25,000	**50%**				**£7,500**

Figure 6 / **Total exposure**

Product	Fund Style	Total Invested	% Held
SEIS	Early Stage	£10,000	13.3%
EIS	Early/Developing	£25,000	33.3%
EIS	Developing/Maturing	£40,000	53.3%
Totals		**£75,000**	**100%**

This approach – assuming the client is a higher rate taxpayer – will:

- Phase the clients wealth with a bias towards companies that have greater maturity (c. 53%); investing into more mature companies may reduce risk, relative to early stage companies (i.e., longevity potentially indicates ability to survive/succeeding business model).

Figure 7

Type	Total invested	Max potential tax relief	Max potential loss relief for higher rate taxpayer
SEIS	£10,000	£5,000	£2,000
EIS	£65,000	£19,500	£18,200
	£75,000	**£24,500**	**£20,200**

- The total tax relief returned to the investor – assuming they have paid this much income tax – is £24,500, thus generating an immediate return of 32.67% over the two years (**Figure 7**, above).
- Combining the maximum potential income and loss tax relief received, assuming the investments fail in full, the investor would have a max potential return of £44,700 (60%), of their original investment minimising the downside risk.

Portfolio weight adjustments: The Financial Planner may consider adjusting the asset class weights in the portfolio to help maintain risk profile discipline and because the investor cannot rebalance the SEIS (or tax advantaged fund holding) during its investment term. Alternatively, the SEIS could be viewed as a separately managed account.

Let's consider some approaches they could follow.

New portfolio construction: If establishing a new portfolio, the adviser can separate the individual equity components into sub-sectors. This approach ensures that it is easy to account for the SEIS exposure in the overall portfolio.

For example, the adviser in this case has reduced the small cap and mid cap weights and increased the large cap exposure to account for the investment in the UK SEIS, whilst maintaining overall UK exposure at the same level (**Figure 8**).

Figure 8

Market & Regional Exposure	Equity Style	Recommended	Strategic Tilt
UK Large Cap Companies	Growth/Value Blend	20%	27.5%
UK Mid Cap Companies	Growth/Value Blend	10%	2.5%
UK Small Cap Companies	Blended, with Growth Bias	5%	0%
SEIS - Early Start UP's	Growth	0%	5%
Totals		**35%**	**35%**

Figure 9

Asset class and regional Exposure	Market cap	Portfolio role	Current weight	Strategic tilts
Global equities	Blend, with large cap bias	Core: Return Generation	35%	30%
SEIS: Start UP's	Micro, nil	Satellite: Return Generation, Diversify Systemic Risk	0%	5%

Maintaining higher exposures to large cap stocks will help maintain risk positions.

Existing portfolio rebalance: If the client has an existing portfolio the adviser could apply a 'top level' strategic asset allocation approach and adjust the overall equity position.

For example, splitting the asset classes into core and satellite positions allows the adviser to maintain risk exposures (**Figure 9**, above).

This approach allowed the adviser to make a short to medium strategic portfolio shift, with an immediate return of capital generated by the tax relief and losses capped via loss relief.

Adviser Firm Level Exposures: Adviser firms will need to consider overall firm level exposure to SEIS and EIS funds and product providers, and seek new funds and providers as exposures grow.

Adviser firms could, as per the earlier examples, hold large positions in well established, financially strong provider firms, with a longer market track record and smaller positions in new entrants.

HOW MUCH TO INVEST ? EXPERIENCE AND QUANTITATIVE BASED APPROACHES

Tax strategy generally will drive the sums to be invested, however, for Inheritance Tax planning or HNW investors with greater risk appetites or investors with higher risk tolerances these figures could be higher.

In general most people will have low exposures, probably less than 5%, but a key challenge for advisers is what sum of a client's assets should they commit to these investments and how does this impact the risk in the wider portfolio

A quantitative approach to this solution adds discipline to the portfolio construction process, however many advisers prefer to employ experience based approaches or follow peer group trends in determining the appropriate sums to invest.

Experience Based Approaches: The general trend in the amounts being invested into an SEIS is similar to the sums being invested into EIS. The majority of investors claiming Income Tax relief invested small sums of £10,000 or less; investments of over £25,000 contributed to 60% of the total sums invested into SEIS (with the sums attracting less than 10% of investors at the level of £75,000 and £100,000).

The most popular sums to invest are £500 or less, £10,000, and £50,000. [3]

Quantitative Based Approaches: One question to address is: how much SEIS exposure can an investment portfolio be potentially exposed to before the risk profile changes?

To answer this question we modelled the risk and return characteristics of a moderate risk global multi asset portfolio (see **Figure 10** next page), with a 50% global equity and 50% global bond exposure, and then adjusted the portfolio's SEIS exposure at 5% increments whilst maintaining the portfolios 50/50 equity and bond exposure.

Figure 10

Portfolio	SEIS Weight	Annual return	Sharpe ratio	Risk	Skew	Max drawdown
50% global equity & 50% bond	0%	4.90	0.56	7.62	-0.61	-9.28
1	5%	4.69	0.49	8.26	-0.73	-10.54
2	10%	4.46	0.42	8.96	-0.80	-11.80
3	15%	4.22	0.37	9.72	-0.84	-13.04
4	20%	3.97	0.32	10.51	-0.87	-14.30
5	25%	3.71	0.27	11.34	0.88	-15.57
6	50%	2.26	0.10	15.76	-0.92	-26.37
70% global equities & 30% global bonds	0%	5.02	0.42	10.49	-0.61	-13.56

Source: Morningstar Office, 36 months ex-post point estimates based on monthly data, December 2020

A portfolio holding 70% in global equities and 30% in global bonds will act as our upper level risk band which we define as moderately adventurous, or five out of six. The FTSE Fledgling and FTSE AIM indices will act as proxies for our SEIS risk exposures and we will hold a 50/50 weighting to each.

We used a sample of the last three years of ex-post monthly historical data to understand the impact of micro-cap exposures on the risk and return profile of the portfolio, during a period which included an extreme market correction. This approach was chosen because investors are more concerned with losses as these can have a significant impact on their lives.

We used three year annualised risk at the one standard deviation level and maximum drawdown (peak to trough return) as our primary measures of risk.

We can conclude from the above table the following:

- As the overall exposure to equities increases (as you would expect) the risk measures increase most notably from portfolio two by c. 15% and portfolio three c. 20%.
- A 15% to 25% SEIS exposure (portfolio three to five) would move the risk profile of the portfolio into the upper part of moderate risk band relative to the 50% Equity and Bond portfolio is our base risk profile and has no SEIS exposure (of circa 12.52, assuming one standard deviation).
- A 20% to 25% SEIS exposure (portfolio four and five) would start to move the risk profile of the portfolio into the next risk band. As we can see at exposures around 20% to 25%, portfolio risk exposures at the one standard deviation level are starting to change the investor risk profile as they are experiencing risk at levels similar or higher relative to the 70/30 portfolio which has 10.49 risk score relative to 10.51 in portfolio four and 11.49 in portfolio five (they are generating similar or higher risk scores for a lower return).
- Advisers should consider reducing the equity exposure in the portfolio when making allocations to the SEIS to maintain portfolio risk levels. This is because:
    - The example in the table does not account for the illiquidity of the SEIS or the inherent risk of loss in these companies, especially in the early years.

- Early stage companies have greater levels of 'company specific risk' (called unsystemic risk).
- We can never fully capture risk within our models i.e. risk is a scaler representation.

Professional fund management: SEIS investments can be directly into a single business or into a portfolio managed by a professional fund manager. For advised clients our preference is to employ a team of professional fund managers as this will manage investment risk and pass the decision making to a team of professionals specialised in this sector.

Areas to consider when screening SEIS funds and fund managers are as follows:

1. Fund manager experience
2. Performance record of profitable exists
3. Costs vs peer group
4. Impact of performance fees
5. Time in market
6. Manager investment strategy (which must be clear)
7. Manager risk management strategy (which must be clear)
8. Manager expertise
9. Investment opportunity identification & deal flow
10. Sector focus; exposures
11. Subscription limits, tax certificates, valuation and closing dates
12. Regulatory permissions
13. Business financial strength & operation
14. Client access and implementation process
15. Awards and independent analysis
16. Excessive sales or marketing tactics

Markets and economic states: Decision making

All investment decisions look to the future. HRMC has forecast that the sums to be invested into an SEIS for the 18/19 tax year will be less than the five years previous and so when investing the adviser should consider the future market regimes and economic states that the client's investment will have to potentially navigate.

To aid advisers to form views of world markets and assist them with making investment choices, a decision making system is required.

A suggested approach is as follows:

- In markets or economic states where we do not have much information or we have greater uncertainty about the future, our decision making should be more cautious and our actions less aggressive.
- In markets or economic states where we have more information and greater certainty about the future, our decision making can be neutral or more adventurous.

> He was the wisest man in Athens because he alone was prepared to admit his own ignorance rather than pretend to know something he did not.
>
> PBS 2020 [12]

By employing a base foundation to your decision system it allows you to have a 'fall back' point when you have tough decisions to make or uncertainty. It essentially provides a strategy to aim the development of one's views.

ALTERNATIVE TAX ADVANTAGED FINANCIAL PLANNING STRATEGIES

The traditional financial planning reasons for employing an SEIS in a client's financial strategy are well known. To aid discussion, a few others (not an exhaustive list) to consider are as follows:

- Utilise the tax relief from the SEIS to fund a pension contribution, (potentially) generating additional tax reliefs.
- Invest gains on a property or asset to release wealth into an SEIS and reduce CGT by 50%.
- Business profit extraction through the re-investment of the dividend into an SEIS.
- The surrender of an investment bond generates a gain with a tax liability; some of the proceeds of the bond can be invested into an SEIS to utilise the tax relief to pay the tax on the bond gain.
- Inheritance Tax mitigation in the short term (two years), assuming the funds are held until death.

How to structure an SEIS and EIS portfolio:

Advisers will undoubtedly reduce risk by building portfolios of tax advantaged products and funds to reduce risk, but how should these be structured? One approach is to consider which sectors are attracting money in the SEIS and EIS as this could indicate potential for returns.

This is a 'market sector weighted' approach to portfolio construction. (See example in **Figure 11** below)

This approach will:

- Identify the sectors that investment professionals and investors believe to be of economic importance.
- Provides a relative assessment of a sector's valuation and long run trends.
- Represent the current 'opportunity' set available to the investors and the areas that the market believes will generate the best risk and reward trade off.

Multi-product example portfolio excluding cash assets

An example tax advantaged portfolio is detailed in **Figure 12** (on next page) below alongside the client's other investment assets.

- The pension has no access until age 55, but it provides tax relief on contributions, has no CGT on gains, and 25% of the fund is tax free when drawn at retirement, with Income Tax due on 75% of the fund. On death before age 75 the beneficiaries have access to the fund tax free and the pension is free from Inheritance Tax.
- The ISA has no personal liability to Income Tax or CGT. It offers immediate access.
- Gains from the unit trust can fall under the annual CGT allowance of £12,300, whilst dividends are offset against the £2,000 annual dividend allowance. The unit trust can fund the annual ISA allowance. Access is immediate.
- EIS and SEIS offer tax relief on contributions and no CGT on withdrawal, with loss relief if the investments fail. Access is after three years.

In summary:

- 93% of the portfolio is held in moderate risk investments. 7% of the portfolio is focused into high risk investments (which

Figure 11

Product	% Held	Fund Sector Focus	Product
SEIS	34%	Information Technology & Communication	SEIS
EIS	40%	Professional, Scientific, technical, admin & support services	EIS
EIS	26%	Other	EIS
Total	**100%**		

Figure 12

Product	Value	% of Wealth	Portfolio Type	Risk	Access	Tax Efficient
Employer Pension	£375,000	67%	50% Equities & 50% Bonds	Moderate	Age 55	Y
ISA	£125,000	22%	50% Equities & 50% Bonds	Moderate	Immediate	Y
Unit Trust	£25,000	4%	50% Equities & 50% Bonds	Moderate	Immediate	Y
EIS 1	£15,000	3%	Generalist - Maturing Companies	High	After 3 years	Y
EIS 2	£10,000	2%	Specialist - Early and maturing companies	High	After 3 years	Y
SEIS 1	£10,000	2%	Specialist - Early stage companies	High	After 3 years	Y
Total	**£560,000**	**100%**				

CONCLUSION

The Nova Cofoundery SEIS is a suitable investment for experienced HNW clients who have a UK tax liability. It should be held as part of a wider portfolio in a satellite position. SEIS, or tax advantaged investing in general, is a high risk area for most clients. Selecting a managed fund which mentors the underlying investment companies could potentially improve the chances of success.

The primary driver for selecting the fund and the SEIS should be the client's desire to reduce the impact of taxation on their affairs. This Cofoundery Fund, with its slightly different investment process, will diversify the strategies being employed in the tax advantaged element of the portfolio.

It should be held alongside other investments, especially those holding more mature businesses, and the primary protection to the client is the 'loss and tax relief'; clients should be made aware that approximately 30% to 70% of the underlying portfolio could fail in the early years and ideally the investment should be held for at least six years. Expectations for returns should also be reduced, especially given the economic outlook following the recent health crisis.

The fund's lack of initial costs makes it attractive, as the full sum invested will attract tax relief - a positive for the investor. The 2% annual charge is not excessive and offset by the 20% higher performance fee hurdle rate of 150%.

Nova's approach to deal flow (especially given it was one of the reasons the fund was primarily established), ensures that an investor's money will be invested without delay as they have a nine to 12 month lead time; however investors again should note the health crisis may cause some disruption to this.

Investors should note that they will not be able to reclaim tax until the tax certificates are available (in October following the tax year of investment); again any economic lock down of tax offices could impact this

Nova's longevity in the sector, and work experience with other tax advantaged funds, should be viewed as offering investors some reassurance over their expertise. An easy to use website and easy reporting aids the application process and management of client wealth and helps communicate information to them.

SEIS RISK WARNINGS

To access the tax benefits associated with SEIS you need to invest for three years. It can take much longer for the investments to reach a successful exit. As most SEIS companies are not listed, it will usually be impossible to liquidate the investments in the event of you needing money rapidly.

The Investment Manager, and Investment Advisor, will exercise their discretion with respect to all Investments made on behalf of Investors.

SEIS investments are subject to:

- Systemic Risk
- Specific Risk
- Liquidity Risk
- Concentration Risk
- Unquoted Companies Risk
- HMRC SEIS Eligibility Risk.

An investor's money might not be invested immediately and this may delay the tax reliefs available. The taxation is dependent on the individual circumstance of each investor and may be subject to change in the future.

These investments should be held for a minimum period of at least five to eight years or until death if being used for Inheritance Tax Planning.

Investment losses can exceed the potential tax savings. An SEIS should be considered a high risk investment. The value of the investment can fluctuate to a much greater degree than established companies. Past performance is no guide to future performance.

The SEIS will be developed by the provider based on their understanding of the law and practice of HMRC pertaining at this time.

SOURCES

[1] The Paraplanners
SEIS Market Sample Survey
Interview by The Paraplanners. 2020

[2] 360 Environmental Ltd. n.d.
http://www.siccodesupport.co.uk/sic-division.php
Accessed 10 December 2020.

[3] HMRC. May 2020
Enterprise Investment Scheme Seed Enterprise Investment and Social Investment Tax Relief; Statistics on Companies raising funds (Opens PDF). Annual Report, UK: HMRC.

[4] Sapphire Capital Partners, 2020.
SEIS/EIS Loss relief: Do I lose all my investment if the company fails?

[5] EISA
EIS/SEIS Performance
Accessed December 2020.

[6][7] Nova Growth Capital Limited, 2020
https://invest.novagrowthcapital.co.uk
https://invest.novagrowthcapital.co.uk/information-memorandum
Login required. Accessed December 2020.

[8] Sapphire Capital Partners, 2020.
SEIS and EIS funds: How they are typically structured?

[9] The Paraplanners
Investment Research, December 2020.

[10] Committee of European Security Regulators 2009.
Annex to CESR's technical advice on the level two measures related to the format and content of Key Information Document disclosures for UCITS
Ref. CESR/09-949: Methodology for the Technical Report, CESR EU.

[11] Ryguasu et al. 2002
Chebyshev's inequality, Wikipedia
Accessed 22 December 2020

[12] PBS, 2020
The Greeks: Crucible of Civilisation
Socrates and the Oracle of Delphi
Accessed in December 2020

Contact us

Telephone: **0845 125 9644**
Email: **hello@theparaplanners.com**
Online: **theparaplanners.com**
Social: **@TheParaplanners**

Paraplan Plus Limited trading as The Paraplanners