

## EIS Due Diligence

Due Diligence carried out by advisors into investment products and services is rightly a key area of focus for the FCA. XPM's approach to due diligence is not only based on the FCA's published guidance but also on what our hands-on experience of fund management tells us are the key things to look out for when making an investment decision and what we would like to know if we were investing our own money.

Feedback from advisers has shown EIS to be a particularly difficult area to research as typically only a small proportion of their client base uses this type of investment, but due diligence must be as thorough as for the core investment strategy. We offer a "package" of research to overcome this and provide advisers with a cost-effective due diligence solution.

The EIS due diligence package includes:

- quantitative screening of the investment universe to achieve a full market review
- a shortlist of candidates for deeper research
- in depth due diligence reports on two potential investment solutions
- concise conclusions supported with clear evidence enabling advisers to make client recommendations.

## Why XPM?

Following a career of more than 15 years with UBS Global Asset Management, Nicki Hinton-Jones CFA has a thorough understanding of investment and financial management. As a Global Equities Portfolio Manager, she was part of the team responsible for managing \$60bn institutional clients' assets at its peak. Her role involved identifying appropriate investment opportunities in global equity markets across all regions and industrial sectors in order to meet client performance and risk objectives. Latterly, Nicki also had responsibility for the risk management and portfolio construction of all global equity products.

Nicki has a price/intrinsic value based approach to investment, which she uses in collaborating with advisers when looking at investment strategies for clients. She believes that retail investors should receive the same quality of research and product that is available to institutional investors and that due diligence should be a core part of the investment process. With this in mind she established XPM Investment Consulting in November 2014 to provide support to financial advisers and planners in setting investment strategy.

***Please note that XPM Investment Consulting Ltd does not provide investment recommendations and is not authorised to give advice to retail clients. We work with Independent Financial Advisors to support them in their investment research.***

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## The Shortlist

Micap is used to screen the universe of EIS investments available to UK retail investors. Micap targets whole of market coverage and currently lists over 200 EIS investments. We use it as a starting point for screening the universe, but undertake our own due diligence research of the funds shortlisted via the screen. Any data relied upon is verified directly with the provider.

Products are screened based on quantitative criteria including:

- number of holdings – we seek the products that offer a strong degree of diversification
- entry fees relative to the market
- combined AMC and admin fees
- stage of investment - funds that provide seed capital are excluded as this carries higher investment risk than targeted
- compliance with Section 21 of the FSMA – where prospectuses are not compliant, products are excluded as this is considered an indicator of the quality of the investment provider

This results in a shortlist of providers, which are then researched in more detail to identify the strongest candidates for full due diligence. Full DD will be produced on two solutions. Please see the description of our due diligence process attached and an example report.

## The Deep Dive

When completing due diligence we examine a series of areas, carrying out in depth independent research and analysis. We then interpret the relevance of what we find out to the underlying client - this is not a box-ticking exercise nor one of reviewing marketing material!

Areas covered include, but are not limited to:

**Company Details** – is the organisation a Ltd Co., Partnership, other structure, where is it registered, is information freely available?

**Company Background** - what is the ownership structure of the company, who owns it, who founded it? We look at information that helps us understand how the company is run and what the drivers of the management might be.

**Reputation and Financial Strength** – we access the company's financial statements and review them to understand how strong the company is and assess its prospective longevity and ability to meet the financial requirements of sustaining its business to a high standard. We engage an accountant if we need clarity on technical elements of the accounts.

**Management Team and Governance** – who are the management team, what’s their background, what are their motivations, do they have the skills needed to manage the organisation well, is there sufficient depth of resource? Where needed, is there sufficient supervision in place to oversee the executive management?

**Investment philosophy** - what is the organisation’s investment philosophy and is it evidenced in the end-product, are they doing what they say they do?

**Model/Portfolio Objectives** - these should be clearly stated in terms of performance and risk targets. Are they suitable for the clients we are considering the product for and is there enough transparency to enable the adviser to decide if a product is suitable for the risk objectives and goals of their individual clients? What are the parameters within which the product operates and are they in line with the stated objectives?

**Investment Process** – how are individual assets selected, what analysis is carried out, how thorough and objective is the selection process, how are opportunities compared relative to each other? Does the manager have a pipeline of appropriate investments that provide a path to HMRC benefits for the underlying client? We are looking for a sound, repeatable, rigorous process that can be clearly articulated and is not reliant on the strength of key individuals.

**Holdings** - what investments have been made in existing funds? This provides insight into how the product is being managed and if the manager is sticking to their mandate. We want to review the entire contents of a fund, not just a product brochure with flagship examples. We also look for exit strategies and how successfully they have been achieved in the past and if investments have maintained HMRC approval for EIS status.

**Investment Personnel** - what depth of resource is behind the process, who is involved in decision making for the product, what is their background and experience, how are they incentivised, what other responsibilities do they have outside of this product, is there Key Man Risk?

**Risk Management Process** what is the risk management process and is this articulated clearly enough to give us a full understanding of how risk is managed within the investment product and how managers adhere to their risk budget?

**Compliance Process** - what oversight is there internally to ensure the product is run within its stated parameters, how is fair dealing ensured, what is the trading process (where applicable)? These areas are required to satisfy us that our clients are dealt with fairly and in a manner which meets regulatory requirements. These areas also give us good insight into the quality of the provider.

**Investment Performance** - how has the product performed over time, have investments provided adequate returns given the risk profile of early stage investments.

**Management Fees and Charging Structure** - how much does it cost to engage this provider and their investment process and does it represent good value for clients? We need transparency here on all

charges, including entry and exit fees, dealing charges and custody fees so we can assess them against other available opportunities.

**Management Information (IFA Reporting) and Client Service** - what information is available to advisers and clients, is there good ongoing accessibility? The due diligence process should be a continuous one - advisers and clients need access to information on an ongoing basis.

**Capacity considerations** - how large are the assets following the strategy, how large will the manager allow it to become, are there any other products following the same process, if relevant we ask are other funds using the same research output from the organisation and therefore likely to be investing in the same companies at the same time as the fund? These elements give us insights into how the firm works and help us explore fair dealing processes for our clients as well as hidden costs of trading in large amounts or generating rebalancing.

**Custody** - where are a fund's assets held and is it a high quality institution?

**Platform** - is the fund available on a range of platforms that offer a good service to our clients?

**Products/wrappers** - is the fund available in a variety of wrappers that enable clients to make use of efficient tax planning?

**Financial planning considerations** – when is the fund open for investment, how are HMRC approvals obtained, any restrictions on investment size, timing of contributions?

All findings are presented in a comprehensive report. The relevance and importance of all findings to selection of a provider are made clear, enabling the adviser to demonstrate comprehensive evidence of research to support any recommendations.

***We trust this description of our research process is helpful. Please do not hesitate to contact us to discuss anything in further detail or receive access to a sample of due diligence report.***

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