Consumer Duty

Product & Service Review

Blackfinch Spring VCT Portfolios

Product Details

Description of the product

Blackfinch Spring VCT is a Venture Capital Trust (VCT) listed on the London Stock Exchange. It is a generalist VCT focused on investments in innovative growth-stage technology-enabled companies which are on their scale-up journey. It aims to provide long-term returns where shares are invested for at least 5 years, whilst enabling investors to benefit from available VCT tax reliefs.

Describe the key features and benefits of the product

The main benefits of VCT investments:

- Income Tax relief of up to 30% on a maximum investment of £200k per tax year, providing shares are held for a minimum of 5 years.
- Gains on investments are exempt from Capital Gains Tax (CGT) on disposal
- Dividends paid from the VCT are exempt from Income Tax

The features of the product:

- Investment into high-growth technology-enabled businesses, each with a strong founding team, good ESG values, and a product for which they have established there is a large market.
- A growing portfolio that is diversified over stage and tech-enabled sector – of 17 companies by end August 2022 and expecting to expand by adding 5-15 new companies per year, less successful exits or failures.
- Regular dividends of 5% pa targeted from 2024 onwards (not guaranteed), along with the potential for special dividends arising from early or above-target exits.
- A buy-back facility at a discount of 5% to NAV, subject to the availability of distributable reserves and board discretion.

Describe the limitations of the product

- To qualify for income tax relief, investors must hold shares in the VCT for a minimum of five years.
- Income tax Relief is available on a maximum investment in VCT schemes of £200k per tax year.
- Investors must have a sufficient income tax liability to claim the full relief.
- The product is high risk and it is possible that the full investment would be lost.
- Shares in VCTs are illiquid, typically with a very limited secondary market. Investors are likely to need to relay on the share buyback scheme, in which shares are bought back at a discount to NAV, and may not always be available.

Events

Has there been an event which could result in the product posing a risk to customers?	(Event = any concerns identified during review about the product or its literature that may be perceived as a consumer harm). ☑ Yes ☐ No
If yes: explain the risks now posed to customers	1. VCT investors, especially non-advised investors, who only read the brochure and not the prospectus may not realise that product is not suitable for those with insufficient income tax liability to benefit from the full tax relief offered by the product. 2. Direct clients who invest just before an allotment date will not benefit from either independent advice or time to reconsider before shares are issued, and will have reduced friction.
Detail mitigating action taken [or to be taken]	1. State this point explicitly in the brochure. 2. Add a warning and possibly a default cooling off period for direct applications.
Following mitigating action, is the product still suitable?	☑ Yes ☐ No

Needs and Objectives

Describe the needs and objectives [including financial objectives] of the target market for the product [include vulnerable customers].

Investors in the target market will:

- Be looking to reduce their UK tax burden within long-term schemes (at least 5 years) – to reduce income tax and potentially also capital gains tax.
- Want diversification in their portfolio.
- Want or be willing to have exposure to small company investing.
- Want a regular tax-free income from their investment.
- Have large amounts of capital and an ability to accept high risk on the portion to be invested in the product.
- Want to invest sustainably in a product that considers Environmental, Social and Governance (ESG) factors.

Vulnerable customers may also have these objectives but it would be more important that they have relevant advice, or are otherwise able to demonstrate their capacity as Sophisticated Investors.

Product Risks

Identify the risks posed by the complexity or nature of the product

Customers may not understand that:

1. Investments made by the VCT are high risk and it is likely that some will fail completely.
2. This product is not suitable for those with insufficient income tax liability to
3. benefit from the full tax relief offered by the product.
4. In order to obtain and retain the tax reliefs investments must be held for a minimum of five years.

Explain how these risks are mitigated

These risks are mitigated by clear client communication. This comes in large part from our published documentation, especially the prospectus, brochure and KID. For advised clients it also comes through the advice and explanations provided by qualified advisers. Our published Target Market Assessment (TMA) helps direct advisers to customers for which the product is appropriate, and to avoid sales where it would be inappropriate, but advised sales are also reliant on their own expertise. More specifically:

1. Is stated explicitly as a risk, for example in the brochure and prospectus.
2. Is covered explicitly in the TMA for advisers and in the prospectus. However, it should also be stated explicitly in the brochure.
3. Stated explicitly.

Identify the risks posed to the target market by the Product

1. Capital is at risk; the VCT invests into small unquoted companies and values may go down as well as up so investors may get back less than they originally invested.
2. There is no guarantee that the target dividends will be made.
3. Changes to the taxation environment may affect investment returns. (Tax rates, benefits and allowances are personal to an investor and they depend on personal circumstances).
4. The VCT will invest in a diverse range of tech-enabled companies. However, the failure of any individual company will have an impact on the overall value of the portfolio, and investors should be aware of the concentrated nature of the portfolio.
5. Shares in VCTs are inherently illiquid and there is likely to be a very limited secondary market in the shares, primarily because income tax relief is only available to those subscribing for newly issued shares. While a share buyback facility is offered, it is subject to board discretion and the availability of distributable reserves, and may therefore not be available when a client wishes to sell shares.
6. The VCT may be unable to maintain its VCT status with HMRC, which could result in the loss of tax reliefs.

(The minimum holding period is covered in the section above, not repeated here.)

Explain how these risks are mitigated

Risks 1 and 2 are mitigated by the VCT investing in a growing portfolio of multiple companies, as noted in Risk 4. It maximises the chance of exposure to successful companies that can deliver a substantial return, while limiting the impact of companies that fail. Care is taken within the portfolio to reduce the correlation of risks affecting companies by diversifying by stage and sector. In addition downside risk with an individual company investment is reduced by the use of "A-Ordinary shares" that carry a priority to return at least the amount invested where there are sufficient proceeds to do so.

However, Risks 1, 2 and 4 remain and clients must be willing and able to accept them. They are made clear in the brochure, TMA and other documentation.

Risk 3 depends on the personal circumstances of clients, as well as government policy, and it is important that customers take professional advice or are able to assess their likely future circumstances and the regulatory environment themselves.

Risk 5 is mitigated by the buyback policy, but noting per the risk that it is not guaranteed at any given time. Again, this risk is made clear in the documentation.

Risk 6 is mitigated by the VCT reviewing the VCT conditions at every regular board meeting, along with forward planning to ensure the conditions are on track to be met a year ahead. An independent tax opinion is commissioned on every investee company before completing the investment, to ensure it is VCT compliant. Whilst the risk is low, it remains, and is highlighted in the documentation.

Identify the risks posed to vulnerable customers by the Product

Some vulnerabilities may make someone unsuitable for the product. For example, the long-term illiquidity of the product would make it unsuitable for those with low financial resilience, such as those likely to have insufficient or erratic income and who may need to withdraw funds on demand.

However, it may be suitable for those with many vulnerabilities, but there would be potential risks:

1. Lack of understanding of the product, whether arising from a long-term condition, low capability, or short-term stress. The risks above relating to the nature and complexity of the product would be particularly relevant.
2. Emotional stress or circumstances making it difficulty (whether realised or not) to make decisions, particularly a long-term decision, given that investing in this product would irreversibly tie up their funds for several years.
3. Life changing events, whether relating to work or a personal life, making it hard to predict circumstances some way ahead, again relevant for what is a long-term product. But noting that such changes in life may equally be a reason for the product to be appropriate, or to prompt a desire to make long-term financial plans.

Explain how these risks are mitigated

In most cases, the risks to vulnerable clients are mitigated with independent, advice from qualified financial advisers who assess the individual client's needs, desires and capabilities.

For advised clients we further mitigate the risk with clear, simple statements about the main attributes and risks of the product, particularly noting the points in the section above on the nature and complexity of the product.

We have a Vulnerable Customers policy in place and all staff are trained on how to identify and deal with vulnerable customers.

Testing

Is the product meeting the needs and objectives of its target market and vulnerable customers?	Testing is based on comments and questions from advisers and clients, and on the performance to date of the VCT in delivering the stated objectives – noting that it is not yet at the point it is due to start paying dividends. On both measures, the product is meeting its objectives so far.
Has a value assessment been completed, and does it demonstrate good value? (separate review document)	See separate document.
Has the product been distributed in accordance with the value assessment findings?	Yes, with the bulk of investments made on the recommendation of financial advisers. This tax year to date, ~88% of VCT applications have been advised, rather than direct or execution only.
Are communications being used as detailed within the product approval?	Yes, the product is being distributed according to the value assessment and third party reviews.
Does data demonstrate the communications are effective in allowing the target market to understand the key features and benefits of the product and make effective decisions?	The number and nature of queries received indicates that in general the target market does understand the product. In addition, no complaints have been received, and no VCT shareholder has yet to raise any issue at an AGM.
Does testing demonstrate the communications are clear, fair and not misleading?	Yes.

Are customers adequately supported after the point of sale?	Yes, information is provided on a regular basis, with documents available on a customer portal for those who wish to have this facility, and with responsive customer support for direct clients and advisers who route queries from clients. (Noting that we do not have good visibility of the support provided by advisers to clients.)
Have testing of the actions of distributors been undertaken?	As above, there is little visibility of the actions and support provided by advisers other than through their questions, discussions with them, and very occasional direct contact from advised clients.
Where testing identifies the product is not meeting the needs of some or all of its target market [including through identified issues with communications] has the following action been taken: • *Cease distribution* • *Mitigate failures* • *Inform distribution chain*	The testing indicates the product meets the needs of the target market.

Consumer Support

Has the product been designed to support retail customers such that it meets the needs of retail customers, including those with characteristics of vulnerability?	Yes
Is there evidence demonstrating that retail customers can use the product as reasonably anticipated?	Based on the questions and comments received from clients and advisers, and the absence of complaints, there is reasonable evidence that retail customers are able to use the product as expected.
Is there evidence demonstrating appropriate friction in the customer journeys to mitigate the risk of harm and give retail customers sufficient opportunity to understand and assess their options, including any risks	Retail customers most invest when advised, which significantly reduce the risks. With shares allotted in the VCT only on a handful of dates throughout the year, for all investors there is usually good opportunity to reverse a decision if it is reconsidered, providing good friction. However, direct clients who invest just before an allotment date will not benefit from either advice or the opportunity to reconsider; there will be less friction in this situation. To date only one shareholder has requested a share buyback.

Is there evidence demonstrating retail customers do not face unreasonable barriers (including unreasonable additional costs) during the lifecycle of the product, such as when they want to:

(a) make general enquiries or requests.
(b) amend or switch the product.
(c) transfer to a new product provider.
(d) access a benefit which the product is intended to provide.
(e) submit a claim.
(f) make a complaint; or
(g) cancel a contract, agreement or arrangement or otherwise terminate their relationship

The product is long-term and illiquid. It is stated very clearly that withdrawing funds, including to switch to a new product or to transfer to a new product, would result in the loss of income tax relief and would only be possible subject to a secondary sale (unlikely) or a share buyback at a discount to NAV. There are therefore significant costs involved in (b), (c) or (g), but they inherent to the nature of the product.

(e) is not applicable.

However, (a), (d) and (f) are readily possible with no additional cost.

Findings

Is the product demonstrating a clear set of benefits for its target market [including vulnerable customers]	Yes, there is clear benefit for the target market, which may well include vulnerable customers.
Does the product provide fair value for the target market [including vulnerable customers]	Yes. The costs are fair compared both to the value provided (noting the high risks that may result in a poor return) and to providers of comparable products.
Have identified risks of the product been reasonably mitigated and distribution strategies designed to significantly reduce such risks?	Yes, notably a clear primary focus on serving clients through independent qualified advisers.
Is the product allowing identified groups of customers to pursue their financial objectives?	Yes.
Have customers been able to use the full benefits of the product?	Yes – as far as can be established at this stage, given that it is a relatively new, long-term product.
Is the product design avoiding foreseeable harm as set out in PRIN 2A.2.10 G?	Yes.

Consumer Duty

Price & Value Assessment

Blackfinch Spring VCT Portfolios

Target Market

Identify the target market

Retail and professional clients who:

- Are looking to reduce their UK tax burden within long-term schemes (at least 5 years) – to reduce income tax and potentially also capital gains tax.
- Want diversification in their portfolio.
- Want or be willing to have exposure to small company investing.
- Want a regular tax-free income from their investment.
- Have large amounts of capital and an ability to accept high risk on the portion to be invested in the product.
- Want to invest sustainably in a product that considers Environmental, Social and Governance (ESG) factors.

Detail the characteristics of the target market

Investors' knowledge and experience

- Understand the risks involved in investing in illiquid shares.
- Awareness of other tax-efficient products such as EIS and ISAs.
- An understanding of the venture capital trust scheme (VCT) and the threshold of £200,000 for tax relief.
- An understanding that the amount of tax credit received cannot exceed the total income tax liability for the same tax year.
- An understanding that the movement of the VCT NAV is dependent on the performance of underlying investments in unquoted companies.
- Understand the minimum qualifying period of 5 years for the income tax benefit.

Investor financial situation and ability to bear losses

- The investor will need to ensure that they can bear the full loss if the VCT does not perform as intended.
- Investors should have no immediate need to access their investment and be comfortable with committing their capital for a minimum period of 5 years in order to keep the investment qualifying for income tax relief purposes.
- The investor likely has a total income tax liability that exceeds the amount of tax credit they are likely to receive.

Risk tolerance and compatibility of the risk/reward profile of the product with the target market

- Willingness to invest their capital for a minimum of 5 years, understanding the risks involved.
- Willingness to put the entire capital invested at risk.
- High tolerance for risk/reward.
- Financial Advisers must assess their clients' risk tolerance.

Clients' objectives and needs are covered in the description of the target market above.

Explain why the target market has been selected	This target market has been chosen because these customers will be able to derive most value from the product, including its tax reliefs and long-term potential return, whilst being willing and able to accept its limitations and high risks, including its long-term illiquidity and potential for losing the entire investment.
Identify any characteristics of vulnerability in the target market which may impact the value received by those customers	Vulnerabilities may impair a client's ability to plan or make a decision about the longer-term, or to understand the risks and limitations of the product. However, such vulnerabilities would place them outside the target market. The risk is that potential clients incorrectly believe they are in the target market. But where it is established that they are in the target market, notably where their purchase of the product is on the recommendation of a qualified financial adviser, then they would receive the expected value from the product.
Identify the drivers of vulnerability in the target market	The main drivers of vulnerability that could relate to the target market including: • Health, possibly affecting understanding of the risks and limitations of the product, which may be mitigated by appropriate advice and support, or a lack of clarity about long-term circumstances. • Life-changing events, with similar impacts above, noting that such changes may also be a trigger for potential benefit from the product. • Financial limitations, either in the short or longer term, which would typically place someone outside the target market • Poor communication or ability to understand, that again might be possible to be mitigated by additional support and advice.
Could the customers vulnerabilities impact full/ value use of the product	Vulnerabilities could impact the value received by customers, particularly considering its long-term illiquidity and high risks. However, such vulnerabilities would place the potential client outside the target market, as appropriate understanding, acceptance and capacity for these characteristics are essential elements of that market.
Do cognitive or behavioral biases of customers impact on the value of the product to the customer?	Such biases may affect the decision to select the product, but providing the elements of the target market are satisfied then the customer will still receive the appropriate value from the product.

Nature and costs of the Product

Does the design of the product [i.e.the key features] enable use by the target market ensuring they are able to pursue their financial objectives?	Yes, considering the characteristics of the target market, the product will help the target market to achieve its financial objectives.
Do any aspects/limitations of theproduct prevent the average target customer from fully enjoying the product?	No. Understanding the limitations is an important element of the target.
Does the product allow for comparison to other products in the market?	Yes. VCTs are readily compared by their NAV per share and dividends paid, both of which are formally announced to the market.
Does the product allow for easy switching to another provider or product?	No. VCT shares are necessarily illiquid and will relinquish the income tax relief if sold within 5 years. There is also a very limited secondary market for VCT shares. The share buyback policy is designed to mitigate these issues and to permit withdrawal of funds where necessary (e.g. to switch to another provider) but it is not guaranteed to be available at any particular time.
Total maximum cost, including all fees / commission payments	The maximum explicit client fee would be 2.5% of the amount invested. Advisers are also able to charge up to 5% initial fee, though the average is just 0.65%. Other fees are charged to the VCT itself, including 2% AMC, up to 0.5% for advisers (average 0.28%) plus other costs charged on; but with costs capped at 3.5% of NAV. In addition there is a 20% performance fee above £1.30 or subsequent high water mark of the performance value per share. There is no theoretical maximum of these fees. The overall costs (inc. initial but exc. adviser fees) in the scenarios modelled for the KID and TMA vary between 3.8% (stress) and 7.6% (favourable).

Maximum possible cost of contingent charges [i.e. late payment fees]	None.
Non-financial costs [i.e. data use by the firm]	None.
Will the product have a finite lifespan? If yes, explain the relationship between the lifespan and the price to the customer. Explain why the overall price is good value.	The product is expected to continue, and to continue to be available for new clients, subject to the relevant VCT legislation being maintained
Is it likely the customer will renew at the end of the contract period? If so, explain why the overall price is good value [must factor in any price increases at renewal].	Customers have no fixed contract period. However, after the minimum 5-year holding period, they can choose to withdraw their funds; and it is likely that a significant proportion will do so in order to gain the income tax relief of reinvesting in another VCT. Customers may also choose to invest more funds in the Spring VCT in the intervening years but this will depend on their personal circumstances and availability of funds, as well as their preference in keeping investments simpler with one provider, or getting greater diversification by using multiple VCT providers.
Taking all of the above into account, explain why the product offers fair value to the target customer	The product offers fair value because in return for the costs, there is the potential for capital gains (tax free), up to 30% income tax relief, tax-free regular dividends from 2024 and the opportunity for special dividends.The tax reliefs more than outweigh the costs (exc. performance fee), and there remains the potential for high returns, albeit with high risk.
Taking all of the above into account, explain why the product offers fair value to vulnerable customers	Vulnerable customers are no less able to obtain value from the product providing they are able, with appropriate advice, to meet the conditions of the target market.

Costs

Total costs for manufacturing the product per unit sold	The total cost of the Blackfinch Ventures EIS and Spring VCT, including salaries, legal, operational and support functions is currently circa £3.10million. This is against annual fees of around £5.71million. Therefore, for each £1 sold in terms of overall income, the cost is 83.6 pence. Dividing the costs pro rata by income between the EIS and VCT would keep the figures in proportion. Therefore for the VCT, for each £1 sold in terms of overall income, the cost is 83.6p.
Identify the market rate for the product	According to Micap, the market rate for initial fees is 2.5 - 7.5% with an average of 3.25%. At 2.5%, the Spring VCT is therefore right at the bottom of this range, below average. The industry ongoing AMC is 0 – 4.85% with an average of 2.04%, so the Spring VCT is average with its effective rate of 2%; and similarly the average running costs (exc. adviser fees) are 3.0% (range 2.3% to 3.6%) so the Spring VCT is average with its cap at 3.0% The performance fee at 20% is also the most common rate applied in the market.
Is the final price paid by the customer significantly higher than either the total cost for manufacturing and distribution or above the market rate? *If so, is there an added benefit to the service which means the customer is receiving fair value?*	The final price paid by the customer is competitive in the market – with fees being average or below average. It is also appropriate to the costs incurred in manufacturing the product, with costs running at 83.6p for each £1 of income. The performance fee is not directly linked to costs but ensures our alignment with clients in picking investments to deliver the best return for clients.

Pricing

Is differential pricing used by the firm and if so explain the objective and justifiable reasons for doing so?	The product offers early bird discounts on the initial fee of up to 1.5%, and a loyalty discount of 1% for existing Blackfinch investors. The latter is a loyalty reward for existing customers, while the former is to keep the product in line with the market, which conventionally drops initial fees in the months leading up to the end of the tax year.
List each group where the pricing is different and explain why the value is fair, factoring in cost and market rate for that group of customers.	The early bird discount applies to all customers equally and does not discriminate between groups. The loyalty discount applies to existing Blackfinch clients. Costs are lower with this group as there is no need to set up internal records, ID checks, communication infrastructure (such as the portal); and communications can be combined where appropriate with details of their existing portfolio(s). In the market, it is intrinsically fairer to reward a longer-term relationship with lower fees than to attract new customers with low fees and then to try to extract greater profits from established customers later on.
Is there another product offered by the firm which offers similar benefits for a lower cost? *Explain the reasons for the difference [i.e. enhanced customer service]*	No.

Distribution Arrangements

Does the distributor have access to all appropriate information from the manufacturer to be able to understand the value that the product is intended to provide for the customer?	Yes, all relevant information is provided through Blackfinch and to advisers, notably including the prospectus, product brochure and the target market assessment but also including other collateral.
Does the distributor understand: • *Intended benefit of the product* • *Value to be provided to customer by the product* • *Characteristics, financial goals and needs of the target market* • *The level of pricing set* • *Quality of service required to represent good value* • *Potential impact of distribution arrangements*	Yes, distributors including advisers have access to information as described above to cover all these points.
Are there any renumeration arrangements with the distributor which may impact the value customers receive?	Advisers are able to charge their own initial and ongoing fees, up to maxima of 5.0% and 0.5% respecitvely. These fees are at their discretion and reduce the client funds, hence decreasing the value received. However, the average adviser fees are 0.65% initial and 0.28% ongoing. This is reasonable and proportionate given the importance of the advice in assessing clients' individual circumstances as regards the target market.
Are proposed distribution arrangements consistent with the value of the product?	Yes. It is important that, other than with a minority of direct clients who are sophisticated investors, clients receive advice appropriate to their individual circumstances to ensure the product's suitability.
Explain how the distribution arrangements support the value of the product	As above.

Findings

Does the product in its current form offer fair value?	Yes.
Explain why the product provides value for the target market	The product offers the generous VCT tax reliefs to those who can benefit from them, whilst offering the potential for high returns for those who can afford to risk the loss of the capital invested with no liquidity over several years – all criteria in the target market. The costs are reasonable compared to the tax reliefs available and the potential return – with the biggest cost potentially being the performance fee which is directly linked to the value provided to the customer.
Explain why the product provides value for the vulnerable customers in the target market	Vulnerable customers who satisfy the conditions of the target market are no less able to benefit from the product, and will receive the same long-term value.
If the product is sold as part of a package, does the overall package offer fair value?	N/A
Are there any adverse findings in this assessment?	No.
Set out mitigating actions to occur prior to distribution or remedial action to prevent foreseeable harms to current customers	N/A

IMPORTANT INFORMATION