

Product: Mercia Knowledge-intensive EIS Fund 2024/25

Investment Manager: Mercia Fund Management Limited

Our approach and assessment of compliance with the Consumer Duty: January 2025

Background

Mercia Knowledge-intensive EIS Fund 2024/25 (“the Fund” or “the product”) invests in unquoted venture capital holdings with the aim to generate capital gains and provide investors with the tax advantages associated with EIS investments. Mercia Fund Management Limited (“Mercia”) is the investment manager of the Fund.

The Financial Conduct Authority (FCA) has introduced an over-arching Consumer Duty Principle, with four key outcomes and with underlying rules with which all firms that have a role in the manufacture and distribution of products must comply. This document contains Mercia’s assessment of the Fund’s compliance with the four key outcomes.

Process of assessment

Mercia’s implementation work commenced in 2022, with an assessment of its compliance with the Consumer Duty on a firm-wide level, including its governance and culture, as well on a product-level basis. This update contains further detail and iteration of the methodology employed to assess compliance with the Consumer Duty.

Product Assessment

Mercia has assessed how it will meet the Consumer Duty in respect of the Fund. Its review of each outcome is set out below.

1. Products and Services Outcome

The firm’s products and services should be fit for purpose. The terms match the target consumer needs and products and services work as expected.

Key features of the product

The main benefits of EIS investments

Tax treatment depends on the individual circumstances of each investor and may be subject to change in the future. The tax reliefs detailed below are based on current legislation and assumes an investor may utilise the tax benefits and that the shares are held for the minimum holding period to qualify for relief.

- Up to 30% income tax relief on the amount subscribed for Shares in EIS-qualifying Companies (up to an annual maximum £1 million for the 2024/2025 tax year, or £2 million provided that the additional £1 million is invested into Knowledge Intensive Companies). As a knowledge-intensive approved fund, for income tax relief purposes, all investments will be considered to have taken place on the closing date of the fund, rather than the date of each underlying investment, provided the approved fund conditions are met. An Investor may also choose to treat some, or all of their investments as made in the year prior to that in which the Fund closed, meaning an investment into the Fund could be carried back to 2023/24.
- Capital gains tax deferral on unlimited gains invested into qualifying companies, in respect of gains that arise within three years before and 12 months after the date of issue of the underlying shares.
- Gains on investments are exempt from Capital Gains Tax on disposal.
- Share loss relief, which is additive to income tax relief, provides a total tax relief on a failed EIS company of up to 61.5% (for a 45% taxpayer), including the initial 30% income tax relief (subject to any relevant caps). A loss on any qualifying investment in the portfolio, irrespective of the overall performance of the portfolio, can be offset by an investor against their income of the tax year of the loss, or of the previous tax year.
- Through the availability of Business (Property) Relief, there may be reliefs against inheritance tax.

Features of the product

- Knowledge-intensive approved fund which will create a managed portfolio of approximately 12 investments in sectors such as software, life sciences and deep tech/ enabling tech.
- The Fund aims to triple the net invested capital (including tax reliefs).
- Investors may subscribe a minimum of £10,000.
- Strong investment team and ability to co-invest with other Mercia managed funds.
- Experienced manager; Mercia has been raising and investing EIS funds since the 2012/13 tax year.

Key limitations of product

- The product is high risk and it is possible that the full investment could be lost.
- There is no market, nor is there intended to be a market for the shares acquired through the Fund; you may not be able to sell your shares to another investor should you wish to exit ahead of the Fund. Holding periods are expected to be seven years or more.
- No dividend income should be expected.
- Once the Fund is fully invested it cannot provide any follow-on capital and therefore there is an increased risk of dilution.
- To qualify for income tax relief and CGT free gains, investors must hold the underlying shares for a minimum of three years and qualifying conditions must be met by both the investee company and the investor. If the qualifying conditions are not met, this will impact the level of tax relief available.
- If the conditions prescribed for a knowledge-intensive approved fund are not adhered to, it will result in a different tax treatment for the investor.
- Investors must have a sufficient income tax liability to claim the full relief.

Consumers and our Target Market

As set out in its target market analysis, Mercia's consumers, in the context of tax-efficient investing are:

- An advised investor whose regulated financial adviser has deemed the product suitable.
- Sophisticated/high-net-worth investors or restricted investors (as defined by the FCA's Conduct of Business Rules).
- Able to understand the risks of venture capital investing.
- Able to utilise the tax advantages that are provided as a counterbalance to the risks that are inherent in early stage investing.

Mercia has considered the design of the product and believes that the product meet the needs, characteristics and objectives of the target market. It has set out the target market for the product and believes that the features meet those needs and objectives, in particular in relation to the tax benefits that are sought by investors in the Fund.

2. Price and Value Outcome

Products and services should be sold at a price that reflects their value. There should be no excessively high fees.

Mercia has considered the factors set out below in assessing its products against the Price and Value outcome. The full review can be found in appendix 1.

Ongoing assessment

The FCA rules require Mercia to undertake a price and value assessment upon any significant product changes or fundraising activity – the fees for this product will be assessed on an ongoing basis, and this document will be updated, in compliance with these rules.

3. Consumer Understanding Objective

Consumers are equipped to make good decisions. Information is made available at the right time and is understandable.

There are resources available for consumers to understand the product including, but not limited to, the Information Memorandum for the Fund.

Consumers are able to contact Mercia to obtain further information.

4. Consumer Support Objective

Customer service should be responsive and helpful. It should be as easy to complain about or switch and cancel products or services as it was to buy them.

The product is long-term and illiquid. It is stated clearly in the Fund documentation that withdrawing from the investment, including to switch to a new product or to transfer to a new product, can only happen in very limited circumstances. A sale of shares within the three year qualifying period will trigger a claw back of tax reliefs. There may be significant costs involved in amending / switching / transferring or cancelling an investor's investment in the product, as is in the nature of the product.

It is possible to make general enquiries / requests, access the benefits of the product or make a complaint with no unreasonable barriers or additional costs. In assessing this, Mercia has taken into account the response to legacy EIS funds, year-on-year adviser feedback and low number of eligible complaints. In any instances where a complaint has been referred to the FOS, it has not been upheld by the FOS. Mercia, as FCA regulated manager, follows the FCA's rules in relation to complaints handling and monitors compliance with those rules. In addition, the board of Mercia reviews the progress and performance of Mercia's EIS funds.

Mercia has a vulnerable customer policy that covers how retail customers with characteristics of vulnerability will be supported.

Testing Summary

Is the product demonstrating a clear set of benefits for its target market including vulnerable customers?	Yes
Is the product meeting the needs and objectives of its target market and vulnerable customers?	Yes
Does the product provide fair value for the target market including vulnerable customers?	Yes
Has a value assessment been completed, and does it demonstrate good value?	See Value Assessment below.
Has the product been distributed in accordance with the value assessment findings?	Yes
Is the product allowing identified groups of customers to pursue their financial objectives?	Yes
Are communications being used as detailed within the product approval?	Yes
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?	Yes
Have customers been able to use the full benefits of the product?	Yes, as far as we are aware
Does testing demonstrate the communications are clear, fair and not misleading?	Yes
Are customers adequately supported after the point of sale?	Yes
Have testing of the actions of distributors been undertaken?	Yes
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.
Is the product design avoiding foreseeable harm as set out in PRIN 2A.2.10 G?	Yes

Appendix 1: Value for Money Assessment

Target market

Retail and professional clients who:

- Are looking to reduce their UK income tax liability upon initial investment
- Are looking to defer a capital gain
- Are able to hold their investment for at least 7 years
- Wish to invest in a portfolio of unquoted companies
- Have large amounts of capital and an ability to accept high risk on the portion to be invested in the product
- Have an income tax liability in excess of the tax relief available from their initial investment
- Has a high tolerance to risk, and able to lose the capital invested
- Understand the risks involved in investing in unquoted, illiquid shares

This target market has been chosen because these customers will be able to derive most value from the product, including its tax benefits 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.

Mercia's approach to vulnerable customers is covered under the response to the Consumer Support objective.

Costs of the product

At the date of assessment, costs of holding / investing into the products leveraged both directly and indirectly on an investor in the Fund is categorised as follows:

Cost	Description	Frequency	Payable by	Payable to
Initial fee*	2% initial fee, reduced to 1.5% existing and advised investors	Upon subscription	Investor	Mercia
Adviser fee	Initial fee facilitated on behalf of advisers, as agreed with the investor	Upon subscription	Investor	Adviser
Annual management charge*	Annual charge of 1.75% per annum for the first six years^	Annually	Investor	Mercia
Custodian and administration fee*	Annual charge of 0.25% per annum for the first six years^	Annually	Investor	Mercia
Performance fee	20% of the amount of cumulative cash returned to an investor which is in excess of the net investment subscribed by them into investee companies through the Fund.	Upon each sale of underlying shares	Investor	Mercia

**charged on the subscription into the fund, less any adviser fees deducted from the investor's subscription.*

^the default position is for two years fees to be withheld from the initial subscription and subsequent year's fees will be accrued and deducted from proceeds.

Mercia shall be entitled to charge each investee company a pro rata proportion of expenses reasonably incurred by it in respect of the monitoring of the relevant investment. Mercia will bear any legal, accounting and other fees incurred by the Fund in connection with potential Investments which do not proceed to completion and may retain for its own benefit any arrangement fees and director's or monitoring fees which it receives in connection with Investments and any fees for services relating to fund raising and corporate advisory services, accounts, company secretary, legal advice and assistance in maintaining EIS status.

Ability to switch / withdraw from product

Shares acquired through the Fund are illiquid. There is a very limited secondary market for the shares. Withdrawing from the investment can only happen in very limited circumstances and may incur significant costs. A sale of shares within the three year qualifying period will trigger a claw back of tax reliefs.

Product lifespan

The product is expected to continue until full realisation of the investment portfolio and distribution of proceeds.

Cost of manufacturing the product

The costs of the product enables Mercia to employ the investment team, finance, custodian and other administrative resources to invest in, hold and monitor the Fund. Fees charged are assessed on at least an annual basis to ensure that they are commensurate with the costs charged.

Market rate for the product

The product is assessed regularly to ensure it is in line with the market rate, and Mercia regularly reviews fees of market participants to ensure that costs are in line with comparable products.

Distribution arrangements

Mercia works with a number of distributors to provide investors access to the product. All relevant information is made available to distributors, including the information memorandum and access to the Mercia investor relations team. Adviser fees are the responsibility of the adviser to agree with their clients directly. Mercia will facilitate payment of the initial adviser fee on behalf of investors, provided that Mercia has received appropriate authority.

Assessment

The product is assessed to offer fair value because in return for the costs, it offers the opportunity for capital gains (tax free), up to 30% income tax relief, the deferral of capital gains and other tax reliefs. Costs are in-line with market average. 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. There are no adverse findings from this assessment.