Over the past few weeks I have been overwhelmed (but not surprised) by the passion, forthrightness and strength of feeling that EISA members have for the SME and investor ecosystem that we have so carefully nurtured within the EIS and SEIS industry for over 20 years. Your feedback to the EISA response and to wider issues in respect of the Patient Capital Review has been very welcome and I thank you.

Even at this late stage, we continue to engage with HMT and with Government, more generally, about the recommendations that will be made to the Chancellor. It was after one such meeting with HMT that I was reminded of my first job out of university as an insurance salesman.

In the HMT meeting, I was focussing on outlining EISA's agenda, the positive changes we hoped to see in the budget our concerns about damage through unintended consequences and, as I believed was only right, conveying your views but it felt like a brick wall was being hit. I was replaying the meeting later in my mind when I remembered the first lesson I was taught as a trainee salesmen 20 years ago, "If I'm going to sell Bill what Bill buys, I'd better see things through Bill's eyes."

One of the greatest limitations we face as human beings is when we only look at the world from our own subjective perspective —especially in situations that directly involve us, but you can glean tremendous insight when you understand someone else's currency and circumstances. When you know where the other person is coming from, that knowledge is power.

So, I would urge you, as I have tried to during our talks with HMT, to play devil's advocate and consider their point of view for a moment.

Firstly, we get a good idea of where HMT are coming from as the Patient Capital Review lays this out quite clearly. The focus of EIS and SEIS must, we are told, be on higher risk, growing, and innovative companies with the ability to scale up. Further conversations with HMT reveal that, whilst they view many activities and investee companies within EIS and SEIS portfolios as "good", some are, in their view, not worthy of tax relief. Increasing employment and revenue within an EIS or SEIS funded company are not enough in themselves, they want more of a focus on growth and higher risk activities. Listen carefully and the key words you will hear over and over are growth, innovation and technology. This is their new definition of "well targeted". Whether you agree with this or not, this is HMT's desired direction of travel.

Secondly, when HMT look around the market, what do they see?

They tell us they see a whole new language having entered the EIS industry, "asset backed", "capital preservation" "risk mitigated" are all words created by the industry and regularly found in EIS IMs and marketing brochures. Allow me to quote a direct example taken from a recent IM I read, "Portfolios allow you to access asset-backed trading activities that provide a degree of capital preservation and risk mitigation". Now whilst I understand the IFA market has largely driven the demand for a supply of EIS products that meet this criterion, HMT don't understand (and probably don't care) as their concern is for EIS money to be well targeted (as we explored earlier) into growth companies. Compare the sentence from the EIS IM above with this definition of Patient Capital "long term investment in innovative firms led by ambitious entrepreneurs who want to build large scale businesses" and you can see an immediate fault line developing between two increasingly divergent views. An additional issue is that some Government ministers who don't take the time to understand EIS structures simply equate capital preservation with abuse.

Then consider that in 2016/17 the figures show HMT that circa £746M was raised by EIS funds. Of this £746M, over £450M was raised by EISs classified as "capital preservation" – 62% of the market.

Perhaps then by stepping out of our shoes momentarily and seeing the opposite view, even if you don't agree with it, you can understand why HMT is at best at odds, and at worst, on a collision course with certain sectors of our industry.

So, this was the challenge EISA faced when submitting a response to HMT and in the ensuing negotiations. Our meetings with HMT had revealed where HMT and Government were coming from;

- All EIS/SEIS funds need to refocus on funding growth orientated companies if EIS/SEIS is to continue – every £1 invested in EIS/SEIS must be a £1 at risk
- There is no appetite at HMT to keep revisiting the rules year on year
- This is not a cost cutting exercise. The amount of tax relief currently being paid is sustainable as long as tax relief is paid in respect of capital growth focused
- HMT have changed the rules before but they have seen little evidence of a change in behaviour. A cultural shift is now expected

Armed with this the knowledge of the direction HMT and the Government want to take in order, as they put it, to "refocus" EIS gave EISA a very difficult juggling act. As the body that represents the whole industry we were acutely aware that this direction was potentially unfavourable to a number of our members whilst at the same time being potentially favourable to others. In short, there was little or no prospect of keeping all members happy. An EISA sub committee was set up consisting of EISA Board members and EISA members and tasked with formulating the EISA response. The sub committee took views from many sources; current EISA members, BVCA, AIC, VCTA, HMT, Government and after much consideration and care took the view that based on the knowledge we had gleaned from these sources and in particular our one on one meetings with HMT that the writing was very much on the wall and we had to make some tough and unpopular decisions in respect of certain areas of investment in particular around freehold property which HMT have repeatedly quoted as a source of their frustration. Consequently, recommendations were included in the EISA response about preventing EIS funds to be used to acquire freehold or long leasehold property.

Another area of contention was TV and Film. Again, HMT have previously flagged up this area as not necessarily always focused on growth with too many structures using EIS funds where they felt bank or collateralised ending should be the appropriate source of funding. This market is also huge. Of the £450M raised in 2016/17 via EISs with a capital preservation strategy, £280M was in TV and Film. In our response we offered recommendations to restrict EIS money being used where the venture benefits from pre-sales and tax credits and offered to work with HMT, alongside industry participants, to create appropriate legislation. Controversially, we also noted that if no resolution can be agreed in these discussions, we would be prepared to discuss adding TV and Film to the excluded activities list. Firstly, note the wording "only if no resolution can be agreed" and "prepared to discuss". Clearly, we knew this wouldn't be popular but we also knew cultural change was expected and we took the view that this showed a statement of intent and that the industry is prepared to embrace change. We were (and remain) confident that HMT do not wish to exclude most TV and Film ventures as a qualifying EIS activity but want to see certain restrictions rather than complete exclusion. Since our response work has been ongoing with help from many of our members from the TV and Film community to present HMT with recommendations for change but which allow TV and Film to continue as an EIS qualifying

investment fairly and squarely focused on ensuring EIS money invested in this sector is money at risk. Because of the nature of those negotiations, it hasn't always been possible to involve everyone in those talks but EISA are working hard to find a sensible resolution that will meet objectives on both sides and we are confident this can be achieved. Negotiation isn't a matter of trying to get what you want and walking away feeling you have won and the other side has lost, its about both sides walking away content.

So where are we now? Since the deadline, EISA have been on the front foot and have been engaging with key stakeholders across Government, the industry panel and the EIS industry. We have written to all MPs outlining the importance of EIS and our concerns that any changes should not go too far and have received a number of meeting requests on the back of this. We have also had various update requests from Ministers and their departments including the Department of Business, Energy and Industrial Strategy, the Department of Culture, Media and Sport, and slightly oddly, the Scottish National Party! Finally, we hope to have an open letter published in the Sunday Times voicing our concerns and signed by a number of supportive, high profile individuals. As mentioned earlier, we have also been working with participants in the TV and Film sector to come up with recommendations for this sector which are workable suggestions for change that can be codified in legislation. This is the problem we face. Not simply shouting loudly that no change should occur or offering very broad brush changes but putting forward wording and language that can be put into easy to understand, unambiguous legislation, without unintended consequences.

From HMT's side they have spent the time since the consultation deadline battening down their hatches and reading through responses and collating information. Within the last week, they have re-opened lines of communication and, at our meeting with them this week, once again the message was that EIS has to refocus away from capital preservation back to growth. There was an acknowledgement that they and the Government haven't expressed this view clearly enough over the past few years which has led to the proliferation of risk mitigation/protected/asset backed investments. EIS in many Government circles has a perception problem where in their simple, soundbite analysis, capital preservation equals abuse. As a result, we are now at a cliff edge and for EIS to survive all money invested into EIS/SEIS funded companies by investors must be money that is at risk. HMT accept all businesses attempt to minimise risk and that's fine but risk that is structurally or artificially mitigated through the EIS tax reliefs will no longer be tolerated. The Budget will announce changes to reflect this as well as further consultation on additional changes at a later date. What HMT can't tell us is exactly what these changes will look like and what the timescales for the enactment of those changes will be.

The key message to take away is this - every £1 of EIS/SEIS investment has to be a £1 that is equity at risk. If you are a fund and you can satisfy this rule you will be fine, if not you will likely have a problem.

So how do we as an industry respond? My view is that EIS and SEIS are at a precipice – accept change or risk the schemes being scrapped altogether. Over the years, EIS and SEIS have been incredibly resilient and had to adapt and change many times in the face of changing levels of tax relief, withdrawal of solar and renewable energy as investments and the 2015 State Aid rules and for me, there is absolutely no reason why EIS and SEIS can't go from strength to strength. Britain continues to be the start-up capital of the world and EIS and SEIS have a proven track record in helping businesses to start, build and grow. You can't scale up a business if it has not started and gained some traction. It's evident that small businesses still face significant funding challenges – that problem hasn't gone away and if anything has been exacerbated. This is the strength of EIS and SEIS and there are a myriad of small businesses across all sectors, not just technology, very worthy of investment and with the

potential to grow for the benefit of both themselves and investors and which are well within the Government's new definition of "well targeted". The portfolios of EIS and SEIS fund managers already include examples of this and I have no doubt their expertise will continue to find many more. EIS and SEIS are evolving but surely entering the mainstream as an asset class as switched on investors realise that small company investing can add both diversification and attractive potential returns to their investment portfolios.

So, as Bob Dylan sang "the times they are a changing". Rest assured EISA are working with Government to minimise the impact of those changes for our members but with change comes opportunity and I'm certain any changes will be not only be accepted by our industry but will bring out the best in it!

Mark Brownridge
Director General – EIS Association