UK Finance

Individual Savings Account: UK ISA Consultation

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UK Finance is the collective voice for the banking and finance industry.

Representing more than 300 firms across the industry, we act to enhance competitiveness, support customers and facilitate innovation. Our members include businesses that are large and small, national and regional, corporate and mutual, retail and wholesale.

General Comments

We welcome the opportunity to respond to the HM Treasury ('HMT') Consultation 'Individual Savings Account: UK ISA Consultation'.

Thriving capital markets are vitally important to the UK's economy and UK Finance members are strongly supportive of measures to enhance them. For this reason, UK Finance commissioned and published a report[1] in 2023 to obtain insights on the health of the UK capital markets. A key message of that report was the need for a market that works not only for sophisticated investors and corporates, but for everyone. An increase in widespread retail investor participation would be positive to UK citizens and the UK economy.

Our members believe that the government needs to take a holistic approach, with a UK ISA being only the first of a number of policy interventions required to scale the participation of retail investors in UK capital markets.

The ISA regime is already a complicated landscape and evidence suggests that retail investors do not have a solid understanding of what is currently

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[1] 'UK Capital Markets: Building on strong foundations', UK Finance, May 2023

UK Finance

available to them. According to research undertaken by AJ Bell in 2023, despite 96% of people having heard of ISAs only half of people could identify the main types of ISA. The research also showed that less than a third of people knew that the annual ISA allowance is £20,000. HM Revenue & Customs' ('HMRC') latest available statistics show that 1.6 million (7%)[2] of ISA holders used their full annual ISA allowance in the tax year 2020/21, and fewer than a million of these have a stocks and shares element to their ISA portfolio.

Our members believe that the introduction of another type of ISA with different limits and other features to the existing types of ISA may further add to customer confusion unless HMT/HMRC actively manage this challenge. We, therefore, believe that the design of the UK ISA should closely mirror that of the existing stocks and shares ISA ('S&S ISA'), and that HMT/HMRC should endeavour to minimise complexity for both customers and ISA managers.

The launch of the UK ISA should also be accompanied by policy measures to increase financial literacy to support the public's understanding of ISAs and the government should consider how it might incorporate independent financial guidance (provided by the Money and Pensions Service ('MaPS')) into the subscription of ISAs.

The industry will need the UK ISA scheme rules to be communicated at least a year in advance of the go live to enable ISA managers to conduct a full assessment of the target market and to evaluate the business case viability of the product. To facilitate this process, it would be helpful for HMT to publish their own more detailed analysis. At present, it appears that the planned design of the UK ISA will be significantly more restrictive than a S&S ISA, and as such a S&S ISA would likely be a lower risk choice for the majority of people that have not already used their full £20k ISA allowance. This is because the S&S ISA would provide more flexibility to diversify into other investments and/or asset classes in a tax efficient manner. Therefore, it seems as if the

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2 https://assets.publishing.service.gov.uk/media/64930b46b32b9e0012a96c37/Individual_Savings_Accounts_ISAs_Tables_June_2023.ods

UK ISA only appears to appeal to a target market of clients that have already fully used their main £20k allowance.

Another important issue relates to perceived regulatory challenges regarding the UK ISA, such as in relation to the Consumer Duty or regarding retained interest on cash balances. As always, UK Finance would urge HMT and HMRC to engage early with the Financial Conduct Authority (FCA) to ensure that product is developed with such considerations in mind.

The experience of implementing the Autumn Statement ISA Changes has demonstrated that rushed policy changes and inadequate lead-time result in unintended consequences and poor customer outcomes. We would want HMT and HMRC to invest more time into developing the UK ISA with a sensible lead time for implementation from the point at which legislative provisions and guidance are available. We, therefore, think it would be advisable to re-engage in dialogue with stakeholders after the consultation is closed, when possible to do so, to address issues raised through the consultation process.

Specific Questions

Defining the UK ISA

Question 1: Should ordinary shares in UK incorporated companies that are either listed on a UK recognised stock exchange or admitted to trading on UK recognised stock exchange be eligible for the UK ISA?

UK Finance considers that ordinary shares in companies that are either listed on a UK recognised stock exchange or admitted to trading on UK recognised stock exchange should be eligible for the UK ISA.

While there may be a potential concern that simply focussing on the listing and/or admitted to trading requirement may unintentionally benefit non-UK companies, an important consideration must be the ease of administration of the regime. We would observe that a requirement to exclude certain companies based on source of revenue or location of assets may prove prohibitively complex and costly for some ISA managers. A pure nationality test would potentially prohibit UK businesses with a Topco incorporated in another jurisdiction. Allowing investments based on a much simpler definition

would be consistent with the existing requirements for qualifying investments for other types of ISA such as S&S ISAs.

Notwithstanding the above comments, and in the alternative, if any additional thresholds and tests are introduced, there should be an impartial mechanism by which ISA providers could confirm that the ordinary share is eligible for inclusion in a UK ISA. ISA managers should not have to make a judgement or determine whether a company qualifies.

The rules should also be clear on what happens if a company ceases to be eligible or meet the definition within a tax year (e.g., no longer listed or admitted to trading). We recommend that ISA managers should not have to sell the holding immediately as this could lead to a loss being crystallised for the customer if the market has fallen, instead, we would recommend that the asset should be moved to sell-only status. We would also recommend a standard review period, so that assets no longer qualifying are only removed at set intervals, for example, at the end of the tax year.

Question 2: Should collective investment vehicles be eligible for the UK ISA and if so, which vehicles specifically? What should be the minimum requirement for each of the underlying investments and how would each be monitored by ISA managers?

UK Finance agrees that collective investment vehicles should be eligible for the UK ISA, to the extent that these vehicles are allowed under the existing S&S ISA. Fundamentally, any minimum requirements will need to be easy to communicate to customers to ensure their understanding (as per consumer duty) and easy for ISA managers to operate.

UK Finance members consider that HMRC/HMT should conduct an assessment of the market to understand the number of existing vehicles that would qualify under a minimum threshold approach (as it is unlikely that fund managers would create new funds specifically to meet the criteria and there needs to be sufficient funds to make the UK ISA viable). This analysis may determine if the minimum threshold approach may be too rigid and may impact the eligibility of some vehicles, given the nature of investment market movements and corporate actions.

If the minimum threshold approach is pursued, we suggest that when a fund breaks the minimum threshold, there should be a 30/60 day rule to allow the fund to get back within the threshold, so that ISA managers are not required to deal with fluctuations in and out. Similar considerations would apply to a benchmark requirement, paired with the backstop of an absolute minimum requirement, as HMT/HMRC would need to ensure any set threshold does not limit product compatibility and therefore reduce client choice.

We consider that the onus should be on the fund manager to declare that the fund is UK ISA eligible, as is existing practice. We would not expect an ISA manager to be penalised by HMRC if the (third party) fund manager has failed to comply with the relevant limit. Nor would it seem appropriate for ISA customers holding such a fund to be adversely impacted, e.g., by having their entire UK ISA voided, if a particular fund held has become invalid to be held in a UK ISA. Instead, we consider that if the fund no longer meets eligibility, the fund should be moved to sell-only status.

It would be a significant burden on ISA managers, and in some cases impossible to police any threshold, without support from fund managers. Therefore, we would favour a simple process for the ISA manager to obtain confirmation from the fund manager (either directly or via a third-party data provider) that the relevant limits have been adhered to. This could be triggered on an automatic and periodic basis, or alternatively on the basis of a defined trigger event, such as the initial purchase and the fund ceasing to be eligible.

Question 3: Should corporate bonds be eligible for the UK ISA?

UK Finance believes that corporate bonds issued by UK enterprises should be eligible for the UK ISA. We understand the purpose of the new regime is to encourage and facilitate capital formation for domestic enterprises and most businesses maintain a mix of debt and equity financing in their capital structures. Accordingly, an incentive for UK savers to assist in the provision of both debt and equity financing would seem the most powerful means of accomplishing the overall objective.

This option would also enable customers to de-risk from holding equities or equity-based funds when their circumstances change, e.g., to sell equities and reinvest the sale proceeds into bonds later in life, while still retaining the tax

efficient ISA wrapper depending on the policy outcome on the question of UK ISA transfers.

Legislation should, however, make clear that the provision of financing across the full capital structure is eligible, so as not to create inappropriate incentives in favour of particular forms of debt or equity financing. For example, debt instruments of differing maturities, currencies, interest rates (e.g., fixed / floating) and coupon/redemption formulas (e.g., linked to other financial instruments or measures) should all be eligible, provided the issuer of the instrument is a domestic enterprise.

Question 4: Should gilts be eligible for the UK ISA?

UK Finance is of the view that gilts should be eligible for the UK ISA as it would support customers in creating diverse sets of investment holdings Similarly to our comments under Question 3, this option would also enable customers to de-risk from holding equities or equity-based funds when their circumstances change while still retaining the tax efficient ISA wrapper.

Question 5: Are there other investments that already qualify for an ISA that should be eligible for the UK ISA? How would they meet the policy objectives?

In general, it is envisaged that all the types of investments that currently qualify for a S&S ISA, subject to the requirement for a UK-nexus, should be eligible for the UK ISA.

Design of the UK ISA

Question 6: Should the UK ISA allow subscriptions to multiple UK ISAs in the same tax year?

UK Finance considers that the UK ISA should align with existing ISA rules to allow multiple subscriptions, with the onus on the customer to adhere to the scheme rules.

This approach would align with consumers' understanding of the general ISA regime post Autumn Statement 2023 and provide greater flexibility to investors. For example, although some providers of UK ISAs might offer a product where both direct equities and collective funds can be held in the same account, other providers might offer a product where 'only' collective

funds can be held and not direct equities, or vice-versa. There might be reasons why an investor would prefer to split their £5k UK ISA allowance between a 'funds only' and 'equities only' product, perhaps with different ISA managers.

Such an approach would also future proof the UK ISA to provide for the eventuality that the annual limit might be increased at some point in the future. In the immediate term we appreciate that the lower annual limit of £5k arguably renders the ability to subscribe to multiple UK ISAs less important as it is for other existing types of ISA, such as cash ISAs and S&S ISAs.

Question 7: Should transfers from any type of ISA to a UK ISA be allowed? Should there be a limit on transfers from other types of ISAs to a UK ISA?

UK Finance members have divergent views on this question.

Some members consider that the transfer rules for the UK ISA should align with existing ISA transfer rules, which would prevent adding complexity to the administration of the regime.

For some members, the question of whether transfers should be allowed into a UK ISA is contingent on whether the UK ISA will offer any additional features and/or tax benefits over and above those available in a S&S ISA. In the absence of any additional benefits, and noting the comparative lack of flexibility of a UK ISA compared to a S&S ISA, there are concerns, from a regulatory perspective, about foreseeable harm in the context of the Consumer Duty.

Other members do not believe that transfers should be permitted. They have flagged concerns regarding the inherent complexity in determining how current year £20k contributions could affect the £5k allowance, and how the allowance interacts with the non-UK ISA limit post-transfer, and concluded that it would be very difficult to manage the proposed approach of allowing transfers from other types of ISAs up to the subscription limit of the UK ISA. Consequently, they consider that keeping the UK ISA product separate would be a good way to ensure a better service for clients and reduce complexity and challenges to ISA managers.

Question 8: Are there any downsides to the government's proposals on transfers out of a UK ISA?

We would like to note that the inability to transfer from a UK ISA to another type of ISA will mean those holding a UK ISA will be unable to diversify into non-UK investments within the tax-efficient ISA wrapper. Also, depending on the regulations, they may not be able to de-risk into cash while still being able to earn tax-free interest on such cash within the ISA wrapper. As these risks will need to be made clear to anyone considering investing in a UK ISA, we would anticipate this would deter some investors from choosing a UK ISA.

UK Finance members views diverge on this question. Some UK Finance members acknowledge that the restriction is necessary to prevent undermining the policy objectives. However, other UK Finance members consider that the UK ISA investor should be afforded maximum flexibility and should be treated fairly i.e. have the same benefits as existing S&S ISA investors. All members are wary of adding further complexity to the ISA regime.

Should HMT/HMRC persevere with plans to prevent transfers from a UK ISA to another type of ISA, it may be helpful for the FCA to be consulted on this aspect of the design to rule out the possibility of 'sludge practices'.

Question 9: Should the UK ISA have cash holding rules? Which rules should be included in the UK ISA?

Although we support the policy objective of creating a specific investment type product and understand the concern that holding cash within this new wrapper could enable taxpayers to utilise the extra allowance without making any investment, we nevertheless consider that the UK ISA must allow customers to hold cash for legitimate reasons

Such restrictions may inhibit well-established practices designed to support investment. For instance, as part of encouraging savings habits, some ISA managers give their customers the option to save a regular amount into an ISA (e.g., £50 per month) and trade once reaching a certain amount. It would be unhelpful to introduce differential rules that would prohibit this approach.

Any cash holding restrictions will also make the product more complex for customers and for ISA managers, and complexity should ideally be avoided.

Furthermore, we need to understand whether the FCA has been consulted on how to align the UK ISA rules with potential concerns regarding retained interest on customers' cash balances.

If it is determined that some requirements in this area are needed, contrary to our members' primary position, then we would make the following observations (noting that these approaches would introduce complexity to the design of the UK ISA):.

- **'Cash-like' qualities of other qualifying investments** - Should cash holding restrictions apply, HMT would presumably have to give consideration not just to the holding of cash on deposit, but also regarding 'cash-like' qualities of other qualifying investments (equities, bonds, gilts, funds etc).
- **Base the approach on the Flat Rate Charge previously used for S&S ISAs** – this approach would permit cash to be held in a UK ISA, with interest subject to UK tax (including a potential withholding tax obligation). However, the withholding processes would be an unwelcome administrative burden and this approach would make it difficult to promote the UK ISA as a tax free/tax exempt product.
- **Base the approach on the £180 de minimis rule previously used for Personal Equity Plans (PEPs)** – this approach would permit interest to be paid to the investor free of income tax as long as the amount of interest was within the specified limit. There may be associated requirements imposing time limits for how long cash could be retained in the UK ISA without being invested or withdrawn. However, we would note that the PEP rules were very complex to understand and administer, including systems and processes to comply with various 'first in, last out' (FILO) requirements to take account of transactions happening on different dates.
- **Not allowing interest to be paid on cash held, or cap the rate at which it can be paid** – though the simplest solution, this seems in direct conflict with the FCA's expectation of firms to ensure that where they retain interest on cash balances that they do so in a way that delivers good outcomes in line with Principle 12 and PRIN 2A and meets the Consumer Duty obligations.
- **Possible 'cash-like test' for qualifying investments** - If it is decided that restrictions need to be placed on cash held on deposit to prevent

or limit the extent to which tax-free interest on cash can be paid, then we assume additional considerations to prevent 'cash-like' investments from being held may be required. In this regard, we presume this could be along similar lines to the S&S ISA 5% cash-like test that used to apply to purchasing shares and funds and the minimum 5 year to redemption requirement for purchasing corporate bonds and gilts at the time when the amount that could be subscribed to a cash ISA was only 50% of the overall ISA subscription limit. However, we would note that when this requirement was in place, it was not always straight-forward to establish up front whether a particular investment would or wouldn't satisfy the test, particularly once the risk of issuer or counterparty failure or default was factored in. So if a cash-like test for investments is introduced, we would suggest that clarity would be required for ISA managers, the providers of underlying investments, and, not least, ISA customers to establish which investments do or do not qualify.

Question 10: Are there any other design features that the government should consider at this stage?

Clear guidance would be welcomed on dealings with non-qualifying assets, where they no longer meet the eligibility criteria. We believe it would be a better outcome for investors (whilst being simpler for ISA managers to implement) if the non-qualifying product must be sold and reduced to cash, as opposed to being removed from the ISA wrapper.

Although it would be beneficial to see the target market for the UK ISA expanded, UK Finance members are not persuaded that adding further rules or design features will necessarily be advantageous. On balance, UK Finance members are in broad agreement that the design of the UK ISA should be guided by the need for clarity and simplicity, to aid customer understanding, and encourage take up by ISA managers.

However, to the extent that HMT may be considering other design features, we would observe that an additional benefit, such as a 'matching contribution/bonus' feature, similar to the Lifetime ISA, would likely expand the target market, but would be a significant additional cost for the Exchequer. The introduction of additional tax benefits, such as exempting the purchase of investments within a UK ISA from Stamp Duty/Stamp Duty Reserve Tax

(SDRT) or exempting the value of a UK ISA on date of death from inheritance tax, would introduce further inconsistency with other types of ISA, making it more difficult for investors (and advisors) to decide what type(s) of ISAs may be most appropriate for them.

If SDRT benefit is provided under UK ISA, we also ask HMRC to clarify whether SDRT would become retrospectively payable for investments previously purchased if it was subsequently determined that a subscription made to a UK ISA was invalid, and how that would be administered, and what customers would need to be made aware of.

Flexible ISA (replacement of withdrawals) feature

For the existing types of ISA, ISA managers have the option to offer 'flexibility' whereby in-year withdrawals can be replaced later in the year without counting as a further subscription against the customer's ISA allowance. HMT would need to confirm whether UK ISA should also allow flexibility if the ISA manager wants to offer it.

Position on the death of the account holder

When the holder of a UK ISA dies, will the account become a 'continuing account of a deceased investor' in line with other types of ISA whereby the account retains ISA status for up to three years after date of death?

Also, if there is a surviving spouse/civil partner, will they be entitled to an Additional Permitted Subscription (APS) allowance based on the value of the UK ISA? If yes, a key consideration will be whether the surviving spouse/civil partner would be able to use that allowance to subscribe to any type(s) of ISA of their choosing (potentially alongside the APS allowances they may have from other types of ISA that were held by the deceased), or will they be restricted to only being able to use it to subscribe to a UK ISA of their own?

Reporting Requirements

UK Finance members are currently participating in HMRC roundtable discussions about Digitalisation of ISAs. Reporting requirements for the UK ISA should be in line with any changes made to reporting for other ISAs. Consideration should be given to the timing of both changes as members may

not have sufficient resource to implement reporting changes and launch a UK ISA at the same time.

Question 11: Are there any other unintended consequences from this approach?

It is hard to comprehensively predict potential adverse implications of the proposed UK ISA regime, without understanding the final design details, at which stage some of the consequences will become clearer.

At present, we anticipate some of the following potential outcomes:

- Subject to the similarities/differences between the current ISA rules and the new UK ISA rules, there may be considerable confusion for investors as well as ISA managers.
- The new UK ISA regime may only benefit experienced investors.
- If UK ISA managers are required to monitor qualifying investment rules for any restricted offering on an ongoing basis, to ensure they continue to meet any qualifying requirements, the administrative burden in maintaining the new UK ISA products may be prohibitively expensive.
- If an asset ceases to be eligible, the customer will need to have another account to move the asset to which could mean that they would need to open multiple accounts (e.g., UK ISA and S&S ISA or General Investment Account) at the same time.
- Investors fully utilising allowance for the proposed UK ISA will face potential downside risk as a result of reduced diversification.
- Any existing investment advice customers obtained to date may no longer be valid.

Delivery and compliance

Question 12: Would you be interested in offering a UK ISA based on the design set out in chapter 2 and 3?

UK Finance members are supportive of HMT's intention to deliver policy interventions designed to enhance the UK capital markets. Our members also support product innovation and are keen to encourage UK citizens to invest for their future, in addition to holding cash savings.

The decision on whether to offer a UK ISA is a commercial decision each of our members will need to make individually. Members who consider offering a UK ISA will need to ensure there is a business case for doing so, for example taking into account the target market comments made elsewhere in this response, as well as the estimated costs to them of developing and offering the product.

Until the final design of the UK ISA becomes clearer it will be difficult for our members to reach that decision. Our members are keen to continue the dialogue with HMT, HMRC and the FCA to further develop the UK ISA product. It is essential that government provides the final rules and guidance in advance of any launch or implementation date. We think that this should be at least 12 months in advance of a new tax year.

Question 13: How long would it take for you to launch a UK ISA product and when would you start building it following this announcement?

The implementation timetable for a UK ISA would depend on a number of factors contingent on the final design of the product, and the extent to which ISA managers may be able to use/adapt their existing systems and processes for administering other types of ISA that they currently offer. Where a new fund or investment mandate is required to be launched, or where ISA rule changes means additional changes need to be made to existing reporting framework and processes, this will increase the cost, time and complexity of launching a UK ISA product.

The types of changes required might include:

- systems updates to accommodate the new product type;
- new processes for customer application and servicing; and
- new procedures and controls to be put in place for the product operation and to cope with new reporting requirements.

Our members indicate that without re-prioritising existing products in the pipeline, it is estimated the process to design, build and launch a UK ISA could take from 6 to 18 months once the final regulations and guidance are made available. However, the actual timeline will depend on the complexity of the UK ISA and other competing regulatory priorities. In any event, we would always urge changes to the ISA regime to be made at the start of a tax year.

Question 14: What would the cost implications be and what operational changes would you need to undertake?

As with our answers to questions 12 and 13, the cost implications and operational changes required to implement the UK ISA will depend on a number of factors including final decisions on the product design questions in the consultation, and the extent to which our members may be able to use/adapt their existing systems and processes for administering other types of ISA they currently offer. At this stage of the design process, it is not possible for members to sensibly assess the potential cost implications.

When building such an ISA product, some examples of operational considerations would include, but are not limited to, the following:

- New product build and onboarding journeys.
- Systems and online changes to enable servicing
- Client Assets Sourcebook (CASS) compliance
- Additional procedures required in managing the potential restrictions on eligible investments
- Changes to transfer processes
- Potentially different ISA functionality
- Dependency on third parties, e.g., in relation to ISA transfers.

Question 15 What, if any, issues do you foresee from a compliance perspective for the UK ISA? Please provide details.

Similar to Question 11, it is hard to fully anticipate the potential compliance issues at this stage of the product design process. UK Finance has identified the potential for an increased administrative / compliance burden at several points in the answers to the Questions above.

Subject to the similarities/differences between the current ISA rules and the new UK ISA rules, there may be confusion caused for investors as well as challenges for ISA managers, fund managers and data providers etc. This may have consequential implications for Consumer Duty regulatory requirements.

UK Finance

Solutions may also need to be thought out to support data feeds in order to satisfy any new and different reporting and information sharing requirements under the new UK ISA regime compared with existing ISA rules.

UK Finance would welcome the opportunity to continue dialogue with HMT, HMRC and the FCA as the UK ISA product is developed.

If you have any questions relating to this response, please contact Demi Butler (demi.butler@ukfinance.org.uk).

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