Response by TISA to ISAs and open-ended property funds

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About TISA

The Investing and Saving Alliance (TISA) is a unique, rapidly growing membership organisation for UK financial services.

Our ambition is to improve the financial wellbeing of all UK consumers. We do this by focusing the convening the power of our broad industry membership base around the key issues to deliver practical solutions and devise innovative, evidence-based strategic proposals for government, policy makers and regulators that address major consumer issues.

TISA membership is representative of **all sectors of the financial services industry.** We have **over 200-member firms involved in the supply and distribution of savings, investment products and associated services**, including the UK's major investment managers, retail banks, online platforms, insurance companies, pension providers, distributors, building societies, wealth managers, third party administrators, Fintech businesses, financial consultants, financial advisers, industry infrastructure providers and stockbrokers.

As consumers, the financial services industry and the economy react to and recover from the effects of the pandemic, the importance of the three key pillars of work that TISA prioritises has never been more apparent:

- **Strategic policy initiatives that influence policymakers** regarding the financial wellbeing of UK consumers & thereby enhancing the environment within which the industry operates in the key areas of **consumer guidance, retirement planning, later lifetime lending, vulnerable customers, financial education, savings and investments**.
- TISA is recognised for the **expert technical support provided to members** on a range of operational and regulatory issues targeted at improving infrastructure and processes, establishing standards of good practice and the interpretation and implementation of new rules and regulations covering **MiFID II, CASS, ESG/RSI, operational resilience, Cyber Risk, SM&CR** and a range of other areas.
- **Digital transformation initiatives** that are driving ground-breaking innovation and the development of industry infrastructure for greater operational effectiveness and revenue promoting opportunity for firms. TISA has become a major industry delivery organisation for consumer focused, digital industry infrastructure initiatives – **TISAtech** (a digital marketplace that brings together financial institutions and FinTechs for greater collaboration and innovation) and **TURN** (TISA Universal Reporting Network – a digital platform providing a secure data exchange for financial services using blockchain technology) – alongside projects **Digital ID** and **Open Savings & Investment**. This reflects TISA's commitment to open standards and independent governance.

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The view of most respondent member firms, which TISA supports, is that neither option proposed in the consultation is the best one as far as the ISA customer is concerned. Such funds are a significant element of many ISA client's portfolios providing an important spread of risk. Limiting their ability to fully utilise this asset class in the future within their ISA wrappers could have a significant impact on their long-term investment objectives.

We accept that the ISA regulations would need amending to accommodate the inclusion of property funds which mandate either 90- or 180-day notice periods but we don't feel that these are insurmountable. The ISA regulations, as the consultation makes reference to, already permit assets (peer to peer loans, debentures) with long notice periods to be held in innovative finance ISAs and we see no reason why the regulations for stocks & shares ISAs couldn't also accommodate a similar approach.

Such an approach would inevitably create conflicts with the 'current year' ISA transfer regulation so this could be an ideal time to revisit the need for this long-standing regulation and HMRC has previously agreed to consider this.

An argument would therefore be that should the ISA regulations be amended to accommodate the inclusion of property funds that have a lengthy notice period, as long as ISA terms & conditions make this clear, it would then be investor choice as to whether they wish to invest in such funds.

Should the FCA proposals be implemented and should HMRC decide not to amend the ISA regulations to accommodate such funds, the responses from member firms strongly supported the use of Option 1 in the consultation. Although both options would create administrative problems for ISA managers, there was a consensus that Option 1 was manageable, albeit it would need a significant lead in time, whereas Option 2 was generally deemed to be too complicated to implement from a systems point of view. One member firm was of the view that, should the FCA proposals be implemented, many advisers and discretionary fund managers would simply remove affected funds from their client portfolios before the FCA's regulations came into force.

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Question responses

TISA is not in a position to answer the specific questions raised below which relate specifically to ISA managers, however, we have included the responses of two member firms who have confirmed to us that they do not plan to respond to the consultation directly. We have documented the responses of one-member firm in italics to distinguish between the two responses.

Question 1
In order to gauge the potential proportion of ISAs affected:

a. What proportion of the stocks and shares (or Lifetime) ISAs you offer include property funds invested in non UCITS retail scheme?

2.4% currently of ISA assets under management

b. What is their value?

£397,323,311

c. Do they form part of a mixed portfolio?

The vast majority, yes

d. Are these self-select funds?

Our ISA is offered almost exclusively through Financial Advisers. Our records show circa 98% of ISAs holding property funds are advised clients.

The T&Cs of a number of our S&S ISA products allow non-UCITS retail schemes (NURS) property funds to be held. These include:

- Those that operate as part of a broader discretionary investment management agreement, with both ISA and non-ISA (General Investment Account) investments collectively forming the overall model portfolio.
- An execution-only/self-select S&S ISA whereby NURS property funds are within a wide universe of in-house and third-party collective investment funds available to investors to choose from.

The property funds are typically held as a small proportion of a broader portfolio of ISA investments in line with usual principles of diversification of investments and holding non-correlated asset types.

Question 2

As an ISA manager, and with the experience of extended suspension in mind:

a. Would it be feasible for you to continue offering ISAs which include property funds affected by the FCA proposals if either of the models set out at paragraphs 21 and 22 were introduced?

It would create great difficulty for switching assets. We offer % switches (along with other methods) where the buy leg doesn't start until the sell leg is priced. The delay of pricing/settlement makes this unworkable so would have to look to limit asset switching in property funds. It is envisaged that advisers/discretionary managers running model portfolios would not use property funds should an extended redemption period be introduced as the model would not be manageable i.e., ability to rebalance asset allocation.

Operationally (relative to model 2) we think model 1 would be much easier to implement and administer. It would need something like a 'sell only' system flag/marker to be placed against all property funds held in ISAs that were caught by the change to the regulations. We already use such a marker for other purposes. Model 2 seems unduly complex as it would apply at individual fund and account/investor level, and our initial thoughts are this might be largely unworkable or at the very least, complex, costly and time consuming to put in place. In addition, it may cause customer confusion plus arguably a sense of unfairness between different investors, some of whom could continue to invest further in a particular fund while others could not.

b. What is your experience of applying different redemption requirements for different investments within an ISA (where applicable)?

All our funds deal on a single daily dealing point (or more frequent where listed on an exchange) and generally work on 5 or less days settlement period. We have encountered suspended funds frequently and stop trades in such funds. This generally has two impacts on ISA's:

- stops full cash transfers although in specie can proceed

- stops ISA closures

No comments

c. What would be the implications for:

i. partial withdrawals of previous years' subscriptions?

We currently only offer full transfer out. Suspensions create a lot of problems currently as this blocks transfers where cash is requested

ii. partial withdrawals of previous years' and current year's subscriptions?

As above

We are assuming that if the FCA introduce a 90 - 180-day notice period requirement, existing investors in those funds will need to be notified of its introduction.

If the only ISA investments held were property funds subject to a minimum 90-day redemption period, then when the investor subsequently gives a withdrawal instruction, they may need to be reminded that the withdrawal would not be able to be completed until the relevant notice period had expired. Assuming the investor still wanted to go ahead with the instruction, the deal would need to be placed with the fund manager and then procedures put in place to diarise and ensure the trade goes through in due course, and the withdrawal request duly completed. Once the sale proceeds are received by the ISA manager from the fund manager, prior to making payment to the investor it may be necessary to double check that the details originally provided by the investor remain valid/the same, e.g., bank account details. Obviously with a delay of up to 180 days there is a risk these might have changed in the meantime.

If a combination of ISA investments were held, some of which were property funds subject to the notice period and other investments that were not, it may be necessary to establish whether the amount requested for withdrawal could be totally covered by the non-property fund related investments, and then seek confirmation from the investor around whether they should be sold and the property fund left intact, or otherwise agree revised instructions. If the withdrawal amount requested could not be achieved without selling some or all of the property fund holdings, again this would likely necessitate further contact with the investor to agree what approach to take, including whether to amend (reduce) the requested amount or to undertake separate withdrawals at different times aligned to the settlement timescales for the various investments.

Importantly we are assuming that there would be no requirement for ISA managers to 'pre-fund' the expected sale proceeds from the property fund in order to pay out withdrawal proceeds sooner than the length of time required to sell the underlying investments. Among other issues, to do so would result in ISA managers taking on the market risk involved as the sale price would not be known in advance.

We also assume that the mandatory clauses that need to be included in ISA T&Cs under the ISA Regulations relating to withdrawals (and transfers) will need to be varied to allow for the 'exception to the rule' that some withdrawals/transfers might take longer than the 30 days maximum period currently being quoted in T&Cs.

iii. full withdrawal of funds?

We pay all other available funds. Once the suspension is lifted, we can pay the rest. An extended redemption period would operate in a similar way.

Some of the comments under i) and ii) above apply here too. In addition, where there is a mix of property funds and other investments there would likely be a need to agree with the investor whether each investment should be sold as soon as possible (and proceeds paid to the investor), or for none of the investments to be sold until the property fund notice period has expired so that everything was sold at around the same time. Procedures/T&Cs will need to be clear on these points to avoid the risk of error/delay in selling and possible complaints resulting from the market moving to the investor's disadvantage.

iv. partial transfer of previous years' subscriptions to another investment-based account?

As above, full transfers only.

We assume 'another investment-based account' includes transferring from one S&S ISA to another S&S ISA. If the transfer of the property fund is undertaken in-specie (re-registration of legal title, without selling the investment) we assume that it could be done within the normal 30-day timescales and would not be subject to the 90 -180-day notice period for redemptions. If the transfer was via the need to sell the property fund investments and transfer the sale proceeds to the other investment-based account, then similar considerations to those mentioned on the other points above would apply.

v. partial transfer of previous years' and current year's subscriptions to another investment-based account?

As above.

vi. full transfer to another investment-based account?

In-specie only where a *where a fund is suspended. If an extended redemption applied, it shouldn't change the in-specie transfer. Cash transfers would take a long time to complete.*

The main issue relating to the transfer of investments relating to current tax year subscriptions relates to the ISA Regulation requirement that such subscriptions must be transferred in whole, not part. Unless this regulation was changed to allow partial transfers of current tax year subscriptions, where the transfer was being undertaken in cash (by selling existing investments) rather than in-specie this would presumably mean that, in the scenario where any part of the current tax year subscription was represented by property funds, the transfer could not be completed until shortly after any property fund notice period had expired.

Again, this would raise questions and issues around the timing of when to sell all the other (non-property fund) investments that may also comprise some of the current tax year subscription. There may also be questions and issues to address around the situation where at the time the transfer instruction is given by the investor it appears that the transfer of investments relating to current tax year subscriptions are involved, but by the time the redemption period on the property fund has expired the next tax year may have already started. So, would that mean it was still deemed to be a transfer of current tax year subscriptions?

As part of previous representations to HMT and HMRC about potential ISA changes, TISA has mooted the idea of abolishing the requirement for current tax year subscriptions to be transferred in whole. So, the property fund issue might mean it's now an appropriate time to consider this further.

vii. partial transfer of previous years' subscriptions to a cash ISA or Innovative Finance ISA?

Full transfer only which would be blocked where an asset is suspended.

As property fund investments subject to a notice period would need to be sold and the sale proceeds transferred, in line with comments, above this might require the transfer to be undertaken as a couple of different transfers if other non-property fund investments are also within the scope of what is being sold/transferred. Alternatively, agreement may need to be reached with the investor that none of the investments will be sold and/or transferred until around the time the property fund is sold.

viii. partial transfer of previous years' and current year's subscriptions to a cash ISA or Innovative Finance ISA?

As above.

ix. full transfer to a cash ISA or Innovative Finance ISA?

Would block this due to inability to sell suspended assets. Extended redemption periods would again delay a transfer significantly.

See comments under v) and vi) above about the need for all investments constituting current tax year subscriptions to be sold and their proceeds transferred to another S&S ISA. The same issues would apply to a transfer to a different type of ISA such as a cash ISA.

d. Do you currently offer flexible stocks and shares ISAs which include relevant property funds invested in non UCITS retail schemes?

Yes.

e. Would it be feasible for you to continue offering flexible ISAs which include property funds if a notice period of more than 30 days were introduced?

Anticipated that we would. The point of the withdrawal would drive the flexi sub amount.

f. Would it make any difference to your answer to any of these questions if that notice period were 90 or 180 days?

No, any notice period makes changing assets within the ISA wrapper very difficult. 90 days is preferable from a client redemption perspective and transfer via cash

We don't think any of the answers would materially change, but the shorter the notice period the less chance there is for things to change in the meantime, e.g., investors contact details, investor circumstances, bank account details, moving from one tax year to another, stocks market fluctuations (although 90 days could still see a lot of change!). Hence if there is to be a notice period of between 90 and 180 days, we would prefer 90 days.

g. Do you anticipate difficulties in accommodating the retention of affected property funds in a Lifetime ISA given that funds must be realised for a house purchase?

N/A, we do not offer Lifetime ISA

h. What difficulties or administrative obstacles would the retention of existing investments present?

We have 'soft closures' today (where we limit new investments) so we could accommodate such an outcome

Hopefully some of the difficulties and obstacles have been brought out in the answers to the specific questions above. In addition to that:

- To repeat one of my main high-level points above, should HMRC decide to retain the maximum 30-day timescale and go ahead with either the model 1 option or model 2 option outlined in the consultation, we think model 1 should be chosen. Operationally (relative to model 2) we think model 1 would be much easier to implement and administer. Model 2 seems unduly complex as it would apply at individual fund and account/investor level, and our initial thoughts are this might be largely unworkable or at the very least, complex, costly and time consuming to put in place, as well as potentially causing customer confusion plus arguably a sense of unfairness between different investors.
- It would also be useful to get further clarity over the types of property fund that are in scope for these potential changes. We note that the HMRC consultation states the following under paragraph 7: *The proposal set out in the FCA consultation paper relates specifically to UK non-UCITS retail schemes which invest **directly** in property.* However, the FCA consultation appears to capture some indirect investment in property too as we note the 'Scope' section of their consultation mentions that: *Similar to our definition of a fund investing in inherently illiquid assets (FIIA), we plan to include in scope of these rules any NURS that invests 50% or more of its assets in immovables (or in other schemes that invest in immovables to the same extent),….*
- Also, in terms of scope, although both the FCA and HMRC consultations refer to potential impacts on ISAs, I think I am right in saying that NURS property funds are eligible to be included in a Child Trust Fund (CTF) under the CTF Regulations (and Junior ISAs under the ISA Regulations). If that is correct, I assume consideration will need to be given to CTFs and JISAs too, neither of which appear to be specifically mentioned in the consultation papers. We do not hold such a fund in the CTF that we offer, and we don't offer JISAs, but if other CTF/JISA providers allow/hold them then I assume some sort of 'grandfathering' requirement to at least allow existing property funds to continue to be held in a CTF/JISA will be needed, as I assume the option to remove the property fund intact (in-specie) from the CTF/JISA wrapper will not be available due to the 'lock-in' nature of the account until age 18.

i. Would there be any financial implications for investors or increased administration costs for you?

Investors would face delays in obtaining their money. This could have financial implications depending on what they are requiring the funds for. We have existing functionality to deal with limiting new money but would need to make some adjustments to accommodate a process where a fund is potentially not priced/settled for some time on redemption

We assume this question is on the assumption that either the model 1 or model 2 proposal is adopted. There would be systems and operational costs associated with either model. In particular although detailed analysis has not yet been undertaken, our initial view is that model 2 would be particularly complex and costly to implement, if indeed a workable solution was feasible. We also assume investors would need to be contacted/mailed with notifications including amended T&Cs referencing revised maximum timescales for withdrawals and transfers. Similarly, other ISA product literature referencing these timescales may need amending with the associated costs involved.

j. Would you be able to act on the investor's instructions immediately after the 90-180-day notification period has expired – or would you need the period of up to30 days (which is normal for stocks and shares ISAs) in addition to the 90-180 days)?

We could act immediately after the notice period. We deal daily on our assets.

Generally, the current settlement timescales for selling existing investments to carry out a withdrawal or transfer instructions are incorporated within the overall maximum 30-day timescale. So once the 90-180-day notification period had expired we do not believe we would require a further 30 days from that point to complete the withdrawal/transfer instruction. But sufficient time would still be needed for the sale proceeds to be received by the ISA manager, processed and allocated to the investor's account, and then paid away as per the withdrawal/transfer instruction. More detailed analysis of how long this might take may be needed, but we suspect it would be somewhere in the region of a maximum 5 working days from when the sale proceeds have been received.

k. Do respondents foresee any risks or detriment for account holders resulting from the proposal?

Yes, *the asset class is likely to be avoided. This could add diversification risk. The delay in receiving the funds is likely to also cause detriment as mentioned earlier.*

Many ISA providers offer their ISA as part of a broader investment proposition to retail investors that also includes a non-ISA 'wrapped' account, typically referred to as General Investment Account (GIA). This might be on a discretionary investment, advised or non-advised/execution only basis. Irrespective of the basis offered, we believe it's fairly common for such providers/platforms to only offer funds that can be purchased in both the ISA and GIA. So should NURS property funds no longer be generally available to purchase in ISAs, there is a risk they may not be as widely available outside an ISA (in a GIA) either.

There is a risk some investors may sell any existing NURS property funds they hold in their ISA soon in anticipation that the FCA and associated HMRC proposals will go ahead. For example, if they think that the changes are likely to see a lot of investors seeking to redeem their investments before the notice period requirements take effect, which might in turn cause the share price to drop or (ironically bearing in mind the reason for the FCA notice period consultation in the first place) the fund being suspended. Linked to this there may be some investors who only want to hold all of their investments within an ISA wrapper. If they think there is a risk from the current proposals that they may not be able to hold it in an ISA in future and be forced to sell it at a future date when they may not be 'happy' with the share price, they might choose to sell ahead of the expected date for the regulations to be changed.

Conversely some investors might see this as a 'buy now while stocks last' opportunity to purchase property funds in an ISA wrapper before the opportunity is lost forever and might perhaps allocate more of their overall ISA investments to property than would otherwise be appropriate because they think they will not be able to 'top-up' in future. It may also subsequently result in investors being reluctant to sell existing property holdings in ISAs after the regulations were changed as it would be a 'one-way' decision, as they couldn't buy them back again within an ISA at a later date.

l. Do respondents foresee any particular benefits for account holders of either of the possible models set out in paragraphs 21 and 22?

Model 2 allows for regular savers to continue uninterrupted by the change. Without this, regular savers will need take action/obtain advice to re-allocate monies previously going into property.

Both models would enable investors to continue to benefit from the tax advantages associated with holding a property fund in an ISA, compared to the less attractive option of making all existing investments non-qualifying which would result in the fund either needing to be sold or removed from the ISA.

Model 2 appears more beneficial for the investors that hold property funds on the date the regulations changed, as they can make new purchases in the same fund in addition to retaining their existing investment, but as noted above from an operational perspective this proposal might be difficult for the ISA manager to implement. This might mean that even though the regulations would permit it, some ISA managers might choose to no longer allow such investments to be held.

One possible impact/issue regarding model 1 is that some investors may seek to undertake a share class switch ahead of the possibility of HMRC implementing that proposal. This may occur where the investor currently holds an income share class of a NURS property fund rather than the accumulation share class. We assume that where an investor currently holds an income share class and has given an instruction to the ISA manager to reinvest income distributions to buy additional shares in the same property fund, that these would be considered to be 'new' purchases that would not be permitted under the model 1 proposal. Whereas if they switch to the accumulation share class of the same fund ahead of the changes taking effect, such income is retained within the fund with a requisite increase in the price of the existing shares held, rather than any new shares being purchased, so presumably would not count as a new purchase under the regulations. Investors who undertook such a switch would then benefit from being able to increase the value of their existing property fund investment within the tax favoured ISA wrapper.