



**Response by TISA, UK Finance, and the
Building Societies Association to ISAs
Compliance & Penalties: call for evidence**
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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.



About UK Finance

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

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

About the Building Societies Association (BSA)

The Building Societies Association represents all 43 UK building societies, as well as six credit unions. Building societies have total assets of over £477 billion and, together with their subsidiaries, hold residential mortgages over £351 billion, 23% of the total outstanding in the UK. They hold over £328 billion of retail deposits, accounting for 18% of all such deposits in the UK. Building societies account for 40% of all cash ISA balances. They employ approximately 43,000 full and part-time staff and operate through approximately 1,380 branches.

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General Comments

The questions and feedback that we receive from ISA managers strongly suggest that ISA managers have a huge desire to ensure that they fully adhere to the ISA regulations and ISA Managers' Guidance. The regulations and accompanying guidance have become increasingly complex over recent years with the introduction of numerous changes and new ISA types and with the best will in the world, it can be difficult for managers to be compliant 100% of the time. We try and use our knowledge of the ISA rules and many years of close contact with the HMRC ISA Savings team to help our ISA manager member firms adhere to all the necessary ISA rules.

The feeling that we have, resulting from our close relationship with our member firms, a significant proportion of whom are authorised ISA managers, is that the current system of compliance and penalties isn't broken, and most ISA managers adhere to the ISA regulations in the vast majority of cases and a significant proportion of any breaches are inadvertent and not intentional. We feel that the issues that were experienced with London Capital & Finance were a one-off scenario and in no way a reflection of the ISA industry as a whole.

Looking at the reintroduction of the ISA audit process, which was recently announced by HMRC, we think it may be prudent for HMRC to analyse the results of the initial ISA manager audits before deciding whether a new compliance and penalty process is actually required. Is there adequate evidence at present, available to HMRC, to justify the imposition of a new system of penalties? Other than the London Capital & Finance issues, we note the call for evidence does not itself appear to contain any other evidence or indication of the nature and volume of ISA regulation breaches by the rest of the industry, hence in our view it doesn't really present a strong evidence-based case for change.

In terms of penalties, as outlined in the Questions section, it is our view that financial penalties are only appropriate and effective if they are imposed on ISA managers who commit frequent and multiple breaches. We don't feel that a new rigorous penalty regime, as proposed in this paper, for infrequent and minor breaches, would actually work as a means of incentivising ISA managers to adhere to the ISA regulations. As outlined in our response to question 7 below, we feel that the proposed new penalties could be, in certain scenarios, wholly disproportionate to the types of breaches outlined.

We feel that having good ISA guidance and providing ISA managers with the necessary resources to liaise with HMRC regarding any concerns or questions they have would be a preferable approach. Such communication would provide ISA managers with the opportunity to discuss specific issues/concerns and agree on suitable courses of action going forward.

There are now millions of ISA customers and consideration should be given to the impact that a new and harsher penalty regime would have on them even though the majority of the proposals in this call to evidence are aimed specifically at ISA managers and not ISA investors.



In terms of three specific areas highlighted by the call to evidence, we have the following comments:

- 1) The key areas of ISA non-compliance based on regular feedback from member firms:
 - a) Permitting non-qualifying investments to be held in ISAs in the short term.
 - b) Not providing a Transfer History Form as part of an ISA transfer.
- 2) The causes of ISA non-compliance:
 - a) There are various reasons for this. The ISA regulations are quite complex in terms of qualifying investments which is reflected by the number of questions we receive. Various types of corporate actions (eg. returns of capital, capital reorganisations, de-listings) result in shareholders automatically receiving investments into their ISA that may not be ISA qualifying. Investments that were ISA qualifying at the time of purchase lose their qualifying status for various reasons.
 - b) This is a common error and there appear to be no obvious reasons as to why ISA managers fail to adhere to this as it's a regulatory requirement.
- 3) Any further ideas to improve ISA compliance:

One of the key requirements to maintaining compliance is by making the ISA Managers' Guidance as clear and transparent as possible and we feel that the current guidance in the section titled 'Inspections of ISA Managers by HMRC' (ie. the section that contains the details on ISA audit and breaches) doesn't fully achieve that. We would be happy to provide further feedback on this to HMRC in addition to other areas of the guidance that may benefit from an update.

We also feel that there is a need for better collaboration and dialogue between HMRC, ISA managers and relevant trade/consumer associations with ISA managers as members such as UK Finance, TISA and the BSA. Historically HMRC would, where appropriate, discuss and agree changes to be made to the guidance before it was finalised and published, as well as providing a clear and detailed explanation of the changes being made. This cross-industry approach was very effective but in the last few years it has often not been the case, sometimes leaving ISA providers and industry bodies unsure about exactly what has been changed and why.

Simplified Voiding

This is a long-standing approach to ISA compliance, but we question how effective this model is. In terms of the actual formulas that are used, we would question whether the formula is now outdated. Is the formula of £10 for cash ISAs (per £1,000 subscription) compared with only £5 for stocks & shares ISAs still appropriate?

We feel that the current rate of £10 takes no account of the subsequent and significant reductions in interest rates since 2003 in addition to the introduction of the personal savings allowance (PSA) in April 2016. It was back in 2003 when HMRC last changed (reduced) the cash ISA simplified voiding formula (from £15 to £10) to reflect falling rates between 1999 and 2003. Rates have



fallen a lot further since then with no further reduction in the formula, even though base rate has been less than 1% for well over 10 years.

Also, the formula doesn't include innovative finance ISAs.

We've made further comments on the simplified voiding regime in Questions 7 and 9.

Question responses

Significant or persistent breaches of the ISA regulation

Question 1 – Do you have any suggestions for ways in which rule-breaking behaviours might be addressed that are not penalty dependent?

The phrase 'rule-breaking behaviours' may need further clarification and definition. Our initial thinking is that it may not be overly helpful terminology as, arguably, it appears to start from an assumption that all/any breaches of the ISA Regulations by an ISA manager happen deliberately or carelessly, which we do not believe is the case.

It should be noted that, even though the ISA regulations have become increasingly complex, most ISA managers do adhere to all the rules most of the time and breaches are trivial in nature (see our general comments earlier). The constant questions received on ISAs from our member firms suggest that most managers want to ensure that they adhere to all the ISA regulations, and in our experience, the vast majority of ISA manager breaches are inadvertent. We were certainly not aware, as suggested in the above summary, that some ISA managers regularly breach the ISA regulations.

As already mentioned above, providing ISA managers with easier access to HMRC so that they can discuss any areas of concern or confusion would be especially helpful and this additional support would help to reduce breaches. Managers could agree some kind of corrective action, where required, to reduce the likelihood of any future breaches. A return to a thorough analysis of ISA manager's annual returns of information would also be helpful, especially in the identification of ISA investor breaches.

HMRC could make greater use of the information that ISA managers already share with them, such as ISA COM100. We have noted that in recent years few void or repair notices appear to have been issued, suggesting that HMRC may not be actively working on these returns.

We believe that penalties should be the last resort and only applied for multiple/consistent breaches as opposed to one off or occasional breaches and we're not convinced that simply implementing a new regime with higher penalties will automatically increase compliance with the ISA regulations. Breaches of ISA rules attract regulatory attention, which is a great deal more troublesome than a fine.

We also believe that greater scrutiny of newer, more complex, and higher risk ISA types, such as Lifetime and Innovative Finance, would target HMRC resource to those areas where non-compliance is a greater issue.

Possible alternatives to imposing financial penalties could include:

- Giving some sort of warning, particularly if it is not a 'repeat breach'. For example, no penalty this time, but a warning that if similar breaches happen in the future (perhaps within a defined period) then a penalty may or will be applied. This could potentially be linked with the ISA manager giving an undertaking to HMRC to carry out some sort of corrective action over and above repairing any accounts impacted by the breach (where repair is possible), such as making specific and mutually agreed changes to resources (staff), processes, procedures, systems, or controls aimed at mitigating the risk of the breach happening again in the future.

Question 2 – Do you agree that there should be different levels of penalty applied to minor and significant breaches of the ISA regulations? What are your reasons?

Yes. Essentially the 'punishment should fit the crime' and any penalty needs to be proportionate and fair.

If the consequences of breaches were such that ISA managers had a risk of disproportionate penalties being applied this might influence their decision on whether to continue as (or become) an ISA manager, which might in turn lead to undesired outcomes for customers, e.g., less choice of products/providers.

Due to the complexity of the ISA regulations and the limited resources available within HMRC to help authorised ISA managers correctly interpret the myriad of ISA regulations and accompanying guidance, we feel that financial penalties should only be applied for multiple/consistent breaches of the regulations. In such cases, we would support a lesser penalty for minor breaches, but any penalties system imposed by HMRC should be simple, transparent, proportionate, and fair. We believe HMRC were of the same view when the HMRC ISA guidance on penalties was last significantly changed in April 2009 as covered in HMRC ISA Bulletin 10. The risk-based approach outlined in that bulletin has formed part of the HMRC ISA guidance ever since then

Minor and inconsequential breaches by careful, diligent managers will not be prevented by the threat of penalties.

We feel that the current system of penalties, in place since 2009, provides an adequate regime and as outlined in other parts of our response, we are not convinced that a new penalty regime is required at this point in time.

Question 3 – Do you agree that HMRC should be able to charge a penalty on all breaches of the ISA regulations? What are your reasons?

See above. We don't believe that all breaches should result in a financial penalty. Where breaches are minor, infrequent in nature or caused by events outside the manager's control, we feel that to apply financial penalties in all cases would be both unreasonable and difficult to police/administer.



An example of such a breach would be where maximum transfer out timescales are exceeded due to the customer and/or the other ISA manager involved in the transfer not replying promptly to requests for further information.

The imposition of a financial penalty should be dependent on the individual case, whether the breach was voluntarily notified to HMRC and the ISA manager's willingness to address any breach and implement additional systems/controls to reduce the likelihood of future breaches.

We further note that the call for evidence references the possibility of imposing penalties where transfer timescales are not met. We believe such an approach, if implemented, may require ISA managers to capture and maintain additional Management Information relating to the reasons for all delayed transfers, which might require some sort of detailed HMRC guidance to ensure fairness and consistency of approach across the industry. Such guidance would have to be proportionate to avoid a significant administrative burden on managers, particularly smaller ones with fewer resources.

Question 4 – Do you agree that HMRC should be able to charge a penalty regardless of whether the breach leads to a potential tax loss? What are your reasons?

See above answer regarding the suggestion of maintaining the current penalty regime which could apply to breaches where there has been no tax loss.

Minor breaches of the regulations

Question 5 – Which types of ISA management errors would respondents consider to be minor. What are your reasons?

Due to a long list of possible examples, might it be easier and clearer to provide an exhaustive list of what HMRC class as 'serious breaches' meaning that any other breach would be, by definition, a minor breach. An alternative to attempting to produce a specific list of errors would be to adopt/retain a set of higher-level principles, similar to the current ISA guidance. Also note our comments in question 7 where a minor breach can currently (using the current penalty regime) result in a significant financial penalty which we believe could be disproportionate to the breach and the penalty could be increased further with the proposed new penalties.

Please see the appendix for worked examples illustrating this point.

Significant or persistent breaches of the regulations

Question 6 – Are there any other specific breaches of the ISA rules which should be considered significant, and your reasons why?

We think further discussions are required to try and determine what is treated as a 'significant' breach. The first example provided in the paper is 'allowing ineligible investments to be held in an ISA'. We know from many years of responding to queries on this topic and running ISA training

courses that the ISA qualifying rules can be very complex and investments can regularly change their status resulting in investments that were qualifying one day not being ISA qualifying the following day. For these reasons, we are not convinced that this breach should always be treated as 'significant' and this highlights the difficulties in trying to label breaches as either 'significant' or 'not significant'. We also believe that the proposed new penalties for significant breaches are excessive and could result in hugely disproportionate and unfair penalties.

For example, another 'significant' breach listed is 'failing to notify HMRC of the intention to make bulk transfer of ISA business to another ISA manager'. Setting aside the question of whether such a breach should be considered 'significant', for a large ISA manager, a bulk transfer might relate to the whole or a significant proportion of its existing account base, which might be over one million accounts. Applying a penalty of, say, £100 million (£100 per account) where one million accounts were bulk transferred to another ISA manager but HMRC were not correctly notified seems totally disproportionate, bearing in mind the customers themselves would likely have been given the required advance notice, and the ISA status of the customers' accounts has (operationally at least) been maintained with the new ISA manager (assuming the failure of the ceding manager to notify HMRC did not result in all accounts subsequently being made void).

Applying a penalty of 5% of each account's value might lead to an even higher penalty, bearing in mind ISAs have been in existence for over 20 years and most ISAs operate under a 'continuous application' basis whereby subscriptions are made to the same account year on year. We note HMRC ISA statistics published in June 2020 estimate the average value of an ISA account to be in excess of £26,000. So, if that was the average value of an ISA manager's one million accounts being bulk transferred in the breach scenario above, the penalty would equate to circa £1,300 million.

Question 7 – Are the penalties appropriate and proportionate to each type of breach?

To firstly note that even the current regime of applying a penalty of up to £1 per error can result in some excessive penalties. We did have sight of a recent case where some minor amendments were required to an ISA managers' ISA terms & conditions (ie. there had been a minor breach with some required wording omitted) and due to the extremely large number of accounts involved, the penalty imposed by HMRC utilising the £1 per error approach, was significant (six figures). We thought this wholly excessive for what is classed as a minor breach which was inadvertent.

If the penalties were increased to those that are being proposed which, for minor breaches, are either £10 per account multiplied by the number of tax years or a 1% charge of the total value of accounts affected by the breach, either option could result in a huge penalty which would be wholly disproportionate to the breach which has occurred. For a large ISA manager with 500,000 accounts, for example, the £10 per account option would result in a penalty of at least £5 million for what could be a minor administrative breach. For a manager that has approximately £5 billion of assets under management held within stocks & shares ISAs, for example, applying a 1% charge to these values would result in a penalty of £50 million.

The proposed penalties for significant breaches could, as outlined in the Appendix and question 6, result in hugely disproportionate and unfair penalties

It is furthermore useful to note that the current simplified voiding penalties no longer reflect commercial reality of average tax loss. For cash ISAs the penalty is £10 per £1,000 invested per tax year. For a basic rate taxpayer this would mean earning 5% interest i.e., £50 on £1,000 invested on which they would pay £10 tax assuming they had fully utilised their PSA. Even for a higher rate taxpayer they would have to earn 2.5% interest. Most cash ISAs are paying less than 1%. As mentioned earlier in our response, the current rate of £10 takes no account of the subsequent and significant reductions in interest rates since 2003 when the simplified voiding formula was last reduced from £15 to £10 to reflect falling rates between 1999 and 2003. Rates have fallen a lot further since then with no further reduction in the formula, even though base rate has been less than 1% for well over 10 years.

We feel that the current penalties are already sufficient to act as a sufficient deterrent to ISA managers and we should look to update this regime before considering implementing a totally new regime with, potentially, much higher penalties.

Question 8 – Do respondents favour the calculation of penalties by reference to a set amount per account or a percentage of account value?

It's hard to be specific as we are not an ISA manager, but initial thoughts are that using a percentage approach would add extra complexity to the process and such an approach can result in disproportionately high penalties for minor errors as noted in question 7. We also feel that the 'per account' approach, as mentioned in questions 6 and 7, can result in disproportionately high penalties, especially for large providers that manage many thousands of accounts, with the majority of accountholders having unused personal savings allowances and dividend exemptions. Here the loss to HMRC is far less than the penalty and an alternative approach may be required. An alternative approach could include HMRC having the ability to levy a penalty of a fixed amount (reflecting the materiality of the breach), rather than applying a per account methodology to certain breaches where that approach may not be appropriate.

Where a per account penalty is appropriate, we think a set amount per account would be preferable to a percentage of value-based approach. This is simply in terms of the former likely being much easier for the ISA manager to establish, as it avoids having to check the value of each impacted account at a particular point (or possibly multiple points) in time, which might be time consuming and/or onerous, particularly where a large number of accounts are impacted.

Question 9 – If respondents consider different amounts or formulae should be applied please describe them and explain why you think they would give a better compliance behaviour outcome than the proposals above?

As already mentioned, we think that the current penalty regime is suitable and adequate albeit we feel that the long-standing simplified voiding formulas currently being used may need to be



updated to better reflect current economic conditions. For instance, as outlined in question 7 above, a reduction from the current £10 per £1,000 for cash ISAs to reflect the actual loss.

In addition, as mentioned in our response to Question 1, one potential approach would be for the amount of any penalty (or, in the context of Question 1 the decision not to impose a penalty at all) to be conditional on the ISA manager giving an undertaking to HMRC to carry out some sort of corrective action over and above repairing any accounts impacted by the breach (where repair is possible). Such as making specific and mutually agreed changes to resources (staff), processes, procedures, systems, or controls aimed at mitigating the risk of the breach happening again in the future.

Also, note our comments to Question 8 regarding the option of using a fixed penalty approach rather than a per account approach.

We are happy to liaise further on this issue.

Question 10 – How should a combination of minor and significant breaches be dealt with? Do respondents agree with the approach suggested?

Once ‘significant’ breaches have been adequately categorised, we think it appropriate that where an account contained both a significant and a minor breach, it would seem appropriate to just impose a penalty based on the significant breach. There could be added confusion however, if both minor and significant breaches occurred at different points in time resulting in record keeping requirements for ISA managers becoming potentially onerous if the specific accounts impacted by previous/historic breaches had to be cross checked against the accounts impacted by subsequent breaches. Would it always be clear what penalty should be imposed? This may require further discussion.

Question 11 – Should the amount of the penalty be reduced by mitigating circumstances?

Yes, we feel that any penalties applied should include the potential to be reduced due to mitigating circumstances. This could be agreed with HMRC and take into account any corrective action that the ISA manager has already taken and their willingness to make any additional changes to help prevent any future breaches.

Question 12 – Do you agree that any penalty should have a right of appeal?

Yes, we agree that there should be a suitable right to appeal any penalties via a suitable appeal process especially considering the potential penalties that may be imposed should the new regime be implemented.

It would be preferable for discussions between the manager and HMRC to happen prior to the penalty being applied. This would give opportunity for both sides to explain and understand the



events leading to the penalty, any mitigating factors and how the amount has been arrived at. That should reduce the number of appeals.

Question 13 – Do you agree that there should be a minimum penalty? What are your reasons?

No. We do not believe that a case has been made for a new penalty regime. We believe that the costs of imposing a mandatory penalty for trivial or inadvertent breaches are disproportionate to any benefits in compliance and are likely to lead to firms being much more cautious about ISA administration.

We wouldn't support a specified minimum penalty for every single breach regardless of the number of accounts affected. If, for example, there had been a non-qualifying investment held in a handful of accounts for a few days or a week, we wouldn't agree with a minimum penalty of £1,000 or £3,000 and would view this as a disproportionate approach. We reiterate our view that penalties should only be made for multiple and frequent breaches. We also wouldn't support penalties for errors that are outside the control of the ISA manager.

Question 14 – Do you have any thoughts on how a minimum penalty should be calculated for minor and significant breaches?

See our response to Question 13.

Where the decision is taken to apply a penalty, the penalty should reflect the nature of the error and whether those errors were inadvertent and of relatively short term in nature. We accept that it would be difficult and complicated to set multiple minimum amounts for different errors/breaches.

Question 15 – Should the amount of the minimum penalty be reduced by mitigating circumstances? If so, would that reduce the impact of a minimum penalty?

See response to questions 11 and 13 above. As we have also mentioned elsewhere, any waiving or mitigation of penalties could potentially be coupled with HMRC obtaining an undertaking from the ISA manager to carry out certain specified actions (over and above repair of the impacted accounts) aimed at preventing, or at least reducing, the risk of recurrence of the same issue in the future. We believe this would address the concern raised about lower penalties not acting as a credible deterrent to breaching the ISA regulations.

Investor Compliance

Question 16 – Where investors are non-compliant should HMRC introduce a financial penalty, or are there any alternative sanctions that could be imposed that would act as an effective deterrent?

Where investors have breached the ISA regulations by, for example, subscribing to more than one ISA of the same type and/or oversubscribing in a particular tax year, such breaches should be

identified by the HMRC annual compliance checks and investors would currently be notified of this breach. Where an investor has been notified of their invalid ISA subscriptions but continues to breach the rules on multiple future occasions, we have concerns around HMRC being given the powers to levy financial penalties on ISA investors in such circumstances. How would they be imposed and collected?

We feel that a return to thorough compliance checks of ISA manager's annual returns of information followed by the issue of suitable void or repair notices would help prevent the likelihood of repeat offending.

Are HMRC able to provide any evidence as to the frequency of multiple breaches by ISA investors?

Consideration should also be given to customer vulnerabilities. In certain situations, the breaches by customers may not be a deliberate act. The FCA guidance on fair treatment of customers has 4 categories, one of which is Capability, which includes '[l]ow confidence in financial matters or low confidence in managing money. Low capability in other errors such as literacy or digital skills.' All of these could result in errors by the customer. Any penalty system should not have the unintended consequence of being seen to prevent customers who have these capability issues from having access to ISAs.

Also, whilst investor penalties would be a matter between HMRC and the investor there would be a repapering cost for ISA managers as they would need to make investors aware of any potential penalties.

Other compliance issues

Question 17 – Should it be mandatory to report any breaches discovered by ISA managers? What are your reasons?

The ISA Managers' Guidance (chapter - Inspections of ISA Managers by HMRC) already instructs managers to notify HMRC where they discover any breaches outside of an ISA audit albeit the guidance isn't clear as to whether this should be every breach, whether minor or significant. We would question the need for every minor error to be reported to HMRC as this could be onerous for both ISA managers and HMRC. Alternatively, with the reintroduction of the ISA audits, we feel it would be appropriate for ISA managers to simply retain records of any breaches to provide to HMRC during ISA audits which, we believe, was the previous approach when HMRC ISA audits were still carried out on a regular basis.

Question 18 – Should HMRC have the power to suspend ISA manager approval?

We understand that HMRC already has the power to withdraw an ISA manager's authorisation so we're assuming from the question that this power doesn't currently permit HMRC to simply 'suspend' an ISA manager's approval. If that is the case, then we would only want to see powers to suspend authorisation being available as a last resort for significant and persistent ISA breaches.

Although a 'hybrid' approach, where ISA managers are permitted to continue to manage existing ISA business but not take in new ISA monies (either transfers in or new ISA subscriptions), may not be the most effective approach, it would be preferable to the full withdrawal of manager authorisation.

Considerations would also need to be given to ISA investor's option during any suspended period. So would they, for example, still be entitled to transfer ISAs out to new ISA managers and/or as they will no longer be able to make new subscriptions to the suspended ISA manager, would they be eligible to make subscriptions to a different ISA of the same type in that tax year despite this breaching the usual 'one ISA per tax year rule'. The key point is that we don't believe ISA investors should be disadvantaged in any way because of a suspension being placed on their ISA manager and we feel that a regulation change may be required to obligate managers to notify ISA clients of the suspension and the potential implications mentioned.

Question 19 – Where ISA managers have not conducted any ISA business in a period of 12 months, should HMRC withdraw their ISA manager approval?

Would a fairer approach be to contact ISA managers towards the end of the proposed 12-month period and inform them that their authorisation will be withdrawn unless they provide an adequate reason as to why they are not currently offering ISAs to the public. So we wouldn't support a 'blanket' approach where authorisation is automatically withdrawn after a 12-month period of not appearing to conduct any ISA business.

Other related issues and questions

Question 20 – Are the proposals a fair and proportionate approach to ISA breaches?

No, we do not think they are a fair and proportionate response. The problems with LCF would have arisen even if all the proposals mentioned had been in place. Also, as already mentioned, there are even elements of the current regime which we also deem to be not wholly fair and proportionate.

We reiterate our previous comment that allowing a sufficient period of time to reintroduce the ISA audits and analyse the results of these before implementing any new compliance & penalties regime would be a preferable approach. As already mentioned, apart for the unique case of London Capital & Finance, we have not seen **any** evidence of widescale breaches in the ISA industry to justify a new and harsher regime. Any such regime would likely impose significant costs on the industry and lead to poorer customer service outcomes for ISA or would be ISA investors.

Question 21 – Would the suggested penalties for being in breach of the ISA rules encourage better compliance with the rules?



We're not convinced that financial penalties act as a significant incentive for ISA managers to maintain compliance with the ISA regulations. In our experience, the need to remain in compliance with current regulation, including ISA regulation, is a priority for firms and penalties should only be applied in the case of multiple and consistent breaches. Developing a closer and more effective relationship between HMRC and the industry would be preferable.

Question 22 – Will any administrative or other burdens be created if the proposed ISA penalties are introduced? If so, what are they?

Yes. Prima facie, if a new (and more punitive) penalty regime is introduced along with a more confrontational relationship with HMRC it is bound to lead to more administrative burdens as firms strive to avoid the penalties.

It is difficult to comment on what specific administrative burdens will be placed on our member firms as a result of the proposals in the consultation suffice to say that should the penalty regime be implemented in such a way where penalties are commonplace and applied for infrequent, minor, and inadvertent breaches, the administrative burden on ISA managers would obviously increase. An example of this would be the additional burden of managers potentially having to calculate penalties based on the value of funds under management. Additional feedback from some of our member firms suggests that the proposed new penalty regime could result in significant and disproportionate financial costs, especially for large ISA managers who manage many thousands of ISAs.

Question 23 – What is the likely estimate of costs of any additional burdens?

We believe they are likely to be disproportionate to any benefit in reduced breaches and would not, in any event, have prevented what went wrong with LCF.

Question 24 – Are there any other points you would like to raise or suggestions you would like to make to improve compliance with the ISA regulations?

There have been instances where HMRC regulations cause conflict with the spirit of other banking regulations (e.g., PSD2, Consumer Duty, TCF Principles, FOS principles, Anti Money Laundering). Greater liaison and alignment between the different regulators would be helpful. These regulations have been introduced for different reasons; however, they can create conflict when managing ISA products. Should HMRC be reviewing their ISA regulations in line with existing and new non-ISA regulations to decide whether there should be amendments to existing ISA and JISA regulations?

Also, as outlined at the start of our response but important to reiterate, we feel that there is a need for better collaboration and dialogue between HMRC, ISA managers and relevant trade/consumer associations with ISA managers as members such as UK Finance, TISA and the BSA. Historically HMRC would, where appropriate, discuss and agree changes to be made to the



guidance before it was finalised and published, as well as providing a clear and detailed explanation of the changes being made. This cross-industry approach was very effective but in the last few years it has often not been the case, sometimes leaving ISA providers and industry bodies unsure about exactly what has been changed and why.

We feel that a return to this collaborative approach could significantly improve compliance with the ISA regulations.

Appendix – worked examples of ‘minor management errors’

In line with the existing HMRC ISA guidance we would consider minor errors to include those where the customer’s eligibility to apply for or hold the ISA (or the qualifying investments in it) is not in doubt, meaning the error does not result in a loss of tax to the government, and also errors where the customer is not disadvantaged.

We also think it would be appropriate to review whether an approach of applying a penalty amount per account affected is the correct approach to take where a single error potentially impacts a large number of accounts (for both minor and more significant errors). We suggest that consideration is given to instead allowing HMRC to impose a penalty of a (to be determined) fixed/maximum amount for some types of breaches where appropriate, where such amount is not directly derived from the number of accounts impacted, but adequately and reasonably takes into account the nature and severity of the breach.

In this regard we note the call for evidence includes examples of such minor breaches where existing ‘per account’ penalties might be significantly increased. This gives us significant cause for concern, as arguably even the existing approach might lead to a disproportionately large/unfair penalty, hence our comment above offering a suggestion for a possible alternative approach.

To illustrate this further, one of the breaches listed is where there have been ‘omissions relevant to the regulatory requirements in ISA manager terms and conditions, that did not lead to a breach of ISA subscription rules’.

We think that drafting errors on some of these mandatory terms and conditions (T&Cs) clauses are unlikely to call into question the customer’s eligibility for an ISA or cause them any real detriment. Hence, we believe that under the existing HMRC guidance such an error would likely currently be settled under the ‘maximum £1 per account administration error’ recovery approach (rather than the much higher ‘simplified voiding’ recovery formula).

Choosing one of those mandatory clauses as an example, ISA T&Cs are required to state that:

the ISA manager will satisfy himself that any person to whom he delegates any of his functions or responsibilities under the terms agreed with the investor is competent to carry out those functions and responsibilities

If this clause was inadvertently omitted from the T&Cs in whole or part, then all ISAs being managed under those T&Cs (which might be the ISA manager’s entire account population) would be technically invalid. Despite this, the reality of the situation is that the ISA manager will have applied these requirements in practice for anything they have delegated to a third party,

particularly bearing in mind other regulatory obligations they are under in that regard (e.g., FCA Rules).

We note that the existing HMRC guidance on T&Cs finishes by saying:

A failure to include any of the above in the ISA terms and conditions will invalidate all ISAs opened under those terms and conditions. HMRC Audit will seek a recovery where they find that an ISA manager has omitted any of the ISA conditions, even if they are applied in practice.

Assuming the recovery in the T&C omission example above would currently be settled under the 'maximum £1 per account administration error' recovery approach (rather than the more penal 'simplified voiding' recovery formula), as the nature of the error would likely impact every ISA being managed under those same T&Cs, the penalty could be in excess of £1million (e.g. if the manager had over one million accounts, which some larger ISA managers do).

We are not sure such a penalty would be proportionate to the nature and impact of the error. We are even more concerned to note that under the proposals in the call for evidence, such a 'minor error' might instead attract a much higher penalty of either:

- £10 per account multiplied by the number of tax years (including part years) in which the breaches have occurred; or
- 1% of the value of investments in the affected accounts for each tax year in which the breach took place.

We note the call for evidence uses a simplistic example of where 200 accounts are impacted over a two-year period. But as mentioned earlier, something like a T&C drafting error is likely to impact all accounts for that particular ISA product, which for larger ISA managers might be much, much higher volumes.

If one million accounts were impacted in the same scenario, a penalty of £10 per account per year would result in a penalty of £20million, for a breach where there was no doubt about the customers' eligibility for their ISA nor any real detriment to the customers. In our view that would be totally disproportionate, as would an approach of a penalty based on a percentage of each account's value.

We also note that when referring to the existing approach for 'administration error' penalties, the call for evidence appears to incorrectly imply the penalty would always be £1 per existing account, rather than reflecting the current guidance which states a maximum of £1, with reductions made where appropriate, e.g., for voluntary disclosure. In addition, the examples appear to assume that



the current 'administration error' penalty is applied 'per year' but we do not believe this to be the case. We think it is simply 'per error' as quoted in the existing guidance.

Our understanding is that the 'per year' methodology only applies to the more significant breaches that can't be treated as 'administration errors' and instead are dealt with under the 'simplified voiding' guidance. The recovery settlement formula for those is £5 per year per £1000 subscribed for stocks and shares ISAs, and £10 per year per £1,000 subscribed for cash ISAs.

While on the topic of the simplified voiding recovery rates of £5 and £10 we note that the ISA guidance says:

The figures used in the settlement formula are based on estimates of the average yield for each type of ISA, and of the amounts invested by higher rate, basic rate, and non-taxpayers. The figures will be revised should the yields, and the amounts invested, change markedly from our initial estimates, but the figures are not expected to change more frequently than annually. These figures will apply until we notify you otherwise. Recovery from a stocks and shares ISA is based on the amounts subscribed to the ISA, not the value of the investments held.

These recovery rates have been in place for many years, dating back to when interest rates were generally much higher, and prior to the introduction of other tax allowances such as the Personal Savings Allowance and dividend allowance. Hence, we think this call for evidence should be used as an opportunity to review whether these recovery rates remain appropriate.