

TISA RESPONSE TO

ISA qualifying investments: consultation on including peer-to-peer loans

12th December 2014



INTRODUCTION

TISA is a not-for-profit membership association operating within the financial services industry.

TISA's membership comprises over 145 member firms involved in the supply and distribution of savings and investment products and services. These members represent many different sectors of the financial services industry, including banks, stockbrokers, asset managers, insurance companies, fund managers, distributors, building societies, investment managers, third party administrators, consultants and advisers, software providers, financial advisers and pension providers.

Having a legacy of focusing predominantly within the tax incentivised products area, TISA has in recent years moved into the broader savings and investment world, extending our status of 'trusted advisor' to the authorities over a much greater remit. This has been welcomed by our members and the authorities as a natural progression.

TISA has a highly successful track record in working cooperatively with government, regulators, HMT, DWP and HMRC to improve the performance of the industry and the outcomes for consumers. Policy and regulation continues to be the major focus for our members with regard to corporate responsibility.

TISA and its members' remit is evolving into a clearer focus on pro-active consultation in the regulatory world in order to influence policy and associated regulation before its creation, rather than reacting to issue policy directives. This will help to ensure a more considered policy creation from the authorities.

What makes TISA unique is that we cover the entire industry, incorporating cross sector policy, industry and technical expertise. Whilst we maintain a solid partnership with government, the regulators and wider industry, we remain independent and develop neutral views and opinions. This impartiality is reflected in our ability to drive development projects which improves industry performance and puts us in the unique position of being able to constantly challenge the status quo to bring about material improvement. At the forefront in all of our recommendations and actions is to consider national and consumer outcomes.



RESPONSE TO CONSULTATION

Introduction

TISA members represent many different sectors of the financial services industry, including banks, stockbrokers, asset managers, insurance companies, fund managers, distributors, building societies, investment managers, third party administrators, consultants and advisers, software providers, financial advisers and pension providers.

Many ISA managers are members of TISA and this response has benefitted from the expertise of its members. TISA has held an open meeting for members to discuss the issues arising from the consultation, as well as continuing discussions with member firms on the practicalities and implications of the inclusion of peer-to-peer loans in ISAs.

We should like to thank staff of HM Treasury and HMRC for their willingness to engage with the industry about the inclusion of peer-to-peer loans in ISAs. This inclusion within ISAs is something TISA has long sought and we welcome the Government's commitment to ensuring this.

Summary of response

Our key recommendations are

- Peer-to-peer loans should be invested in a separate ISA type. This will permit appropriate regulation and controls over transferability and liquidity to be controlled in ways that do not impact stocks and shares ISAs and cash.
- Care should be taken to ensure that the costs to the existing market of complying with the additional reporting and compliance requirements are minimized. Many, perhaps most, of the existing market will not, initially at least, offer peer-to-peer loans. The impact of amendments to HMRC reporting, to disclosure, and to systems should be minimized. This applies in particular to the introduction of a peer-to-peer ISA.
- The Government should look to amend regulations (including the RAO) to permit qualifying loans to be included in collective investment vehicles, whether closed end or open ended, as this will make such loans more accessible to retail investors, and thus enable retail investors to get exposure to this asset class through existing ISA managers, without forcing existing ISA managers to become peer-to-peer platforms to offer exposure to their retail customers.



Response in detail

Question 1

In relation to the proposals generally, what necessary set-up costs (one-off costs) would be necessary for your business to arrange peer-to-peer loans meeting the proposed eligibility requirements for ISAs? What would be the estimated ongoing annual costs of doing so?

TISA has no comment on this question. This is a matter for individual companies.

We can say that for many existing ISA managers, acting as a peer-to-peer manager would be radically different in the areas of pricing, dealing, valuation and settlement.

Question 2

Do respondents agree that the government's proposed approach provides sufficient clarity as to which peer-to-peer loans will be eligible for ISA inclusion?

Yes.

Question 3

Do respondents agree that the proposed regulatory requirements strike the correct balance between investor protection and a proportionate regulatory regime?

Members debated this point in the context of issues around evenhandedness between existing ISA managers and new entrants.

We agreed that it would not be desirable for the weight of regulation to inhibit the development of innovation in financial services. We agreed that a lighter touch might well be appropriate for peer-to-peer at this stage in the development of the market and agree that the proposed regulatory requirements strike the correct balance between investor protection and a proportionate regulatory regime.

On balance this lead us to believe that a separate ISA, as discussed more fully below, would be a sensible way of gathering together an appropriate regulatory regime, with better disclosure of risks for peer-to-peer, without effectively compelling all existing participants in the market to have to be able to deal with peer-to-peer loans.

Question 4

Are existing ISA managers considering offering peer-to-peer loans alongside other ISA eligible investments? What factors may affect this decision?



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We understand that some existing firms are considering doing so. Any decision will depend on views on potential demand, ease of fit with existing services and, crucially, the regulatory and compliance load of offering peer-to-peer loans.

Question 5

Are firms operating peer-to-peer platforms considering seeking authorisation to act as ISA managers if the government permits this? What factors may affect this decision?

We cannot comment on this.

Question 6

Do respondents have any concerns regarding FCA-authorised firms operating peer-to-peer platforms being allowed to act as ISA managers? If so, what are they?

In general terms the view is that if firms can operate within an appropriate regulatory regime they should be allowed to do so.

Question 7

Do respondents see any risks arising from firms operating peer-to-peer platforms approved as ISA managers not being required to have legal ownership of peer-to-peer loans held within ISAs?

Members considered that there bound to be some unforeseen risks, but did not believe these were unmanageable. We further believe that if relaxation in this area does not prove problematic, then perhaps consideration could be given in the future to extension of this more generally in ISAs.

Question 8

Are there any drawbacks to the proposed withdrawal procedure for peer-to-peer loans? If so, what are they?

In principle, we believe that existing peer-to-peer platforms should not have to change their existing model unless for very good reasons. This strengthened our view that it would be better, initially at least, to have a separate ISA type, with all its drawbacks, to keep risks, disclosures and compliance in one place and permit existing practice in the peer-to-peer market to be retained without requiring unnecessary changes.



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Question 9

If the transfer requirement is applied to peer-to-peer loans – do respondents foresee any risks or detriment for consumers resulting from the proposed modification of the current ISA requirements? If so, what are these?

Members' view initially was that transferability was a key feature of ISAs and should be preserved. On discussion and further consideration we considered that creating a false market in peer-to-peer loans would not be sensible. Therefore, we believed that it was not essential to require transferability or liquidity. Obviously, there will be some risks of customer detriment, but the existing market outside ISAs seems to work.

Were a separate ISA type to be created for peer-to-peer with an appropriate risk and disclosure regime, spelling out clearly the terms on which early redemptions would or could take place, and that realisation might take (in some cases a great deal) longer than 30 days, this would be acceptable.

Question 10

Following the sale of the peer-to-peer loan and transfer instructions from the investor, what would be the most appropriate time period within which the cash realised should be transferred?

If our comments above were accepted, we believe that the existing 30 day rule, in an appropriate and clearly spelled out peer-to-peer ISA regime, would be unnecessary. This relaxation would have to go hand in hand with clear upfront disclosure to customers that they might have to wait for their money, that the amount received might be less than the nominal value, and so on.

A relaxation of the 30 day rule would require changes to HMRC regulations. We would welcome this more generally, as the 30 day rule significantly affects the ability of ISA managers generally to offer competitive cash products to customers. Changes in this area would increase competition and lead to better deals for customers. We should like to discuss this with you in more detail.

Question 11

Is the proposed modification to transfer requirements likely to present any difficulties or administrative obstacles for ISA managers (including those receiving transfers)? If so, what are these?

Most of the difficulties would be avoided if peer-to-peer were held in a separate ISA type. If peer-to-peer were to be held within existing ISA types then we believe they should be subject to the existing requirements around transferability and liquidity.



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Question 12

What are respondents' views on requiring the existence of a secondary market in order for a peer-to-peer loan to qualify for ISA eligibility? Would such a requirement provide a useful degree of reassurance to investors?

We do not believe that this required. If there is to be a separate ISA type for peer-to-peer, with an appropriate clear disclosure regime, then this should be a matter for firms offering peer-to-peer loans.

Question 13

Would a requirement to offer a secondary market pose any problems or difficulties for peer-to-peer platforms and if so, what are these? Could secondary market arrangements of this type be easily defined?

We have no comment on this. This is a matter for peer-to-peer platforms.

Questions 14

Do respondents think that a guarantee of a sale at market value within a given period would be desirable in addition to the proposed requirement of a secondary market?

In the context of a separate ISA type this should be a matter for the market to determine. It should be noted that guarantees in general are very expensive and requiring such a guarantee might strangle the market ab initio.

There is no real secondary market at present, in the sense of competing market makers to provide liquidity and a market price. After discussion we came to the view that the requirement for a secondary market was not necessary provided customers were told quite clearly about the risks, including around liquidity and transferability, before investing.

Questions 15

Is there merit for investors in requiring that there must be a mechanism by which loans can be sold at market value within a given period? What period should this be, taking account of the times taken at present to achieve sales on existing secondary markets?

See our responses above, particularly to question 10, where we argue that the existing 30 day should be relaxed.

We do not believe that secondary markets can be conjured into existence by regulatory fiat. We believe that market pressure and the desire to respond to customers' needs is a better way of meeting the objectives of encouraging all participants to deliver liquidity and transferability for their customers.



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If it appears that there is a market failure to which firms fail to respond adequately, that is the time to consider regulatory intervention.

Questions 16

Are there other ways in which to facilitate transferability, besides those described above? If so, how might these work?

We understand that existing peer-to-peer platforms use a best endeavours approach. As the market develops we would expect secondary markets to develop. That would be the appropriate time to introduce regulation in this area.

This reinforces our view that a separate peer-to-peer ISA is a sensible way forward. This ISA type could have a sensible appropriate regulatory regime, preserving as much as possible of the features of the existing non ISA market, insulating the impact on those existing ISA managers that do not wish to offer peer-to-peer at present, and giving clear disclosure to customers about transferability and liquidity.

Questions 17

Overall, do respondents feel that the benefits to investors from applying transfer requirements to peer-to-peer loans held in ISAs outweigh the possible risks of doing so?

No, for the reasons we set out above.

Questions 18

Do respondents have suggestions as to how loans held within ISAs could continue to be managed by an ISA manager in cases where either a firm operating a peer-to-peer platform collapses and they were acting as ISA manager, or where such a firm becomes ineligible to act as an ISA manager following removal of its FCA permissions?

We understand that existing platforms do not have legal title to the loans. We would expect the FCA to require firms to have arrangements in place for these eventualities.

Questions 19

How important is it that investors should be able to mix peer-to-peer loans with other eligible investments within their ISA in a single tax year? Do respondents believe most investors wishing to place peer-to-peer loans into an ISA account will additionally want to invest in other types of non-cash ISA investments within the same tax year?



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From a practical viewpoint we believe that most existing ISA managers will not wish to offer peer-to-peer loans alongside stocks and shares for reasons relating to liquidity, transferability, valuation dealing and pricing. This would mean that a customer that wanted to invest say £1,000 in peer-to-peer could be unable to invest in stocks and shares unless the peer-to-peer platform offered this facility, or that existing managers would be prevented from competing unless they offered peer-to-peer. This problem would be avoided if a peer-to-peer ISA to be created, with a separate regulatory and clear disclosure regime.

Questions 20

Would a third ISA type be helpful in alerting investors to the different rules, which will apply to peer-to-peer loans within ISAs? Overall, would a third ISA type aimed specifically at alternative finance products such as peer-to-peer loans be a good thing – and if so, why?

We agree, for the reasons discussed above.

Questions 21

What potential difficulties or challenges might the creation of a third ISA type present for savers, investors, ISA managers or others?

We believe there are many advantages with a third ISA type. This could permit the extension of ISA qualifying investments to include other asset types, such as crowdfunding.

However, the drawbacks should not be minimised.

There will be impacts on reporting to HMRC, on transfers of ISAs between ISA managers (which type is being transferred, etc.), on literature and training to staff and in explanation to customers, whether or not existing ISA managers wish to offer this third ISA type.

On balance, we believe the advantages outweigh the disadvantages, not least in avoiding problems around transferability and secondary markets, but we believe the market needs sensible time to develop solutions in this area. We are therefore pleased that HM Treasury does not expect a new regime to come into effect before the end of calendar 2015. We believe a sensible start date for the third ISA type would be April 2016.

Questions 22

If the government decides not to introduce a third ISA type, how can we best ensure that customers are clear about the special characteristics associated with peer-to-peer loans,



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for example that they are not covered by the FSCS, and that they may be difficult to liquidate?

We think this option would not be a good one, for the reasons we set out above.

Question 23

Do respondents have any concerns about offering a tax advantage where loans made by or on behalf of children might be made without knowledge of the intended recipient(s) or usage of the loaned funds? If so, what are they?

We have no comment in this area.