



HM Treasury

ISA qualifying investments:

response to the consultation on
including peer-to-peer loans



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Contents

		Page
Chapter 1	Introduction	3
Chapter 2	Summary of responses	5
Chapter 3	Annex A	15

1 Introduction

1.1 The government is committed to supporting savers and to increasing the choice available to ISA savers. To support this aim the government announced at Budget 2014 that loans made through peer-to-peer platforms will become ISA qualifying investments.

1.2 On 17 October the government launched a consultation on its proposed approach for implementing this policy. The government's proposal would extend the range of investments that are eligible for inclusion within an ISA to include peer-to-peer loans arranged through an electronic platform. This consultation closed on 12 December.

1.3 The government received 81 formal responses to the consultation, from 39 individuals and 42 interested organisations. A list of those who responded is provided in Annex A.

1.4 This document summarises the responses received and sets out the government's decisions on implementation. The government is grateful to all those who contributed their views during the consultation process.

Aim of the consultation

1.5 The purpose of the consultation was to obtain views on the government's proposed approach for expanding the list of ISA qualifying investments to include peer-to-peer loans, rather than on the principle of doing so. The government has already taken the decision to introduce this policy in order to increase the choice of investments available to ISA investors, encourage the growth of the peer-to-peer sector and improve competition in the banking sector.

1.6 Chapter 2 summarises the responses received to the questions set out in the consultation document. The 24 consultation questions covered various design issues, including how to define and regulate peer-to-peer loans, the role of the ISA manager, withdrawals and transfers, a potential third ISA type, and Child Trust Funds and Junior ISAs (JISAs).

1.7 During the consultation period, the government engaged extensively with stakeholders across industry and held a number of meetings with interested parties to discuss the impact of this change.

Next steps

1.8 The government has carefully considered all of the responses to this consultation. While noting that the majority of respondents were broadly supportive of the proposed approach, it has taken account of the concerns expressed and has considered the alternative approaches suggested.

1.9 On balance, the government believes that the proposed approach set out in its consultation document is the most appropriate method of implementing the policy, subject to certain modifications set out in this summary document. It intends to publish draft legislation for technical consultation later this year, with a view to legislating to allow peer-to-peer loans to be held in an ISA from 6 April 2016.

2 Summary of responses

2.1 This chapter summarises the key points and suggestions put forward by participants in the consultation. It explains the government's response and highlights any changes that will be made to the design of the policy.

2.2 The key policy design decisions that have been made in response to the consultation are to:

- create a third ISA (the 'Innovative Finance ISA') to accommodate peer-to-peer loans;
- modify existing ISA rules regarding legal ownership of investments for the Innovative Finance ISA, in order to accommodate the established peer-to-peer operating model; and
- adapt ISA rules regarding withdrawals and transferability for the Innovative Finance ISA, so that these only apply to cash held in an Innovative Finance ISA.

Set up costs

2.3 The consultation document asked respondents to consider the potential set-up and one-off costs for platforms resulting from the inclusion of peer-to-peer loans in ISAs.

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?

Summary of stakeholder responses

2.4 Of those respondents that answered this question (mainly peer to peer platforms who wished to become ISA managers), the majority predicted that they would have costs of £50,000 or more.

2.5 Costs identified as relating to the initial set up as an ISA manager included: building the necessary technology platform; legal advice costs; management time; implementation and other project-related costs. Costs identified as relating to the ongoing operation of the platform as an ISA manager included: employing additional staff or hiring an ISA specialist; legal & compliance costs; technology improvements and platform maintenance.

Government response

2.6 The government believes that the set-up and ongoing costs outlined by respondents do not create a barrier to businesses arranging peer-to-peer loans that meet the ISA eligibility requirements. Where available, further details of the potential costs to businesses of including peer-to-peer loans within ISA will be set out in a Tax Information and Impact Note, to be published alongside draft legislation later this year.

Defining peer-to-peer loans

2.7 As stated in the consultation document, the government proposed using the definition of "relevant agreements" in article 36H of the Financial Services and Markets Act 2000 (Regulated Activities) Order 2001 (article 36H) (i.e. carrying out the activity of 'operating an electronic

system in relation to lending') as the basis for specifying the peer-to-peer loans that are eligible for ISA inclusion.

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?

Summary of stakeholder responses

2.8 Over half of respondents answered this question with the majority (39 of 47 responses) agreeing that the government's proposed approach was clear. Some respondents felt further clarity was required either from the government, the FCA or HMRC on which types of loans would be ISA eligible as the definition contained in article 36H allows a wide class of loans.

Government response

2.9 In light of the responses received the government confirms its intention to use the proposed definition of "relevant agreements" in article 36H of the Financial Services and Markets Act 2000 (Regulated Activities) Order 2001 as a general basis for identifying peer-to-peer loans that will be eligible for ISA inclusion. Further details will be included within the draft legislation to be published later this year.

Regulation of peer-to-peer loans

2.10 The consultation document considered the regulatory framework for the peer-to-peer loans industry, including whether to make the provision of advice to investors on loans made via peer-to-peer platforms a regulated activity.

Question 3

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

Summary of stakeholder responses

2.11 There was broad support for the government's proposed approach to make the provision of advice to investors in peer-to-peer loans a regulated activity, with a few respondents noting that further regulation would be desirable. A small minority argued that peer-to-peer loans should be required to be backed by the Financial Services Compensation Scheme (FSCS).

2.12 A few respondents took current market conditions into consideration and thought that the government should monitor the market and strengthen the regulatory regime if appropriate in the future. In addition, some respondents felt that the government should make it compulsory that peer-to-peer loans could only be sold with advice.

Government Response

2.13 The government will proceed with its proposal to make advising on peer-to-peer loans a regulated activity. All firms currently authorised to advise on investments will be eligible to elect to have this authorisation automatically conferred upon them.

2.14 The FCA has not chosen to include peer-to-peer lending platforms within the scope of the FSCS. Both the FCA and the government think it is important for the regulatory framework for peer-to-peer platforms to be proportionate and the FCA does not consider that this is necessary

at this time. The FCA is committed to reviewing the regulatory framework in 2016 and at that stage, it will consider again whether peer-to-peer should be within the remit of the FSCS.

The role of the ISA manager

2.15 The consultation document proposed that peer-to-peer platforms that wish to become ISA managers will not be required to change their existing practices to satisfy current ISA manager requirements such as ownership rules.

Question 4

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

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?

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?

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?

Summary of stakeholder responses

2.16 Nearly all peer-to-peer platforms (15 of 17) who responded said that they would consider seeking authorisation to act as an ISA manager if the government were to permit this. Platforms that responded to say that they wouldn't seek to apply for ISA manager status stated that they would look to outsource this role to a third party.

2.17 A small majority (26 of 43 respondents) who answered Question 6 had no concerns regarding peer-to-peer platforms acting as ISA managers. Some were concerned, however, that the failure of a peer-to-peer platform would lead to the subsequent loss of the ISA tax advantages for any peer-to-peer loans held, and argued that a solution to this issue would be needed.

2.18 The majority of existing ISA managers (6 of 8) who answered Question 4 said that they were not currently considering offering peer-to-peer loans within ISA, but would consider doing so in the future depending on the way the peer-to-peer market develops and the experience of peer-to-peer platforms' inclusion within ISAs. A number of respondents noted that the most likely route for existing ISA managers to include peer-to-peer loans within the ISAs they offer would be through products such as investment trusts. Shares in these trusts already qualify under the existing rules for stocks and shares ISAs.

2.19 In regards to ownership of the peer-to-peer loan, the vast majority (81%) of those who responded to Question 7 saw no risks arising as a result of peer-to-peer platforms not having legal ownership of the loan held within an ISA. It was thought that requiring the ISA manager to have legal ownership would increase the cost and complexity of providing ISA qualifying loans, would not be consistent with the established operating model for peer-to-peer loans and would not be of benefit to the consumer.

Government response

2.20 The government welcomes confirmation that peer-to-peer platforms are interested in becoming ISA managers, and is content that they should be able to do so (subject to the appropriate FCA permissions). The government intends to proceed based upon its original proposal: peer-to-peer platforms that become ISA managers will not be required to legally own or co-own loans held within the ISAs they manage.

2.21 In view of its decision to proceed with a third ISA to accommodate peer-to-peer loans, the government does not currently intend to include peer-to-peer loans in stocks and shares ISAs as eligible investments in their own right. However, it also confirms that, subject to certain conditions, these loans can be held within investments that are currently eligible for a stocks and shares ISA, such as investment trusts. The government will look to revisit this in the future if there is an increased demand from traditional ISA providers to do so.

Withdrawals and transfers

2.22 The consultation document proposed a mechanism for withdrawals and transfers of peer-to-peer loans, considered how this differs from arrangements for existing ISA eligible investments and whether requiring a secondary market or the sale of a loan at market value is necessary.

Withdrawals

Question 8

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

Summary of stakeholder responses

2.23 Most agreed with the government's proposed withdrawal procedure whereby, in response to a withdrawal request from an account holder, the ISA manager should remove the ISA wrapper from a loan, but that the loan should not be liquidated by the manager unless they are the legal owner. Several respondents argued that the current ISA requirement that withdrawal instructions must have been processed within 30 days may not be practically achievable in the case of peer-to-peer loans, given the lack of a guaranteed secondary market for this investment. Respondents felt that this question raised the need to clarify whether the withdrawal requirement would apply to the investor's entire peer-to-peer ISA portfolio, or whether the investor would be able to withdraw individual loans from the ISA wrapper.

Government response

2.24 Due to the illiquid nature of peer-to-peer loans and the fact that a secondary market for every loan cannot be guaranteed, the government has decided not to require that investors should be able to withdraw any non-cash investments from the Innovative Finance ISA within 30 days. However, this should not preclude platforms that can facilitate withdrawals via their own secondary market from doing so. The rules around withdrawals of these non-cash investments will therefore be matters for the agreed terms and conditions of the account, rather than the ISA rules. However, the current ISA requirements that allow an investor to withdraw their ISA investment within 30 days will be applied in relation to any cash held in an Innovative Finance ISA.

Transfers

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?

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?

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?

Question 16

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

Question 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?

Summary of stakeholder responses

2.25 The majority of respondents felt that there would be risks in requiring that peer-to-peer ISA investments must be transferable to another provider within a specified time period. The government had suggested that – if any transfer requirements were to be applied in relation to these investments – the ISA manager will only be obliged to effect a transfer after the investor has found a buyer for the loan and the cash realised on sale of the loan will be transferred, not the loan itself. Some respondents expressed concern that it could take a significant length of time to sell *all* of an investor's loans prior to being able to transfer any funds. The current 30 day window for completion of a transfer was commonly referenced as being too short a time period to effect a complete transfer.

2.26 Of the respondents that answered Question 10, most felt that if it was necessary to liquidate a loan in order to transfer it, the transfer should take place within the same amount of time as is currently the case for a cash ISA (15 days) or a stocks and shares ISA (30 days). Most felt that 30 days would be more appropriate, assuming completion of the sale of the loans on the secondary market. Of the 32 respondents that answered Question 11, most did not think the modification to transfer requirements would cause significant difficulties or administrative obstacles for ISA managers.

Government response

2.27 The government has noted respondents' views on the difficulty of transferring peer-to-peer loans and believes that requiring the transfer of peer-to-peer loans between ISA managers would impose significant burdens on peer-to-peer businesses and potentially negative impacts on the consumer. Therefore the government has decided not require peer-to-peer loans held within ISAs to be transferable. However, the current ISA requirements that allow an investor to

transfer their ISA investment within 30 days will be applied in relation to any cash held in an Innovative Finance ISA.

2.28 As is currently the case for other ISA investments, it will not be possible to transfer only part of the amount subscribed to the ISA in the current year (any such amounts can only be transferred as a whole); and the availability of partial transfers in relation to previous years' ISA subscriptions will be a matter for the agreed terms and conditions of the account.

Secondary Markets and sale at market value

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?

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 markets be easily defined?

Question 14

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

Question 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?

Summary of stakeholder responses

2.29 A large number of respondents answered these questions, with many arguing that the existence of a secondary market should be a requirement to ensure that peer-to-peer loans can qualify for ISA. Respondents felt that the existence of a secondary market would be particularly helpful in providing inexperienced investors with a degree of reassurance as they would be able to exit the market before their loan matured if they wished.

2.30 However others also argued that, although a secondary market is desirable, it should not be a requirement to ensure peer-to-peer loans are ISA eligible. These respondents argued that the provision of short term loans and the fact that the peer-to-peer market is still developing means that it is unrealistic for new entrants to create a secondary market in order for their loans to qualify as ISA eligible. It was also felt that the existence of a secondary market would increase the costs on investors or lenders without providing the guarantee that an alternative lender will be provided or that the value of the loan will be maintained at par value.

2.31 Overall, respondents felt strongly that guaranteeing a sale at market value within a given period would in practice be detrimental to the consumer. Many respondents argued that it could not be guaranteed that a buyer would be found within the given time, and therefore it risked being sold at a very low market value. It was also thought that most consumers would not understand that this would be a consequence of liquidating their investment as this is not the case with other ISA eligible assets that are more readily realisable.

2.32 Others felt that if investors are made fully aware of the liquidity risks inherent within different platforms, then there is no need to require a liquidity mechanism be in place. One

organisation felt that it should be the case that a third ISA type puts more emphasis on making investors aware of the risks and less emphasis on insulating them from the risks. A number of respondents provided alternatives to how the transfer requirement could work in a way other than described in the consultation.

Government response

2.33 The government supports the view that, where secondary markets exist, ISA investors should have the opportunity to sell their loan, where they wish to withdraw or transfer cash from their ISA. However, it is noted that not all peer-to-peer platforms have an active secondary market. Imposing a requirement to operate a secondary market, or any requirement on the provider to guarantee the sale of a loan at market value, risks placing disproportionate costs on platforms - particularly new platforms - and is unlikely to be effective in ensuring consumers can liquidate without facing potentially significant losses. The government has therefore decided not to require the existence of a secondary market, or to require any guarantees that loans can be sold at market value as a condition of ISA eligibility. Peer-to-peer platforms will therefore not be required to provide a means by which the investment can be liquidated (and therefore transferred).

2.34 The effect of this is that peer-to-peer investments held in an ISA may only be transferable or available for withdrawal when they are cash, for example after a loan has been sold on a secondary market. There will be no guarantee for any investor that it will be possible to withdraw or transfer their investment in all cases. The government believes that it is important that peer-to-peer platforms offering ISAs ensure that investors are aware of this position, and how the rules in this area differ from the withdrawal and transfer rules that are in place for other ISA investments.

Collapse of an ISA manager

Question 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?

Summary of stakeholder responses

2.35 There was a general consensus among respondents that in the instance where a platform were to collapse or lose its FCA permissions, there should be a backup ISA provider in place that could manage the run-down of the loans and ensure that the loans remain within the ISA wrapper, or a mechanism or arrangement to ensure the ISA book is transferred to a new ISA provider.

Government Response

2.36 The government agrees with respondents that argued, where possible, loans should still be managed by an ISA manager to ensure the loans maintain their ISA eligibility. The government will work with the peer-to-peer industry and the FCA to develop options to support this aim.

Mixing peer-to-peer loans with other qualifying investments within a single ISA account

2.37 The consultation document considered the case for creating a third ISA to accommodate peer-to-peer loans.

Question 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?

Question 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?

Question 21

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

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

Summary of stakeholder responses

2.38 The consensus amongst respondents was that investors would want to diversify their investments in peer-to-peer loans with investments in cash and stocks and shares. It was also felt that as peer-to-peer loans are still a relatively new product for most people, it is likely that investors would prefer to try the product without necessarily committing a full year's ISA allowance. Respondents to Question 22 argued that there would be considerable risk of confusion and misunderstanding if a third ISA type was not adopted for peer-to-peer loans.

2.39 Nine out of ten respondents that responded to Question 20 felt that a third ISA type would be helpful in distinguishing peer-to-peer loans and highlighting the different rules that apply to them, and the fact that peer-to-peer loans are not protected by the FSCS. Many of those who supported a third ISA type felt that separating peer-to-peer loans from stocks and shares would keep the different ISA investment types separate and easy for investors to understand.

2.40 Of those that didn't support a third ISA type, one platform believed that creating a third ISA type may mean that peer-to-peer loans are seen as 'alternative' and not for mainstream investors, which would defeat the object of making them eligible for ISA inclusion.

Government response

2.41 As set out in the consultation document, the government's objectives are to increase the choice of investments available to ISA investors and to encourage the growth of the peer-to-peer sector. Allowing ISA savers to invest in peer-to-peer loans in addition to cash and stocks and shares should support the take-up of peer-to-peer loans within ISAs, as individuals would

not need to choose between investing in a stocks and shares ISA or in peer-to-peer loans, within a single tax year.

2.42 The government has decided that peer-to-peer loans should be included within a newly created third ISA type – the ‘Innovative Finance ISA’. This reflects the fact that they are different to other ISA qualifying investments, and will be subject to different rules in relation to withdrawal, transfer and ownership. As stated previously, the government believes that it is important that peer-to-peer platforms offering ISAs ensure that investors are aware of this position. The creation of the Innovative Finance ISA is consistent with the government’s objectives to encourage peer-to-peer growth and ensure maximum consumer choice as investors will not need to choose between stocks and shares and peer-to-peer investing. The Innovative Finance ISA would also send a clear signal to consumers that peer-to-peer loans are different to more traditional forms of investment.

Child Trust Funds and Junior ISAs

2.43 The consultation document considered the case for including peer-to-peer loans in Child Trust Funds (CTFs) and Junior ISAs.

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?

Question 24

Do respondents agree that if peer-to-peer loans are made eligible for CTFs and Junior ISAs, these loans should be in the legal ownership of the ISA manager? If not - what alternative approach might be considered?

Summary of stakeholder responses

2.44 Of those who responded, most did not raise specific concerns about peer-to-peer lending being included in Junior ISAs or CTFs. One platform felt that this could allow tax avoidance by parents and acknowledged that “whilst this would benefit the peer-to-peer industry by adding liquidity, we think it is right that restrictions are put in place to ensure parents aren’t unfairly avoiding tax over their personal ISA limit.”

2.45 Most respondents agreed that peer-to-peer platforms should be the legal owner of any peer-to-peer loan when invested in an ISA, as is the case with stocks and shares Junior ISAs – although there were mixed responses from platforms over whether they could, or would wish to, accommodate such a change to their operational practice.

2.46 For those that agreed, it was thought that there was no reason why the legal ownership of the investment should be different for peer-to-peer loans held in Junior ISAs than is the case with investments held in stocks and shares JISAs.

Government response

2.47 As far as is appropriate, the government aims to ensure consistency between what can be held in an ‘adult’ ISA and what can be held in Junior ISAs/CTFs. However, the government has decided not to make peer-to-peer loans eligible for its tax-advantaged children’s accounts as holding peer-to-peer loans in these accounts could restrict the diversity of investments that can be held in these accounts for children. This is because children can only have one CTF account and, as the government is not requiring that peer-to-peer be liquid or transferable, children

would effectively be locked into this investment. Furthermore, the government is aware that requiring a platform (as the ISA manager) legally own the loan would require a change to the established operational processes within the peer-to-peer industry, and notes the lack of agreement from respondents on whether this was possible or desirable.

3 Annex A

3.1 There were 81 responses to the consultation. The following organisations submitted responses. Please note, where submissions did not answer any of the questions in the consultation we have counted these as enquiries and not formal responses.

Ablrate
Abundance Generation
AltFi LTD
Altus Consulting
Assetz Capital
Brewin Dolphin Wealth Management
Crowd 2 Fund
Crowd Cube
eMoney Union
Federation of Small Businesses
Financial Services Consumer Panel
Folk2Folk
Funding Circle
Funding Knight Limited
GLI Finance Limited
Institute of Chartered Accountants in England and Wales
Institute of Directors
Interactive Investor Trading Limited
International Financial Data Services
Investment Management Association
Invest and fund
Invest UP
Killik & Co
Lending Works
LendInvest
Madiston LendLoanInvest
MarketInvoice
MoJoMoneyMart.com Limited
Money & Co
P2PFA
Quid Cycle
RateSetter
rebuildingsociety.com
Standard Life
The Share Centre Ltd
The Wealth Management Association
Thin Cats
TISA
Trillion Fund and Buzzbnk
UKCFA
Yorkshire Building Society
Zopa

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