



HM Treasury

ISA qualifying investments:

summary of consultation responses

July 2013



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1

Introduction and next steps

1.1 The Government announced at Autumn Statement 2012 that it would consult on expanding the list of qualifying investments for stocks and shares ISAs to include shares traded on small and medium-sized enterprise (SME) equity markets. In taking forward this change to the ISA rules, the Government is aiming to encourage more investment in growing businesses, and also to extend choice for ISA investors.

1.2 On 13 March the Government launched a consultation on its proposed approach to implementing this policy. The Government's proposal would extend the range of investments that are eligible for inclusion within an ISA to include company shares admitted to trading on a recognised stock exchange in the European Economic Area (EEA). This consultation closed on 8 May.

1.3 The Government received 99 responses to the consultation, from both individuals and interested organisations. A list of the organisations that responded is provided in Annex A.

1.4 The aim of this document is to summarise the responses received, and to set out the Government's response. The Government is grateful to all those who contributed their views during the consultation process.

Aim of the consultation

1.5 As was made clear in the consultation document, the consultation was designed to obtain views on the Government's proposed method of expanding the list of ISA qualifying investments to include more shares traded on SME markets, rather than on the principle of doing so. The Government had already decided to introduce this policy in order to encourage investment in smaller companies.

1.6 Chapters 2 to 4 summarise the responses received to the questions posed in the consultation document, together with the Government's response.

Next steps

1.7 The Government has carefully considered all of the responses to this consultation. Whilst 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. On balance, the Government believes that the proposed approach set out in its consultation document is the most appropriate method of implementing the policy. It therefore intends to lay legislation before Parliament in July 2013 to extend the range of qualifying ISA investments to include company shares admitted to trading on a recognised stock exchange within the EEA. It is expected that this legislation will take effect shortly after.

2

Qualifying markets – the Government's proposed definition and its implications

2.1 This Chapter addresses the questions posed in the consultation concerning the scope and likely impact of the Government's proposal that company shares admitted to trading on a recognised stock exchange in the EEA should be eligible for inclusion within an ISA, and potential alternative approaches.

Question 2: Are there any EEA SME equity markets that would not qualify under the proposed criteria, and if so, which markets? Is there a case for including these markets? If so, how could this policy be implemented differently to include these markets?

Question 4: Which non-SME equity markets would also qualify for ISAs under the proposed expanded criteria?

Question 7: Is there another approach for implementing this policy that has not been considered above? What would be the benefits and drawbacks of such an approach?

Question 8: When the "SME Growth Market" classification is introduced as part of the Markets in Financial Instruments Directive (MiFID) Review, should the Government revisit the ISA Regulations for qualifying SME equity markets to bring them into line with the new classification? What would be the advantages to doing so? What would be the disadvantages?

Responses received

2.2 Few respondents directly addressed the question of whether there are SME markets within the EEA that would not qualify under the proposed criteria (only one private individual did so). Most of those who responded were not aware of any SME markets that would be excluded, though one respondent identified Multi-lateral Trading Facilities (MTFs) aimed specifically at SMEs (where these are not recognised stock exchanges). It was suggested that defining the newly qualifying markets in this manner (i.e. MTFs aimed at SMEs) would be better focused on SMEs than the Government's proposed approach and would therefore be preferable.

2.3 There were also few responses regarding non-SME markets that would potentially qualify under the proposed approach, and only one such market was identified – the London Stock Exchange's High Growth Segment. However, despite the larger size of some of the companies trading on it, its inclusion was considered appropriate by the respondents who named it. Another more general response suggested that some of the companies admitted to trading on markets that would qualify for inclusion in ISA using the proposed approach are not SMEs. Again, however, the respondent did not object to these markets' inclusion, arguing that their diversity is an important factor in their success as fundraisers for companies of all sizes, by giving confidence to investors at all levels.

2.4 Most respondents did not address the question regarding alternative approaches but of those that did the vast majority did so to register their support for the Government's proposal. Three organisations welcomed the use of concepts already used in tax legislation, with which the ISA industry and the wider business community are already familiar. Two organisations commented that the use of recognised stock exchanges in defining markets ensures a degree of regulation.

2.5 However, a few alternative approaches were suggested: including MTFs that specify they are solely aimed at SMEs (also mentioned in response to Question 2, see 2.2 above); excluding all non-UK markets; and phasing in the proposal by including a single new exchange initially (these last two suggestions would breach our EU Treaty obligations in relation to the single market and/or state aid). One respondent suggested broader changes to existing arrangements for markets and listing, which go beyond the scope of the consultation.

2.6 The majority of respondents did not address the question of whether the Government should revisit the definition of qualifying investments when the SME growth market classification proposed in the EU's MiFID Review is introduced (no private individuals did so). Those that did expressed a mix of views. The majority were open to a review, though only half of these indicated that the intention of such a review should be to adopt the new classification. Around a third of those that responded did not think the new classification should be used or a review conducted. One response suggested that implementation of the expansion of qualifying investments could be delayed until the new classification is introduced.

The Government's response

2.7 The Government acknowledged in the consultation that its proposed approach is not perfectly targeted at SMEs. It also highlighted its desire to simplify compliance by using terminology already in use in tax legislation. It believes that there is currently no more targeted definition of markets aimed at SMEs that could easily be applied for ISA purposes. Whilst it is possible that separate policy discussions may result in such a definition, this is not yet certain.

2.8 As set out at 4.4 below, there were many requests in the responses for swift implementation. The Government does not consider that it should delay implementation of this measure to await the outcome of other policy discussions, particularly given that there is no certainty these would result in the creation of a suitable tax category for ISA purposes. In addition, the Government agrees with respondents who pointed out the benefit (in terms of clarity and simplicity) of using recognised stock exchanges in defining eligible markets. It will therefore proceed with implementation based upon its original proposal that ISA qualifying investments will include shares admitted to trading on a recognised stock exchange in the EEA. If newer categories of market are defined in future (e.g. as a result of the MiFID review), then the Government can consider whether to review the ISA rules at that time.

3

Risks and safeguards

3.1 This Chapter addresses the questions in the consultation concerning compliance with ISA rules, whether there are any risks associated with the Government's proposed method of implementation, necessary safeguards, and whether any alternative approaches or additional measures should be considered.

Question 3: What risks, if any, does the proposed approach have for ISA investors? What alternative method of implementing this policy would reduce such risks?

Question 5: Consultation objective 2 requires that all new ISA qualifying investments comply with the ISA rules. Would any of these rules disproportionately restrict the eligibility of smaller company shares for ISAs if the range of ISA qualifying investments were expanded as proposed in this consultation?

Question 6: Are any other safeguards required to provide investors with additional reassurance, without compromising the main objective of this policy?

Responses received

3.2 A large number of respondents addressed these questions, with the majority (77 of 86 responses) saying that there were no or few risks for ISA investors, or that investors should be free to make their own decisions regarding investments and the level of associated risk. Many respondents pointed out that some shares traded on the markets involved are already eligible for ISA inclusion as a result of dual listing on a qualifying market. Thus the vast majority of respondents believe the proposed approach is the right one.

3.3 However, in response to Question 3 there were two expressions of concern regarding a higher level of risk associated with shares traded on some SME markets, and two more respondents expressed concern regarding the level or effectiveness of regulation of the markets involved. Another respondent suggested that ISA qualification should not be automatic for companies on the relevant markets but should instead be available only to companies prepared to comply with a new set of governance requirements.

3.4 None of the many respondents to Question 5 considered that the requirement to comply with existing ISA rules would restrict smaller companies' initial eligibility. Respondents were confident that company shares that would become eligible under the Government's proposed approach could meet the general ISA rules (for example, the requirement that the time taken for transfers and withdrawals must not exceed 30 days). One respondent suggested that shareholders might experience difficulty in trying to exercise their rights as beneficial owners, but did so largely in the context of raising concerns regarding what they felt to be existing shortcomings in this area. Two respondents suggested that companies trading on the relevant markets could be more susceptible to losing eligibility for ISA inclusion, due to either delisting (which the respondent concerned suggested is more common on SME markets and frequently results in the value of the shares involved dropping considerably), or to changes in company

structure. In such circumstances the investor could be forced to choose between retaining the shares outside their ISA or selling the shares – possibly at a substantial loss – in order to reinvest in ISA-qualifying investments. In both cases therefore, the comments related to the possible effect of the Regulations on investors rather than their restricting SME eligibility. It was suggested that once eligibility for ISA inclusion had been determined and shares accepted into the ISA, they should be allowed to remain within it, notwithstanding any subsequent change to the eligibility of the shares.

3.5 A number of respondents said existing SME practices were compatible with ISA rules, but were keen to see the provisions of Part 9 of the Companies Act 2006 applied more broadly.

The Government's response

3.6 As stated in the Introduction above, the purpose of the consultation was to consider how best to implement a policy decision already taken by the Government to expand ISA qualifying investments to include shares traded on SME markets. The Government agrees with those respondents who suggested that investors should be free to choose the investments they hold in their ISAs. Its proposed approach will expand the range of choice available to investors but will in no way compel them to invest in any particular type of shares. The Government recognises that all stocks and shares investments carry a degree of risk and believes that investors should make sure they fully understand the risks involved before investing. The Government also recognises the need for investor protection safeguards to be in place, such as the existing conduct of business standards for ISA providers and the requirement to conduct suitability assessments of clients before recommending investments.

3.7 The Government's proposed approach requires that to be eligible for ISA inclusion, shares must be admitted to trading on a recognised stock exchange. When considering whether an exchange should be designated as a recognised stock exchange for UK tax purposes, HM Revenue and Customs takes due account of whether proper and effective arrangements for financial regulation are in place, which meet internationally accepted modern standards – as well as considering whether there are any wider public policy grounds on which there might be objections to the designation. The Government believes this is a proportionate approach to regulation whilst also allowing choice to investors.

3.8 The Government welcomes confirmation from many respondents that the company shares that would qualify under its proposed approach can satisfy the ISA rules and requirements, and accordingly it does not intend to make any changes to these. In particular, it believes there could be drawbacks for investors if investments could be retained in an ISA after they ceased to be eligible (for example, the loss of the regulatory reassurance provided by the requirement relating to a recognised stock exchange). As is currently the case, it will be for providers to ensure that the ISA products that they offer satisfy the ISA rules and requirements.

3.9 With regard to SME companies and Part 9 of the Companies Act 2006, existing ISA rules require that ISA qualifying investments are in the beneficial ownership of the investor; and beneficial ownership of shares provides investors with rights pursuant to Sections 152 and 153 within Part 9 of the Act.

Overall, the Government does not consider that any new safeguards – in addition to those within the current regulatory framework and ISA rules – are necessary as a result of its proposal.

4

Other issues

4.1 The consultation also asked whether the proposed changes should apply to Child Trust Funds and Junior ISAs, and invited respondents to raise other points regarding the Government's proposals and possible alternatives.

Question 1: Do respondents agree that the set of investments that can be held in Child Trust Funds and Junior ISAs should be expanded in line with 'adult' ISAs, to include shares traded on SME equity markets? If not, why not?

Question 9: Are there any other points that respondents would like to raise about the Government's proposed approach and alternative approaches?

Child Trust Funds and Junior ISAs – responses received and the Government's response

4.2 A large proportion of respondents answered Question 1, with the overwhelming majority agreeing that the newly qualifying investments should be available to Child Trust Funds and Junior ISAs. Individuals who responded unanimously agreed with this proposal but two organisations disagreed, arguing that the level of risk and the volatility of shares in the markets concerned make them inappropriate investments for minors.

4.3 The Government's views on the risks and appropriate safeguards in relation to its proposed approach are set out at Chapter 3 above. On balance, it does not believe that any restrictions or additional safeguards will be required in relation to Child Trust Funds and Junior ISAs, where the range of qualifying investments has always been broadly similar to that available for 'adult' ISAs.

Other issues – responses and comments received

4.4 The majority of respondents expressed the hope – either in response to Question 9 or in other more general comments – that the proposed measures would be speedily implemented.

4.5 Beyond this, comments were relatively few but the following issues were raised:

- unhappiness at the limited scope of the consultation in addressing implementation rather than the policy itself;
- concerns that the newly qualifying investments will be high risk products – leading to one suggestion that the industry warn investors of this, and another that inheritance tax business property relief should be removed, as combining this with ISA advantages is a step too far and will attract investors who do not understand the risks involved;
- concerns regarding control, management, regulation and transparency in some SME companies and markets; and

- concern that the rights of shareholders as beneficial owners should be better advertised and protected.

Other issues – the Government's response

4.6 The Government's views on risks, regulation and transparency and safeguards are set out at Chapter 3 above.

4.7 The Government decided to introduce this policy in order to encourage investment in smaller growing companies and increase the choice available to ISA investors. It responds to the persistent difficulties smaller firms face in accessing equity finance. The Government also made clear in its consultation document that eligibility for inclusion in ISAs will not affect the availability of other tax reliefs for qualifying shares. Having already decided to make changes to the ISA rules, the Government considered that consultation on the implementation of a proposed approach, and on the alternative approaches available, was most appropriate.

4.8 ISA providers are responsible for the management of ISA accounts and for ensuring compliance with the ISA rules, including the requirement that account investments must be in the beneficial ownership of the account investor, and the rights of investors in this regard. Any investor concerned about whether their accounts are being managed in accordance with the ISA rules should raise this with their account provider, or may contact HM Revenue and Customs for advice on the relevant rules (contact details are available via the link below).

<http://search2.hmrc.gov.uk/kb5/hmrc/contactus/view.page?record=agUO91tWzfU>



List of respondents

Only organisations that responded are listed here; there were additionally 77 responses from private individuals.

A J Bell

Asset Match Ltd.

Association of Investment Companies

Association of Private Client Investment Managers and Stockbrokers (APCIMS)

Barclays

BioIndustry Association

British Bankers' Association

CBI

Duncan Lawrie Private Banking

Friends Life

Grant Thornton

ICAP Securities and Derivatives Exchange

Institute of Chartered Accountants in England and Wales (ICAEW)

Killik & Co

London Stock Exchange

Quoted Companies Alliance

Standard Life Savings Ltd.

St James's Place Wealth Management

Tax Incentivised Savings Association (TISA)

The Share Centre Ltd.

The UK Shareholders' Association

UK Individual Shareholders' Society

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