HM Revenue
& Customs

ISAs and authorised open-ended property funds

Consultation

Publication date: 28 October 2020
Closing date for comments: 13 December 2020

Subject of this consultation:	The Financial Conduct Authority (FCA) is currently consulting on a proposal to introduce a requirement that investors in open ended property funds must provide between 90 and 180 days' notice before their investment can be redeemed. The proposal has implications where such investments are held within an Individual Savings Account (ISA), as the ISA legislation requires account holders to be able to access the funds or transfer them to another ISA within 30 days of making an instruction to their account manager.
Scope of this consultation:	In order to mitigate the impact on ISA account holders and managers if the FCA introduce the proposed change, the Government is considering the idea of allowing existing investments in open-ended property funds to remain within the ISA whilst prohibiting the inclusion of 'new' investments in such funds. The aim of this consultation is to gather views on the viability of such a proposal. The views expressed will inform the government's decision.
Who should read this:	The consultation is of interest to: • ISA managers and others involved in the investment industry who have experience of including property funds within a client's ISA portfolio or who have concerns about the interaction of the ISA regulations with the FCA's proposal; • individuals, particularly those who currently invest in daily dealing property funds via their stocks and shares ISA and who might be affected by FCA's proposal; • representative bodies of any of the above groups
Duration:	28 October to 13 December.
Lead official:	Helen Williams. Her Majesty's Revenue & Customs
How to respond or enquire about this consultation:	Comments/responses should be sent by email to: savings.audit@hmrc.gov.uk Or write to: Property Funds Consultation, HM Revenue and Customs, Room 3C.07, 100 Parliament Street, London, SW1A 2BQ.
Additional ways to be involved:	**On request this document can be produced in Welsh and alternate formats including large print, audio and Braille formats.**
After the consultation:	Once this consultation has closed on 13 December, the government will consider all responses and publish a 'summary of responses' document. This will review the responses received and set out the government's decisions in response.

Getting to this stage:

The Financial Conduct Authority (FCA) published a consultation paper (CP20/15) on 3 August (www.fca.org.uk/publications/consultation-papers/cp20-15-liquidity-mismatch-authorised-open-ended-property-funds).

The paper explains that FCA is seeking to reduce the potential for investor harm which comes about because the terms for dealing in units of some property funds are not aligned with the time that it takes to buy or sell the buildings that the funds invest in. This type of property fund needs to hold a significant cash balance otherwise it might not have time to sell properties to pay investors who can request their money back at short notice. If a fund runs out of cash, this can cause it to suspend dealing. As a result, this can cause investors to request their cash in anticipation of such suspensions, potentially increasing the problem further.

To address this, the FCA proposes that investors must notify fund managers that they want to redeem their investment. It is consulting on the precise length of this notice period, proposing between 90 and 180 days notification. The aim of the notification period is to enable funds to operate fairly and efficiently in the interests of all investors. FCA anticipates that the introduction of notice periods would deliver the potential for a material increase in returns to property fund investors, as the funds could operate in a more stable and sustainable way, with more assets invested in property and less in cash.

The FCA consultation paper explains that it is liaising with Her Majesty's Treasury (the Treasury) and Her Majesty's Revenue and Customs (HMRC) to confirm whether these funds would remain eligible for ISAs following a change in their rules for property funds, as it recognises that, for retail investors, this could offset other benefits of the rule change.

Contents

1. Introduction

1. An Individual Savings Account (ISA) is a tax-advantaged savings account within which any interest, dividends or capital gains that arise are tax-free for the investor. Tax relief and inclusion within the ISA ‘wrapper’ is dependent on the ISA rules being satisfied.

2. The ISA rules are set out in the Individual Savings Account Regulations 1998 (S.I. 1998/1870) (ISA Regulations). Amongst other things these provide the general basis on which ISAs must operate; what qualifies for investment in an account; who can provide ISAs; and a number of requirements which apply solely to specific types of account – of which there are four: a cash ISA, a stocks and shares ISA, an Innovative Finance ISA and a Lifetime ISA.

3. With the exception of Innovative Finance ISAs (whose intrinsic nature precludes liquidity), it is a longstanding requirement of the ISA rules that an account investor must be able to access any account investments and associated proceeds, or transfer them to another ISA, within 30 days of making a withdrawal or transfer instruction. This central tenet exists to ensure that investments are liquid, and that the investor can always access their funds in a reasonable timeframe - broadly reflecting ISA’s original status as a retail investment scheme. The ability to transfer ISA investments (whilst remaining in the ISA ‘wrapper’) also contributes to the development of effective competition within the ISA market.

4. The ISA rules underpin ISA’s success as a popular and trusted savings product and are understood by savers, investors and ISA managers alike. Any changes to the ISA regime should be simple to apply, provide certainty, and not impose disproportionate compliance, assessment or monitoring requirements on HMRC. In particular, any change which introduces different criteria for specific products within an investment class should be readily understood by a retail customer.

5. It follows that, under current legislation and policy for ISAs, certain property funds would no longer be eligible investments if the FCA proposal goes ahead. However, the Government recognises that this could create problems for ISA managers and investors where such property funds are currently held in ISAs. It is therefore considering whether an alternative approach would be viable and is seeking views on the impact, on managers and investors, of a provision whereby existing property funds could be retained within an ISA (and receive the tax benefits) but either:

    - no further money could be invested in those property funds within the ISA; or
    - account holders could not invest in any new, different property funds within the ISA (although they could continue to invest in those specific funds that are already in the ISA).

2. Stocks and shares ISAs and Lifetime ISAs

6. The ISA Regulations provide for the setting up of accounts in which individuals may make investments. They also regulate how the account must operate in relation to both the account provider and the account holder.

7. Regulation 7 of the ISA Regulations specifies the types of investments which may be purchased, made, or held within a **stocks and shares ISA**. This includes qualifying units in, or shares of, a non-UCITS retail scheme (Regulation 7(2)(g)). The proposal set out in the FCA consultation paper relates specifically to UK non-UCITS retail schemes which invest directly in property.

8. Regulation 8ZA relates to the type of investments which may be purchased, made or held within **a Lifetime ISA**. These are

    a) qualifying investments for a stocks and shares ISA and

    b) qualifying investments for a cash ISA.

   Qualifying units in, or shares of, a non-UCITS retail scheme therefore qualify for a Lifetime ISA.

Withdrawals and transfers

9. Regulation 4 of the ISA Regulations sets out the general conditions with which ISAs must comply, including the rules which apply where an account holder requests a withdrawal of funds from an ISA or a transfer of investments to another ISA or another ISA provider.

10. Under the ISA rules an ISA manager must, within thirty days of receipt of a **withdrawal** request, either remove the ISA 'wrapper' and transfer the assets into the sole name of the investor (thereby retaining the asset outside the wrapper) or liquidate the relevant assets into cash and make a cash payment to the investor.

11. Where an investor requests the **transfer** of the assets to another stocks and shares ISA manager or to a Lifetime ISA (an 'in specie' transfer), the current manager must comply with the request - which must be completed within thirty days. Where the receiving ISA manager is unable or unwilling to accommodate an in-specie transfer, or where the investor has requested that the assets in a stocks and shares ISA be transferred to a cash-based ISA, the assets will be liquidated into cash so that the cash value can be transferred to the new manager.

12. Regulation 21 provides the basis on which any transfers must operate. Regulation 21(3) applies to a transfer from any ISA and states that current year's subscriptions may only be transferred as a whole (with or without the whole or part of any previous years' subscriptions). Previous years' subscriptions may be transferred in whole or part. This has implications for accounts containing investments which were purchased with a combination of funds from the previous year and the current year as the current year's funds must be transferred in whole. Regulation 21 also provides for 'bulk' transfers of accounts between providers (for example where a provider wishes to leave the market or ceases to qualify as an ISA manager).

13. The rules underlying **Lifetime ISAs** provide that, where a withdrawal is made from an account for the purpose of a first-time house purchase; where the account holder is terminally ill; or is 60 years or older, no withdrawal charge shall apply. Paragraph 6(6)) of the Schedule to the ISA Regulations requires the first-time residential purchase to be funded by a loan (e.g. mortgage) and paragraph 6(14) requires that the transfer of Lifetime ISA funds to a conveyancer for that purchase is made within the time period stipulated in regulation 4(7) – that is within 30 days of receipt of the request.

Redemption of units or shares in a non-UCITS retail scheme

14. Regulation 2(1)(b) provides specific rules in relation to the redemption of units or shares in a non-UCITS and states that they '*shall take place no less frequently than bi-monthly.'.* This ensures that the timescale for liquidating investment complies with the ISA Regulations. There is no requirement for daily dealing.

15. Regulation 4 also allows for the 30-day rule to be extended where dealings in units held in UCITS or non-UCITS retail schemes are suspended in accordance with FCA rules. In such cases requests for withdrawals must be allowable within 7 days of the suspension ending. This change was introduced in 2009 to address instances where fund managers were experiencing liquidity pressures. A significant proportion of daily dealing UK authorised funds are currently suspended.

3. The FCA consultation

16. Authorised property funds offer investors an option to invest in commercial property and to take their money out on a regular basis. While some of these funds are targeted at institutional investors such as pension funds and have limited redemption arrangements, a number offer daily redemptions and are marketed to retail investors. These schemes must process redemptions on demand (unless suspended) and cannot impose a notice period on investors.

17. On 3 August the FCA issued a consultation on introducing mandatory notice periods of 90 to 180 days for daily dealing UK authorised open ended property funds. Investors submitting redemption requests to their fund manager would have their orders dealt after the determined number of months and would receive payment based on the fund's value at redemption.

18. Paragraph 4.8 of the FCA document recognises that the proposed notice period has significant implications where such funds are held in an ISA as existing rules prohibit units in, or shares of, property funds with restricted liquidity from remaining in an ISA. Depending on the outcome of the FCA consultation, it is possible that "property funds" as defined in that consultation document would no longer meet the requirement of Reg 4(7) of the ISA regulations and would need to be removed from the ISA 'wrapper'.

19. Removing the ISA wrapper would mean that the investments would no longer be eligible for tax-advantaged status and the investor could become liable for tax on any subsequent income or capital growth on these investments.

4. Accommodating existing property funds

20. An alternative to requiring all affected open-ended property funds to be removed from the ISA wrapper would be to introduce a provision whereby those funds which are already in an ISA on a given date can remain in the ISA despite having extended redemption arrangements, but no new “property funds” could be included in an ISA. This is on the basis that, following the FCA consultation, such funds are not redeemable within 30 days.

21. There are two possible models under which this alternative could operate. Under **model 1** existing property funds could be retained within an ISA (and receive the tax benefits) but no further money could be invested in those property funds within the ISA. The investor could continue to subscribe to the ISA to the extent that the subscription was invested in other qualifying investments.

22. Under **model 2** property funds which are already held within an individual’s ISA could be retained within the ISA (and receive the tax benefits) and the account holder could continue to invest in those specific funds. The account holder could not invest in new, different, property funds within the ISA.

23. While either of these approaches could address the tax implications for consumers currently holding property funds in ISAs, they would potentially introduce greater complexity for ISA managers, particularly where property funds form part of a mixed portfolio and the investor wishes to transfer or liquidate all or some of their assets. In the case of **Lifetime ISA**, it is unclear how an extended notification period can be accommodated where the investor needs to withdraw funds for the purchase of property and, for example, may require the funds for the deposit.

24. In order to assess the implications of the proposed notification period and whether either model provides a viable solution, it is necessary to acquire a clearer view of the proportion of relevant property funds which are held in stocks and shares ISAs or Lifetime ISAs, either as the sole investment or as a component of the investment. This evidence would establish the extent to which the proposed changes would affect the operation of existing investments, whether either model is viable, and the implications for ISA investors or ISA managers.

25. Many daily dealing UK authorised open ended property funds have been suspended since March 2020 (a period equivalent to the notification period proposed in the FCA consultation). ISA managers have therefore, in effect, been accommodating extended redemption arrangements.

Question 1

In order to gauge the potential proportion of ISAs affected:

a. What proportion of the stocks and shares (or Lifetime) ISAs you offer include property funds invested in non UCITS retail scheme?
b. What is their value?
c. Do they form part of a mixed portfolio?
d. Are these self-select funds?

Question 2

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

a. Would it be feasible for you to continue offering ISAs which include property funds affected by the FCA proposals if either of the models set out at paragraphs 21 and 22 were introduced?
b. What is your experience of applying different redemption requirements for different investments within an ISA (where applicable)?
c. What would be the implications for:
    i. partial withdrawals of previous years' subscriptions?
    ii. partial withdrawals of previous years' and current year's subscriptions?
    iii. full withdrawal of funds?
    iv. partial transfer of previous years' subscriptions to another investment-based account?
    v. partial transfer of previous years' and current year's subscriptions to another investment-based account?
    vi. full transfer to another investment-based account?
    vii. partial transfer of previous years' subscriptions to a cash ISA or Innovative Finance ISA?
    viii. partial transfer of previous years' and current year's subscriptions to a cash ISA or Innovative Finance ISA?
    ix. full transfer to a cash ISA or Innovative Finance ISA?
d. Do you currently offer flexible stocks and shares ISAs which include relevant property funds invested in non UCITS retail schemes?
e. Would it be feasible for you to continue offering flexible ISAs which include property funds if a notice period of more than 30 days were introduced?
f. Would it make any difference to your answer to any of these questions if that notice period were 90 or 180 days?
g. Do you anticipate difficulties in accommodating the retention of affected property funds in a Lifetime ISA given that funds must be realised for a house purchase?
h. What difficulties or administrative obstacles would the retention of existing investments present?

i. Would there be any financial implications for investors or increased administration costs for you?
j. Would you be able to act on the investor's instructions immediately after the 90-180 day notification period has expired – or would you need the period of up to 30 days (which is normal for stocks and shares ISAs) in addition to the 90-180 days)?
k. Do respondents foresee any risks or detriment for account holders resulting from the proposal?
l. Do respondents foresee any particular benefits for account holders of either of the possible models set out in paragraphs 21 and 22?

Question 3

As an ISA investor:

a. Does your stocks and shares ISA or Lifetime ISA have property funds affected by the FCA proposal as a component of the investment? If so, what proportion of your ISA is invested in these funds?
b. Did the recent suspension of property funds prevent you making a withdrawal when you wished to do so?
c. Are your ISA subscriptions invested wholly in property funds affected by the FCA proposal?
d. What would be the implications for you if you couldn't liquidate your investments in existing property funds for up to 180 days and up to 30 days for the provider to act?

5. Summary of Consultation Questions

Question 1

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

b. What is their value?

c. Do they form part of a mixed portfolio?

d. Are these self-select funds?

Question 2

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

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

c. What would be the implications for:

    i. partial withdrawals of previous years' subscriptions?

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

    iii. full withdrawal of funds?

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

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

    vi. full transfer to another investment-based account?

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

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

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

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

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

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

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

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

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

j. Would you be able to act on the investor's instructions immediately after the 90 - 180 day notification period has expired – or would you need the period of up to 30 days (which is normal for stocks and shares ISAs) in addition to the 90-180 days)?

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

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

Question 3

a. Does your stocks and shares ISA or Lifetime ISA have property funds affected by the FCA proposal as a component of the investment? If so, what proportion of your ISA is invested in these funds?

b. Did the recent suspension of property funds prevent you making a withdrawal when you wished to do so?

c. Are your ISA subscriptions invested wholly in property funds affected by the FCA proposal?

d. What would be the implications for you if you couldn't liquidate your investments in existing property funds for up to 180 days and up to 30 days for the provider to act?

6. The Consultation Process

The purpose of the consultation is to seek views on the potential implications for ISA managers of the FCA proposal and on possible alternative for retaining certain current investments within an ISA.

How to respond

A summary of the questions in this consultation is included at chapter 5

Responses should be sent by 13 December:

By e-mail to savings.audit@hmrc.gov.uk

Or write to: Property Funds Consultation, HM Revenue and Customs, Room 3C.07, 100 Parliament Street, London, SW1A 2BQ.

Paper copies of this document or copies in Welsh and alternative formats (large print, audio and Braille) may be obtained free of charge from the above address. This document can also be accessed from HMRC's GOV.UK pages.

When responding please say if you are a business, individual or representative body. In the case of representative bodies please provide information on the number and nature of people you represent.

Confidentiality

Information provided in response to this consultation, including personal information, may be published or disclosed in accordance with the access to information regimes. These are primarily the Freedom of Information Act 2000 (FOIA), the Data Protection Act 2018, General Data Protection Regulation (GDPR) and the Environmental Information Regulations 2004.

If you want the information that you provide to be treated as confidential, please be aware that, under the FOIA, there is a statutory Code of Practice with which public authorities must comply and which deals with, amongst other things, obligations of confidence. In view of this it would be helpful if you could explain to us why you regard the information you have provided as confidential. If we receive a request for disclosure of the information we will take full account of your explanation, but we cannot give an assurance that confidentiality can be maintained in all circumstances. An automatic confidentiality disclaimer generated by your IT system will not, of itself, be regarded as binding on HM Revenue and Customs.

Consultation Privacy Notice

This notice sets out how we will use your personal data, and your rights. It is made under Articles 13 and/or 14 of the General Data Protection Regulation.

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The data

We will process the following personal data:

Name
Email address
Postal address
Phone number
Job title

Purpose

The purpose(s) for which we are processing your personal data is: *add the title of your consultation*

Legal basis of processing

The legal basis for processing your personal data is that the processing is necessary for the exercise of a function of a government department.

Recipients

Your personal data will be shared with HM Treasury.

Retention

Your personal data will be kept by us for six years and will then be deleted.

Your Rights

- You have the right to request information about how your personal data are processed, and to request a copy of that personal data.
- You have the right to request that any inaccuracies in your personal data are rectified without delay.
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- You have the right to request that your personal data are erased if there is no longer a justification for them to be processed.
- You have the right in certain circumstances (for example, where accuracy is contested) to request that the processing of your personal data is restricted.

Complaints

If you consider that your personal data has been misused or mishandled, you may make a complaint to the Information Commissioner, who is an independent regulator. The Information Commissioner can be contacted at:

Information Commissioner's Office
Wycliffe House
Water Lane
Wilmslow
Cheshire
SK9 5AF
0303 123 1113
casework@ico.org.uk

Any complaint to the Information Commissioner is without prejudice to your right to seek redress through the courts.

Contact details

The data controller for your personal data is HM Revenue and Customs. The contact details for the data controller are:

HMRC
100 Parliament Street
Westminster
London SW1A 2BQ

The contact details for HMRC's Data Protection Officer are:

The Data Protection Officer
HM Revenue and Customs
7th Floor, 10 South Colonnade
Canary Wharf, London E14 4PU
advice.dpa@hmrc.gov.uk

Consultation Principles

This call for evidence is being run in accordance with the government's Consultation Principles.

The Consultation Principles are available on the Cabinet Office website: http://www.cabinetoffice.gov.uk/resource-library/consultation-principles-guidance

If you have any comments or complaints about the consultation process please contact:

John Pay, Consultation Coordinator, Budget Team, HM Revenue and Customs, 100 Parliament Street, London, SW1A 2BQ.

Please do not send responses to the consultation to this address.

Annex A: Relevant Government Legislation

The ISA rules are set out in the Individual Savings Account Regulations 1998 (S.I. 1998/1870).

Regulation 2(1)(b) defines qualifying units in or shares of a non-UCITS retail scheme as:

> "(a) the instrument constituting the scheme secures that redemption of the units or shares in question shall take place no less frequently than bi-monthly (see Rule 6.2.16(6) of COLL omitting the words "Except where (7) applies, and", read with Rule 6.3.4(1), whether or not those Rules apply to the scheme), and
>
> (b) a provision for suspension of dealings in exceptional conditions in accordance with Rule 7.2 of COLL (or any foreign procedure which is a direct foreign equivalent of that Rule) shall not be treated as a provision contrary to paragraph (a) of this definition;"

Regulation 3 provides:

> "for the setting up of plans in the form of an account, by account managers approved by the Board, under which individuals may make certain investments, for the conditions under which they may invest and under which those accounts are to operate, for relief from tax in respect of account investments and generally for the administration of tax in relation to such accounts."

Regulation 4(6) provides (inter alia):

> "(f) that on the instructions of the account investor ("the transfer instructions") and within such time as is stipulated by the account investor in the transfer instructions -
>
> > (i) an account, with all rights and obligations of the parties to it, or
> >
> > (ii) such parts thereof as may be agreed between the account investor and the account manager,
>
> shall be transferred to another account manager subject to and in accordance with regulation 21 or 21B and, where it applies, regulation 21A;
>
> (fa) that on the instructions, subject to regulation 9(3)(b), of the account investor ("the withdrawal instructions") and within such time as is stipulated by the account investor in the withdrawal instructions, account investments, interest, dividends, rights or other proceeds in respect of such investments or any cash shall be transferred or paid to him or, where paragraph 6(12) of the Schedule applies, an eligible conveyancer;
>
> (g) that the account manager shall notify the account investor if by reason of any failure to satisfy the provisions of these Regulations an account is or will become no longer exempt from tax by virtue of regulation 22(1)."

Regulation 4(7) provides:

> “(7) The time stipulated in the transfer instructions or withdrawal instructions shall be subject to any reasonable business period of the account manager required for the practical implementation of the instructions, but such period—
>
> > (a) must not exceed 30 days; and
> >
> > (b) must be consistent with regulation 21A where it applies.
>
> Where the account is a Lifetime ISA and an amount is being withdrawn for the purpose of a first-time residential purchase by the account investor under paragraph 6 of the Schedule, the period of 30 days referred to in sub-paragraph (a) runs from the date on which the account manager receives the information from the account investor’s conveyancer in accordance with paragraph 8(2) and (3) of the Schedule.”

Regulation 4(8) provides:

> “(8) Where an account holds units in or shares of a UK UCITS, recognised UCITS or non-UCITS retail scheme, and dealings in the units or shares are suspended in accordance with Rule 7.2 of COLL, or any direct foreign equivalent of that Rule, the business period in paragraph (7) may be extended to 7 days after the end of such suspension.”

The Lifetime ISA rule are provided by the Savings (Government Contributions) Act 2017 and the ISA Regulations

Paragraph 7(1)(b) of Schedule 1 to the Act provides that a withdrawal charge does not apply:

> “(b) for the purposes of a first-time residential purchase being made by the investor”

Paragraph 6(14) of the Schedule to the ISA Regulations provides:

> “Where the account manager has received all of the information specified ……, the account manager must transfer the amount of the withdrawal to the account investor’s conveyancer within the period stipulated under regulation 4(7)”