AJ Bell policy paper:

# ISA Simplification – One ISA

## Introduction - Andy Bell BSc FIA, chief executive

People need to save more. This is an undisputed fact, as the emphasis for long term savings and care shifts from employers and the state to individuals. Yet the FCA's Financial Lives survey* shows that 71% of UK adults don't hold any type of investment product, over a quarter (26%) of UK adults have no savings or investment product at all and nearly half have savings or investments worth less than £10,000. Those relying wholly on cash savings are seeing inflation and low interest rates erode the purchasing power of this money.

This savings gap is one of the most serious problems modern society faces. As people live longer they can face a stark choice: save more today, work for longer, trust the state to support them in later life or suffer a significant drop in their standard of living.

Lack of understanding is one of the biggest barriers to saving and investing. Complexity and excess choice do not make understanding any easier. AJ Bell's core purpose is to help people invest and we do that by making it as easy as possible for them to do so. In trying to do this we constantly come up against unnecessary complexity in the rules governing long-term savings. This is caused by legislative changes year on year, leaving a legacy of long-term savings products that are hideously complicated to the point where many simply give up trying to understand them, let alone engage.

Individual Savings Accounts (ISAs) are a perfect example of this. The base concept is simple – a savings account in which people can hold cash or stocks and shares without having to pay tax on interest, dividends or capital gains.

This simplicity has resonated with customers. The latest ISA statistics from HMRC** show that 21.2 million adults hold £608 billion in ISAs. That is almost half the UK adult population, so this affects a huge proportion of our society. It is not just high earners – the median ISA holder by income has annual income of between £10,000 and £19,999.

The problem is that through multiple Government interventions we now have at least six variations of ISAs which all aim to cater for slightly different customer needs. Customers, and even their financial advisers, can struggle to work out which one is right in any given set of circumstances and too often this results in people doing nothing or making the wrong choice.

Pensions were simplified thirteen years ago. We are now in desperate need of ISA simplification.

Peter Hopkins, the architect at HMRC responsible for pension simplification, now works at AJ Bell as our technical director. In this paper he outlines our vision for a single ISA product and shows how all the existing variations can be merged into one easy to understand regime without any additional tax burden on the Exchequer.

## About the author

Peter Hopkins previously worked at both HM Revenue and Customs and the Department for Work and Pensions.

At HMRC he led the pension simplification project which resulted in the new pension rules that came into effect on A-day (6 April 2006) as well as major projects such as the tax regime for Stakeholder pensions and the introduction of real time reporting of PAYE (RTI).

*The financial lives of consumers across the UK: Key findings from the FCA's Financial Lives Survey 2017. Published 20 June 2018
**HMRC: Individual Savings Accounts (ISA) statistics. Published April 2019

# ISA Simplification – One ISA

## The objective

The ultimate objective of our One ISA vision is to encourage more people to save for their futures. However, as someone who has worked at both HMRC and DWP, I know that you have to consider not only the customer outcomes but also the impact any changes will have on Government finances and how easy it will be to make the necessary changes. So we therefore start with a three pronged objective:

1. Simplify ISAs into a single ISA product to encourage people to save more
2. Do it in a way that won't cost the Government more
3. Ensure an easy transition to a single ISA product

We believe that a radically simpler system with a single ISA product would be easier for customers to understand, easier for advisers to recommend and ultimately get ISAs back to what they originally were - a simple, tax efficient, long-term savings account.

## The problem

As Andy mentioned in his introduction, there is a savings gap in the UK and, left unchecked, that is only going to get worse. Demographics are not on our side. People are living longer but not necessarily staying healthier so long-term care is a growing problem.

At the same time, defined benefit company pensions are a thing of the past for most and although auto-enrolment has been successful in getting more people into the defined contribution pension system, the current contribution levels are unlikely to be enough for a comfortable retirement.

ISAs are the perfect product to complement pensions. In their traditional form, they don't cost the Government anything in up front incentives but for customers they offer a wide choice of investment options, are tax efficient and can be accessed immediately if required. They can also be used to incentivise and drive behaviour eg purchase of a first home.

That is why 46% of UK adults have an ISA, but this still means that 54% don't and only 17% have a Stocks and Shares ISA. This means that even the majority of people who have an ISA are in cash products that are likely to be going backwards in real terms once inflation bites – cash investments being a concern the FCA has recently identified in relation to pension savers in the de-cumulation phase.

The core ISA product is very simple. However, over the past decade or so we have seen a number of new iterations dreamt up by politicians looking for headlines.

The most recent of those, the George Osborne inspired Lifetime ISA, is a classic example of product over-engineering. Use it for house purchase (we already had a Help to Buy ISA) or use it for retirement (we already had pensions); use it for anything else and you get hit with a pernicious exit penalty.

It's too complicated.

## The solution

Having worked on pension simplification and changing PAYE, I know how daunting changing an established system can be. But we have the original template of a single ISA and I believe that the existing six-legged ISA regime can be rolled back into that.

What's more, I don't think it needs to cost the Government anything, although the final design and detail on how to transition may affect that, and all the current versions can be scrapped or rolled into the main ISA.

Let us first look at our proposed rules for the new One ISA regime, before considering how we can transition the six existing ISA products into the new regime.

## Key rules

| One ISA | |
|---|---|
| Annual ISA allowance | |
| • Under 18 | £4,368 or in-force JISA allowance at introduction if higher |
| • 18 or over | £20,000 or in-force ISA allowance at introduction if higher |
| Eligibility | • UK resident<br>• Can only subscribe to one ISA in any tax year<br>• Person with parental responsibility will be responsible for ISA for under 16s |
| Permitted investments | As for current Stocks and shares ISA |
| Tax treatment | No capital gains tax on realised gains or income tax on interest or dividends |
| Withdrawals | Permitted at any age, with no withdrawal penalty |
| Transfers | Full and partial transfers allowed |
| Bonus | See below |

The above proposals in the main maintain the status quo of the existing ISA regime. Detailed consideration needs to be given to the government incentive, or ISA bonus.

Currently the Government offers a bonus to people saving for a first home via the Lifetime ISA but this could be extended to other important purposes.

We propose that the bonus is calculated as 25% of the ISA funds used for the specified purpose, with a maximum of £1,000 for each "subscription year". The bonus would be paid at the point of using the ISA funds for the specified purpose eg for first house purchase, at the point of exchange of contracts.

Whilst further consultation on this point would be required, we propose that an ISA subscription year is defined as a tax year where:

- The ISA member is over age 18 and under 50 at the start of the tax year
- The ISA subscriptions paid by an individual in that tax year exceeds their withdrawals by more than say £1,000

Tax years before the introduction of the One ISA regime will not count, but credit or debit subscription years may be added or taken away to deal with transitional issues - see Lifetime ISA and Help to Buy ISA below.

Note, imposing a net minimum subscription amount each tax year is required to stop people paying a nominal subscription or recycling subscriptions in order to lock in the subscription years for future usage.

If the One ISA becomes the primary mechanism of saving then the Government can use the bonus incentive to influence and encourage certain behaviours. New bonus rules could be introduced tailored to the behaviour being incentivised, but this would not significantly impact on the administration of the ISA under the One ISA regime. House buying is already catered for. Other behaviours the Government may wish to encourage using ISA bonuses could be repayment of student loans, specific vocations, patient capital or long-term care. These could all be nudged by offering an incentive at the point of usage of ISA funds for a specified purpose.

Any Government incentives would be paid by the Government, through the ISA manager to augment the savings by the ISA customer for the purpose being incentivised at the point it is required.

With this structure in place, any Government incentive could then be linked to subscription years, the amount of savings and age which would allow better targeting than currently.

Let us now consider how we can transition each of the current six ISAs into the One ISA regime.

# Transition considerations

## Stocks and shares ISA

This would form the basis for the new One ISA regime, so no change would be required.

## Cash ISA

This would be merged into the new One ISA regime with no change. ISA managers can simply choose to restrict the investments permitted within their ISA to cash.

## Lifetime ISA

This should be merged into the main ISA by focusing it solely on the primary reason it was created – to help people save for their first home. Promoting the Lifetime ISA as a pension alternative has confused would-be savers. The Government bonus should remain in place for people buying their first home and that bonus should be paid at the point someone exchanges contracts on their first property.

The simplest way to achieve this would be to add a 25% bonus to the ISA withdrawal that is used to assist with buying a first home. To ensure the maximum cost of the bonus to the Government is the same as it is today, it should be capped at £1,000 per ISA subscription year between the ages of 18 and 50. This means the maximum bonus someone can receive for house purchase remains at £32,000.

Existing LISA funds, including bonuses, would move into the One ISA regime but each year that a bonus has already been received and not used would reduce the number of ISA subscription years available to that customer.

The point here being that Government wants to help first time buyers. If someone has saved £30,000 in an ISA then the point of help is at the start of the property purchase. The initial reason they started saving is not really an issue.

We accept that these proposals would mean that people who have already received bonuses would be able to withdraw them without penalty. However, our view is that these people are genuinely saving for a house and most will continue to do so. If a small number withdraw the funds for another reason, it wouldn't cost the Government in real terms and is a small price to pay for the wider benefits of simplification.

## Help to Buy ISA

This is already due to cease to new applications on 30 November 2019. To avoid creating a legacy product, existing Help to Buy ISAs would be transferred into the new One ISA regime where they would be eligible for the Government bonus for house purchase as per the above proposal.

We would propose that each year of contributing to a Help to Buy ISA would count as an ISA subscription year for the purposes of working out the ISA Bonus.

## Junior ISA

This should be abolished as a stand-alone product. The ISA allowance and restrictions on withdrawals for someone under age 18 would broadly remain as they are today. When they turn 18, they would become entitled to the full £20,000 annual allowance, including and not in addition to the JISA allowance as under the existing regime – someone turning 18 in a tax year can pay a total of £24,368 into an ISA.

This would also remove the inconsistency whereby people aged 16 and 17 can subscribe to a JISA and Cash ISA at the same time. The general principles underpinning the JISA regime eg Parent or guardian being responsible for the ISA until the child comes of age would continue under the One ISA regime.

## Innovative Finance ISA

This inappropriately named ISA should be abolished to protect consumers. The collapse of peer-to-peer lender Lendy and mini-bond provider London & Capital Finance has shown the Innovative Finance ISA can be used by poorly run companies to entice ordinary savers into products that are higher risk than they are marketed as and offer no protection from the FSCS.

This is the one area where the Government may choose to continue with a legacy product, closed to new subscriptions and to new accounts being established. No new investments into P2P loans should be allowed. The alternative would be to force, over a reasonable period of time, the P2P loans within Innovative Finance ISAs to be repaid and the cash proceeds be transferred into an ISA in the One ISA regime.

### One single ISA

This would leave one ISA that can be invested in cash or stocks and shares, or a combination of both. Any remaining differences in ISA regulations or HMRC guidance between cash ISAs and stocks and shares ISAs should be removed.

We would recommend that this simplification process be used to consult on other rules that could be changed, some suggestions as follows:

- The Flexible ISA rules where people can make withdrawals and pay them back into an ISA in a tax year without affecting their ISA allowance. There is little demand for this and hence it is not offered by many ISA managers. It is an unnecessary complication.
- The additional permitted subscription for surviving spouses or civil partners on death. This is unnecessarily complicated. ISAs should be able to be passed simply to spouses or civil partners on death within the One ISA regime.

## Conclusion

We recognise some regulatory alignment may be required as part of this proposed simplification process but we believe these changes would be relatively easy to implement and would get strong support from customers, advisers and ISA managers alike.

There would be no additional cost to the Government, if anything the removal of the double allowance for 16 and 17 year olds, the Innovative Finance ISA and the Flexible ISA rules would be beneficial to the Exchequer.

Most importantly it would get us back to an easy to understand ISA product, which people are more likely to engage with and hence save more.

AJ Bell wholeheartedly supports these proposed changes and is willing to invest as much time and resource as the Government, HMRC and the FCA require to explore the opportunities that these proposals present.

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