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Dear HM Treasury colleagues,

Individual Savings Account: UK ISA Consultation

We welcome the opportunity to respond to your consultation on Individual Savings Account: UK ISA.

The Quoted Companies Alliance *Primary Markets, Secondary Markets, Tax,* and *Share Schemes Expert Groups* and *Investor Working Group* have examined the proposals and advised on this response from the viewpoint of small and mid-sized quoted companies. A list of Expert Group members can be found in Appendix A.

We broadly welcome the Treasury's proposals to introduce a UK ISA. The creation of a tax-free allowance for investing in British equities provides an opportunity for restoring the social contract between domestic investors and companies that was first conceived in 1986 by the Personal Equity Plan (PEP)[1]. We believe that the central tenet of this social contract must now be revived: a tax break that benefits UK individuals should contribute to supporting UK businesses.

The proposed creation of a UK ISA comes at a time of alarming levels of delistings on the UK's exchanges, a significant causal factor being recent high levels of domestic capital flowing out of UK equities[2].At the QCA, we have welcomed the broader changes to the UK's public market infrastructure that are currently taking place. We believe that reforms relating to the Primary Markets Effectiveness Review and changes to Prospectus Rules, when implemented, will have a meaningful impact on the accessibility of the UK's public markets and the supply of companies choosing to list and/or remain in the UK.

However, unless these companies have access to the funding they need to scale-up and grow, the UK risks losing them to its international competitors. The UK ISA, alongside other reforms to DC Pension schemes under the Mansion House Compact, have the potential to create the deeper pools of capital that the UK requires and should make a significant contribution to reversing the declining numbers of companies that

[1] A forerunner to the ISA, the PEP initially set aside a minimum of 50% to be held in UK assets.
[2] New Financial. *UK Capital Markets - A new sense of urgency: Analysis of the 'parallel crisis' in UK pensions and capital markets – and how to address it.* (2023).

choose to list and/or remain listed in the UK. Further, the UK ISA should reconnect domestic investors with local companies, foster a share-owning culture and crowd-in further investment.

We previously argued for a more extensive allocation of capital to be held in UK assets than the one being proposed in this consultation on the grounds that this would stimulate greater inward investment in domestic stocks. We highlighted our preference for a higher allocation of 50% of the total £20,000 allowance to be held in British assets[3]. We still believe that, alongside the additional £5,000 allowance, there is merit in considering a higher allowance to be directed to UK equities.

However, overall, we regard this proposal as a positive step as it has the potential to provide a much-needed funding boost for UK companies. For example, estimates show that if half of the 802,000 individuals who maxed out their stocks and shares ISA in 2022 invested a further £5,000, this would result in an extra £2bn in capital per annum into UK equities[4].

Regarding the design of the UK ISA, the Treasury ought to consider the simplicity of the scheme as well as the speed of its implementation if this consultation's stated aim of "increasing the capital available for UK businesses and to support the competitiveness of UK equity capital markets" is to be achieved:

1) **Simplicity**

These changes must be straightforward to implement and monitor, in addition to providing simplicity for individual investors to ensure take-up is high. We support the consultation's proposal that the UK ISA covers UK incorporated companies that are either listed on a UK recognised stock exchange or admitted to trading on a UK recognised stock exchange. While in some cases this may result in capital being diverted to companies with little to no business activity in the UK, we believe that the benefits of applying a more simplistic definition, which should reduce complexity and delays in implementation, outweigh the potential downsides of this proposal.

In addition, the government should aim for a recognised and readily accepted definition for the geographic criteria used for determining investment vehicle eligibility. We opt for the Investment Association's UK All Companies Fund as the most appropriate measurement for deciding which funds meet the requirement of investing in UK stocks. This proposal should ensure greater ease for monitoring by ISA managers.

Furthermore, while we recognise that this is not the focus of this consultation, we would argue for broader simplification to take place across the ISA regime, specifically, the merging of the Stocks and Shares ISA and Cash ISAs. A reduced number of ISAs would simplify the ISA offering for consumers and should improve take-up of the UK ISA.

2) **Implementation period**

Arresting the declining numbers of companies listed on the UK's markets and redirecting capital flows into British stocks requires urgent action. As such, the new UK ISA should be implemented as soon as practicable.

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[3] For example, estimates show that increasing the threshold for new ISA subscriptions to be invested in UK equities to 50% would contribute an additional £7.2bn in capital inflows to that asset class.
Source: New Financial. *A £10bn shot in the arm for UK equity markets: How ISAs could help kickstart a recovery in UK Capital markets*. (2023). p.5.

[4] New Financial. *A £10bn shot in the arm for UK equity markets: How ISAs could help kickstart a recovery in UK Capital markets.* (2023). p.5.

We recommend that the UK ISA be introduced by the end of 2024 or, at the latest, in time for the start of the ISA season in February 2025.

If you would like to discuss our response in more detail, please do not hesitate to contact us.

Yours sincerely,

James Ashton
Chief Executive

Q1. Should ordinary shares in UK incorporated companies that are either listed on a UK recognised stock exchange or admitted to trading on UK recognised stock exchange be eligible for the UK ISA?

We agree with the consultation's definition of eligibility for the UK ISA. We are aware that putting in place additional requirements would create complexity for the UK ISA and that 'vetting' of eligibility would be potentially burdensome and cause delays. There are shortcomings in applying such a simplistic determination (as noted by the consultation itself), that many companies are incorporated in the UK and listed here, with little or no operational activity within the UK. However, the benefit of also potentially promoting the UK as a listing venue may well outweigh this simplification.

We would not advocate companies having to go through an eligibility process (as would be the case with VCT and EIS), and consequently a simple determination that can be readily assessed should be used.

Q2. Should collective investment vehicles be eligible for the UK ISA and if so, which vehicles specifically? What should be the minimum requirement for each of the underlying investments and how would each be monitored by ISA managers?

Yes – if they are investing in eligible securities. Specifically, we recommend the inclusion of investment funds which fall within the Investment Association's UK All Companies Fund. The IA's UK All Companies Fund is a recognised sector definition used to track investments in UK assets and covers funds which invest at least 80% of their assets in UK equities.

We believe that the UK All Companies Fund provides a ready-made definition that would reduce complexity in establishing eligibility for the UK ISA. ISA managers could track this measurement quarterly to ensure eligibility among investment funds.

Q3. Should corporate bonds be eligible for the UK ISA?

Overall, we believe that corporate bonds should not be eligible for the UK ISA. In general, it is our view that the UK ISA should not include investment in interest bearing instruments. The primary policy objective of the UK ISA product should be to generate equity investment instead of debt financing. Moreover, allowing investments exclusively in equity provides a straightforward and easy-to-understand offering that we believe will encourage greater take-up among investors.

However, it is important to note that not all QCA members were in agreement with this view and some felt that corporate bonds should be eligible if the bond instrument is itself listed/quoted on an eligible stock exchange.

Q4. Should gilts be eligible for the UK ISA?

No – the government has alternatives to promote investments and the ISA wrapper for gilts is sufficient.

Q5. Are there other investments that already qualify for an ISA that should be eligible for the UK ISA? How would they meet the policy objectives?

No – as stated previously, we believe the UK ISA should be reserved solely for equities. This is in line with the UK ISA's policy objectives to support the competitiveness of the UK's equity capital markets and giving people the opportunity to invest and benefit from the UK's capital markets and high growth companies. Furthermore, it enhances the simplicity of the product by focusing exclusively on equities.

We would also like to highlight that ETFs which are currently eligible for an ISA, as passive investments that track international markets, form part of the problem the UK ISA is attempting to solve: increasing investment in UK equities and encouraging a culture of share ownership. While an ETF that tracks the UK market would, in a limited sense, fulfil the Treasury's policy objectives, we believe that limiting eligibility to direct investment in equities is a far more effective mechanism for achieving those policy objectives.

Q6. Should the UK ISA allow subscriptions to multiple UK ISAs in the same tax year?

Yes – this principle should carry across to the UK ISA as with other ISAs. However, it is important that this does not add to the complexity of the system and will depend on the ability of industry to implement measures for this to take place.

Q7. Should transfers from any type of ISA to a UK ISA be allowed? Should there be a limit on transfers from other types of ISAs to a UK ISA?

We agree that transfers in should be allowed, provided the eligibility criteria is met. This would benefit consumers who may look to consolidate a holding in a security for management purposes (where they accumulate an interest in both a UK ISA and a normal ISA). In addition, it will reduce friction in getting additional funds into the UK ISA.

Q8. Are there any downsides to the government's proposals on transfers out of a UK ISA?

We advise against enabling individuals to extract money once they have made a UK ISA investment. This is to ensure that individuals are unable to benefit from the additional allocation and then transfer funds out. While there is potential that the UK ISA is seen as being restrictive if there is no ability to transfer out, we believe that in order to meet the government's policy objectives, transfers out should not be allowed. In addition, as long as there is an ability to transfer securities into a UK ISA for management purposes, this would limit the downsides of not permitting transfers out.

Q9. Should the UK ISA have cash holding rules? Which rules should be included in the UK ISA?

We do not agree that there should be cash holding rules as these would limit flexibility and disincentivise individuals from using the UK ISA. In conjunction with restrictions on moving funds out of the UK ISA, penalisation of cash holdings within the UK ISA could have a detrimental impact on their use and take-up.

However, we do agree with the government's proposals that individuals should be prevented from investing in interest bearing instruments in order to ensure that returns are not made from holding cash in the UK ISA wrapper. We believe that this strikes the right balance between encouraging money held in the UK ISA to be productively invested while not directly penalising individuals for holding cash.

Q10. Are there any other design features that the government should consider at this stage?

We provide two recommendations related to transferring employee share schemes into the UK ISA that the government ought to consider as well as our position on the possibility of extending the Inheritance Tax exemption to the UK ISA.

<u>Transfer of employee share schemes</u>

One feature of the current stocks and shares ISA is linked to transferring shares from tax-advantaged (Share Incentive Plan) SIP and (Save As You Earn) SAYE plans to an ISA. If employees transfer shares to an ISA within 90 days of taking those shares out of the SIP or SAYE plan, they do not have to pay Capital Gains Tax on any gains on those shares. The government should consider extending this benefit to the UK ISA. A number of our members are UK companies offering their employees SIP or SAYE plans and can see the benefit of this in encouraging employees to hold their company's shares.

A further point to consider with regard to employee share schemes would be to allow individuals to transfer shares acquired from a Company Share Option Plan (CSOP) or Enterprise Management Incentive (EMI) scheme into the UK ISA without triggering a tax charge, as is currently possible for the SIP and SAYE schemes.

Inheritance Tax exemption

It has been argued that extending Business Relief on Inheritance Tax (IHT) to the UK ISA would encourage further take-up. However, we would caution against this proposal. It is important that the new UK ISA wrapper is simple to understand and implement. Placing an additional IHT exemption risks complicating the offer.

Given the scrutiny IHT often receives within the public and political domains, it could also become an unnecessary cause of friction for what is undoubtedly a socially and economically beneficial proposal, and one that should garner widespread public and political support.

Finally, making the UK ISA IHT exempt risks diluting the benefits that AIM companies currently enjoy. Business Relief on IHT has been a vital part of AIM's success and has, in large part, been responsible for supporting high growth companies on the market in their search for capital and long-term investment.

Q11. Are there any other unintended consequences from this approach?

Below, we provide our responses to a number of possible concerns surrounding the implementation of the UK ISA. In particular, concerns relating to its cost, and asset diversification. We also provide our suggested timeline for implementation.

Cost of implementation

Regarding the cost to the Treasury in terms of tax revenue, it is estimated that this would amount to around £50million[5]. Given the importance of UK equities and the broader public market infrastructure to the UK economy and the potential boost these changes could generate in terms of economic growth and increased tax receipts, the cost of this proposal is therefore minimal. Furthermore, it can be argued that raising the allowance to £25,000 is overdue given that it has not changed since 2018.

In addition, we believe that the potential, albeit slight, disruption that implementing the UK ISA may have for the operating platforms will be significantly outweighed by the benefits that the UK ISA should provide in terms of helping reinvigorate domestic stocks, raising valuations and increasing liquidity.

Finally, it is important to highlight the broader socio-economic benefits of this proposal. The UK ISA will contribute to reconstructing a pool of investors focused on UK equities, reconnect domestic investors with

[5] Peel Hunt. *The UK ISA: How to turbocharge the UK capital markets (response to HM Treasury Consultation).* (2024). p.7.

local companies, increase retail investment, boost market sentiment, and encourage broader engagement in the UK's equity markets.

Diversification

We believe that concerns around the risks associated with the UK ISA resulting in insufficient asset diversification to be overstated. Undoubtedly, it would restrict options within the £5,000 additional allocation. Nevertheless, it is important to recognise that this allocation would still include a wide geographic exposure give the breadth of UK listed companies, alongside the sheer quantity of these companies with around 1,300 companies listed in the UK that would be eligible for the UK ISA.

Furthermore, around 70% of the UK workforce has a pension that offers significant investment diversification according to geography and asset class[6]. Indeed, pension funds and insurance firms only invest around 4% in UK equities[7]. Given that ISAs are a discretionary investment, we believe that it is fair that an additional tax benefit should go towards benefiting UK equities. The introduction of a UK ISA would not preclude individuals from investing in equities listed outside of the UK, they would simply be unable to benefit from the tax break offered by the UK ISA when doing so.

Implementation period

Given the current pace of delistings on the UK's public markets and the well-documented outflows of capital[8], it is imperative that these changes are implemented as quickly as feasible. We recommend that the UK ISA be introduced by the end of 2024. At the latest, it should be operational in time for the start of the ISA season in February 2025.

Q12. Would you be interested in offering a UK ISA based on the design set out in chapter 2 and 3?

We have no comments.

Q13. How long would it take for you to launch a UK ISA product and when would you start building it following this announcement?

We have no comments.

Q14. What would the cost implications be and what operational changes would you need to undertake?

We have no comments.

Q15. What, if any, issues do you foresee from a compliance perspective for the UK ISA? Please provide details.

We have no comments.

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[6] New Financial. *A £10bn shot in the arm for UK equity markets: How ISAs could help kickstart a recovery in UK Capital markets*. (2023). p.6.
[7] Peel Hunt. Report - *The UK ISA: How to turbocharge the UK capital markets*. (2024). p.2.
[8] According to the Investment Association, in 2023, UK equities suffered £14bn in outflows in what was the eighth consecutive year of outflows. *Press release: UK households feel the squeeze as £24.3bn taken from investment funds in 2023.* (2024): https://www.theia.org/news/press-releases/uk-households-feel-squeeze-ps243-billion-taken-investment-funds-2023

Appendix A

The Quoted Companies Alliance *Primary Markets Expert Group*

Samantha Harrison (Chair)	**Grant Thornton UK LLP**
Colin Aaronson	Grant Thornton UK LLP
Stuart Andrews	Zeus Capital
Mark Brady	Spark Advisory Partners Limited
Andrew Buchanan	Peel Hunt LLP
David Coffman	Novum Securities Limited
Richard Crawley	Liberum Capital Ltd
Dru Danford	Liberum Capital Ltd
David Foreman	Zeus Capital
Chris Hardie	W.H. Ireland Group PLC
Stephen Keys	Cavendish
Nick McCarthy	Shoosmiths LLP
Katy Mitchell	WH Ireland Limited
Hayley Mullens	Radnor Capital Partners Limited
Nick Naylor	Allenby Capital
Claire Noyce	Hybridan LLP
Jeremy Osler	Cavendish
Niall Pearson	Hybridan LLP
Mark Percy	Shore Capital Group Ltd
Oliver Pilkington	Shoosmiths LLP
George Sellar	Peel Hunt LLP
James Spinney	Strand Hanson

The Quoted Companies Alliance *Secondary Markets Expert Group*

Amber Wood (Chair)	**Liberum Capital Ltd**
Jasper Berry	Cavendish
Andrew Collins	Charles Russell Speechlys LLP
Sunil Dhall	Peel Hunt LLP
Nick Dilworth	Winterflood Securities Ltd
Fraser Elms	Herald Investment Management Ltd
Richard Fenner	Euroclear UK & International
William Garner	Charles Russell Speechlys LLP
Jon Gerty	Peel Hunt LLP
Alex Giacopazzi	Winterflood Securities Ltd
Mitchell Gibb	Stifel
Keith Hiscock	Hardman & Co

Niall Pearson	Hybridan LLP
Jeremy Phillips	Cameron McKenna Nabarro Olswang LLP
Katie Potts	Herald Investment Management Ltd
Chris Robinson	Peel Hunt LLP
Stephen Streater	Blackbird Plc
Peter Swabey	C/o The Chartered Governance Institute

The Quoted Companies Alliance *Share Schemes Expert Group*

Fiona Bell (Chair)	**RSM UK Group LLP**
Jennifer Rudman (Deputy Chair)	**Equiniti**
Simon Allum	LexisNexis
Chris Barnes	KPMG LLP
Danny Blum	Eversheds Sutherland
Ian Brown	Slaughter and May
Michael Carter	Osborne Clarke
Stephen Diosi	Mishcon De Reya
JD Ghosh	MM & K Limited
Andy Goodman	BDO LLP
Elissavet Grout	Travers Smith LLP
Caroline Harwood	BDO LLP
Helen Hopkins	Link Group Service Company Limited
Stuart James	MM & K Limited
Graham Muir	CMS
Isabel Pooley	Grant Thornton UK LLP
Ian Shaw	Korn Ferry
Nicholas Stretch	Stephenson Harwood

The Quoted Companies Alliance *Tax Expert Group*

Zoe Andrews	Slaughter and May
Colin Askew	Eversheds Sutherland
Edward Brown	Grant Thornton LLP
Matthew Creevy	KPMG
Elissavet Grout	Travers Smith LLP
Madeline Gowlett	Travers Smith LLP
Caroline Harwood	BDO LLP
Liz Hunter	Mishcon de Reya LLP
Emma Locken	Crowe LLP
Ian Shaw	Korn Ferry
Tom Wilde	Shoosmiths

The Quoted Companies Alliance *Investor Working Group*

Paul Stevens (Chair)	**Business Growth Fund (BGF)**
Fraser Elms	Herald Investment Management Ltd
James Goodman	Schroders Investment Plc
Judith Mackenzie	Downing LLP
Katie Potts	Herald Investment Management Ltd
Richard Power	Octopus Investments
Eustace Santa Barbara	Canaccord Genuity
Gervais Williams	Premier Miton Group Plc