



ISA QUALIFYING INVESTMENTS: CONSULTATION ON WHETHER TO INCLUDE INVESTMENT BASED CROWDFUNDING

ICAEW welcomes the opportunity to comment on *ISA Qualifying investments: consultation on whether to include investment based crowdfunding* published by HM Treasury on 8 July 2015, a copy of which is available from this [link](#).

This response of 30 September 2015 has been prepared on behalf of ICAEW by the Corporate Finance Faculty, the Financial Services Faculty and the Tax Faculty.

Recognised internationally as a source of expertise on corporate finance issues and for its monthly *Corporate Financier* magazine, the Corporate Finance Faculty is responsible for ICAEW policy on corporate finance issues including submissions to consultations. The Faculty's membership is drawn from professional services groups, advisory firms, companies, banks, private equity, law firms, consultants, academics and brokers.

As a leading centre for thought leadership on financial services, the Financial Services Faculty brings together different interests and is responsible for representations on behalf of ICAEW on governance, regulation, risk management, auditing and reporting issues facing the financial services sector. The Faculty draws on the expertise of its members and more than 25,000 ICAEW members involved in financial services.

Internationally recognised as a source of expertise, the Tax Faculty is a leading authority on taxation. It is responsible for making submissions to tax authorities on behalf of ICAEW and does this with support from over 130 volunteers, many of whom are well-known names in the tax world.

ICAEW is a world-leading professional accountancy body. We operate under a Royal Charter, working in the public interest. ICAEW's regulation of its members, in particular its responsibilities in respect of auditors, is overseen by the UK Financial Reporting Council. We provide leadership and practical support to over 144,000 member chartered accountants in more than 160 countries, working with governments, regulators and industry in order to ensure that the highest standards are maintained.

ICAEW members operate across a wide range of areas in business, practice and the public sector. They provide financial expertise and guidance based on the highest professional, technical and ethical standards. They are trained to provide clarity and apply rigour, and so help create long-term sustainable economic value.

Copyright © ICAEW 2015
All rights reserved.

This document may be reproduced without specific permission, in whole or part, free of charge and in any format or medium, subject to the conditions that:

- it is appropriately attributed, replicated accurately and is not used in a misleading context;
- the source of the extract or document is acknowledged and the title and ICAEW reference number are quoted.

Where third-party copyright material has been identified application for permission must be made to the copyright holder.

For more information, please contact representations@icaew.com

icaew.com

MAJOR POINTS

Reservations about the proposals

1. We do not support the proposal to include investment-based crowdfunding in the list of qualifying investments for ISAs. At best this proposal is premature while at worst we consider it to be at odds with government policy of encouraging responsible retail savings and investments.
2. The investment-based crowdfunding market involves high risk investments where capital losses are likely to be commonplace and speculative gains hyped. The current ISA regime can provide a suitable home for retail investors' savings and, within the regime, there are funds that invest in smaller, riskier companies. If the ISA regime becomes an outlet to satisfy the chase for yield in a low return environment, this risks leading retail investors into inappropriate decisions.
3. The ISA regime was implemented to provide tax-efficient savings vehicles for the general public. It should not be seen as a source of early stage funding. There are tax-advantaged schemes such as the Enterprise Investment Scheme /Venture Capital Trust (EIS/VCT) regimes that do this successfully for those with expertise and ability to risk capital by investing in appropriate vehicles. If it is desired to use tax advantages to encourage equity crowdsourcing via properly regulated platforms, we would suggest it would be better to keep within the existing EIS environment. Indeed, more could be done to encourage companies to apply for this status by removing complexity in the EIS/VCT legislation and encouraging early professional advice including on a business's capital structure.
4. The proposal to waive general ISA conditions such as liquidation and withdrawal is, in our view, unjustifiable, and not consistent with the approach recently taken towards AIM shares. In April 2016, peer-to-peer (P2P) loans will be eligible to be held in Innovative Finance ISAs. There is an opportunity to evaluate the effects of that policy before designating investment-based crowdfunding as an ISA-eligible asset class; specifically, the implications of not requiring the existence of a secondary market or other liquidity mechanism and of not requiring P2P loans held within ISAs to be transferable. Evaluation should also incorporate monitoring of investor take-up and of the volume and quality of applications for ISA fund manager status.
5. The investment-based crowdfunding market is not mature and the FCA's associated regulatory framework has not yet been subject to a full post-implementation review. Significant changes, for example to increase consumer protection, cannot be ruled out. In the circumstances, we do not believe there is a compelling case for the proposals.

RESPONSES TO SPECIFIC QUESTIONS

Q1: Do you agree with the proposed principles for assessing whether to extend ISAs to equity and debt securities offered via a crowdfunding platform? Please provide any comments as appropriate.

6. We agree with the government's approach to consider the case for including crowdfunded investments against the core principles that existing ISA-eligible assets must satisfy. We set out below observations in relation to each of those principles:
7. **Principle 1 Consistent with the ISA's reputation as a trusted savings brand.** We would question whether equity- and debt-based crowdfunding investments can, at present, claim to reflect the 'trusted, flexible and appropriately-regulated' label. Higher risk investments are more akin to the concept of delivering alpha / incremental returns, rather than a relatively safe return on, or diversification of, savings. Take-up is relatively small (£84million at the end of 2014, according to [NESTA](#)) and the FCA's associated regulatory framework will not be subject to a full post-implementation review until 2016. In this context crowdfunding investments cannot be considered to reflect the 'trusted savings brand' for the retail market.

Principle 2 Protects the consumer. This requires that providers are transparent and that the market or regulator provide a regime that encourages competition and prevents abuse. In its [review](#) of investment-based platforms against the financial promotions rules and the requirement to be fair, clear and not misleading, the FCA stated that it ‘identified problems with most of the websites in the review’ (paragraph 54). This may be a function of an immature market with a large proportion of newly-authorized players. In the proposals there is no mention of the requirement/need for suitable understanding and accessible high quality financial advice. The immaturity of the sector also means that market players will not have developed sufficient expertise to advise individuals who do not satisfy the sophisticated or high net worth criteria. We note that AIM shares were included as ISA-eligible assets more than 15 years after ISAs were conceived.

8. **Principle 3 Supports a sustainable tax system.** This principle provides that ISA-eligible assets should not create substantial new opportunities for tax avoidance. According to the above FCA review, in 2014 almost 95% of the equity-based crowdfunded deals were eligible for the Enterprise Investment Scheme (EIS) or Seed EIS (SEIS) schemes. ISA eligibility status would give additional tax reliefs and, if granted across the board, on investments in sectors that are not considered eligible for EIS and SEIS tax relief. We would question the absence of an impact analysis and of commentary on the impact on state aid rules.
9. **Principle 4 Simple to administer.** This will depend on the requirements and costs to platforms of setting up and operating as ISA managers. It would be sensible to monitor the extent of ISA managers offering P2P loans alongside other ISA investments and of P2P platforms seeking authorisation to act as ISA managers.

Q2: Specifically, could respondents provide views on the key characteristics of:

- **Crowdfunding platforms;**
 - **Debt-based securities offered via a crowdfunding platform;**
 - **Equity-based securities offered via a crowdfunding platform.**
10. As an innovative source of finance, there is a range of business models operated by regulated crowdfunding platforms. Common features include:
- most are sophisticated electronic investment platforms joining businesses with funders and taking a proportion of funds raised as a fee; and
 - most websites are detailed and provide warnings about investments, with respect to the high likelihood of losing money.
11. We would also comment that there appears to be substantial ‘informal’ unregulated crowdfunding, not operating through regulated platforms, sometimes more along the lines of ‘donations’ rather than ‘investments’. This is even less suitable for use of ISA funds.
12. Features of debt-based securities offered by crowdfunding:
- mini bonds and convertibles provide a regular yield and some events of default;
 - there is some ability to request early repayment;
 - debt-based securities are normally unsecured, non-convertible and non-transferable; they are normally repaid (or not) after 4 or 5 years; and
 - statistics on default rates or other information on creditworthiness are not reliable.
13. Features of equity-based securities offered by crowdfunding:
- Shares are held either directly by the funder or via a limited partner (nominee structure).

- Convertibles are sometimes offered; subscribing for shares at a valuation which can be converted into a different class of shares with a higher return on capital usually on the next funding round.
- Platforms differ with respect to the extent to which they are involved in the lifecycle of the investment (some are not involved at all and are purely transactional). The amount of information provided to investors through their investment therefore varies.
- Investor protections vary considerably between platforms. Some offer a legal framework for the investment in the form of a subscription/investment agreement but the terms are basic, whilst others do not, and rely on protections set out in the company's Articles of Association. A few platforms offer multiple classes of shares with differing levels of protection. The City Code does not usually apply (unless the company is registered as a PLC).
- There is little or no commercial assessment of an opportunity provided to the investor and often the valuation of a business is set by the company (sometimes 'sense-checked' by the crowdfunding platform). There may be an absence of information about the valuation of shares previously issued to company insiders.
- Some require a minimum investment from angel investors before opening to 'the crowd' and these are set apart from others especially in terms of the financial and commercial assessment of opportunities.

14. Various business models of investment-based crowdfunding are also described in the [*Opinion Investment-based crowdfunding*](#), published by the European Securities and Markets Authority (ESMA) in December 2014.

Q3: Do:

- **debt-based securities; and**
- **equity-based securities**

offered via a crowdfunding platform meet the 'protect the consumer' principle? Would any additional safeguards be required if these securities become eligible for ISA? Please explain your answer.

15. Concerns as to whether debt-based securities meet the 'protect the consumer' principle arise from the following:

- Inability to transfer and only repayable after a period of time. The consumer (investor) has no control over this unlike quoted stock which can be liquidated immediately.
- Mini bonds are unsecured and so have no certainty of being repaid the capital invested or the yield if the company has no cash.
- Absence of standard terms.

16. Concerns as to whether equity-based securities meet the 'protect the consumer' principle arise from the following:

- Even more illiquid in a private company; limitations within the articles of association such as the ability to sell at any time subject only to any pre-emption; directors' right to refuse transfer provisions.
- Absence of standard terms for shareholder rights.
- Absence of City Code protections.
- Valuation at time of sale – determined between vendor and purchaser or as decided by the board?
- How is the value of the investment to be tracked? Will it be based on available financial information? How will an ISA manager be able to assess this and advise?
- The investment could be diluted by a further funding round.
- One or two secondary market platforms are in development although given the immaturity, have yet to be proven.

17. We note certain other considerations regarding the 'protect the consumer' principle. For example, to be ISA qualifying, could an investor insist their securities could be transferred to another ISA qualifying manager and would a private company agree to this?
18. Additionally, there is no advice given to investors in terms of financial, commercial or legal advice with regard to the proposed investment. If this is a proposal to encourage a different set of investors save via ISAs without necessarily having access to appropriate financial advice, which most people do not have, the risk of people not understanding what they are investing in, must be very high.

Q4: How far are:

- **debt-based securities; and**
- **equity-based securities**

offered via a crowdfunding platform already subject to the safeguards set out above? Please explain your answer.

19. We consider that, due to the infancy of the market and the associated regulation and the wide range of business models, there are uncertainties surrounding safeguards such as:
- transparency and genuine investments;
 - limited scope for value manipulation and tax avoidance;
 - provisions for disclosure of material transactions; and
 - rules regarding related-party transactions.

Q5: What additional safeguards, if any, would be needed to ensure that debt and equity securities offered via a crowdfunding platform are not susceptible to tax avoidance if made eligible for ISA?

20. At present we consider that debt and equity securities offered via a crowdfunding platform would be unsuitable underlying assets for ISAs, irrespective of existing or possible safeguards for preventing tax avoidance.
21. We also believe that the regulatory environment should be allowed to evolve and to address market changes. It could then be reassessed in a few years' time to establish what safeguards might be appropriate, if there becomes a case for extending ISAs to equity offered via crowdfunding platforms.

Q6: Are there types of debt security offered via a crowdfunding platform that respondents believe will not be covered by the Personal Savings Allowance? Please provide examples.

22. We have no comment.

Q7: Do respondents feel there is a compelling case for extending ISAs to equity offered via a crowdfunding platform in addition to existing tax reliefs?

23. No.