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Response to HM Treasury's 'ISA qualifying investments: consultation on including shares traded on small and medium-sized enterprise equity markets'

Dear Sirs,

Our submission in response to HM Treasury's consultation on "ISA qualifying investments" is given below.

Our organisation is one which represents and supports individual investors. On behalf of our three thousand members, many of whom hold investments in listed small and medium UK companies, we have an interest in ensuring that the implementation of any changes to the list of investments that qualify for ISA inclusion are thoroughly considered.

Below you will find a response to each of the questions set out. We have attempted to address each pragmatically, outlining points we believe are important considerations.

**• 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?**

Yes, we believe this is a logical step that will aid the simplification across a range of ISA products.

**• 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?**

None that we are aware of.

**• 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?**

The proposed approach in itself does not present any risks. The expansion of the range of ISA qualifying investments is a positive move for investors.

However the generally lax regulation of AIM companies (and those on other smaller markets) does create substantial additional risks for investors which investors in ISAs may not be aware of. For example, there is little deterrent against directors making misleading statements, no control over what they pay themselves, and substantial risks of dilution from share placings in which only certain shareholders can participate. Even when failings by directors including breaches of AIM regulations are identified, the penalties may be trivial and usually are kept secret. These issues were covered at some length in our submission to the Kay Review which can be read here:

<http://www.sharesoc.org/ShareSoc%20Kay%20Review%20Response%202.pdf>

We would like to see an independent review of the regulation of the AIM market (not to increase the amount of regulation, but simply to improve its effectiveness), if the population of investors in the market is to be broadened by permitting AIM shares in ISAs.

We also take note of the statement in point 3.5 "markets can apply to HMRC to be considered for recognised stock exchange status"; this is positive for potential junior markets and we would hope the application process is as streamlined as is possible.

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

None that we are aware of.

**• 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?**

We don't believe any of the current ISA rules would restrict eligibility of smaller company shares for ISAs at point of purchase. We do however believe there are circumstances subsequent to investment purchase in which ISA rules may disproportionately restrict the eligibility of smaller company shares for ISAs. The specific circumstance we'd like to raise is delisting (delisting being when a company exits an exchange, in this scenario when a company would exit an ISA qualifying exchange).

Delisting could occur for a number of different reasons and whilst the risk is applicable to all companies, for a number of different reasons (including ownership structure and listing costs being proportionately higher), smaller companies historically carry a greater risk. Delisting in main LSE market companies (which are those currently mainly eligible for inclusion in ISAs) are unusual and when they do occur it is mainly because of moves to other markets or from take-overs. Delisting in AIM companies are much more common and typically leave the investor with the option of selling out or retaining shares in a non listed entity.

As ISA rules currently stand, should an investor hold shares of a company that are delisting within an ISA, the investor would be forced to dispose of these shares. This disposal would invariably be at a significantly lower price compared to the price before the delisting announcement. Should the investor subsequently choose to buy these shares back they would obviously lose the tax advantages of the ISA product.

This situation could actually drive up the cost of capital to reflect this anomaly, working against point 1.6 "The Government wants to ensure that businesses, particularly small businesses, are able to access finance and support".

Based upon this, we suggest ***the eligibility of ISA investments should be conclusively determined at the time of purchase***. In other words, whilst delisting will render an investment ineligible for future purchases in an ISA, it should not lead to a requirement for investments already held in an ISA to be sold. This will simplify the responsibilities of ISA account operators, their need to monitor such investments and be a positive deregulatory move.

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

See our response to question 5.

● **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?**

No, the approach to determining eligible markets seems comprehensive.

● **Question 8: When the "SME Growth Market" classification is introduced as part of 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?**

At this point, we don't believe there would be any advantage in revisiting the ISA Regulations for qualifying SME equity markets upon the implementation of the "SME Growth Market" classification.

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

We also suggest point 3.7 in the consultation document needs addressing, "ISA investors who hold shares in a company should have access to certain information about that company, and be entitled to attend and vote at investors' meetings".

It is the duty of the ISA manager to ensure this rule is met. ISA held shares have to be held in nominee accounts by the beneficial owners and whilst information rights and entitlement to vote at general meetings may be offered we feel it is not often prominently advertised. As part of this consultation, we therefore seek provisions to ensure promotion and enablement of these shareholder entitlements for all new and existing ISA investors.

Whilst retail investors can elect to own shares directly (and automatically gain the previously mentioned shareholder information and voting rights) this option is not compatible with the ISA rules, making the above point particularly important.

Ideally we would prefer to see the ownership of shares via ISA accounts be implemented via direct ownership as an option rather than require the use of nominee accounts. This

would remove all the existing disadvantages that arise and ensure the full enfranchisement (voting and information rights) of ISA investors. There would of course have to be some mechanism to keep dividends paid within the ISA wrapper in this case.

Should you wish to discuss any of the above then please don't hesitate to contact us.

Yours sincerely

Oliver Goodarzi  
For and on behalf of ShareSoc

**About the UK Individual Shareholders Society (ShareSoc)**

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