Response to HM Revenue & Customs - Individual Savings Accounts: Compliance and Penalties Call for Evidence

21st February 2022

Dear Hasmukh Dodia,

We welcome the opportunity to respond to this consultation. ABCUL is the primary trade association representing credit unions in England, Scotland and Wales with around two thirds of credit unions in mainland Great Britain affiliated to the Association.

Credit unions are co-operative societies who provide financial services – primarily savings and loans facilities – to their member-owners. They are registered as Co-operative Societies under the Co-operatives and Community Benefit Societies Act 2014 and the Credit Unions Act 1979. As deposit-takers they are dual-regulated by the Prudential Regulation Authority and the Financial Conduct Authority.

Credit unions have since their inception in Britain in 1964 been closely associated with anti-poverty and financial inclusion. They tend to provide savings and loans facilities to those with limited or no access to financial services from mainstream providers, generally due to their low income and / or lack of a developed credit profile. They have been a central element of numerous government and philanthropic initiatives to extend financial inclusion and address the lack of adequate provision of affordable credit and secure savings facilities for large sections of the population. They are capped in the interest that they can charge at 42.6% APR under the Credit Union Act 1979 and provide credit in competition with high-cost lenders.

They are numerous, with 250 credit unions active in mainland Great Britain today and have 1.4 million members and £1.95 billion in assets under management. They range from mid-sized businesses of up to 50 staff to small voluntary organisations.

Response to Consultation

ABCUL are responding on behalf of the portion of the credit union sector that provides cash and junior ISAs to its members.

ABCUL fully support a change in the ISA compliance regime to prevent ISA managers from repeatedly and carelessly breaching regulations. Nevertheless, we concerned that the proposed penalty regime would also punish firms making minor and genuine administrative mistakes. Further, there is a risk that a harsher compliance regime and increased penalty fees could work to discourage credit unions from offering ISA products.

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Subsequently, our response to this call for evidence will discuss how the proposed penalty reform could be made more proportional to minor or one-off breaches, in consideration of the credit union sector. We would suggest an alternative compliance regime in which minor breaches are treated with a warning in the first instance, and then subsequent penalties where repeat offences are made. ABCUL feel that such an approach would manage minor mistakes proportionately, whilst also discouraging intentional and repeat offences. In cases where a fee would appropriately apply to a credit union's breach of the ISA regulations, we would strongly support the mitigation of fees so they can be reduced to a proportionate level for credit unions.

Question 2 – Do you agree that there should be different levels of penalty applied to minor and significant breaches of the ISA regulations? What are your reasons?

We would agree that there should be different levels of penalty to reflect the seriousness and impact of the breach. This is to ensure the penalty regime remains appropriate and proportionate to the nature of the breach.

Question 3 – Do you agree that HMRC should be able to charge a penalty on all breaches of the ISA regulations? What are your reasons?

We strongly disagree that HMRC should be able to charge a penalty on all breaches of the ISA regulations. This is on the basis that all ISA providers, including credit unions, will sometimes make minor administrative mistakes that breach the ISA regulations. A penalty in such cases may be disproportionate to the nature of the breach. Further, minor breaches that are accidental may not be effectively prevented by higher penalties if these breaches are unintentional in the first instance.

Instead, we would support a compliance regime where minor breaches are treated with a warning in the first instance, with subsequent penalties if repeat offences are made. Such a penalty regime would be effective in ensuring small breaches of the ISA regulations are not treated too harshly, but also that repeat offences are prevented.

Question 7 – Are the penalties appropriate and proportionate to each type of breach?

The proposed penalty levels present a large increase in fees for minor breaches, up from £1 per account per tax year with the Simplified Voiding arrangement currently in place to the suggested £10 of 1% of investment value per account per tax year. This fee increase risks being disproportionate for minor breaches that arise out of genuine administrative mistakes.

The penalty fee for significant breaches of the ISA regulations presents another large increase. The example levels given for significant breaches, of £100 per affected account or 5% of the value of investments in the affected account could quickly escalate to a very high level if an accidental breach affects a number of accounts. It would therefore be appropriate for this level of fee to only apply where there has been a prior warning from HMRC, or where there has been serious or intentional breach of the rules.

Question 8 – Do respondents favour the calculation of penalties by reference to a set amount per account or a percentage of account value?

Given that ISA providers may have a varying level of average investment across their accounts, it could be suitable to combine the two methods of calculation so that the penalty charged is based on the method that results in a lower total fee. This would favour the calculation by percentage of account value up to a set maximum penalty value per account. For example, a penalty could be charged for breaches at a value of 1% of investment up to a maximum of £10 an account. This would prevent impacting firms with either a low or high average investment value across their accounts disproportionately.

Question 9 – If respondents consider different amounts or formulae should be applied please describe them and explain why you think they would give a better compliance behaviour outcome than the proposals above?

As above, we would suggest using both methods of calculation and a penalty cap, so that firms with higher or lower average investment values across their accounts are not unfairly penalised.

In accordance with our response to question 7, it is suggested that penalties are not set at the proposed amount, particularly for minor breaches. The proposed penalty level for minor breaches presents a significant increase from the current fee level with the Simplified Voiding arrangement. We would see this increase as misdirected, given that HMRC's intention behind a new penalty regime would be to prevent recurring breaches of the ISA regulations, rather than minor administrative breaches.

Question 11 – Should the amount of the penalty be reduced by mitigating circumstances?

We would strongly support that any penalty regime should allow penalty reduction in mitigating circumstances. Penalty mitigation would allow penalties to be reduced to a level appropriate for credit unions. Credit unions are unique in their limited legal scope to generate revenue (their primary source of income is from loan interest, which is capped at 3% AER) and so have a much greater challenge in absorbing the cost of fees compared to other types of financial firm. As a result, we view the ability to mitigate fees as essential to making an enhanced penalty structure proportionate to the credit union sector.

Question 12 – Do you agree that any penalty should have a right of appeal?

We would agree that penalties should have a right of appeal so that firms can oppose a penalty where they feel it should not apply. A right of appeal would go a step further than fee mitigation in allowing firms to oppose penalties, which should be considered given the significant increase in penalty levels proposed.

Question 13 – Do you agree that there should be a minimum penalty? What are your reasons?

We would strongly oppose the introduction of a minimum penalty. There is great disparity in scale of ISA providers, and the different proposed methods of calculating a minimum penalty stand to affect ISA providers unevenly.

We are most strongly opposed to a fixed minimum, as this penalty is most likely to be disproportionate to the credit union sector. The suggested fixed penalties - £1000 and £3000 for minor and significant breaches respectively – are disproportionate compared to other charges paid by credit unions. For comparison, a medium sized credit union pays an annual periodic regulatory fee of £300 to the PRA. The suggested fixed penalty level would not reflect that credit unions will have a much lower number of ISA accounts than most other ISA providers.

As posed in question 8, there may be scope for a maximum, rather than minimum, penalty to apply to each account.

Question 15 – Should the amount of the minimum penalty be reduced by mitigating circumstances? If so, would that reduce the impact of a minimum penalty?

In accordance with our response to question 11, we would strongly support that the minimum fee level can be reduced in mitigating circumstances, so the unique requirements of credit unions can be taken into account when calculating the final fee level. We would also strongly encourage that more minor or one-off breaches are able to be exempt from penalties, in tandem with mitigation of penalties on more significant breaches made by credit unions.

We believe that any level of penalty is costly enough to deter credit unions from breaching ISA regulations, but mitigation may allow the penalties to be reduced to a low enough point where they would not discourage credit unions from offering ISA products altogether.

Question 18 – Should HMRC have the power to suspend ISA manager approval?

We would not oppose the introduction of the power to suspend an ISA manager from carrying out new ISA activity, in cases where ISA regulations have been continually breached. If this power was to be introduced, we would expect that ISA manager approval could be reinstated where the manager has proven that their systems and procedures have been corrected appropriately.

Question 20 – Are the proposals a fair and proportionate approach to ISA breaches?

We would argue that the proposals have the potential to unfairly penalise ISA breaches that are genuine administrative mistakes, and that any revised penalty regime should more fairly distinguish minor breaches from serious, careless and repeated breaches of the regulations.

Question 21 – Would the suggested penalties for being in breach of the ISA rules encourage better compliance with the rules?

We expect that enhancing a penalty regime would encourage more strict compliance of the ISA regulations by firms as they try to avoid paying costly fees. However, the intensity of the penalties regime must be balanced with the cost risk disincentivising firms from offering ISA products. This is particularly an issue for the credit union sector, where a high potential cost of making a breach of the ISA regulations could act as a deterrent from credit unions offering ISA products to their members.

Please let me know if you wish to discuss ABCUL's consultation response.

Yours sincerely,

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