

## **COMPLIANCE COST REVIEW**

### **INDIVIDUAL SAVINGS ACCOUNT (AMENDMENT) REGULATIONS 2004**

#### **1. Introduction**

##### **1.1 Background**

In line with Government commitments to reduce the compliance burdens that are placed on businesses, HM Revenue & Customs (HMRC) assesses the likely change in compliance costs whenever a policy is introduced or changed. The results of that analysis are published in an Impact Assessment (IA) when the associated legislation is laid before Parliament. Interim “consultation stage” IAs may also be published as part of consultation prior to implementation.<sup>1</sup>

This document summarises the outcome of a post-implementation review of the above IA published in November 2004. A copy of the published IA is attached.

This review re-assesses the compliance cost analysis published in the original document and addresses two main questions:

- whether the estimates of compliance costs used in the IA were correct, with hindsight; and
- whether the processes used to estimate compliance costs were appropriate and reasonable, given the circumstances at the time.

HMRC intend to use this review to improve the IA process, and also to assist in future policy development and evaluation work in general. As such, the emphasis is on identifying learning points for future assessment of compliance costs. The review does not revisit the original policy decision.

#### **2. The published Impact Assessment**

##### **2.1 Description of the policy change**

The Individual Savings Account (Amendment No.2) Regulations 2004 (Statutory Instrument 2004/2996) were laid on 16 November 2004. These regulations:

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<sup>1</sup> Impact Assessments were previously known as Regulatory Impact Assessments, but were renamed in 2007 for simplicity.

- allowed stakeholder<sup>2</sup> medium term products and life insurance products to be included within the stocks & shares component of ISAs;
- allowed the stakeholder cash deposit product to be included within the cash component of ISAs;
- merged the ISA insurance component with the stocks and shares component so the separate insurance component would cease at 5 April 2005;
- introduced a new risk test to determine whether qualifying insurance products bought after this date were of low risk (and should thus be included within the cash component) or higher risk (included within the stocks & shares component);<sup>3</sup> and
- increased the investment limit for the stocks and shares component from £3000 to £4000.

The IA considered a range of alternative options, including maintaining the status quo, but the above changes were recommended and later implemented with effect from 6 April 2005.

## **2.2 Anticipated compliance costs or savings**

For the recommended changes, the IA identified the following compliance cost impacts for business:

- ISA providers would incur a range of one-off costs: changing ISA systems, training staff or advisors, and updating any advice or marketing literature. They would also have to advise existing affected ISA investors of their options. The total one-off cost was expected to be no more than £10 million across the industry;
- costs would be greatest for those who provide ISA insurance products (less than 20 of the 435 ISA managers). The process of advising existing customers of options and impacts was likely to be more complex than for non-insurance products, with a total cost on insurance providers of up to £1 million (additional to the previous bullet);
- providers wishing to sell insurance and/or medium term stakeholder products within the ISA wrapper would need to apply the new risk test to determine whether the cash or the stocks & shares component was appropriate. This test was described as relatively simple to apply in all but a minority of cases. Those few providers offering more complex investments might incur a larger cost in applying the test; and
- any firm deciding to enter the insurance ISA (or any other) market as a result of these reforms would incur set-up costs accordingly.

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<sup>2</sup> The term "Stakeholder" replaced the former "CAT-standard", and is used to indicate a product with low charges, easy access and simple terms & conditions. They are defined fully in the Financial Services and Markets Act 2000 (Stakeholder Products) Regulations 2004 (SI 2004/2738).

<sup>3</sup> The risk test essentially judges whether the investment is likely to be exposed to the risk of a 5% or greater capital loss in the medium term.

For the alternative options (shown in the annexed IA) quantified estimates were not available, but in general businesses had said the costs would be higher than for the chosen option. The status quo was expected to be more costly to administer in the long run. These factors, coupled with a lesser fit with the Government's broader aims of simplicity for the less sophisticated investor, and greater equity of tax treatment, meant that the alternatives were rejected.

### 3. Conduct of the review

Each compliance cost review (CCR) is conducted individually, and the review process is adapted to suit the particular circumstances applying in each case. The emphasis is on making sure that the review itself - and any burden of consultation - are sufficient to meet the objectives of the review, but proportionate to the likely benefits.

In this case, the review was led by an HMRC project team supported by consultants. The staff in the review team were completely independent of those involved with the original policy change.

An essential element of the review was drawing on the consultants' expert knowledge of those affected, and their ability to engage with them through a mix of informal consultation and in-depth interview. The research was not intended to deliver any degree of statistical robustness (to do so would have been costly and impractical) but instead to provide indicative findings. This has allowed the research to identify the major issues and any associated learning points.

The external research was complemented by an internal review of HMRC paperwork and electronic files.

### 4. Were the original estimates of compliance costs accurate?

This section addresses two main aspects – the nature of the change in compliance costs (i.e. what did people have to do differently) and the monetary impact of that change (what did it cost or save them).

Question	Comments
<p>Were the specific types of cost and benefit identified in the IA (e.g. reading legislation, filling in forms, updating IT systems, saving time etc.) incurred?</p>	<p>Different types of ISA appeal to different groups of investors, and the profitability of such schemes from a provider's perspective will vary. This may have influenced the number of providers offering each product and hence incurring the compliance costs mentioned.</p> <p>Having said that, according to our consultants' research, the IA's identification of likely changes in compliance costs was considered to be reasonably accurate.</p>

	<p>The benefits identified in the IA focused on simplifying the ISA product for customers, and enabling more choice and flexibility. As such, they were somewhat removed from the issue of compliance costs to business, on which this review concentrates. Where businesses have provided feedback on the wider impacts we have passed that information directly to the relevant policy teams within HMRC.</p>
<p>Were costs/savings incurred at the expected time?</p>	<p>The IA implied that the bulk of the costs would be one-off at or near the time of implementation.</p> <p>Although the ISA year runs from 6 April, heavy marketing is often seen in the following February/March to encourage investors not to lose their annual ISA allowance. This may have spread the timing of some of the costs related to updating literature or providing advice, although businesses have not identified any particular problems with that.</p>
<p>Were costs/savings incurred by the expected people?</p>	<p>Yes, namely ISA providers and independent financial advisors. Private investors will have received information and/or needed to make decisions too.</p>
<p>Were any other costs/savings, not identified in the IA, incurred ?</p>	<p>No, but there is a conceptual issue over how much of the cost was a marginal cost over and above what businesses would incur anyway. Marketing material, for example, would be routinely updated each year. While the reform would have increased such costs, businesses would have been able to dovetail with existing systems and processes to some extent, reducing the size of any increase.</p> <p>It was not possible at the time for either HMRC or businesses to estimate compliance costs precisely, but even so the IA could have discussed this marginal cost aspect in a little more detail.</p>
<p>If the type of costs/savings varied from the original estimates, why was that?</p>	<p>The estimated cost to notify customers of changes to their ISAs varied. Most respondents provided estimates that were broadly consistent with those in the IA. Some suggested costs per</p>

	<p>person were higher (and in one case significantly higher) than the £3.00 quoted in the IA although this may have reflected the small size of the firm's customer base. Because of economies of scale, the average cost per notification will fall as the number of customers increases. The IA did explicitly identify this possibility, and indeed respondents endorsed HMRC's assessment that for larger providers the costs were probably less significant.</p> <p>Despite the indications of a slight underestimate for a few firms, none of the respondents considered the compliance costs associated with the changes to be a significant burden in the broader scheme of things.</p>
<p>Could such variances have been foreseen at the time?</p>	<p>The variances appear to have been minor, and where they have occurred the IA did identify the possibility of variation between firms in advance.</p>
<p>What is the assessment now of the total value of costs and savings?</p>	<p>The original IA quoted overall costs of up to £11 million across some 435 ISA providers (with a disproportionate burden on the 20 or so firms offering insurance products). Overall this implies an average one-off cost per provider of £25,000. Our consultants have canvassed opinion and while the results are not robust in a statistical sense, they are broadly consistent with the IA. In general, providers have now quoted figures between £10,000 and £50,000. These estimates are tentative because firms had not generally allocated a separate budget for the work.</p>
<p>If different from the original IA, what has caused the discrepancies?</p>	<p>The IA analysis stands as a reasonable estimate of costs per business. Where there are discrepancies it would seem that they are caused by variation between businesses, rather than any failure to identify the types of cost incurred.</p>
<p>With hindsight, were the compliance cost estimates accurate?</p>	<p>Yes. Respondents felt the estimates were about right for what was a relatively non-controversial change.</p>

## 5. Was the process used to estimate compliance costs reasonable?

Irrespective of whether the analysis turned out to be correct, the review has considered whether the original analysis was completed in a reasonable way.

Question	Comments
Who worked on the original IA?	The IA and associated consultation were managed by policy specialists in the area of savings policy. They were supported by Better Regulation advisors and analysts.
Was an adequate audit trail maintained?	Yes – a full electronic log was maintained by the policy owner. This covered both consultation and the final IA itself.
Was Cabinet Office and/or internal HMRC guidance on IAs followed correctly?	Yes.
How much effort was devoted to compliance cost estimation, and was that effort proportionate in the context of the policy measure?	The analysis was sound and has since been confirmed to be accurate. We have identified a few learning points (section 6 below) but none that suggests a problem with resourcing.
Were the right people (both internal and external) consulted, and were their views reflected appropriately?	<p>We consider that the level of consultation was very good, with all significant stakeholders able to take part. Views did differ on the detail, but we consider that the IA took full account of the representations made.</p> <p>The IA explained very fully why the views of some providers had not been implemented and we consider this to have been a helpful response to those firms. One can debate the extent to which discussion of an individual firm's views is appropriate given the global coverage of an IA. We consider that this particular IA presented a very fair and honest picture and made clear whether views were held by most businesses or just by a minority.</p>
Did those who were consulted when the IA was written express views on the reasonableness of the process?	Not as such. Most comment focused on the choice of policy option rather than the process by which the compliance costs were being assessed.

<p>Have those who have been consulted now as part of this compliance cost review expressed views on the reasonableness of the process?</p>	<p>We have not identified any major problems with the IA process. On consultation more broadly, some respondents have expressed concern that the reforms were not implemented sooner. They have also questioned whether alternative proposals (such as enhancing tax-exempt life policies) should have been considered as part of these ISA reforms. We have passed these views to the relevant policy teams, and observe simply that all representations, whether accepted or not, are fully considered by HMRC. This CCR focuses on identifying learning points for improving the accuracy and reasonableness of compliance cost analysis. This will help ensure that policy decisions continue to reflect the various drivers accurately.</p>
<p>Were compliance costs estimated for all options mentioned in the IA?</p>	<p>Compliance costs were identified in qualitative terms for all options. They were not always quantified, but the IA made clear that genuine attempts had been made to do so. Businesses had been unable to provide robust numbers either, although they said that the preferred option would have been less costly to implement than the alternatives. Accepting this view was reasonable in the circumstances, and we have not identified anything since to suggest those views were inappropriate.</p>
<p>Were compliance costs estimated separately for key groups (such as small businesses, large businesses, self-employed)?</p>	<p>The original IA made a range of comments relating to specific groups. Small and large firms were discussed separately. Impacts on independent financial advisors and ISA providers were discussed separately. The benefits for consumers were discussed, although not the costs to them.</p> <p>Our assessment is that the IA was well above average in identifying these sorts of issues. Possibly there could have been extra reference made to groups who, even if they were not directly affected by some of the reforms, might have been affected indirectly through competition. The IA mentioned one provider who chose to reform their offering because the change in ISA limits made a difference to their business model.</p>

	<p>The IA identified greater consumer choice as a positive benefit, but could perhaps have extended the discussion of how that choice might affect the market (and hence businesses). The IA did say that data on ISA takeup would be monitored to inform this aspect, albeit after implementation.</p>
<p>Was an appropriate analytical approach used, with economists or other analysts consulted appropriately?</p>	<p>Yes.</p> <p>Our main recommendation is that the competition assessment could have been extended. For example, the IA mentioned the possibility of new providers entering the market, but this was not analysed explicitly in the competition section. Similarly, recent feedback suggests that some of the anticipated effects (such as allowing insurance providers to compete more effectively) may have been limited by general low demand for some insurance-based ISA products. The IA did discuss this possibility to an extent (and indeed one of the aims of reform was to make ISAs more accessible), but a more detailed discussion of competition effects would have added value.</p>
<p>Was there sufficient time to produce a robust assessment of compliance costs?</p>	<p>Yes – it proved difficult to quantify the impacts precisely, but time was not a critical factor.</p>
<p>Were any assumptions reasonable, given the circumstances at the time?</p>	<p>Respondents generally agreed that HMRC's assumptions were reasonable and correct, for the standard insurance ISA provider. Inevitably there would be variation, but this possibility was correctly identified at the time.</p>
<p>Were any estimates of compliance costs caveated appropriately?</p>	<p>Yes. The analysis was correctly labelled and caveated where there was uncertainty.</p>
<p>Were any risks correctly identified, addressed and explained?</p>	<p>Respondents felt that given the relatively small impact of the change, all relevant risks had been considered.</p> <p>We agree, although we do identify the underlying risk that consumer behaviour may or may not concur with expectations. This may indirectly affect the level of compliance costs as businesses interact with the market.</p>

	<p>The IA relied on business judgement, expressed through consultation, to assess the relative compliance costs of the alternative options. This was clearly the right approach in this case, but there is a slight risk that such views may not have been fully representative since not everyone responded to the consultation. This risk could have been identified in, and mitigated through, the monitoring and evaluation plan. The generic learning point is not just to monitor the impact of a preferred option, but to consider (briefly) whether it was indeed better than the alternatives.</p>
<p>Were any disagreements identified and reflected appropriately (e.g. if the figures were disputed by businesses, or if more than one set of figures was available)?</p>	<p>While views varied as to the scope and nature of the reform itself (some people wanted the reforms to go further) we are not aware of any disagreements over the estimates of compliance costs specifically.</p>
<p>Would HMRC do anything differently if the exercise were repeated, and hence could the IA process have been improved?</p>	<p>This review has not identified any overarching concerns. At a more detailed level, we identify a number of learning points below.</p>

## 6. Learning points arising from the review

### 6.1 Learning points for future work in this policy area

- The level of consultation, and the time given to allow industry to implement the changes are seen as strengths in this case. Allowing plenty of lead-time to consider the implications of new legislation (and to make representations if unforeseen problems arise) is seen as essential.
- Impact assessments should consider the timing of compliance costs in detail. Where markets are seasonal (for example ISA sales tend to be highest at the start and end of the financial year) this may affect the time at which one-off costs associated with (e.g.) marketing may be incurred.

### 6.2 Learning points for the IA and compliance cost process in general

- The primary focus of an IA is on business, but where a reform may introduce a burden on consumers (e.g. requiring them to review their investments) this should be discussed explicitly as well.

- Where a reform affects the cost of an activity that a business would do anyway (e.g. issuing marketing material) the IA should explain the extent to which such costs might already be incurred. This avoids the risk of overstating the marginal costs attributable to a reform. The same applies to a benefit which might be achieved, or partially achieved, anyway.
- All IAs should make clear to what extent stakeholder views are representative. The fact that a view has been expressed by a minority does not necessarily mean the view is held by only a minority. Nonetheless, in cases where a viewpoint has been expressed by very few stakeholders, care should be taken to ensure any coverage of that view is proportionate.
- We consider that the competition impact section of IAs should explain in some detail how a reform may impact on businesses, consumers and other stakeholders. Guidance on what to include within this analysis could usefully be enhanced. (The guidance at the time this IA was written provided a series of “tests” to determine whether competition would be significantly affected. It offered limited advice on how to present that information, and this has led to some IAs providing a relatively brief summary.)
- When monitoring reforms during and after implementation, there is value in revisiting (briefly) the alternative options in the IA. Information may have come to light which provides further reassurance that the chosen option was indeed the best (or if not, indicates how things could be improved).
- Some respondents have suggested increasing the profile of compliance costs within consultation to help ensure any estimates are as robust as possible.

## **7. The way forward**

Comments are invited on any aspect of this report or the wider compliance cost review programme.

The learning points are being fed into the policy development process directly if particular to one IA or policy area. More generic recommendations are being collated across the review programme overall, and will be used to improve the IA process as a whole.

## **8. Contact points for further information**

Questions about the taxation of ISAs can be directed to our ISA helpline:

Telephone: 0845-604-1701 (Mon-Thu 8.30am-5pm, Fri 8.30am-4.30pm).

For issues relating to HMRC policy on ISAs:

David Ensor  
HM Revenue & Customs  
Room G54, 100 Parliament Street  
London  
SW1A 2BQ  
Telephone: 020-7147-2838      E-mail: [david.ensor@hmrc.gsi.gov.uk](mailto:david.ensor@hmrc.gsi.gov.uk)

For issues relating to the compliance cost review programme generally:

Richard Bowyer  
3E/14, 100 Parliament Street  
LONDON  
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Telephone: 020 7147 0062  
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**ANNEX : THE PUBLISHED REGULATORY IMPACT ASSESSMENT**

<http://www.hmrc.gov.uk/ria/isa-stocks-shares.pdf>