

COMPLIANCE COST REVIEW

- i) ISA & PEP (AMENDMENT) REGULATIONS 2003**
- ii) ISAs : SIMPLIFIED VOIDING FOR INVESTOR ERROR**

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.¹

This document summarises the outcome of a post-implementation review of the two ISA-related IAs above. Although each reform was independent of the other, they have been grouped together for convenience, and to avoid approaching the same stakeholders twice during the review. Copies of the published IAs are attached.

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

- whether the estimates of compliance costs used in the IAs 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 decisions.

2. The published Impact Assessments

2.1 Description of the policy changes

The first IA, relating to the ISA and PEP regulations, was designed to maintain the status quo. The Financial Services Authority were making changes to comply with EU requirements, and one result was that certain Collective Investment Schemes were

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

required to convert to become “Undertakings for Collective Investments in Transferable Securities” or UCITS. An unintended consequence was the fact that such schemes would lose the right to provide ISA and PEP investments. The reform corrected this.

In doing so, the reform also introduced a new qualification test to ensure that the underlying investments were appropriate for inclusion within an ISA or PEP. This test (which is explained fully in the annexed IA) aimed to prevent cash-like investments from being included within a stocks and shares ISA.

The second IA, relating to simplified voiding, introduced new procedures for handling the situation where a private investor had broken the rules by applying for more ISAs than they were entitled to, or had applied for an incorrect combination of maxi and mini ISAs. Prior to the reform, such applications were cancelled, and the accounts closed with loss of the tax relief benefits.

The reform introduced a process of repair or “simplified voiding” which allowed accounts to be kept open in certain circumstances, and tax relief maintained. The desired effects were to avoid punishing errors unduly, and to enable ISA providers to retain more accounts. The new provisions included safeguards to ensure that no investor would gain an advantage by not following the rules.

2.2 Anticipated compliance costs or savings

The ISA & PEP amendments were expected to create a small one-off cost for ISA providers: amending guidance and marketing material, and advising investors. Not introducing the amendments would have led to costs too, because investment houses would have felt obliged to advise investors of the loss of ISA and PEP status.

The ongoing costs associated with applying the new compatibility test were not expected to be any higher than the prevailing system. The IA did explain that there might be a very few exceptions to this if underlying investments were very complex, but that guidance would be issued to minimise any costs in that situation.

For simplified voiding, the reform was not expected to make any significant difference to compliance costs, and consultation at the time supported this view. The repair process would place a burden on ISA providers and administrators, but it was unlikely to be very different from the current costs associated with closing accounts completely.

The IA did note that costs could be different in some cases depending on the precise nature of an individual bank’s systems, and it also accepted that some retraining might be required as bank staff became familiar with the new procedures. In the short to medium term, banks would be asked to provide account closure dates to HMRC on an annual basis, but again this was not expected to be a significant burden.

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
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?	In general, businesses have not recorded the costs associated with these reforms because they see them as being nil or negligible. Respondents to our recent research have said that the types of impact identified in the original IAs appeared to be reasonable. Although outside the immediate scope of this review, respondents have confirmed that the wider benefits (protecting ISA status, improving customer retention for "voided" ISAs etc.) were achieved in practice and were correctly identified in the original IAs.
Were costs/savings incurred at the expected time?	Yes.

Were costs/savings incurred by the expected people?	Yes. The original IAs did not measure any costs or savings that might affect private investors (e.g. if one of their accounts was voided). In practice, such impacts were probably very small, but the IAs could have acknowledged this aspect a little more fully.
Were any other costs/savings, not identified in the IA, incurred ?	No. We have not identified any additional impacts.
If the type of costs/savings varied from the original estimates, why was that?	Not applicable. The original estimates (of nil or negligible impact) remain valid.
Could such variances have been foreseen at the time?	Not applicable.
What is the assessment now of the total value of costs and savings?	For both reforms, respondents believe that virtually no additional compliance cost impact was caused by the changes.
If different from the original IA, what has caused the discrepancies?	Not applicable.
With hindsight, were the compliance cost estimates accurate?	Yes. In both cases, respondents felt that the changes were routine and had minimal impact on their businesses.

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 work was led by policy advisors in the former Inland Revenue. They were supported by Better Regulation advisors and additional advice from the Cabinet Office.
Was an adequate audit trail maintained?	Yes – full records have been maintained electronically.
Was Cabinet Office and/or internal HMRC guidance on IAs followed correctly?	Yes it was.

<p>How much effort was devoted to compliance cost estimation, and was that effort proportionate in the context of the policy measure?</p>	<p>With hindsight, businesses themselves have advised us that any increases in standard operating costs were so minimal that detailed analysis was not worthwhile.</p> <p>At the time, HMRC (or more accurately the Inland Revenue) carried out a full appraisal of the options and we consider that this was good practice and proportionate.</p>
<p>Were the right people (both internal and external) consulted, and were their views reflected appropriately?</p>	<p>Yes. Consultation was good with various technical meetings held with industry representative bodies, as well as public consultation. Some of the consultation was restricted, but we consider that this was reasonable given various constraints at the time.</p> <p>More recently, although respondents accept that these changes were non-controversial, they say that greater consultation on the question of anticipated compliance costs might have allowed the IAs to provide more specific estimates in this respect.</p> <p>For example, the Inland Revenue's systems could not identify how many voided ISAs would have been "saved" under the new rules. Consultation might have yielded some data, as well as views on the desirability of different options.</p> <p>The CCR team considers that genuine and proportionate attempts were made in this case to identify such data without success. The IAs could usefully have mentioned any attempt to obtain such information outside the Inland Revenue, as well as within.</p>
<p>Did those who were consulted when the IA was written express views on the reasonableness of the process?</p>	<p>We are not aware of any problems emerging at that stage.</p>
<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>Yes – and they have not identified any concerns. Some respondents said they were unaware of the original consultations, but we do not believe that is indicative of a wider problem. As noted above, industry representatives were consulted throughout.</p>

	<p>Some respondents have observed that while the consultation process in this particular case was good, HMRC did not always consult effectively. The CCR team cannot comment on this but is feeding all consultation-related feedback to the relevant staff in HMRC.</p>
<p>Were compliance costs estimated for all options mentioned in the IA?</p>	<p>On the ISA & PEP regulations – yes. The discussion of different options, while technical, was comprehensive and allowed a range of ideas to be compared.</p> <p>The simplified voiding IA did not present any alternative options explicitly, although the “doing nothing” option was implied, and the proposed option itself had been consulted on previously.</p> <p>We would recommend that similar IAs in future should discuss a range of options explicitly, so that they can be compared. If earlier consultation has rejected certain options then that should be stated. We suggest that IAs should demonstrate not just that a reform is a good idea, but that it is better than any logical alternative that might be proposed.</p>
<p>Were compliance costs estimated separately for key groups (such as small businesses, large businesses, self-employed)?</p>	<p>Both IAs mentioned small businesses briefly. ISA/PEP managers do not usually fall under the definition of a small business, although Independent Financial Advisors do. The impact on IFAs could usefully be considered explicitly in all future investment-related assessments. The amendments IA mentioned financial advisors briefly, but the simplified voiding one did not.</p>
<p>Was an appropriate analytical approach used, with economists or other analysts consulted appropriately?</p>	<p>Involvement from Departmental economists and statisticians appears to have been limited, although that would not be unusual in cases where both Exchequer and compliance cost impacts were expected to be low.</p> <p>The original analysis was constrained by a lack of data on the numbers of ISAs that might be affected, but the analysis itself was reasonable.</p>

	<p>Finally, there was no obvious attempt in the IAs to quantify the amount of HMRC resource that might be needed to (e.g.) issue voiding instructions to ISA providers. This should have been included where possible to help judge the relative costs and benefits overall.</p>
<p>Was there sufficient time to produce a robust assessment of compliance costs?</p>	<p>We have not identified lack of time as being a significant factor, and the IA followed an extended period of discussion with the industry.</p>
<p>Were any assumptions reasonable, given the circumstances at the time?</p>	<p>The main assumptions made in the IAs were agreed by respondents as being reasonable in the circumstances at the time. One respondent noted that the changes to be made were “no brainers” from an operational perspective, so required minimal cost / resource to comply.</p>
<p>Were any estimates of compliance costs caveated appropriately?</p>	<p>Yes – and we identify this as a strength, particularly in the amendments IA. Even though costs were expected to be negligible, this IA made a point of identifying situations where there might be exceptions.</p>
<p>Were any risks correctly identified, addressed and explained?</p>	<p>Respondents generally felt that the risks were minimal. Nevertheless, relevant risks were addressed and explained.</p> <p>The Amendments IA included a section entitled “Risk assessment” which essentially explained the risks in the environment that the reform was designed to address. This was fine in itself, but introduced a danger of overlooking the risks associated with the analysis or the recommended option. Future IAs (which are now being done in a new format) distinguish explicitly between these different types of risk.</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>We are not aware of any problems of this nature.</p>

<p>Would HMRC do anything differently if the exercise were repeated, and hence could the IA process have been improved?</p>	<p>The short answer is no. Both IAs assessed their respective situations thoroughly and correctly predicted the impacts of each reform. Our consultants advise that the process worked well in these two cases.</p>
	<p>We have identified a number of learning points at a more detailed level, but this does not alter the headline that both IAs were accurate and reasonable.</p>

6. Learning points arising from the review

6.1 Learning points for future work in this policy area

- The impact on Independent Financial Advisors, and similar organisations, could usefully be included within all investment-related impact assessments.
- The original analysis was hampered by lack of internal data on the number of voided ISAs likely to be affected by the reforms. We recommend that where situations like this arise, the need to obtain such data should be flagged in the “monitoring and evaluation” section of an IA, so that suitable data systems can be set up (where cost-effective to do so). This ensures that any post-implementation review will be able to fully assess the impact of the reform.

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

- The practice of identifying situations where businesses might experience exceptional costs or savings, as used in the Amendments IA, adds considerable value and is commended.
- IAs are primarily designed to measure the impacts on businesses. However, where reforms are likely to affect private individuals (investors in this case) the IA should discuss, and ideally quantify, the impacts on them. This will help ensure that the cost / benefit analysis of each option is comprehensive.
- Similarly, costs to HMRC should be identified, and ideally quantified, where possible.
- All IAs should present a range of options for consideration. “Doing nothing” may well be a viable option in this context, but at least two options should be presented explicitly. It may not always be enough to demonstrate that the preferred option is better than doing nothing. If other options have been discussed, consulted on, or rejected, then the IA should make that clear.
- When referring to “risks” all IAs should distinguish between the risks that the reform is trying to address, and any risks contained within either the proposed options or the underlying analysis. The IA itself should cover all these elements.

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

For issues relating to the compliance cost review programme generally:

Richard Bowyer
3E/14, 100 Parliament Street
LONDON
SW1A 2BQ
Telephone: 020 7147 0062
E-mail: richard.bowyer@hmrc.gsi.gov.uk

ANNEX : THE PUBLISHED REGULATORY IMPACT ASSESSMENT

[ISA & PEP \(Amendment\) Regulations 2003](#)

[ISAs: Simplified voiding for investor error](#)