



BUILDING SOCIETIES ASSOCIATION

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e-mail: adrian.coles@bsa.org.uk
direct line: 020 7440 2216
direct fax: 020 7836 4176

The Rt Hon Alistair Darling MP
Chancellor of the Exchequer
HM Treasury
1 Horseguards Road
London
SW1

Dear Chancellor

BUDGET 2008: INDIVIDUAL SAVINGS ACCOUNTS

In this submission the Building Societies Association asks that you consider changes to the regime for Individual Savings Accounts (ISAs) to bring cash ISAs into closer alignment with stocks and shares ISAs.

The Building Societies Association (BSA) represents all 59 building societies in the United Kingdom. Building societies hold £210 billion of retail deposits, accounting for about 20% of all such deposits in the UK. Building societies have been strong supporters of ISAs ever since they were first conceived in the late 1990s and they account for over 37% of all cash ISA balances, some £52 billion.

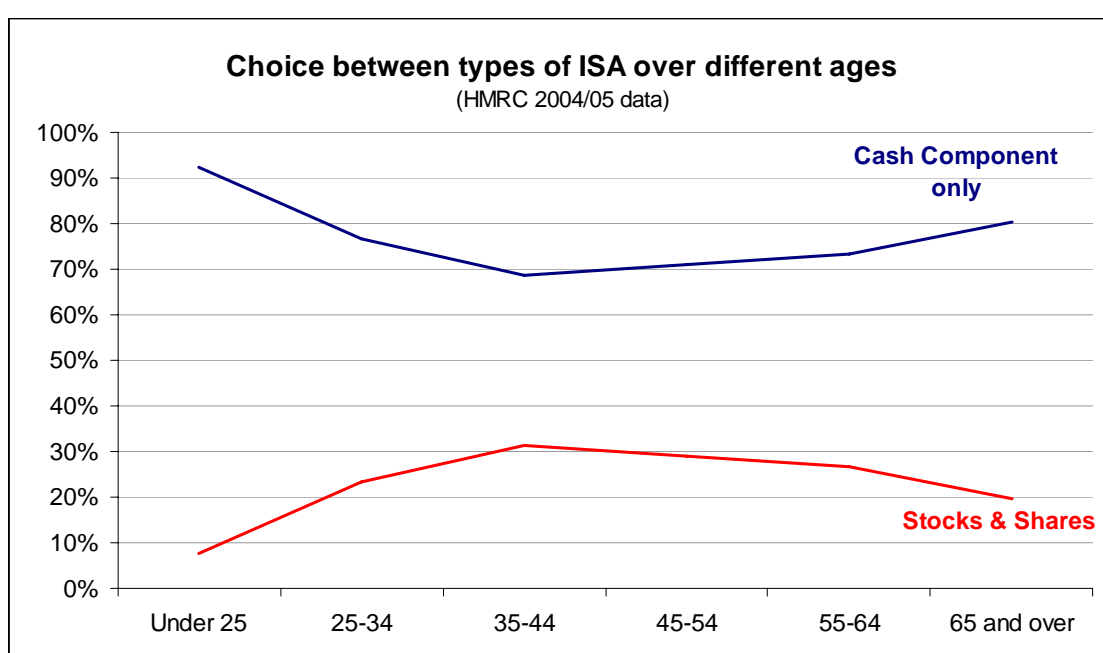
Allowing ISA transfers from stocks and shares into cash

In the package of changes to the ISA regime that you are introducing from 6 April 2008, ISA holders will be able make transfers from their cash ISA to a stocks and shares ISA. However, transfers the other way, ie from a stocks and shares ISA to a cash ISA, will not be allowed.

Building societies envisage problems with this policy of one-way-only switching and urge the Government to reconsider its approach. The concerns we have are as follows:

- People will inevitably make mistakes about transferring from cash to equities. These may be due to errors of judgement by the ISA holder – or, in some instances, poor advice. Evidence from the FSA's Financial Capability study suggests that a significant proportion of ISA holders may be vulnerable to this: it found that "40% of those that owned an equity ISA did not know that the cash value of their investment was directly affected by stock market performance." (*Financial Capability in the UK: Establishing a Baseline*, FSA 2006, Pg 18).

- Such errors of judgement or bad advice could not be rectified within the ISA wrapper.
- Allowing two-way transfers would make ‘lifestyling’ of portfolios much easier. If transfers from stocks and shares ISAs to cash ISAs were allowed, this would allow savers to diversify their assets and benefit from the lower volatility offered by cash holdings. Increasingly, people are seeking to diversify their retirement savings and ISAs are being held for the longer term. People nearing retirement who wish to change their asset allocation to match more closely their liabilities would be able to convert some of their equity holdings to cash without losing the benefit of the tax exemption available within an ISA wrapper.
- The chart below shows that as people approach retirement, a greater proportion tend to opt for the certainty of cash ISAs rather than equity ISAs.



- Allowing two-way transfers would also assist those on lower incomes: stocks and shares ISAs are of benefit only to higher rate taxpayers: there is no tax benefit to those on lower incomes holding equities inside - as opposed to outside - an ISA. Cash ISAs give tax breaks to all taxpayers, including those on lower incomes.
- One-way transfers will potentially disadvantage smaller institutions, such as a number of building societies, that are strong supporters of ISAs, but which provide only the cash ISA component.

The cost of allowing two-way transfers

The BSA estimates that allowing one-way transfers from cash ISAs into stocks and shares ISAs would reduce the total cost of the ISA scheme to the Exchequer by around £60 million in the first year (assuming 3% of cash ISA balances are switched). Allowing transfers the other way, from stocks and shares ISAs into cash ISAs, would reduce this cost saving to under £30 million in the first year, if 3% of stocks and shares ISA balances were switched. However, if a smaller proportion of the stocks and shares ISA balances, say 1%, is switched, the cost saving could be

as much as £50 million. The balance in cash ISAs is considerably larger than that in stocks and shares ISAs, so the effect of switching one percentage point worth of the cash balance has a much greater impact on the total cost than switching a percentage point of the stocks and shares balance. We would be happy to share our working with your officials if that would be helpful.

Future reviews of ISA limits

The increase to £3,600 in the annual subscription limit for cash ISAs - that is to be introduced in April - is very welcome. The BSA considers this limit should be subject to regular future review, to prevent erosion by inflation. Moreover, we consider there is a strong case for the cash ISA limit brought into line with that of the stocks and shares ISA and we would like to see an early commitment to this by the Government.

Conclusion

The BSA supports the Government's aim of engendering a long-term savings culture. Most of the ISA reforms in April 2008 will assist in this and the BSA is doing much to support and raise awareness of the changes. However, the one-way transfer of ISAs will serve to undermine the beneficial effects of other elements of the ISA reforms. Accordingly, we urge that you reconsider the Government's policy on this and on closer alignment of the cash and stocks and shares subscription limits. We hope you will be in a position to make a positive announcement on these in your Budget speech.

Yours sincerely

Adrian Coles
Director-General