Raising the ISA bar

Participants

Simon Keane
Investment affairs editor
Shares Magazine

Dr Stephen Barber
Head of Research
Selftrade

Catherine Penney
Associate Director
Barclays Stockbrokers

Paul Howard
Corporate Development Manager
TD Waterhouse

Guy Knight
Sales and Marketing Director
The Share Centre.

Most investors already know that ISAs are a great way to shelter their hard-earned money away from the tax man, but with such a wide choice of ISA products available, how can you make the best of what's on offer? Shares got four experts around a table to get some answers

Simon Keane: How do ISAs work and what are the broad benefits?
Stephen Barber: The key thing is that ISAs are a tax-efficient wrapper. You pay no capital gains tax and you pay no extra income tax on the income from ISA investments. The choices are managed or self-select ISAs, and then within that there are also the options of cash or more stockmarket-based investments. Within a self-select you'll have a wide choice of investments ranging from equities – including UK and international shares – unit trusts, OEICs and other open-ended funds. You'll also have investment trusts, exchange-traded funds (ETFs) –which are very popular within self-select ISAs –and you'll also be able to have bonds, provided they meet the requirement of five years to maturity.

Catherine Penney: By consistently tucking away and sheltering from tax the maximum amount you can, effectively you're building a pot which, if held for the medium to long-term, is going to really provide you with something that's tangible and represents a valuable benefit. If it weren't so valuable it wouldn't have the £7,000 limit to the allowance available. The value of this allowance depends on how well you manage your investments. We do have some clients with in excess of a million pounds protected from tax in their PEPs and ISAs through judicious management of their funds.

Guy Knight: I think just from a practical perspective, that if you want to build significant wealth over your lifetime you have to start as early as you can, invest as much as you can as regularly as you can and ISAs certainly provide a means of doing that. Starting at the age of 16 you can open up a cash ISA for example and put currently £3,000, soon to be £3,600 cash, into that. And as your opportunity to find more disposable capital to invest comes along then you can move it into safer stock market investments, such as funds, and then once you have the knowledge and experience, move into individual equities.

Paul Howard: An important distinction is about having a cash ISA as opposed to a stocks and shares ISA. So really this is about your attitude to risk and also what you might be investing or saving for. If it's a bit of rainy day money and you're quite risk-averse, then the cash ISA might be the thing for you. But as we've seen over many years, long-term investment in the stock market has the potential to bring you greater returns so if you're willing to trade up a bit of risk then you've got the chance of making a better reward by opting for a Stocks and Shares ISA.

SK: The mini and maxi distinction is being taken away. How will that work in practice?
SB: On a simple level,the mini/maxi distinction will disappear and you'll have overall an increased allowance, to £7,200, of which you could have a cash allowance of up to £3,600. You will be able to effectively have two ISAs if you wanted to, so you could have a cash ISA and a stocks and shares ISA, provided you didn't exceed the limit, you didn't go over £3,600 in the cash.

CP: Fundamentally, investors are going to be able to merge holdings so whereas in the past they would have held mini and maxi ISAs those are going to be two ISAs which are exactly the same. They are stocks and shares ISAs

and investors really should take the opportunity to review where they're holding their portfolios, to take this opportunity to consolidate their holdings and make as many savings as they can, particularly if they're paying fees on these accounts.

SK: What about the changes to contributions? I believe that from April the contribution level will go up, but are there any other changes to how money within existing ISAs can be used?

GK: Yes, I think the thing that we haven't picked up yet is the ability to transfer nine years' worth of cash ISAs without affecting your annual ISA allowance. Some people are studious about putting money aside but, perhaps because of their stage in life, cautious about taking up in riskier investments. But then there comes a point when people think 'What's going to happen when I stop work? Is there anything I need to do and take more control over building my wealth for retirement now?' Potentially, nine years' worth of cash ISAs is somewhere that people can look to – an existing pot that they could make work harder for them, because ultimately if you stay in cash it gets eroded by inflation. But you've still got time in your mid-40s and early 50s to put your cash into something that has the opportunity to grow quite substantially over the next 10, 15, or 20 years into a tax-efficient environment – and I think that's something that people should be looking at.

PH: I think one interesting thing that people are picking up on is the new limit being £7,200. Why's it gone up £200? Well, it's divisible by 12, which implies regular monthly savings. People are also thinking about consolidation, as they come to realise that they can consolidate their separate Pep and Isa investments all in one Isa wrapper. That also brings ease of management through a single statement and with our Isa there will be no administration fee. Another benefit is the ability to diversify portfolios and manage exposure to risk. The new ability to make a one-way transfer of Cash Isas to a Stocks and Shares Isa is, in my view, likely to prove popular – especially for investors who realise they can choose low-risk investments like Bonds and Gilts or Cautious Managed Funds as well as higher-risk single UK or International equities.

CP: It's very surprising how many people still don't realise that they can transfer an ISA from one provider to another and maintain that tax protection, providing they do it in the proper way. And it's frightening actually, because if you bought a fund investment seven or eight years ago it's unlikely to be the same product now as it was then.

SB: I think the changes will just make administering ISAs far easier from an investor's point of view. We introduced these regular investing fund packages last year and the idea is that more passive investors can drip feed cash into a range of more lifestyle-type fund packages such as 'growth' or 'income'. But of course it's very difficult to do 12 equal instalments, so I just think it'll make that whole side of ISAs less hassle for the client.

SK: As well as the contribution, there's also the important consideration, of cost. What are the main charges when it comes to ISAs, and is it cheaper to get an ISA direct or go through the broker?

SB: Managed funds tend to be percentage based, whereas self-select tend to be more flat fees and so what you'll find is as your investments grow you'll end up paying more on a managed fund. But you can't just look at headline costs. I suspect for a lot of *Shares* readers, for instance, who like to make their own investment decisions, switching between investments on a managed ISA can be very difficult and quite costly.

SK: A lot of ISA providers are waiving the initial fee and favour the annual management charge. What's the rationale behind that approach?

CP: Well, what's happening is that a lot of brokers are using their weight with the fund management houses to negotiate better terms for their customers than are necessarily being offered in the direct market and the ability to provide these funds at discounted initial charges, potentially at a nil initial charge, is obviously very attractive to investors. But it's not just about the solution of one fund or a package of funds – a further benefit of a self-select ISA is that alongside it you can hold individual shares and exchange-traded funds (ETFs) – and if you're looking at tracker funds this is probably going to be a cheaper option for you overall. And then you've got brokers that can offer capital protected products. Barclays Stockbrokers offers a range of Investment Notes which give you access to the returns from an underlying market or sector and, if held to maturity, some offer capital protection though, if sold before then, capital is at risk. So you should look at a self-select ISA and look at the assets that are available from different brokers so that you put together the package that you want and manage it in the way that suits you.

SK: So the self-select is the way forward in many cases?

GK: I think it's horses for courses. An investor has to feel confident enough in their own ability because it is very much self-driven. There are opportunities sometimes to get advice on individual investments or strategies – for example The Share Centre offers free advice to its customers. I think the issue with self-select is – whether it's an equity market with more than 4,000 choices in it or a fund supermarket with over 1,500 choices in it – there's just so much choice, so where do you begin? And I think that's where companies such as The Share Centre can help by presenting a shortlist for you of recommendations that match your risk appetite. I think that is very, very helpful for the less confident investor. And there are less confident investors in self-select who understand the principle that in the long term it is the stock market that's going to give you the return rather than cash, but who just want a bit of a help.

SK: With today's volatile markets is there an argument for managed funds rather than investing yourself?

SB: I don't think that a volatile stock market necessarily means that you should buy a managed fund. I think in almost any market circumstances you assess your objectives and attitude to risk – that's the same whether the stock market's volatile or not. If you have a relatively low appetite for risk and you want the benefits of a managed fund then that will probably suit you in all sorts of market circumstances. Those with a higher attitude to risk in fact might welcome the volatility, it means there's opportunities to profit. We keep talking about choice, but one of the choices that you can make in a volatile market is to be able to make the decision when to buy and really have control over market timing. You might want to have a move into different sorts of instruments, so for instance with Exchange-Traded Funds you can effectively buy gold or other commodities as well as a range of sectors and indices.

CP: I think there are a couple of key things. The first thing is not to lose your allowance. All investors should make sure that they subscribe the cash that they're allowed to subscribe before 5 April, the end of the tax year, to secure their allowance. You can hold that money for a period of time pending investment. Providing you intend to invest it, there are no issues around it ➤

being held in cash. But having said that, there are a lot of different instruments out there that people can invest in that don't necessarily give them the concerns of the volatile market. If you are a more cautious investor look for something that gives you the comfort of capital protected. If it's a tradable instrument, such as our Investment Notes, you can sell your holding at any point in time, however if you hold them for the full term some will provide you with capital protection if the markets don't improve. Fundamentally, you should have a range of assets within your portfolio to limit the volatility within it.

GK: We recently conducted some research with investors in general who are exposed to the stock market, asking them over the previous six month period up until January what they felt about what was going on in the market. And I've got some stats here which I think actually support what's already been said. Maybe surprisingly, only 36% of investors feel that the stock market was particularly volatile over the past six months, so there's a potential gap between reality and people's perception of that. But I think probably what we can read in that is that investors are taking a long-term view and not panicking. Some 75% of investors feel that there have been opportunities for informed stock market investors over the last six months, with 37% agreeing it was a good time to pick up bargain stocks over the past six months. And 61% claimed to have a comprehensive financial plan in place, either through working with an independent financial advisor or putting a plan into place themselves. So it's not just about 'I must use my ISA allowances', it's knowing what you're using that for as part of a broader investment portfolio.

PH: I'd echo what's been said before as far as opportunities go. Volatility brings opportunity and we've seen that in the markets – they've taken a big dip, a couple of hundred points one day, risen the next day and the people that have bought back in on that dip have taken profits and got back out again and many will have done very well. So again, the active trader has done very well from that. For longer term investors, a principle of investing is about building a portfolio and I think we should remember that even within the managed funds universe of around 2,100 funds there's a whole risk profile to suit your appetite for risk. You can go from cautious funds based around bonds and cash, index trackers, all the way up to riskier funds such as emerging markets. For those worried about volatility it is possible to choose less volatile instruments – bonds have recently shown improved yields, for example.

SK: In terms of your existing CGT allowance, you already have £9,200 tax free, so you ought to really concentrate on putting the dividend payers into an ISA. Is that a fair argument?

SB: The Government gives you two allowances – it gives you an ISA allowance each year and it gives you a capital gains tax allowance. If you use those two in tandem then you can make your portfolio as tax-efficient as possible and that can mean taking gains outside of your ISA and repurchasing with it, so you maintain exposure to some of those holdings. But I think even the argument about having just income-bearing stocks and shares within the ISA doesn't necessarily hold. I ran some numbers on this recently and the results surprised me. I looked at the FTSE 100 return over 10 years from 1997 to 2007 and the overall return, which I think was a pretty sound 26%, but if you reinvest the dividends into that figure, it comes out at a quite staggering 70% return, which is a huge difference. And that's on the FTSE 100 which has a fairly low yield. So even with dividends at that level, if you reinvest them and reinvest them within the tax-efficient environment of an ISA, then your long-term returns are magnified quite substantially.

> We'll always have the noise around ISA season and the build-up to the end of the tax year, but of course these are things that people invest in the full year round and so the products should meet their investment needs.

SK: Certain Aim shares can be put into ISAs. Are you finding there's a lot of demand for this from your clients?

SB: Aim as a market has developed quite substantially since it was launched back in 1995. There are some serious companies on it – the sort of companies that are on there are mainstream enough to warrant inclusion within an ISA wrapper – and it's no surprise you get clients wanting to do that.

CP: Demand for Aim shares is much more within the active trader community who are looking at the opportunities that the market offers and the high growth that they expect to achieve. More mainstream investors – who tend to buy and hold investments over the medium term – would tend to focus more on the main market, so this is not an issue for everyone. Nonetheless, it would be desirable to see this restriction lifted.

PH: I would like to call for the Government to have slightly better 'joined-up thinking' here. You can hold Aim stocks within a SIPP, there is no difficulty with that – it's another tax-efficient wrapper, and you have to explain to someone who's got a SIPP that we're very happy to have AIM stocks in here but you can't put them in an ISA. And to me that's a mismatch that could be very easily removed. It would take away a lot of customer dissatisfaction and make the plan manager's job easier and hence less costly.

GK: I agree with that – we have actually written to Alistair Darling this week on exactly that point, that there isn't enough joined-up thinking in terms of different tax-efficient vehicles.

PH: Yes, we're using TISA [Tax Incentivized Savings Association] to try and get those points across. But whatever route we choose to lobby for change, I'd like to see it happen.

SK: Do you think price competition is going to hot up this ISA season in terms of charges and waiving charges?

SB: I think every ISA season we see a lot of activity and press coverage – a lot of marketing spend. And there are always good offers out there for investors. But it's really about weighing up the costs with the service that you get from it. So investors need to look at charges, for example do they pay to open the account? What sort of other charges are on the fund if it's a managed fund? How much do you pay to invest – Selftrade, for instance charges no commission on fund purchases. But also they need to really compare that with the levels of service that they're getting – have they got the choice that they want, for example? Can they access the full range of instruments they want? Can they switch investments with ease? What sort of support do they offer in terms of prices, data, charting and research? We offer this as well as two investment review publications to support investment decisions and two research microsites. The other point is that we'll always have the noise around ISA season and the build-up to the end of the tax year, but of course these are things that people invest in the full year round and so the products should meet their investment needs all year round.

CP: We always see price competition at this time of the year. I think the key thing to remember when you're looking at where you're going to invest your ISA is the product's full cost. Don't just look at wrapper charges; look at what you're getting, what you're having to pay to trade, and what you may potentially have to pay in hidden fees. Make sure that you're happy with this total cost. But more importantly, look at what you're being offered in the range of investment products, research and tools such as order types. Make sure that it's going to suit you and go with the proposition that is most closely tailored to what you require and that you consider is good value.

SK: So it's not just about costs?

GK: Absolutely. Investment is a serious business and you want to be dealing with a company that can offer you a wide range of services, both online and on the phone, and that is there to help you when needed, but also able to execute efficiently when you don't need to talk to anyone. Good customer service occurs not just when there's a problem, but is ongoing in things like regular statements coming out to you, good access over the internet and a good level of investment tools.

PH: Yes, I'd echo that. I think number one, go back to your investment objectives. As brokerages, we all offer a wide range of instruments, we've heard about funds and bonds and ETFs as well as individual shares. TD Waterhouse offers international equities as well through an ISA wrapper, because as long as you've got a recognised stock exchange, then those international stocks and shares are eligible as well. Investors need to consider the whole package. What are they paying on dealing fees? What are they paying on fund initial sales charges as well as any wrapper fees? They need to make a judgement call on these kinds of costs versus the service that they're going to get. I think this is something that all of us as brokerages here actually have recognised. Certainly we aim to help the customer make their investment work harder for them, the more that can be invested after fees should mean higher returns for them.

SK: PEPs can be merged with ISAs from April – what are the benefits of this?

SB: I think the key point is simplicity. You will have a single, wider, tax-wrapped account and to an extent we've had a gradual approach to this over the years where the distinction between the old different PEP years were abolished and the old single-company PEP was abolished. I guess this will be the final move to put all mainstream tax-wrapped accounts into one place. We shouldn't see these things as separate parts of a portfolio – this is a portfolio, elements of which can be tax-efficient. Certainly, where you have a single account you won't have two individual holdings shown on that portfolio so it means you can buy and sell more efficiently whether you're selling a whole holding or part of that holding, without having to sell it within each account. So it's convenient – it could reduce costs a little and probably helps you to think about your portfolio as a whole.

CP: I'm hoping that it's going to make people realise that they have these investments, and that they should be managing them. I think there are a lot of people who hold PEPs and who don't necessarily manage them as actively as they do their ISAs. By PEPs becoming ISAs, I'm hoping that people are really going to take account of whether the investment within the wrapper still meets their requirements. As it is possible to transfer from one provider to another, we will probably see quite a lot of consolidation and investors will move to a single provider because it's going to be much easier to view your full portfolio in one place. Potentially you could save yourself some quite significant fees because you can have all your PEPs and ISAs in one account and this is an opportunity for people to take advantage. I would encourage people to review their options, select the broker that offers the solution that suits them – full range of products, good research and flexible order types – and organise their holdings to suit them.

GK: I have to stick up for the old PEP customer who may have opened a PEP over several tax years, and who actually likes to analyse these individually. We certainly see that with our own customers and when people transfer PEPs and ISAs into us – some people still like to see them as individual component parts. So we're not forcing our own customers to merge their PEPs into one account. They will be treated as if they were individual ISAs, but we're not demanding that this will happen. If it does, I think it's good for them and it's certainly good for us as a business. I think it saves a few Amazon rain forests, apart from anything else, in the number of statements you have to send out, and it is good for the investor to have one consolidated view. It also highlights the importance of diversification in our clients' investments, which is much more difficult to see when you have the investments in little isolated pots.

PH: Yes, the benefits of consolidation are there for all to see, especially for customers who consolidate everything in one account, so if they're going to pay fees they just pay them once. If you consolidate that with us then you're not going to pay Isa fees at all, and also have everything under one roof so you get one statement. Everything's consolidated together – you see exactly where you are at the same time of the quarter or the month, depending on when you get your statement. You've also got easy access on the phone or via the web. So I think for customers, allowing them to merge their PEP and ISA plans is great. We recognise that there are people who like to keep PEPs and ISAs separate, but equally, as businesses, we're also focusing on cost. The more we can focus on costs and bring them down, ultimately the simpler and cheaper our service becomes for customers – an example being our removal of the ISA administration fee.

CP: One thing that investors do have to focus on is that this transformation from PEPs into ISAs does have a disadvantage if they are holding cash in their portfolio. Previously, they wouldn't necessarily have had any charges levied on the interest that they earned but under the ISA rules they will automatically suffer a 20% deduction.

PH. An important point I feel. Lets be clear about cash. If it is your intention to hold cash long term then choose a cash ISA to do this – you'll receive higher interest rates and there will be no deductions under HMRC rules. Yes, there will be times with a stocks and shares Isa when you may be out of the market between investments and therefore have some uninvested cash, but because cash is not allowed as a long term investment in this tax wrapper the HMRC use the deduction as a disincentive to hold cash. So part of your stocks and shares Isa strategy should be to maximise your time invested in the instruments of your choice – plan ahead.

SK: From April we're having a new flat rate of 18% on capital gains, and this will affect the attractiveness of ISAs. What are your views on this particular issue?

SB: First of all we need to wait until next month for Darling's first budget to find out what the final outcome of these capital gains tax changes are, because at the moment it's not entirely clear. Certainly for most people the dropping of the rate to 18% makes taking capital gains tax charges a bit more palatable –

the exception being AIM, which we've talked about already and which for the most part has been outside of the ISA. I don't think it makes people any more willing to pay if there's a wrapper within which they can hold assets. If there's a theme to all of what we're talking about here, it's this idea of simply making use of allowances – that's capital gains tax allowances, your ISA allowance and the tax wrapper that you have there to make your portfolios as efficient as possible. If you're paying 18% on your gains year on year, that's a sizeable chunk, even though it is reduced from what it had been. So make sure your portfolio is as tax-efficient as possible anyway, but also make sure you make use of those allowances.

CP: There were similar discussions when the ability to reclaim dividend tax was removed focusing on whether or not this devalued the benefits of ISAs. It meant that potentially you reassess what you might be going to put into that tax wrapper, but fundamentally the value is there. The same remains true now. Why pay tax if you don't need to, even at the lower rate?

GK: I don't think the change in CGT will fundamentally affect the attractiveness of ISAs. An ISA is still a very important tool in your CGT avoidance armoury and you should still continue to utilise it to the full. I don't think anything's changed.

PH: Yes, I'd echo that. The fundamentals haven't changed. Some clarity would go a long way to both reassuring people and just enabling them to see exactly what their own individual position is, and I think that's the worry for individuals.

SK: What about new information rights for nominee investors? If you hold a share in an ISA it has to be via a nominee. Do you think investors will be interested in exercising these rights?

SB: I think probably they will be. The first point to make is actually that ISA investors have always had slightly improved rights than those holding assets within a nominee in any case. We've been able to make letters of representation available to them. I think most of us will welcome the Companies Act, which puts most of the emphasis on the companies to make information available and to give shareholders the rights that sometimes they miss out on. Of course, some of the stuff investors want is available anyway – things like reported accounts for instance – and we've always made them available free to download on our website.

CP: I think it's questionable as to how much tangible benefit this represents for investors. The investment tools that are available and the research that's available already go far beyond what companies are generally publishing. So I think that well-informed investors are already getting what they need, but from other sources. Having said that, anything that widens the rights of investors is obviously positive and to be welcomed, but I don't know that it will make a tangible difference.

GK: We're pretty passionate about this subject. In the precursor to the Companies Act, when the bill was going through Parliament, we lobbied members of both Houses on behalf of the nominee shareholders and pestered them to the point where we even held a rally outside the Houses of Parliament. I think we were fighting on behalf of choice for investors. It doesn't mean that everybody will want to exercise that choice, but we've already put in place for our customers the ability to get communications directly from companies and already in these early days, we have several thousand people who have opted for either email or paper correspondence directly from companies. It does involve a lot of work for stockbrokers, because you have to exchange information with one registrar to tell them that Mr Bloggs would like to have information on this share and another registrar that Mr Bloggs would like some information directly from the company on another investment that he's got. But once you can fully automate it, which I think we've done, it can work on behalf of investors. Will we see millions of people exercising that right? I doubt it somehow, because I think we are in an information world where a lot of this stuff is easily accessible to the private individual now. But I think it's important to have that choice and we therefore support and encourage it.

PH: We welcome more transparency, more choice, and that can only be a good thing. Whether it will make a great deal of difference depends on what kind of customer you are. If you are an active trader it's probably not going to even flicker on your radar. If you're a long-term investor that's particularly into one or two companies that you believe in then that's maybe slightly a different issue. But there's such great independent information out there already. I think a lot of investors are really looking for independent commentary rather than, if you like, the 'party line' of the company. And if they're presented with reports and accounts when what they're often really looking for is an analyst who's looking at that and saying 'Well, OK, they're telling you that, but what lays behind some of those numbers?' So I think the independent research has stolen a march really over what companies are providing.

SK: Lots of people leave their ISA investment to the very last minute. What would you say to those people?

SB: Yes, I think you're right. It's why there's always a push forward at the end of the ISA season. We always say on the website, 'Don't forget to get your ISA allowance in'. If you don't use your allowance before the end of the tax year, you'll lose it for the next year. So I guess the message is, and most people won't do this, is not just to make sure you get your allowance for this year, but start investing as soon as you can for the next allowance.

CP: There really is no reason to leave it to the last minute. If it's just that you're not sure where to put the money, make the contribution well before the tax year end and then take the time to consider where you're going to invest it. The other issue, which perhaps a lot of people don't realise, is that by making their contribution at the last minute they are running the risk that their debit card might be rejected and since there is no time to address these issues with their bank, they actually find that they have missed the opportunity to subscribe.

GK: For a lot of people it's finding that lump sum from somewhere that's the issue. What we'd say to those people is not to forget that you can drip-feed your ISA across the year, so if finding £7,000, £3,000 or whatever on the eve of the tax year is rather difficult, try to do it earlier. If you can't do the full amount earlier, drip-feed it across the year.

PH: Buy now to avoid disappointment. I think this year with Saturday being the last day of the tax year makes it particularly difficult. We're doing what we can by opening late at our London Investor Centre, for example. We've also got our online and telephone facilities that are open on Saturday. We've all got stories from the past about people getting in their cars and driving hundreds of miles to deposit their cheques before the deadline. There really is no reason to do that. So get your investment in now, and then you've got time to think and plan what you want to do with it. Then on the Monday of the new tax year start thinking about your new ISA investment allowance again and if you can't afford a lump sum on the Monday, then I suggest you start dripping it in by making regular monthly contributions. ■

THIS ROUND TABLE MEETING TOOK PLACE AT GRANGE CITY HOTEL, LONDON, ON WEDNESDAY 13TH FEBRUARY 2008