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What's next for the IFISA?

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Covid-19 has stalled the rapid growth of the IFISA. Is there life for the tax wrapper after the pandemic? Michael Lloyd investigates...

2020 should have been a blockbuster year for the Innovative Finance ISA (IFISA).

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Since the tax wrapper was launched four years ago, it has steadily grown in popularity. According to figures from HMRC, £36m was invested via 5,000 IFISA accounts in the 2016/17 financial year, followed by a huge jump to £277m invested through 49,000 accounts during the 2017/18 tax year.

Over the 2018/19 tax year, IFISA investments reached a peak of £328m via 38,000 accounts, and the IFISA market is believed to have broken the £1bn barrier in the 2019/2020 tax year, according to data from The Investing and Saving Alliance.

But then – just when the IFISA was reaching substantial levels – the pandemic hit.

Thanks to almost a year of economic instability, national lockdowns and job losses, investors can no longer afford to invest so much and are becoming more cautious. Many are opting for low-interest paying cash accounts in this uncertain climate, while others are gravitating towards 'safe havens' such as gold.

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Understandably, some investors opted to withdraw their funds in the face of an economic recession, and peer-to-peer lending platforms witnessed a spike of withdrawal activity in the early days of the pandemic.

March and April have always been the busiest months for ISA deposits, but for IFISA providers, 2020's ISA season was characterised by delays in withdrawals, pauses in taking new investments, higher risks of defaults and lower predicted returns.

In addition, this year's ISA season was the first to take place after stricter investor marketing rules were introduced. Under the Financial Conduct Authority's regulations introduced in December 2019, P2P lending platforms can only communicate 'direct-offer financial promotions' to high-net-worth or sophisticated investors, those receiving regulated financial advice or restricted investors.

It is no surprise then, that across the board, the majority of platforms have reported that IFISA inflows have fallen this year. Proplend chief executive Brian Bartaby says that the property-backed platform's IFISA inflows for the current tax year have been running at around 20 per cent below 2019 levels.

Peer2Peer Finance News understands that one platform has seen underwhelming demand for its recently-launched IFISA, while another platform has paused the launch of its IFISA indefinitely.

Filip Karadaghi, co-founder and chief executive of LandlordInvest, sums up the recent trends.

"It's typical risk-adverse behaviour," he says. "Across the whole industry investors are converting to cash and some platforms suffered from liquidity issues."

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This is clearly a worrying trend, but it must be viewed in perspective.

Covid-19 is the reason IFISA inflows are down – it is not a reflection of the product itself or the reputation of the sector. Industry stakeholders believe that once the coronavirus vaccine has been distributed and the pandemic comes to an end, confidence will return, and investors will start searching once more for inflation-beating returns.

"I think ISA money will increase by the end of the tax year," predicts Karadaghi.

"Investors will realise which platforms are stable and continued to function during the pandemic and I would expect ISA inflows to start increasing again. I think it'll pick up next tax year to last year's level."

Although inflows are down overall, the P2P lending sector has witnessed some demand for the product via ISA transfers over the past year. This has mostly come in the form of transfers from stocks and shares ISAs, but there have been signs that the IFISA investment market is maturing, with more and more IFISA transfers coming from other IFISA providers.

Read more: RateSetter to stop receiving IFISA transfers

"We have seen people transferring in their IFISAs from other providers," says David Turner, co-founder and chief executive of Invest & Fund.

"This is due to a number of factors: a clean credit book, six per cent plus returns, exceptional credit rigour and a continual supply of first-class loans."

Other platforms have simply shifted their focus away from their IFISAs this year in order to focus on other forms of financial backing.

Both Funding Circle and LendingCrowd have temporarily paused new retail lending while participating in the coronavirus business interruption loan scheme.

And RateSetter, which was previously the largest IFISA provider, is expected to see a substantial drop in IFISA inflows since the platform closed its doors to new retail investment earlier this year following its acquisition by Metro Bank. Existing investors can still invest in the platform's P2P loans using the IFISA wrapper.

Elsewhere, many platforms including Assetz Capital, CrowdProperty, Kuflink and JustUs have affirmed their commitment to the IFISA as an important part of their long-term strategy. This view could prove particularly prudent if the IFISA market shrinks, leaving existing IFISA investors searching for a new IFISA provider.

"Those with IFISAs at platforms that are no longer conducting IFISA lending will move their accounts if their funds have been paid back," says Atuksha Poonwassie, co-founder and managing director of Simple Crowdfunding.

"People could just take the money out, but chances are they'll transfer to another provider."

This is not the only way for platforms to improve IFISA inflows in the future. Some platforms have been exploring the idea of IFISAs for pension saving.

Pension investors lose their tax advantages when withdrawing their money and can only take their funds out when they are over the age of 55. But IFISA investors can take their money out and put it back in during the same tax year if need be, all without losing the tax advantages.

Stuart Law, chief executive of Assetz Capital, says this flexibility makes IFISAs the perfect investment during the uncertain economic climate.

"People will see by March that businesses are recovering and will have confidence in an IFISA, knowing that if something goes wrong they can withdraw their funds easier," he says.

"I think the next ISA season will be good. People are continuing to find new homes for money with risk."

Law highlights another opportunity that some IFISA providers have been eyeing: IFISAs as a home for landlords' investments.

So-called amateur landlords have been exiting the buy-to-let investing space following tax changes such as the phasing out of mortgage tax relief over the past four years.

From April 2020, landlords are no longer able to deduct any of their mortgage expenses from rental income to reduce their tax bill.

Law says direct ownership of rental properties will continue to decline, with many landlords who may have used buy-to-let investments as a retirement plan being put off due to the higher tax rate. He suggests that investing in property via an IFISA could prove to be an appealing alternative for them.

"Some people coming out of buy-to-let will enter the IFISA market," Law says.

"P2P lending structured in a way that competes with buy-to-let property is the future for buy-to-let investors."

Similarly, Invest & Fund's Turner says that if capital gains tax (CGT) rates increase, IFISA inflows will soar. This follows a report from the Office of Tax Simplification in November which said increasing the minimum CGT rate of 28 per cent to bring it closer to income tax rates could help raise up to £14bn to repair the government's finances from spending during the pandemic.

Read more: P2P platform bosses split on how IFISA inflows will perform this tax year

"The government is talking about increasing CGT rates and if that happens a lot of people will find alternative investments," Turner says.

"Anything producing a yield will become more popular than it is now, particularly within tax wrappers like self-invested personal pensions and ISAs."

Many platforms do not plan excessive innovation to their IFISAs this year, with a couple of exceptions.

JustUs is planning to offer P2P mortgages this year at a 2.5 per cent fixed interest rate for borrowers. The platform's founder Lee Birkett is planning for the product to be eligible for an IFISA, offering investors a one per cent return via the tax wrapper for investing in owner-occupied mortgages, which would help free mortgage prisoners – those unable to remortgage and trapped on their current deal.

He says he is also calling for a one per cent government guarantee.

"[Our IFISA comes] at a time when interest is at zero and looking like it will be negative in 2021," Birkett says.

"It allows investors to help other people and should be very welcome, particularly if backed by low-risk mortgages."

Before Covid-19, IFISA inflows were rising year-on-year. The coronavirus-induced economic crisis may have slowed this growth in 2020 but it will end when the vaccine is eventually rolled out and confidence returns.

Until then, there is plenty to be positive about, as IFISAs provide a flexible investment option during this time, an alternative for buy-to-let investors and those hit by capital gains tax, and soon, a way to invest in owner-occupied mortgages.

There are clear signs that the IFISA has just entered into an autopilot mode for 2020 before re-emerging better than ever in 2021 and beyond.

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