

THE GOOD GUIDE TO THE INNOVATIVE FINANCE ISA

GOOD WITH MONEY
MORE MONEY, FEWER PROBLEMS

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GOOD WITH MONEY



Introduction:

You might have heard of “IFISAs” and wondered what they are. They are certainly a bit of a mouthful.

They are also a relatively new type of ISA, which are very different from both the more familiar Cash ISAs (still the nation’s favourite kind, despite low interest rates) and Stocks and Shares ISAs.

Unlike Stocks and Shares ISAs, IFISA returns come from interest or “Target IRRs” (target internal rates of return) on loans or bonds, rather than dividends, or the growth in the value of company equity.

IFISAs also offer a typically higher rate of return than Cash ISAs, although that’s because they are riskier. With IFISAs, you are lending your money to businesses or individuals via an online platform, rather than putting it in the bank. So the risks are that your capital could be lost altogether, or you may not get back the target returns.

Still, they are building a dedicated following among investors looking to diversify and make their money work harder. Like the sound of it? Read on.

What does IFISA stand for?

IFISA means Innovative Finance Individual Savings Account. All ISAs are tax-free savings vehicles. With this one, you can invest in what's called "innovative finance", tax-free.

What is Innovative Finance?

Innovative Finance refers to things like peer-to-peer lending or debt-based crowdfunding. It's called innovative because it is a way of lending to or investing in individuals or businesses, in exchange for a return, which bypasses the banks. The platforms have "innovated" a way to offer more direct, higher paying investments, in other words.

They are also innovative because they have worked out a way for "normal" investors to put money into small and medium-sized businesses (90% of the UK economy), rather than restricting investors to the large multinational companies that make up a typical stocks and shares portfolio.

Bank of England Base Rate = 0.5%

Target IFISA return = 5 to 7%

Annual % growth in FTSE100 = 8% (2017)

Best-buy cash ISA interest rate = 1.95%

How is an IFISA different from a normal ISA?

There's no such thing as a normal ISA. Now there are lots of types, all with different characteristics. Stocks and Shares ISAs and Cash ISAs have been joined by Help to Buy ISAs, for first time buyers only; Lifetime ISAs, which under 40s can use for either a first home or for retirement; and IFISAs.

The latter, like Cash and Stocks and Shares ISAs, have no restrictions on who can invest (see our table on different types of ISA on page 9), but have different characteristics to both.

“The opportunity to access higher returns while helping innovative businesses access the funds they need to grow and achieve their goals really excited me. I’ve invested more than £200,000 over the past few years and never lost a penny whilst earning a good 9.2% APR return.”

When trying to remember what makes the IFISA special, remember these four Is:

INVESTMENT, not deposit

The most obvious difference between an IFISA and a Cash ISA is that an IFISA typically has a higher rate of return. That’s because they are a riskier investment, rather than just a deposit account.

INTEREST, not equity

The main difference between an IFISA and a Stocks and Shares ISA is that Stocks and Shares ISAs purchase the equity of companies that are listed on an exchange, often via funds, on your behalf, rather than loans or bonds that pay interest.

ILLIQUID, not liquid

Buying equity shares in the stock market means the value can rise or fall in line with the performance of a company, fund or index. You can usually sell your shares at any time, so stocks and shares are considered “liquid”.

With an IFISA, while returns are dependent on company performance, you are lending the money in anticipation of a certain level of interest. Because the IFISA investments are debt-based (so loans or bonds), they are often fixed term, so your money has to remain invested for the term – unless you can find a buyer for it on the platform’s exchange (most IFISA platforms have an exchange where lenders can sell their loans to other users.) They are arguably more illiquid than stocks and shares, “generally speaking”, although some may be relatively easy to sell.

INVOLVED, not passive...

Finally, if you have an IFISA where you lend to businesses or projects rather than people (through P2P IFISAs), you can sometimes pick the business yourself. Unlike some robo Stocks and Shares ISA investment platforms, which pick your funds for you based on your risk profile, some IFISA platforms allow you to browse businesses or projects and self-select the one you think is right for you. You are in the driving seat.

Why are rates of return on an IFISA typically higher than cash?

1. There is always the risk that a company could fail, for whatever reason, even if its historical cash flow has indicated a decent credit risk. The risk of failure of the company or the individual that you are lending to is one reason for the higher return. Bear in mind that the nature of the risk can vary between companies or projects, even when returns are similar, so it's always worth checking the Offer Document.
2. Lower overheads. Innovative finance platforms are reinventing the wheel. They are powered by the latest technology and are relatively new, so they do not have the legacy of cumbersome overheads, such as big back offices, that larger, more traditional investment platforms have. They can pass on the savings from lower overheads to customers, in the form of higher returns. Just like a bank would lend to a business – you become the banker.
3. Lower fees. Partly because of the lower overheads, innovative finance platforms can afford to operate on lower profit margins than older businesses, so they can also afford to charge lower fees for arranging finance deals between lenders and borrowers than banks.

**£20,000 ISA limit
per tax year**

How much can I put in an IFISA?

You can put up to £20,000 in any type of ISA in a tax-year (April 6 to April 5). So you could put all of this into an IFISA, or you can split it between different kinds of ISA if you wish. But £20,000 is the annual tax-free maximum.

For example:



Mr Edwards is 38 and wants to take advantage of the Lifetime ISA for his retirement saving, but likes the idea of an IFISA, because he has found a technology company offering a 7% bond. He has £10,000 to invest in this tax year. The maximum he can put in his Lifetime ISA is £4,000. He chooses to put the remaining £6,000 in an IFISA.

Why would I invest in an IFISA rather than a normal ISA?

It's difficult to give a general answer to this question, as it would depend on the type of loan you are making and also on the type of borrower the borrower. Compared with Cash ISAs, IFISAs have the advantage of typically higher returns (although they are also riskier).

You might also choose an IFISA to complement a Stocks and Shares or Cash ISA you hold, rather than replace them altogether. In fact, many investors open IFISAs as a way to diversify their other investments.

For instance, a stock market investor worried about a downturn in equity markets might put some money in an IFISA, which is not affected by stock market performance, to hedge against a slump.

This could be particularly useful for someone investing tax-free for the long term, for retirement saving, for example, and wanting to use ISAs as well as their pension (see Bruce Davis's blog on page 14).

A Cash ISA investor curious about IFISAs might choose to set aside a small amount in an IFISA to bring a little more profit to their investment portfolio, without sacrificing more security than they are comfortable with.

... And some might say the IFISA is more interesting, because it allows you to choose businesses you think look like good investments directly – and to choose investments you really like.

Why are IFISAs riskier than cash?

The important advantage of cash ISAs is that unless the bank or building society goes bust, you know you will get the quoted interest rate. With IFISAs, it's not so simple. If you are lending to a group of individuals, there's a bad debt risk that may bring down your rate of return.

If you are lending to a business or project, there's also a risk that the business might not hit its targets and so will not be able to return the quoted figure to you.

Cash ISAs with banks or building societies are covered by Financial Services Compensation Scheme deposits cover up to £85,000, so if the bank fails, any deposits up to that limit are protected.

With IFISAs, if the platform fails, FSCS cover usually goes up to £50,000 (if the platform is regulated by the Financial Conduct Authority). But it's important to realise that there is no cover for investment-related losses. In the event of a platform failure, in some cases a third party might step in to manage the loans, so that investors do not lose out.

Often there is some kind of insurance cover that would pay out in case a borrower was unable to repay lenders. But if there isn't any kind of cover for lenders with your IFISA, you run the risk of not getting your capital back at all and certainly the risk that your returns will not be as high as expected.

How can I tell how risky an IFISA is?

Generally speaking, the higher the rate of return, the higher the risk level. You should always research the particular risks of what you are investing in. You may decide, on further investigation of a higher rate offer, that the specific risks involved are risks you are prepared to live with.

There should be an Offer Document, or similar type of document, that clearly lays out what the risks are. Platforms usually also state how much due diligence and credit checking they perform but should be happy to answer questions directly.

Has anybody actually lost money through IFISAs yet?

Some investors have lost money on crowdfunded bonds, yes, although these were not held in an IFISA. Square Pie, the food retailer, recently went into administration. It had issued an 8 per cent bond to investors previously, so it can happen.

Can I invest with different IFISA platforms in the same tax year?

Unfortunately, you can't. All of your IFISA money has to be held with the same platform in that tax year. There's nothing to stop you shifting your IFISA pot between different platforms once a year, but you can't contribute to more than one at a time.

Can I transfer an existing ISA into an IFISA and vice versa?

Transferring your existing ISA funds into an IFISA is really easy. You can find a form on the platform you want to transfer your funds to. Print this off, fill it out and send it to the NEW platform at the address provided. They will then instruct your OLD ISA provider to move the funds across.

What are the different types of ISA?

	Limit	Risk level	Typical interest/return	Features
Cash ISA	£20,000	Low	Low <2%	Allows savers to deposit savings up to the annual limit in accounts covered by the Financial Services Compensation Scheme.
Stocks and Shares ISA	£20,000	Low to high depending on type of fund	Varies depending on risk level, performance and fees. Equity not debt and therefore capital growth rather than interest	Up to £20,000 can be mix of stocks and shares and cash, can be "flexible" so you can take money out and put it back in without losing the tax-free status of that bit of your allowance.
Junior ISA	£4,080	Low to high depending on type of fund	Varies depending on risk level, performance and fees. Capital gains rather than interest	Cash or stocks and shares or a combination of the two. In the child's name so does not form part of your £20,000 annual allowance. The child can access the pot when they reach 18.
Innovative Finance ISA	£20,000	Medium to high depending on diversification/ interest rate	Varies – around 5 to 7 per cent. Debt-based, therefore pays interest not capital growth	Introduced April 2016. Only one innovative finance platform per ISA per year. Can invest in a range of projects or credit profiles on the same platform to diversify. Can also invest in other types of ISA alongside, up to the maximum annual limit.
Lifetime ISA	Up to £20,000 (but only first £4,000 eligible for the bonus)	Cash or stocks and shares. Low to high	Varies depending on type/risk level, performance and fees. Equity not debt, therefore pays capital growth not interest	Government will top up to £4,000 of annual tax-free savings with 25% contribution. You must have been under 40 on April 6 2017 to be eligible. The Government bonus is paid to a maximum age of 50. Savings in the LISA must be used either to buy a house or towards a pension. Pension can be accessed from age 60. Part of annual £20,000 allowance (giving £16,000 left over). Cannot have one of these and a Help to Buy ISA.
Help to Buy ISA	Up to £2,400 (£3,400 in first year)	Low (cash only)	Low <2%. Cash accounts, return is interest	You must use the proceeds to buy a first home worth up to £250,000. Government top-up of 25%. £12,000 max investment, starting deposit of £1,000 minimum. Part of overall ISA allowance (giving £17,600 to invest in other types of ISA). Cannot have a Help to Buy and a Lifetime ISA in the same tax year.



By Chris Hancock,
chief executive of
Crowd2Fund

How IFISA's can help you diversify your investment portfolio

Savers have had a torrid time since the financial crisis. With interest rates still very low, it is now no longer tenable for savers to hold Cash ISAs, as returns are lower than the current rate of inflation.

If savers start to think a little more like investors, they stand a better chance of being able to safeguard their future. Part of this shift might involve investing in an IFISA. The IFISA allows people not only to benefit from higher tax-free returns but also gain further from compounding interest growth over time.

As one of the earliest platforms to introduce the IFISA, we've listed our top tips to help savers maximise their tax-free allowance, while also supporting the growth of British businesses..

Use It Or Lose It

The £20,000 IFISA allowance has to be used up in full by 5 April. It is not possible to retrospectively use this once the tax year has ended. In order to get the full benefits of both tax saved and future growth, investors

should check to see whether they have used their allowance for this tax year in full, and if not consider whether doing so fits in with their investment strategy.

Transfer Historic Lower Yield ISAs Into The IFISA

With the best performing easy access cash ISAs now generating barely more than 1%, and a volatile stock market making Stocks and Shares ISAs look risky, you could consider transferring existing ISAs into the IFISA.

It shouldn't take more than a couple of weeks for funds to be fully transferred, and doing so this way means they will remain within their tax wrapper. The Crowd2Fund IFISA generates an average APR, before fees and bad debts, of 8.7 per cent - meaning a fully invested £20,000 allowance would yield £1,740, compared with £200 from a 1 per cent cash ISA.

Diversify your portfolio to match your investment goals and risk appetite

Take the time to reduce the chance of losses by spreading funds across a range of different investment opportunities to match your investment goals and risk appetite. From a diversification perspective, it is generally good practice to invest in a variety of different industries and companies.

For example; if you are more risk averse you may have a preference for lending to opportunities which are securitised with property.

Review your portfolio on a regular basis

Every quarter, review the performance of your portfolio to assess whether it has performed in line with your expectations and risk appetite.

If you have not reached your desired overall return from interest, you may want to consider deploying a greater concentration of funds into higher risk, higher return campaigns.

A simple way to track performance is with an Excel sheet which forecasts your expected annual return, and breaks this down quarterly. This can then be updated with actual performance as a comparison.

Don't forget to reinvest expired loans

Loan terms can be a few years. If you have been investing on a lending platform already, you might be receiving monthly repayments made up of interest and capital. If these investments are made within the IFISA wrapper, you can still invest them into qualifying IFISA campaigns without losing the tax benefits.

Take the time to log into your account to check whether funds need to be deployed into new investments to maximise returns.

Trade investments on a secondary market

Trading P2P investments on a secondary market can be a useful way to diversify your portfolio and pick investments better tailored to your overall strategy. You may wish to pick opportunities in sectors in which you have a specific interest or expertise, or sell primary IFISA investments to buyers and bank a profit. To maximise returns these funds can then be redeployed back into your IFISA.

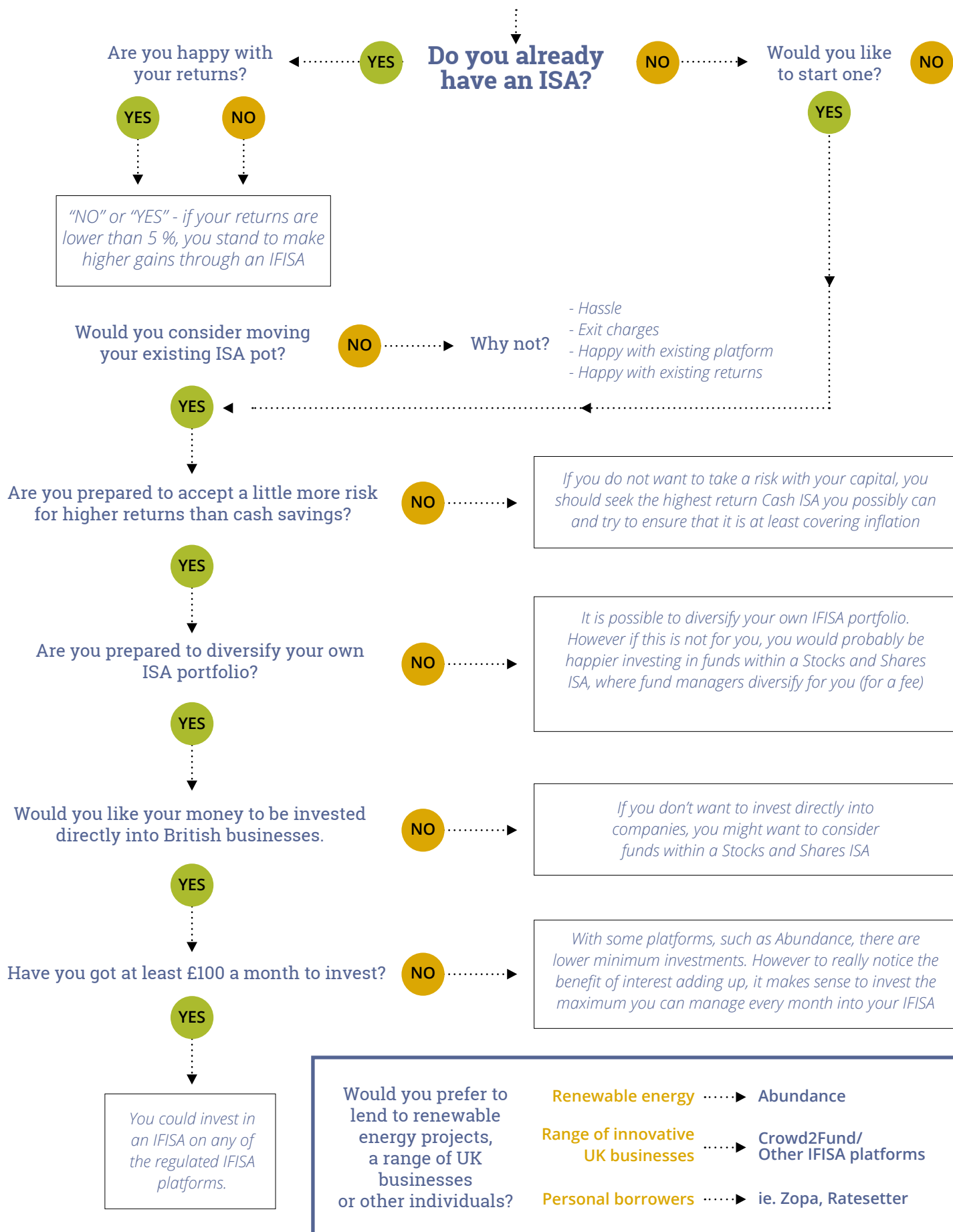
Utilise smart-invest if time pressed

There are currently two different types of IFISAs on the market: one which allows investors to directly choose the individual businesses they lend to and the other which operates a pooled investment approach.

The majority of investments made on Crowd2Fund are facilitated by investors directly choosing the companies they lend to however, it is also possible to take a passive investment approach to the IFISA.

Our Smart-Invest tool allows IFISA users to define their investment criteria, and savings plans. Smart-Invest will then automatically invest funds into opportunities which match this.

Is an IFISA right for me?





By Bruce Davis
*Co-founder and joint
 managing director of
 Abundance Investments*

Can an IFISA form part of retirement savings?

Are pensions losing ground to ISAs for retirement saving? It may never become a reality for most, but there is plenty of evidence to suggest that for a growing number of people, ISAs are central to their retirement plans.

The fourth Great British Money Survey, commissioned in 2016, found that 30 per cent of ISA savers said they were using their ISA to save for retirement. Remarkably, the same proportion (31 per cent) of our own ISA customers told us in 2017 that their financial goal for their Abundance portfolio is retirement.

So what makes an ISA appealing for retirement saving? Consider the annual and lifetime allowances alone:

	Pension*	ISA
Annual contribution allowance	£40,000 + any unused allowance from the previous 3 tax years	£20,000
Annual allowance (high earners)	If you earn more than £150,000 your allowance drops as your income climbs, down to £10,000	£20,000
Annual allowance (if you have started withdrawing money from the product)	£4,000	£20,000
Lifetime allowance (whether from cash savings or investment returns)	£1 million, above which you pay additional tax - but you might be able to protect your pot from this extra tax under certain circumstances	No upper limit

*Pension allowance information taken from: <https://www.gov.uk/tax-on-your-private-pension>

As the above table shows, the beauty of the ISA is its simplicity, while pensions have been victim to the whims of successive chancellors and governments.

So if ISAs are popular for retirement saving, what does a retirement income in an Abundance ISA look like? The key features of the Abundance ISA are listed below.

1. **Investments that pay regular, fixed or predictable returns**

Abundance offers a wide range of individual investments across a range of project lifestages, each of which provides different investment returns. With Abundance, when it comes to generating an income, “Operational” and “Business Growth” investments tend to offer long term returns over 5 to 25 years, with some repaying capital and interest every six months. These investments tend to be in projects and businesses that are well established or generating energy. The revenues which provide the return (and the risks) are dependent on the specific technology or the business activity, for which all information is in the investment Offer Document.

Each investment is different in terms of interest, return structure and risk; our funded investments demonstrate the growing range Abundance offers. This lets you build a diversified portfolio of investments across sectors and between categories, with clear visibility over when you will be paid and how much to expect.

These income-generating features are further enhanced by the positive benefits of ISAs. In an Abundance ISA, you will never be taxed on your capital or income, and when there is cash in your account, you can withdraw whenever you like with no fees.

2. **An income that keeps on giving**

Another useful feature of the investments you can hold in an Abundance ISA is the capital and interest repayment structure, described above. Mostly found in the “Refinance” category, these investments repay an equal portion of the capital you invested at the same time as interest payments, every six months.

This is useful when saving for retirement, as investors can reinvest part or all of their cash return to grow their money using the original pool of cash. It's the same idea as reinvesting dividend payments in a Stocks & Shares ISA, except you're getting some of the money originally invested back too, which can also go into new income-generating investments. This can grow your Abundance ISA holdings and diversify them as, by the time you receive a return, new projects should be available to invest in.

The same strategy can be used during retirement to maintain, or even continue to grow, an income-generating portfolio while drawing an

income. For a live example take a look at the Calculator on the Monnow Valley CHP investment, which is a long term Operational Debenture.

3. **A tax-free retirement income**

This last point is not unique to the Abundance ISA, but is unique to ISAs as a whole, and is a large factor for many people who decide to get a retirement income from ISAs. Pensions have the benefit of upfront tax relief on contributions, and a 25 per cent tax free lump sum allowance.

With an ISA you pay in from your net salary, meaning after income tax has been taken off. At the other end, there is no tax to pay when withdrawing money, no matter how much it might have grown or how frequently you withdraw.

The simplicity of ISAs is undoubtedly a boon. It does not, however, necessarily make it a better product than a pension and you should seek financial advice if you have questions.

But as demonstrated by these key points the Abundance ISA can be a useful tool for retirement saving because:

- Our investments can give you visibility over your income / returns
- Our innovative repayment structure* can allow you to flexibly re-invest and withdraw returns to create a perpetual income
- You never pay tax on the money you earn or spend in your ISA

*Not a feature of all investments.

Risk warning

Part or all of your original capital may be at risk and any return on your loan or investment depends on the success of the company. Investments may not be readily realisable. Estimated rates of return are variable and estimates are no guarantee of actual return. Consider all risks before investing.

How to choose a platform

As you can only invest in one IFISA in a tax year, it might take you a while to decide which one is for you and you should consider how your IFISA will fit within your wider portfolio. If you invest a lot in buy to let property, for example, you may prefer to lend to individuals or businesses instead.

In addition to Abundance Investment (renewable energy) and Crowd2Fund (British businesses) some of the platforms to choose from are listed below.

They can be grouped according to the type of borrowers on the platform.

Lending to individuals ie:

Ratesetter

Zopa

Lending to businesses ie:

Crowdstacker

Folk2folk

Funding Circle

Lending against property ie:

Proplend

Property crowd

About Abundance Investment

USP: Investments that help you make a decent return and a nicer planet.

Specialises in loans to renewable energy projects around the UK

About: Abundance was founded in 2012 and has raised more than £30 million from individual investors for solar, wind and biomass projects around the UK. The platform has a £5 minimum investment and sells, somewhat uniquely, long-term debentures, which are like IOUs from the renewable energy companies to investors.

So far, the loans have been repaid using revenue from electricity generated by the projects, which comes from electricity prices and renewable energy incentives, such as feed-in tariffs.

Terms range from one year to 25 years. Investors can sell debentures they no longer want to other investors.

Investors money is usually paid back to them as capital and interest repayments, which helps to manage the risk of potentially not getting all of your money back at the end of a 25-year period.

Typical rates of return: 5 to 9 per cent

IFISA minimum opening amount: £5

Charges: Abundance charges the projects raising money two fees: one for raising the money and one for managing the investment and investors on a yearly basis.

abundance.

About Crowd2Fund

USP: "We grow innovative businesses"

Crowd2Fund provides opportunities to lend to a range of businesses in different sectors for higher returns than are typical on peer-to-peer platforms. It performs strong due diligence and will not allow companies that cannot repay funds to raise money.

It has a 0% default rate so far and a target default rate of 0.5%.

You can pledge to invest an amount at the interest rate you want to receive, or pick individual businesses.

Established in 2014, the platform has an app, so you can invest on your phone. It also has a "Smart Invest" feature, which automatically invests and re-invests for you, based on your goals and risk appetite.

Typical rates of return: Investments have an interest rate between 6% - 15%, averaging at 8.7% APR

IFISA minimum opening amount: £100

Charges: Crowd2Fund charges the businesses raising money a 6% fee on the total amount raised. Investors are also charged an annual fee on the interest and capital payments.



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Things to remember

- As long as you don't invest more than £20,000 in a tax year, your earnings will be tax-free
- You can only have one IFISA in the tax year, with one provider
- You can use your ISA allowance in a combination of Cash or Stocks and Shares, Innovative Finance or Lifetime/ Help-to-Buy but you cannot have a Help-to-Buy and a Lifetime ISA in the same tax year
- The £4,000 maximum you can put in a Lifetime ISA is part of the £20,000 maximum, so you still have £16,000 to invest or save tax-free before you reach the limit
- Likewise, the maximum £2,400 you can put in a Help-to-Buy ISA is part of the £20,000 maximum
- You can invest lump sums or monthly in all ISAs except the Help to Buy ISA, which must be monthly deposits.

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