THE GOOD GUIDE TO THE INNOVATIVE FINANCE ISA

GOOD WITH MONEY
MORE MONEY, FEWER PROBLEMS

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Introduction

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

Launched in April 2016, the IFISA is quite 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 on peer-to-peer loans, or bonds, rather than dividends, or the growth of a company's share price. These bonds are issued by small organisations and start-ups, making the IFISA an exciting area for investors looking to support small businesses.

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.

However, with average cash interest rates hovering around 1 per cent for nearly a decade now, IFISAs are growing increasingly popular with savers looking for income, as well as with investors looking to diversify their portfolios with a chunk in this new area.

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 in this space 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 per cent 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 = 0.75%
(as of March 2019)

Target IFISA return = 5 to 9%

Annual % growth in FTSE100 = -8.7%
(2018, Source: FE Analytics)

Best-buy cash ISA interest rate = 1.45%
(as of March 2019, Source: MoneySavingsExpert)

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.

IFISAs, 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.

When trying to remember what makes the IFISA special, remember these four I's:

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. The exception is if you can find someone to buy the loan from you. Many IFISA platforms allow their customers to buy and sell their loans to each other.

INVOLVED, not passive...
Finally, many IFISAs allow you to lend directly to businesses that you choose. This gives you full control over where your money is going.

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.

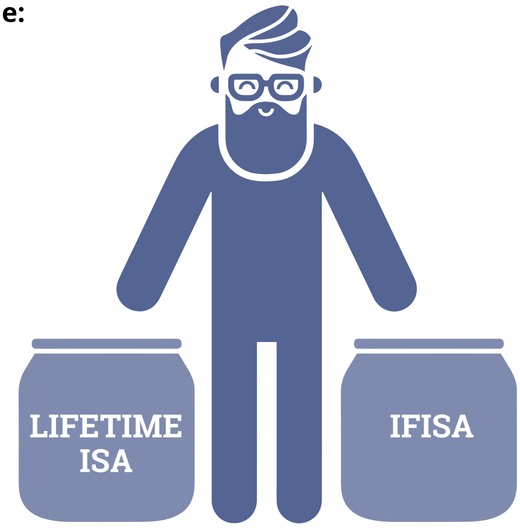
3. Lower fees. Partly because of the lower overheads, innovative finance platforms can afford to operate on lower profit margins than older businesses, so they can also afford to charge lower fees for arranging finance deals between lenders and borrowers than banks.

£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 adult 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 per cent 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. 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. This might include retirement saving, for example, as well as those wanting to use ISAs alongside their pension pots.

A Cash ISA investor curious about IFISAs might choose to set aside a small amount in an IFISA to bring a little more income 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?

Default rates are typically low, but there have been a few cases of peer-to-peer lenders going bust, including BeTheLender in 2014 and Collateral last year. In the former case not all investors recovered their money, while Collateral's collapse is still going through administration. For this reason choosing a well established platform with a strong reputation is important.

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 or shares held	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	£4,260	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%. 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 annual savings of up to £4,000 with a 25% bonus, meaning they will contribute a maximum of £1,000 in any one tax year. You must be over 18 but under 40 during the tax year to open a LISA and government will only pay the bonus up to the 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% up to a maximum of £3,000. Starting deposit £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 to maximise your IFISA returns

Launched less than three years ago, the popularity of the Innovative Finance ISA (IFISA) is still growing – and growing fast. This is because it can both outstrip the levels of return offered by Cash ISAs (although cash and investments are very different in terms of risk, of course) and potentially provide less volatile returns than Stocks and Shares ISAs. With a Crowd2Fund IFISA, for example, investors were making an average of 10.25 per cent APR in January, before fees and bad debt.

Take advantage of tax breaks

Investing in an IFISA allows funds to grow tax-free as they are held within the ISA tax-free wrapper. This ensures that interest repayments are not subject to income tax, which is 20 per cent for basic rate tax payers (on non-ISA interest above £1,000), but can be as high as 45 per cent for additional rate taxpayers – who don't get any tax free savings allowance at all.

Additionally, no income tax is payable on IFISA funds when they are eventually withdrawn. This is one of the reasons the IFISA is such an attractive investment vehicle for building up wealth in the long-term. It should also be noted that while IFISAs form part of an estate for inheritance tax purposes, they can also be passed on without incurring any associated tax if left to a spouse.

Use the full allowance

Each year HMRC sets a tax free savings allowance that can be spread across the whole ISA range. The current allowance is £20,000. This allowance isn't transferable between different years, however, meaning unused allowance is lost forever when the new tax year rolls in. Therefore investors usually aim to use it all, or as much as possible, prior to the 5th April in any tax year in order to shield as much of their savings as possible from tax.

If you have used up your full allowance and are married, be sure to take advantage of your spouse's allocation to shelter up to £40,000 per year from income tax between you both.

Transfer historic lower yield ISAs

While the annual allowance for new investments is not transferable, it is possible to transfer historic ISAs into Crowd2Fund's IFISA, or indeed any IFISA. This point is particularly pertinent for holders of Cash ISAs, with even the best performing easy access Cash ISAs currently generating a return of around 1.5 per cent (again though, cash and investments are very different in terms of risk, which investors must be aware of).

Due to this rate being lower than the level of inflation (1.8 per cent as of January 2019), those saving in cash are, on average, losing money in real terms. As has been the case for nearly a decade now, those looking to beat inflation need to take on investment risk and peer to peer loans within an IFISA are one of the many options available. Cash ISAs can be transferred to Crowd2Fund's IFISA by **downloading and filling in a form**.

Reinvest and reap the rewards of compounding interest

If you have been a Crowd2Fund IFISA investor since its introduction in April 2016, some of the loans you are invested in may have completed by now. If this applies to you, you can redeploy your funds into new investment opportunities. By doing this you will continue to be paid interest on your earnings, which can multiply exponentially over time.

To increase returns even further, you can reinvest your repayments on a monthly basis into a specific new issue, providing you are lending £100 or more. If your repayments are lower than this each month, you can use the Smart-Invest feature, which automatically reinvests your repayments in all the live campaigns, spreading your risk.

Diversify your portfolio with the Exchange

Spreading your risk is an essential tool in managing the inevitable element of risk that comes with any investment. Diversifying your portfolio across a range of different companies and sectors will reduce your exposure to any single risk. This means that should one loan go bad, you have plenty of others to fall back on. As the old mantra goes: "you shouldn't put all your eggs in one basket."

In addition to the primary investment opportunities listed on the platform, investors are also able to use the Crowd2Fund Exchange to buy existing loans – or parts of them – from other investors, increasing the range of investments available. Some investors who sell their loan holdings may also be able to make a profit by setting a higher rate.

Crowd2Fund is unique in that it is the only IFISA on the market which is self-selecting, allowing investors to directly assess and choose the companies and organisations that they want to lend money to.

By following the tips in this guide you will be in an excellent position to diversify your ISA savings and investments and potentially take advantage of strong returns using the IFISA, helping you to ride out short term market blips and secure your financial future over the long term.

Is an IFISA right for me?

Do you already have an ISA?

YES → Are you happy with your returns?

YES / NO

"NO" or "YES" - if your returns are lower than 5 per cent, you stand to make higher gains through an IFISA

NO → Would you like to start one?

NO

YES

Would you consider moving your existing ISA pot?

NO → Why not?

- Hassle
- Exit charges
- Happy with existing platform
- Happy with existing returns

YES

Are you prepared to accept a little more risk for higher returns than cash savings?

NO → *If you do not want to take a risk with your capital, you should seek the highest return Cash ISA you possibly can and try to ensure that it is at least covering inflation*

YES

Are you prepared to diversify your own ISA portfolio?

NO → *It is possible to diversify your own IFISA portfolio. However if this is not for you, you would probably be happier investing in funds within a Stocks and Shares ISA, where fund managers diversify for you (for a fee)*

YES

Would you like your money to be invested directly into British businesses.

NO → *If you don't want to invest directly into companies, you might want to consider funds within a Stocks and Shares ISA*

YES

Have you got at least £100 a month to invest?

NO → *With some platforms, such as Abundance, there are lower minimum investments. However to really notice the benefit of interest adding up, it makes sense to invest the maximum you can manage every month into your IFISA*

YES

You could invest in an IFISA on any of the regulated IFISA platforms.

Would you prefer to lend to renewable energy projects, a range of UK businesses or other individuals?

- Renewable energy → Abundance
- Range of innovative UK businesses → Crowd2Fund/ Other IFISA platforms
- Individual borrowers → ie. Zopa, Ratesetter

By Rebecca Jones, editor of *Good With Money*

Get into the investing driving seat with an IFISA

We at Good With Money spend a lot of time to talking to savers about why, how, and where they stash their ISA allowances. For the majority of Britons, the answer to all three questions is still, overwhelmingly: for a rainy day, with dread, and in cash.

This is starting to change, however, and it is thanks in no small part to the introduction of the Innovative Finance ISA in 2016.

The popularity of the IFISA is clear. According to HMRC stats, the amount subscribed to IFISAs grew by 700 per cent between 2016/17 and 2017/18 – up from £36 million to £290 million. Meanwhile, the number of accounts shot up from 5,000 to 32,000[1].

This rate of growth puts the uptake of the Stocks and Shares ISA in the shade, with the number of accounts open last year falling compared to ten years ago: 2.8 million in 2018 versus 3 million in 2008.

This, arguably, shows just how hungry we Brits are to invest in small organisations and projects. Long the engine room of UK PLC, until recently only Dragons Den type angel investors could get involved in British start-ups – hogging all the innovation for themselves.

Thanks to trailblazing crowdfunding platforms like Crowd2Fund, though, now we can all support small British businesses – helping to fund a vital part of our economy while giving us a chance to get in on what could be the next big thing.

Crucially, this kind of investing helps us to fully connect with our money. Seeing EXACTLY where our savings are going and how they are helping small entrepreneurs to get innovative products and services to the market not only makes for a talking point in the pub, but it's empowering too.

For a long time – perhaps forever – money has felt like a very distant thing to most of us: especially long term savings in bank accounts or pension pots. In the past, the latter has been the only place any of us has put money in the markets, and even then we were unlikely to have had any say in the matter.

[1] https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment_data/file/737084/Table_9.4_Published_August_2018.pdf

The dawn of the Stocks and Shares ISA in 1999 aimed to change that, however as highlighted above, it didn't set the world on fire. A long held theory as to why is that investing is just too confusing for most of us. Few, however, consider it is because it is too distant.

Interestingly, a common theme that comes out among fans of the IFISA is their enthusiasm for the businesses and projects they are investing in. These investors are genuinely excited about where their savings are going and they want to be a part of it. They back these businesses and projects, and are happy to proclaim it to the world.

Of course, there are risks. This is, traditionally speaking, one of the riskiest area of the whole investment universe. As dull as it is, putting a steady £100 a month into a passive index fund tracking the FTSE 100 through a Stocks and Shares ISA is unlikely – over the long term at least – to lead you to ruin.

Leaving the sustainability issues of that approach aside (the FTSE 100 being full of oil and gas, big banks, tobacco, mining and arms), though, this doesn't mean you can't complement a steady, safe strategy like this with investment into an IFISA.

Indeed, having a slug of truly alternative investments in your portfolio is seen by most as a very sensible strategy, particularly during times of global market turmoil. Last year, for example, the FTSE 100 tumbled nearly 9 per cent thanks to factors including the US/China trade war and Brexit: issues that don't tend to affect most IFISA investments.

In many ways, IFISA investments bring a bit of fun to saving for our futures. While not being safe as houses, we certainly have better buffers going through FCA authorised platforms with large pools of capital to fall back on than the Dragons do, yet we still get to brag about our eye for the stars of tomorrow. It's angel investing: but for everyone.

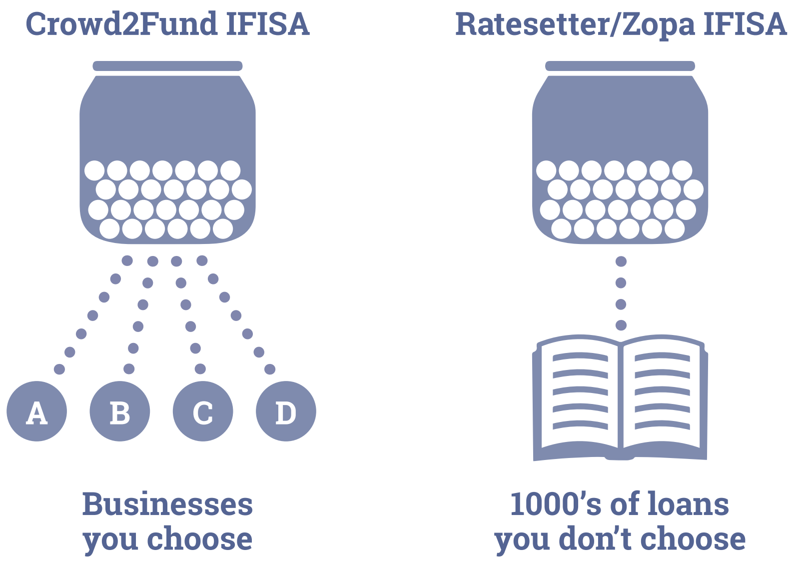
How to choose a platform

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.

There are now a whole host of different IFISA platforms to choose from, all offering something different for interested investors.

Most will help you to open an IFISA and then you can choose which bonds from their platforms you would like to place inside it, up to your annual limit.

If you are interested in lending to small businesses, Crowd2Fund is unique in that it allows you to pick and choose the individual borrowers that your money goes to. This compares to other platforms like Ratesetter and Zopa, which pool investors' money together and then spread it out evenly across their loan books.



This means you know exactly where and who your money is going to. It is still important, however, to manage your risk by investing a wide range of businesses.

If you are interested in renewable energy investments, or perhaps property, there are also dedicated platforms for this too. They include Abundance Investment, Downing Crowd, Ethex and Property Crowd.

About Crowd2Fund

USP: “We grow innovative businesses”

Established in 2014, Crowd2Fund is a leading P2P lending company, building long-term relationships between investors and the great British businesses they invest in.

The Crowd2Fund IFISA

Crowd2Fund was the first platform to offer the Innovative Finance ISA, and was awarded ‘Best Innovative Finance ISA provider’ at the IFISA 2018 Moneynet Awards.

With the Crowd2Fund IFISA, you control where your money goes. The flexible IFISA lets you choose the entrepreneurs you back while potentially earning between 6 and 15 per cent a year returns, tax free.

The investment platform is fully mobile responsive, and also boasts an IFISA iOS app. This makes it easier for you to manage your portfolio and engage with the businesses you invest in.
To find out more visit www.crowd2fund.com/ifisa

Typical rates of return: Investments have an interest rate between 6 per cent and 15 per cent a year. As of January 2019, the average interest rate was 10.25 per cent before fees and bad debts.

Default rate: The current default rate is 3.17 per cent, which is 1.17 per cent above the 2 per cent target. The target recovery rate, which is the amount Crowd2Fund aims to return to investors in the event of a default or non payment, is 60 per cent - the industry standard.

Risk management: It is important that investors manage their risk by spreading their money across a range of different businesses, otherwise known as diversification.

IFISA minimum opening amount: £100

Charges: Crowd2Fund charges the businesses raising money a 6 per cent fee on the total amount raised. Investors are also charged 1 per cent on interest and capital repayments. Based on this, an investor lending £5,000 to a business at an APR of 9 per cent over three years would get back £5,723.95, minus £57 in fees and charges.
To find out more, see: www.crowd2fund.com/amortisation

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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.

CONTACTS

Good With Money
www.good-with-money.com
Editor: rebecca.jones@good-with-money.com
PR and communications: lisa@good-with-money.com

Crowd2Fund
www.crowd2fund.com
info@crowd2fund.com
+44 (0) 203 735 5669