THE GOOD GUIDE TO THE INNOVATIVE FINANCE ISA

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IFISAs - as varied as the colours of the rainbow

Savings made during the lockdowns of the past year or so have been built up somewhat guiltily by those who have been lucky enough not to have suffered an income hit during the pandemic.

Nevertheless, the Bank of England believes around £250 billion will have been saved by British households.

Some people will be looking for places to put some of their extra savings that earns a higher return than savings accounts. Many will have been encouraged to try investing in the stock market for the first time. But there is another 'third way' to invest cash that is still relatively new, but gaining traction.

Innovative Finance ISAs - or IFISAs for short - are a type of tax-free savings wrapper that sits apart from Cash ISAs and Stocks and Shares ISAs.

The investments within them are loans to businesses, projects or individuals. What you put in them counts towards your overall annual ISA allowance of £20,000 a year.

The returns are not like the interest you get from a cash savings account, nor are they like growth from share prices.

If you invest in an IFISA, you are lending money in exchange for an expected (but not guaranteed) return. In general, these loans are riskier than savings accounts, but not usually as risky as investing in individual company shares. The risks are that your capital could be lost altogether, or you may not get back the target returns.

It's important to note that IFISAs are classed as investments rather than savings.

But the risk levels within IFISA investments vary from project to project and business to business. Some IFISA opportunities offer relatively stable long term returns; others offer higher percentage target returns over a shorter term, but with more risk.

Perhaps it is this variety within the IFISA wrapper that continues to confuse - but this is also the beauty of the IFISA. They are a rainbow product - not at all black and white.

It does mean you need to do your research on each individual offer, though, as they will all have different characteristics. If you would like to see some more variety in your investments, they could be for you.

This guide will tell you what you need to know.

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.

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 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 allow you to 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.

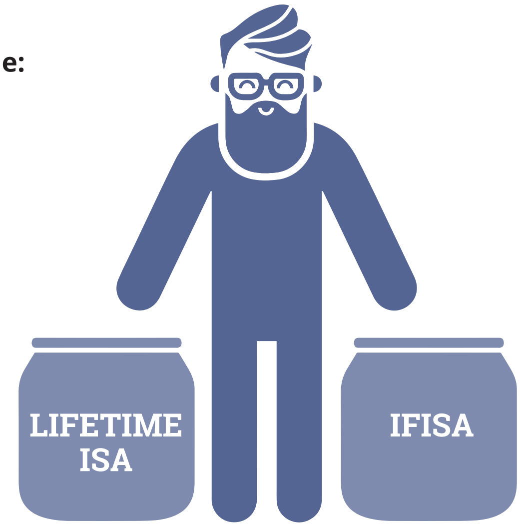
2. Lower overheads. Innovative finance platforms are reinventing the wheel. They are powered by the latest technology and are relatively new, so they do not have the legacy of cumbersome overheads, such as big back offices that larger, more traditional investment platforms have. They can pass on the 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.

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.

£20,000 ISA limit per tax year

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 £85,000 (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?

Yes, they have. London Capital & Finance was an IFISA eligible lender offering mini-bonds, which collapsed in 2019. Many people at first lost all of their investment, though some received compensation. However, the Treasury has decided to offer more compensation in this case because of regulatory failings.

The Financial Services Compensation Scheme pays out up to £85,000 per person if an investment firm fails, and this includes regulated IFISA lenders (the product and the provider should both be regulated). But balances over this amount are not protected in the event of firm failure. Other peer-to-peer lending platforms have closed in the years since the IFISA was introduced and some people's IFISA investments have not performed as hoped, leaving them with lower returns. One of the biggest peer-to-peer lending platforms , Ratesetter, sold its loan book to Metro Bank earlier this month.

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 <1%	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	£9,000	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.

By Julie Dunn
Ethex and Energise Africa

Get switched on to ISA opportunities that make your money matter

Here's the good news. Recent evidence shows that more people in the UK are getting switched on to the idea that their pension pots can be doing more than just growing quietly in the dark, ready to be used in retirement. In fact, sales of ethical investment funds have tripled in the last year as more people see the value of their investments in more than just financial terms.

But what about the power of your ISA? Most of us know about the tax benefits of an ISA, they've been around for over 20 years and were introduced to encourage the UK public to save with the added benefit of a tax-efficient wrapper. So, while investors are getting lightbulb moments about their pension investments, they should also be aware that the money they put into the ISAs can be doing good in the world... or unfortunately, doing just the opposite.

Ever thought about what your ISA could be funding?

Switched on investing means knowing what your hard-earned cash is being used for. Unfortunately, without you being aware, your money could be used to fund industries and businesses you might be uncomfortable with or even opposed to.

According to Ethical Consumer, the UK's leading alternative consumer organisation, the top UK banks have poured approximately £150 billion into financing fossil fuels since the Paris Climate Agreement was adopted in 2015. And you only need to take a look at Banktrack's website and you'll find a whole host of high profile examples of household name banks financing activities that many people would find shocking.

An ethical alternative

Over the last year, lockdown restrictions have meant some people have found themselves with more disposable income to save or invest. This, paired with the growing interest in using money to build back better from the pandemic, means the time is ripe for people to start considering investing in a way that directly supports ethical or 'positive' businesses.

Despite this, many people still aren't aware that since 2016 they have also had an ethical ISA option via the Innovative Finance ISA (IFISA). IFISAs mean investors can create a positive impact with their savings and investments, whilst also benefiting from tax-free returns. Investment in the stocks and shares element of an IFISA means your capital is at risk and projected returns are not guaranteed.

The IFISA was primarily launched to give people more flexibility around their ISA savings and investments. Typically, IFISA returns can be around double the rates offered by Cash ISA providers. IFISA providers are able to do this as investing directly via platforms in ethical organisations cuts out the middle man – the bank - and allows investors to receive a higher return connecting them directly with sustainable businesses that are also able to pay less interest. Peer-to-Peer lending (the type of loans that are made via an IFISA) is not without risk however and these types of ISA are not currently protected by the Financial Services Compensation Scheme.

The good news is that there are a growing number of IFISA providers ensuring customers have more choice when it comes to choosing a sustainable ISA alternative.

Energise your ISA allowance

Energise Africa is a leading UK impact investing platform that helps everyday people in the UK invest from as little as £50 to help bring pay-as-you-go solar energy access to homes and businesses in sub-Saharan Africa.

It's shocking to think that more than 130 million families in sub-Saharan Africa still have no access to electricity, meaning their quality of life and chances of achieving economic prosperity are seriously restricted. Investing in solar energy access for Africa helps address this issue and works towards several of the UN SDGs, including SDG7, access to clean and reliable energy for all.

And it's not just families that benefit, small and medium businesses are getting access to reliable solar energy, helped by Energise Africa investors, leading to better economic growth and sustainable development. It's estimated that power shortages cost African businesses 700 business hours every year–that is just under 90 business days, so access to clean, affordable and reliable solar energy makes commercial as well as environmental sense.

All investments made through Energise Africa can be held within an IFISA, so people in the UK can invest in solar businesses operating in sub-Saharan Africa, helping cut CO2 emissions and tackling climate change, while at the same time improving lives and earning potential tax-free returns of up to 6%. Please be aware that tax benefits of IFISAs are subject to individual circumstances.

Tackling climate change within the UK

Energise Africa's sister positive investing platform, Ethex also offers IFISA eligible investment opportunities that enable investors to use their £20,000 ISA allowance to directly fund extraordinary organisations that are making a positive impact here in the UK. Ethex lists investment opportunities from organisations that are helping the UK to build back better and accelerate the transition to a low carbon economy....but one that works for everyone. And as investors' money is directly funding these projects, it's easy for them to see the impact their money is having.

The IFISA provides an opportunity for people to potentially access higher rates of return whilst also benefiting causes that they truly believe in. However, investors do need to consider that with IFISA investments your capital is at risk and returns are not guaranteed. These investments are not protected by the Financial Services Compensation Scheme either.

Take control of your tax-free investments

If you're looking at your ISA options, don't forget that ethical impact doesn't have to come at the expense of lower returns! Before you assign this year's ISA allowance then make sure you consider some of the ethical IFISA options that are available and switch your money on to creating a brighter future for all.

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*

Would you consider moving your existing ISA pot?

NO → Why not?

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

NO → Would you like to start one?

NO

YES

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 interest Cash ISA or savings account 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 businesses or other individuals?

- Renewable energy → Abundance
- Range of innovative businesses → Ethex, Energise Africa, other IFISA platforms
- Individual borrowers → ie. Zopa

By Lisa Stanley,
Co-founder of Good With Money

What has happened in the IFISA world during the pandemic?

One of the unexpected consequences of COVID-19 has been that a lot of people have more money, through lack of spending, and also more time to devote to their finances.

As a result, interest in all kinds of savings and investment products has shot up. At Good With Money, we noted a surge in traffic to ethical savings and investment articles, which began in April last year and has continued ever since.

This was, we imagine, a direct result of lockdowns focusing minds - and bank accounts - on ways to build back better and build personal financial resilience, throwing into sharp relief the need to make our savings count in every possible way if we are to emerge from this difficult time stronger.

The IFISA was gaining momentum as an alternative to more traditional investments before the pandemic, rising from £352 million in assets in 2018 to £648 million in 2019. If the Energise Africa projects that have launched in the last 12 months are anything to go by, the number of people converted to the merits of IFISAs - particular ethical options - have continued to rise since then.

The IFISA is particularly well-suited to ethical investments, because it gives investors direct access to small projects and businesses, uncomplicated by some of the ESG issues of large listed companies, such as not knowing whether your money really is doing good.

IFISA investments are generally WYSIWYG - What You See Is What You Get. Loans to businesses come with Offer Documents that you should read to understand how your money will be used and how it will generate the quoted returns. Most of the investments have some kind of benefit to the community in which the project or business is based. IFISA loans to individuals are a way to help people obtain affordable credit.

If you want to put lockdown savings you don't need in the short term to good use, for the prospect of a decent return, then now could be the perfect time to consider adding some IF to your ISA allowance.

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.

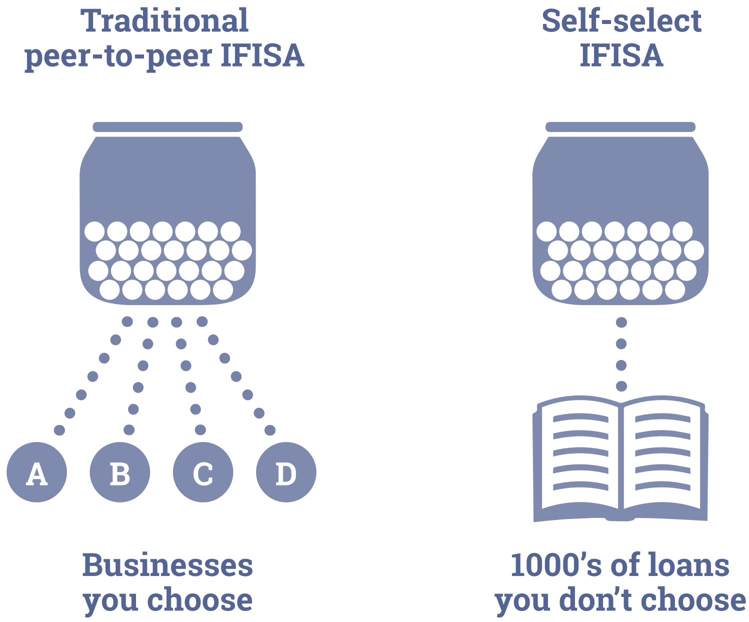
There are now a whole host of different IFISA platforms to choose from, all offering something different for interested investors.

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.

Platforms like Ethex help everyday people make ethical investments that fund businesses doing something extraordinary for other people or the planet. This includes Solar for Schools which works with schools and communities to deliver carbon and cost savings with solar energy. Or VocalEyes, a pioneering platform supplying innovative digital tools to empower communities and organisations to create positive social impact.

You might prefer to lend to organisations in the developing world, and Energise Africa provides such investment opportunities. For example, helping OOLU to install solar home systems in Mali and Senegal to families previously off-grid, or Altech do the same in the Democratic Republic of Congo, or helping CandiSolar provide clean energy to SMEs in India.

Other IFISA platforms and providers include Triodos Crowdfunding for investments in positive impact businesses, Abundance Investment for renewable energy investments, and Zopa for lending to invidivuals.



With these options, vs more traditional P2P lending from the likes of Funding Circle or Zopa, you know exactly where and who your money is going to. It is still important, however, to manage your risk by investing in a wide range of businesses.

If you are interested in UK based options for community or renewable energy positive impact, Abundance Investment and Triodos Crowdfunding are two other platforms to consider.

About Ethex and Energise Africa

Established in 2013, Ethex provides pioneering businesses with the vital finance they need to scale and grow, ethically paving the way for extraordinary organisations to deliver positive impact where it matters most: in protecting people and our planet.

Thanks to its community of more than 20,000 positive investors, Ethex, and its sister ethical investing platform, Energise Africa, have since raised more than £100 million.

The handpicked choice of investment opportunities available range from pioneering grassroots community organisations to ethical profit-for-purpose businesses. The investments have a compelling track record of financial performance, putting the transformative power of money back into the investors' hands.

Energise Africa assists impactful SMEs operating in Africa's energy access industry to access affordable and quick debt funding - empowering UK investors to fight climate change and improve lives through sustainable and ethical investments.

Through the bonds available for investment, investors lend money to one of the solar businesses working with Energise Africa. These businesses can then supply affordable small solar systems to families living off-grid throughout Sub-Saharan Africa.

With all investments available on the Ethex and Energise Africa platforms, investors should consider the return they are expected to receive, the time taken for their money to be repaid, and the risk to their capital of investing in the businesses.

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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 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.
- You can invest lump sums or monthly in all ISAs.

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