



# ISAs come of age

*A report by Cebr for Scottish Friendly / MRM*

March 2020

Cebr

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London, March 2020

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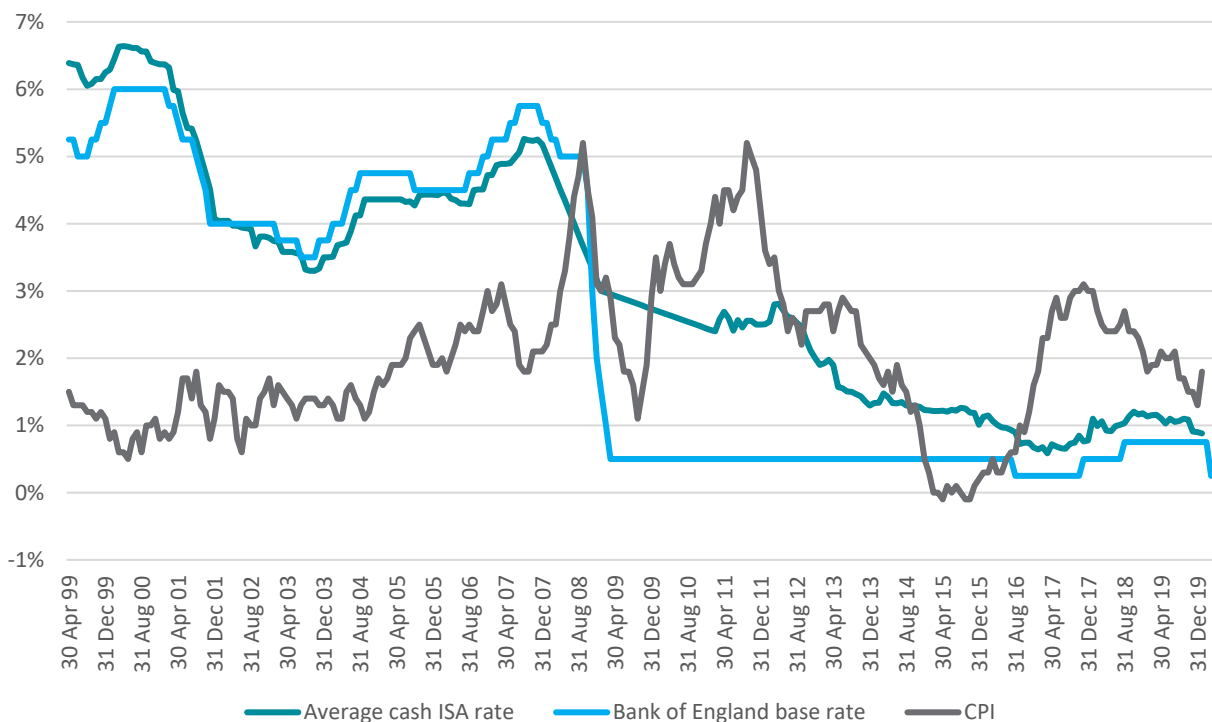
# 1 Bank of England rate cut set to further erode cash ISA returns

## 1.1 Cash ISA returns

While increases to the Bank of England (BoE) Base Rate in 2018 did feed through into the returns being offered on cash ISAs, the average annual interest rate on cash ISAs has since ticked down, from 1.2% in October 2018 to 0.9% in January 2020. Cebr forecasts the consumer prices will rise by 2.0% over the next 12 months, meaning that cash ISA savers are on course to see a 1.1% real terms decline in the value of their savings.

On the morning of 11<sup>th</sup> March, the BoE announced a raft of measures designed to counter the economic fallout associated with the spread of coronavirus. These included a 50-basis point reduction in the Base Rate from 0.75% to the 0.25% - the joint lowest rate in history. As a result of this, a continued and more pronounced decline in the average interest rate paid on cash ISAs can be expected over the remainder of the year.

Figure 1 Cash ISA interest rates, BoE base rate and CPI inflation rate since introduction of ISAs in April 1999



Source: Bank of England, Office for National Statistics, Cebr analysis

## 1.2 Stocks & shares ISA returns

Since April 1999, the annual return delivered by the FTSE All-Share Index – which includes over 600 companies listed on the London Stock Exchange – has averaged 6.3%. Taking into account inflation and

account fees<sup>1</sup>, the average annual real return available to stocks & shares ISA savers since 1999 has been 3.8%. This is nearly four times the 1.0% figure for cash ISAs over the same period. As of 3<sup>rd</sup> March 2020, stocks & shares ISAs tracking the FTSE All-Share Index will have delivered effective annual returns of 5.2% both over the last five years and over the past 21 years.

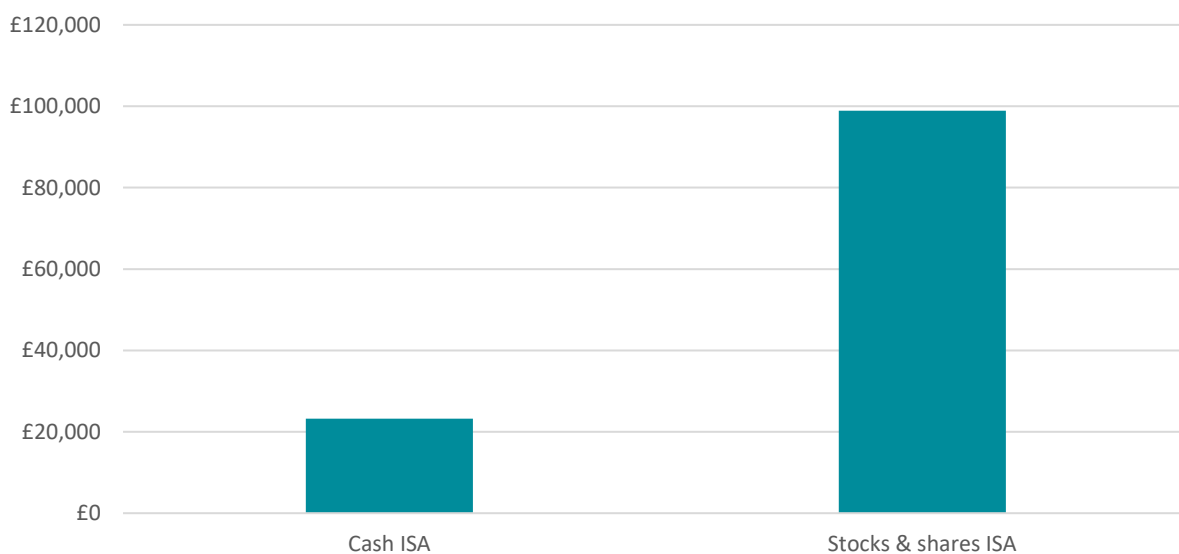
### 1.3 Stylised case studies

To examine the typical returns that individuals using cash ISAs or stocks & shares ISAs may have seen over the past 21 years in which ISAs have been available, we have considered the following case studies<sup>2</sup>:

1. An individual who saves the maximum permitted amount in a cash ISA each year at the average available interest rate for that year<sup>3</sup>.
2. An individual who saves the maximum permitted amount in a stocks & shares ISA which tracks the FTSE All-Share Index, with an annual fee of 0.4%.

Case studies 1 and 2 both examine a case in which an individual utilises their full ISA allowance each year from 1999 to the present. In total, this would equate to £151,860 being invested over the last 21 years. Assuming that the interest rate received on these cash ISA savings corresponded to the national average each year, a total of £23,245 of tax-free interest will have been accrued in Case Study 1. This is around a quarter of the estimated £98,934 that will have been accrued had the same money been invested in stocks & shares ISAs tracking the FTSE All-Share Index (Case Study 2).

*Figure 2 Gains from investing maximum annual ISA allowance into cash ISAs since 1999 vs gains from investing in stocks & shares ISAs*



*Source: Bank of England, Office for National Statistics, Financial Times Stock Exchange, Cebr analysis*

<sup>1</sup> A review of the current market shows that these fees vary significantly between different providers, but on average are around 0.4% per year.

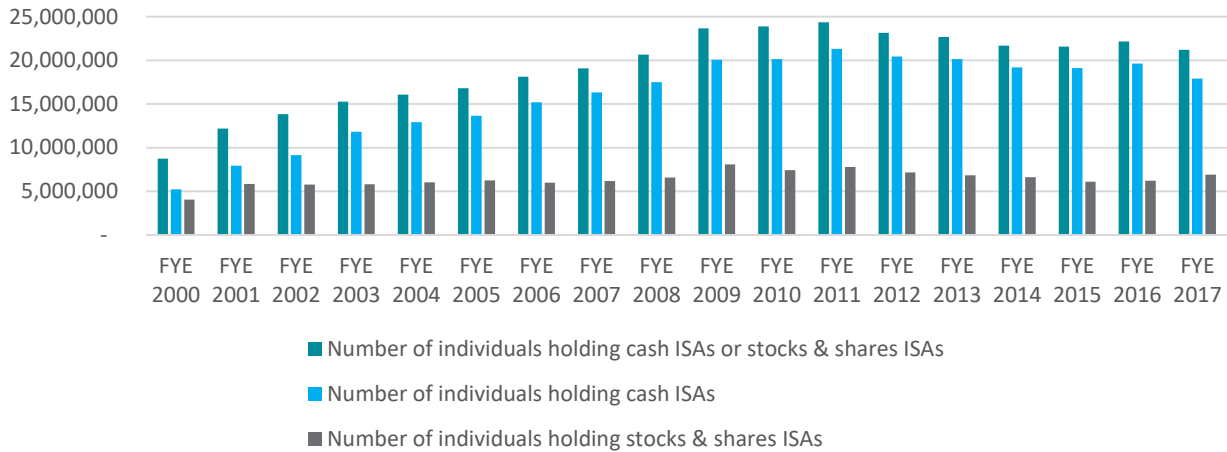
<sup>2</sup> In calculating savings returns for each case study, we have used data running from 1<sup>st</sup> April 1999 to March 3<sup>rd</sup> 2020. Data on average annual interest rates on cash ISAs are published by the Bank of England. Data on total returns from the FTSE All-Share Index are published by the Financial Times Stock Exchange.

<sup>3</sup> The annual individual allowance for ISAs has risen from £3,000 in the 1999/2000 financial year to £20,000 in the 2017/18 financial year.

## 1.4 UK-wide trends in the use of ISAs

The number of adults with either a cash or a stocks & shares ISA fell by nearly 1 million to 21.2 million between FY 2015-16 and FY 2016-17. This was a result of a sharp decline in the number of individuals with cash ISAs, and is indicative of the significant fall in real returns from this savings vehicle during this period.

Figure 3 Number of individuals holding ISAs by financial year



Source: HMRC, Cebr analysis

## 1.5 Regional breakdown

The share of adults with an ISA account declined in all of the UK's regions and nations between FY 2015-16 and FY 2016-17. The figure is the lowest in Northern Ireland, where only a quarter (25%) of adults had an ISA account in FY 2016-17. The South East and the South West of England are the regions in which the highest share of adults hold an ISA – unchanged from the previous year.

Figure 4 Share of eligible adults with an ISA, 2010 & 2017

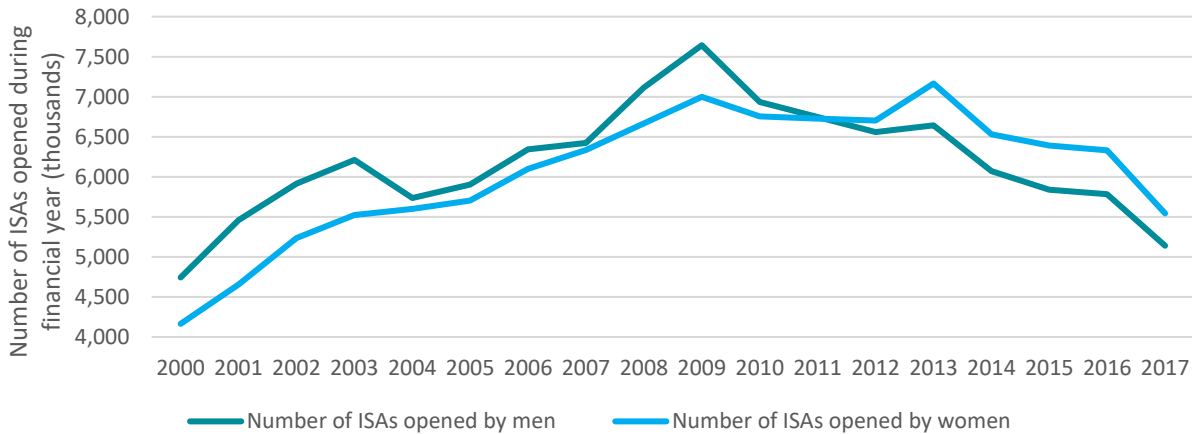


Source: HMRC, ONS, Cebr analysis

## 1.6 Gender breakdown

During FY 2016-17, women opened 5.5 million ISAs – down from 6.3 million in FY 2015-16. This is the steepest year-on-year decline since ISAs were introduced in 1999. However, the number of accounts opened by men also fell significantly over the same period, meaning that women still made up the majority of account openings – as has been the case since 2012.

Figure 5 Number of ISAs opened per year, by gender

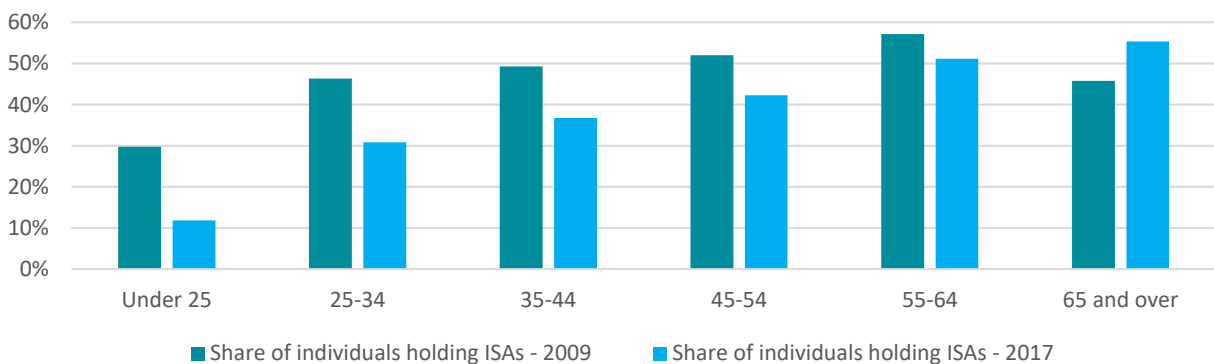


Source: HMRC, Cebr analysis

## 1.7 Age breakdown

ISAs continue to be considerably more popular among older demographics. Indeed, in FY 2016-17, the share of adults aged 65 and over with an ISA was 55% - marginally up on the year before. Meanwhile, the number of those aged under 25 with an ISA dropped from 1.2 million to 0.9 million between FY 2015-16 and FY 2016-17. This is now less than half the share of adults aged under 25 that held an ISA in FY 2008-09.

Figure 6 Share of individuals with ISAs, by age group



Source: HMRC, ONS, Cebr analysis

## 2 ISAs come of age in 2020

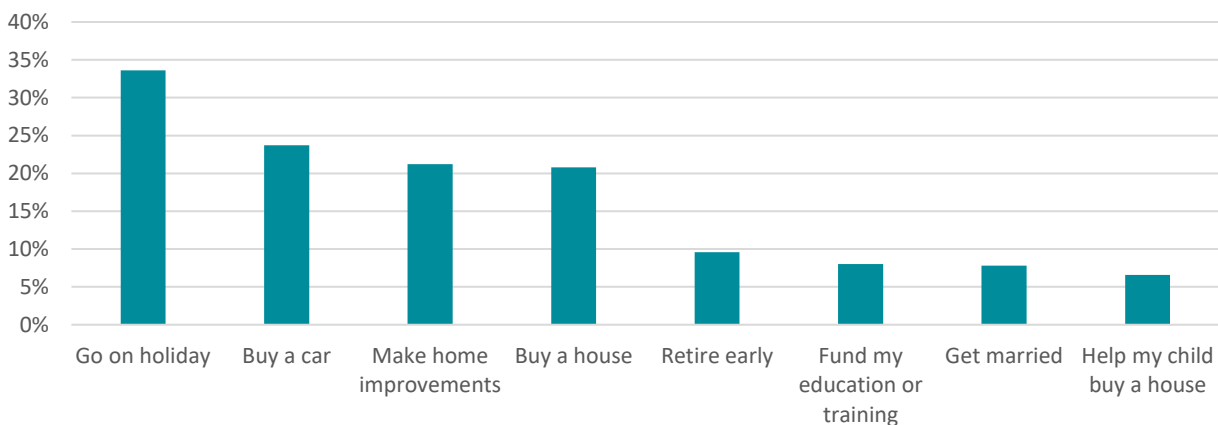
ISAs will be “coming of age” this April, having been introduced 21 years ago in April 1999. To mark this, a survey of 4,000 UK adults has been conducted, looking at consumers’ attitudes towards different types of ISAs, as well as the extent to which these savings vehicles have helped people achieve their savings goals.

### 2.1 ISAs and savings goals

ISA savings have served a number of functions over the course of their 21-year history. The most common use has been to fund major purchases. More than a third (34%) of ISA savers have used money saved or invested in their ISAs to fund a holiday and nearly a quarter (24%) have used the funds to buy a car. However, ISAs have also facilitated other lifestyle decisions, with 10% of ISA savers having used the savings accumulated in their ISAs to retire early. As of 2017, there were 21.2 million adults in the UK with at least one ISA. This implies that ISAs have helped more than 2 million ISA savers in the UK to retire early.

House purchases are another common destination for ISA savings, with more than one in five (21%) of ISA savers have used the savings in these vehicles towards purchasing a house. This equates to more than 4.4 million ISA savers in the UK. Among these individuals, the average value of ISA savings that were channelled towards buying a house was £19,751 – adding up to more than £87 billion. When including the funds directed towards helping a child purchase a home, this figure rises to £119 billion. Nearly three quarters (73%) of these ISA savers indicated that money saved in ISAs helped to buy their first home.

Figure 7 Common uses of ISA savings



Source: 3Gem, Cebr analysis

### 2.2 Attitudes to ISAs

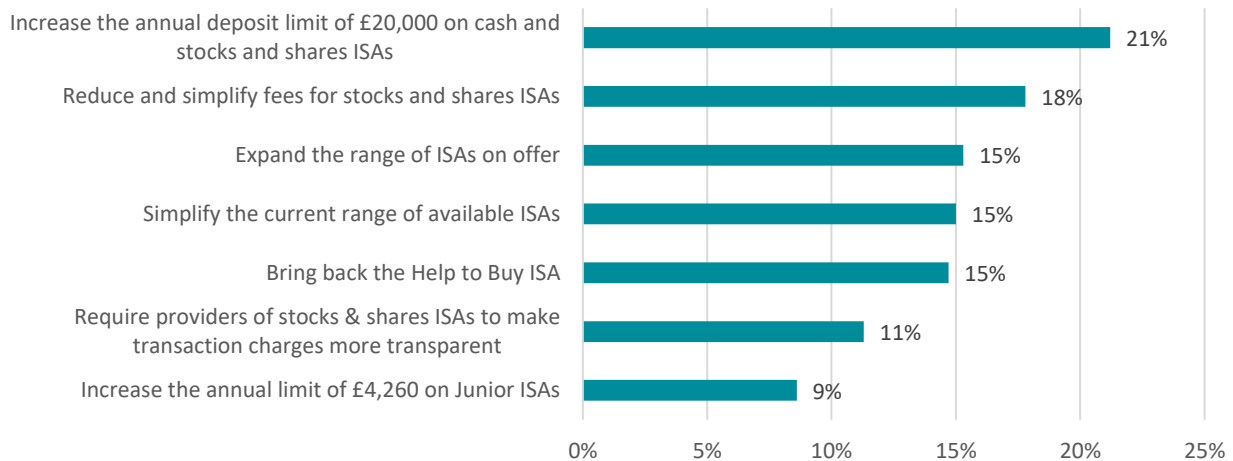
The results presented above highlight the important role that ISAs have played in helping people to realise their savings goals. However, that is not to say that change is not desired, with fewer than one in ten (8%) adults in the survey stating that they would not like the government to make any changes to ISAs.

The most popular policy is to increase the annual deposit limit of £20,000 on cash and stocks & shares ISAs. In the past, average deposits have responded quickly to changes in the deposit allowance, highlighting that a large number of ISA savers are constrained by the limit. The fact that more than one in five (21%) adults would like to see the limit increased suggests that this could be an effective policy to



encourage saving. Meanwhile, the 15% share of adults who would like to see an expansion of the range of ISAs on offer is balanced by the 15% who would like the government to simplify the current range of available ISAs.

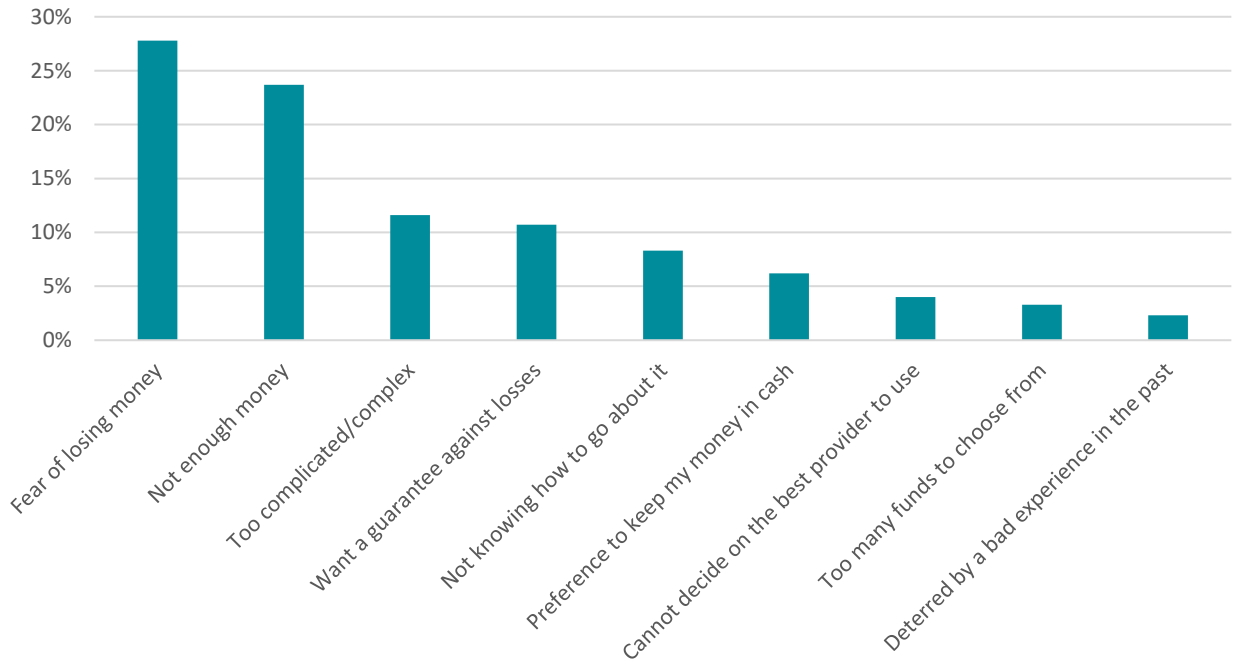
Figure 8 Changes that individuals would like to see the government make with respect to ISAs



Source: 3Gem, Cebr analysis

While the number of adults with a stocks & shares ISA did rise by more than 770,000 to 3.3 million between the 2015-16 and 2016-17 financial years, the vast majority of people do not make use of this savings vehicle. The perceived volatility associated with stocks & shares ISAs stands out as the major deterrent. Indeed, more than a quarter (28%) of those who do not save into a stocks & shares ISA said that the fear of losing money was the main reason behind this. However, the results of the survey also point to a sizeable number of people that would like to open stocks & shares ISAs but have been discouraged from doing so by the processes involved. Indeed, 12% said that the complexity of investing into stocks & shares ISAs was their main reason for not doing so, while 8% indicated that they would not know how to go about doing it. These results suggest that measures to promote awareness and understanding of the stocks & shares ISA could attract a considerable share of individuals towards this savings product.

Figure 9 Main factor discouraging the use of a stocks & shares ISA



Source: 3Gem, Cebr analysis