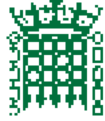

House of Commons

Treasury Committee

Child Trust Funds

Second Report of Session 2003–04

Report, together with formal minutes, oral and written evidence

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Introduction

1. The Treasury Committee established a Sub-committee in July 2001 to scrutinise the work of the various bodies for which Treasury Ministers are accountable. The Sub-committee announced, on 28 October 2003, an inquiry into the Government's proposals for Child Trust Funds set out in a paper issued by HM Treasury and the Inland Revenue that day.[1] We heard oral evidence from HM Treasury and the Inland Revenue on 12 November 2003, from the Association of British Insurers, the British Bankers' Association, the Children's Mutual and Norwich Union on 19 November 2003, and from Ruth Kelly MP, the Financial Secretary, on 3 December 2003. We also received a number of written submissions, most of which we have published with this volume. We are grateful for all the evidence we have received, written and oral.

2. The Government first consulted on Child Trust Funds in *Saving and Assets for All*,[2] published in April 2001 which sought agreement on the broad principles behind Child Trust Funds. This was followed in November 2001 by *Delivering Saving and Assets*,[3] which set out more specific proposals for the scheme. The detailed proposals, published in October 2003, set out how Child Trust Fund accounts will work including:

- the qualifying conditions;
- the particular features of Child Trust Fund accounts;
- what parents and providers will need to do in operating accounts; and
- the role of financial information, education and consumer protection.[4]

3. Under the proposals all children born from 1 September 2002 will be eligible for a Child Trust Fund account. Key features of the scheme include:

- All children in the UK will receive a Government endowment of £250 and children in families receiving full Child Tax Credit will receive an additional £250.
- The Government will make a further payment at age 7.
- Family and friends will be able to contribute up to £1,200 a year between them to the fund.
- Child Trust Fund accounts will be owned by the child and be in the child's name. Access to the Child Trust Fund account will be at age 18, with no restrictions on the use of the Fund.

1 HM Treasury and Inland Revenue, *Detailed proposals for the Child Trust Fund*, 28 October 2003

2 HM Treasury, *Saving and Assets for All, The Modernisation of Britain's Tax and Benefit System*, *Number Eight*, April 2001

3 HM Treasury, *Delivering Saving and Assets, The Modernisation of Britain's Tax and Benefit System, Number Nine*, November 2001

4 *Detailed proposals for the Child Trust Fund*, paras 1.3, 1.4

- Provision of Child Trust Fund accounts will be by open market competition with any authorised provider able to enter the market. Providers will be able to offer a variety of accounts. However, all providers must offer a stakeholder account – a low cost risk-controlled equity account.
- All income and capital growth will be tax exempt.[5]

4. We have conducted this inquiry into the proposals for Child Trust Funds with a view to informing the House's debates on the Child Trust Fund Bill, introduced into the House of Commons on 27 November 2003.[6]

The objectives of Child Trust Funds

5. Child Trust Funds are part of the Government's savings strategy "which aims to ensure that a range of savings products is available to suit people at all stages in their lives."[7] The Government believes that Child Trust Funds will:

- help people understand the benefits of saving and investing;
- encourage parents and children to develop the savings habit and engage with financial institutions;
- ensure that in future all children have a financial asset at the start of their adult life to invest in their futures; and
- build on financial education to help people make better financial choices throughout their lives.[8]

6. The Financial Secretary told us that "there are multiple objectives for the Fund. One is to encourage people to build an asset up so they can think about their future in a different way; another is to encourage people to understand the benefits of saving and investment; a third is to encourage a savings habit to be developed, and the fourth is to build financial education around the product and to use it to help people make informed choices and become responsible for their own decisions […]"[9]

The costs of the programme

7. The explanatory notes to the Child Trust Funds Bill state that "the Child Trust Fund will involve significant public expenditure as the Government will be paying contributions to all children born from 1 September 2002 into the future. Initial contributions (£250 for all children and an additional £250 for children in families on lower incomes) will be met from Annually Managed Expenditure and have been estimated at around £235 million per annum. […] The value of the additional endowments at age 7 has not been announced –

5 *Detailed proposals for the Child Trust Fund*, page 4

6 Child Trust Funds Bill [Bill 1 (2003-04)]

7 *Detailed proposals for the Child Trust Fund*, para 1.5

8 *Detailed proposals for the Child Trust Fund*, para 1.6

9 Q 315

this is an issue that will be determined in future Budgets."[10] The Inland Revenue told us that the probable cost of developing and implementing the Child Trust Fund would be some £90 million and that only a small number of people would be needed to administer the scheme "because most of the administration will be run off the child benefit system and the tax credit system."[11]

8. The first Child Trust Fund accounts will mature after 18 years, when, on the figures currently available, the programme costs will have exceeded £4 billion and could be more, depending in part on additional age-related endowments.

Projected benefits

9. The document setting out the proposals includes a table, reproduced below, illustrating what the money contributed to Child Trust Funds might be worth after 18 years in real terms (today's prices). It assumes a nominal fund growth rate of 7% and inflation rate of 2.5% (contributions are assumed to increase in line with inflation). The figures take no account of account charges, or the additional Government endowment at age 7.

Table: Illustrative projections for Child Trust Fund growth

Nominal rate of return 7%; Inflation 2.5%		
Initial endowment	£250	£500
Value of fund at year 18 in real terms		
No additional savings	£456	£911
£5 per month	£2,198	£2,654
£10 per month	£3,941	£4,397
£15 per month	£5,684	£6,140
£20 per month	£7,427	£7,883
£40 per month	£14,399	£14,854

Source: HM Treasury and Inland Revenue, *Detailed proposals for the Child Trust Fund,* Table 3.1, page 11

10. The projections illustrate the potential significance of additional contributions from family and friends for the value of Child Trust Fund accounts at maturity. The value of the fund after 18 years for a child receiving an initial endowment of £500 from the Government with no additional contributions would, under these projections, be worth £911, compared to £14,399 for a child receiving the lower endowment of £250 who had received monthly contributions from family and friends of £40.

Saving

11. Research from Mintel shows that 35% of parents with children under 15 are not saving anything for their children's future, while 26% of parents only save rarely or when they

10 Child Trust Funds Bill, Explanatory Notes, [Bill 1 –EN] para 78

11 Q 4

have spare money. The survey shows that one of the main reasons for not putting aside money for their children is that some parents just cannot afford to,[12] a view echoed by the Child Poverty Action Group which noted when commenting on the Child Trust Fund that "despite higher initial payments for children from low income families the reality is that many families are too poor to contribute. The tax relief provisions will be of greater benefit to the better off, since they are most likely to be able to top up the fund."[13]

12. We asked the Treasury whether middle-income families would be more likely to invest in Child Trust Funds and benefit from the tax relief in the scheme rather than lower-income families at whom the policy is, in part, aimed. The Treasury accepted that better-off people tend to save more, but considered that the costs of the extra tax relief would be negligible (less than £10 million a year) because in general people were not using the existing tax reliefs that allow them to save up to some £4,200 a year on behalf of their children.[14]

13. The Financial Secretary noted that "if you look at figures on savings of young people under the age of 25 which is the best proxy we have for 18 year olds, the British Household Panel survey suggests that the average young person has zero financial assets. Now that is across income groups. When you get to the 75th centile, the person three quarters of the way up the income distribution, their financial assets are £400, so this policy could make a very significant difference to the vast majority of young people."[15] The Treasury noted that " […] what we also have are surveys conducted by people quite independent of government, [which] say that very large proportions of parents are attracted to and interested in the possibility of saving in the Child Trust Fund […] For instance, in September 2003 the Children's Mutual […] showed that 79% of parents with children eligible for the Child Trust Fund are likely to top up government monies. Were we to achieve 79%, that would be a very good start indeed."[16]

14. The Financial Secretary recognised the need to advise families that making additional contributions may not necessarily be in their best financial interests. The Financial Secretary noted that "one of the things we will be pointing out in the information pack [issued by the Government to parents] is what we call a hierarchy of savings objectives; that it is most important, first of all, to pay off a debt. That it is then most important to try and save a small pool of assets for a rainy day, and that long-term savings for a pension or in the Child Trust Fund are, as it were, slightly further down that hierarchy."[17]

15. We asked why there was no provision for a drawdown facility so that in specified circumstances low income families might access additional contributions they had made to a Child Trust Fund account. The Financial Secretary told us that "when we initially consulted on this […] one of the strongest comments I got back from the financial services industry [was that] they would like the scheme to be as simple as possible. Simplicity was

12 Press release from Mintel, *Parents are financially unprepared for their children's future*, October 2003

13 Press release from Child Poverty Action Group, *Response to Chancellor's announcement on the Child Trust Fund*, 28 October 2003

14 Qq 9, 22–29, 359–368

15 Q 322

16 Q 9

17 Q 385

absolutely paramount firstly to the costs of administrating the scheme and also to explaining the scheme to people. It is also the fact that there is a pool of people out there which thinks that the fact that the assets are tied up until the age of 18 is good and that they would be more likely to contribute to a fund because they know that those funds cannot be drawn down, either by the children themselves or, indeed, if it is relatives and friends, by the parents. So we took all of those factors into consideration and made the decision that the Fund should be locked up."[18]

Asset-based welfare

16. We asked the Financial Secretary what evidence there was that asset-based welfare works. The Financial Secretary told us that

> "I think it is fair to say this is a really ambitious policy; it is a long term project and is not one that has been tried in its current form, as I understand it, anywhere else in the world. We are at the forefront in thinking on these issues. We do have certain categories of evidence that we can point to on each particular count. To name a few sources of evidence, for example, research based on the National Child Development Survey in 2001 suggested that holding assets had a positive impact on health, the labour market, and educational attainment [and] the amount of assets needed to achieve those outcomes was very low, in the order of £300-600. […] the experience of individual development accounts in the United States where I believe about 20,000 people have the opportunity to benefit from matching schemes and can see assets accumulate over a certain period, and the evidence there was that incentives were very beneficial in encouraging even poor people to put money away. We also have interim evidence from the savings gateway which we are piloting in five areas across the country which we will be publishing very shortly which shows that, again, people on low incomes – and there is an earnings cap of only £11,000 in those projects – save significantly and that two thirds of them intend to continue to save regularly after the end of the project, even when the match disappears. There is also evidence from a variety of surveys that have been carried out about the Child Trust Fund itself, particularly from friendly societies and others in the industry, which shows very enthusiastic support among parents for this policy, and that the majority of them think they would add further contributions to an initial government endowment. So there is evidence from a variety of sources but, as I really want to emphasise, this is a very ambitious proposal. It brings together a number of different strands and we are at the forefront in thinking of these issues."[19]

17. The Treasury has not modelled the level of additional contributions that might be made to Child Trust Funds across income bands, on the grounds that the number of variables that would have to be taken into account "would make such a projection extremely unreliable […]"[20] as "everything is to play for in the sense that we cannot model the efficacy of our financial education and what the financial services industry may or may

18 Q 375

19 Q 325

20 Q 10

not do to encourage savings."[21] The Treasury has asked Deloitte & Touche, an independent consultancy "to carry out detailed quantitative and qualitative research to allow us to inform the decisions we take when designing a stakeholder Child Trust Fund product."[22]

18. We were informed that the Government has received a response from Deloitte & Touche.[23] The results of their study should be published as soon as possible.

Measuring progress

19. The Financial Secretary explained that at present there were no plans to set specific targets for Child Trust Funds, although information about the level of take-up of the Funds, the level of additional contributions, and in due course the income distribution to which they relate, would be published regularly. The Financial Secretary noted that "[…] what we do not want to do is distort saving priorities that are currently there […] I think it would be wrong of us to […] say somehow we think people ought to be putting a set level of savings into the Child Trust Fund which is then locked away for the benefit of […] their children. Clearly people may want to do that for a variety of reasons, the children themselves may want to put money aside, their friends, their godparents, their grandparents may want to put money aside for a child's future, but that is not the sort of thing that we as the Government should be setting a target for."[24] The Treasury confirmed that it would be monitoring this information, but noted that "there is a world of difference between that and setting some benchmark where people may have reached very sensible decisions household by household as to what it is that they can put money into. If they have heeded the advice and paid off debt as opposed to putting money into a Child Trust Fund that would be a great success."[25]

Restrictions on use at age 18

20. Research commissioned by the Homeowners Friendly Society into consumer attitudes towards the Child Trust Fund found that "people feel strongly that the proceeds of the fund should be spent on a worthwhile purpose. Education is by far the most mentioned use for the fund, whether this be higher education or of a more vocational nature (64%). Other spending options are identified but the percentage for education is three times higher than any alternatives."[26] We asked the Treasury why there will be no restrictions on the use of Child Trust Funds when they mature at age 18. The Financial Secretary told us that "[…] we think the funds ought to be spent on worthwhile projects […]"[27] but considered that it would be difficult to design a scheme to identify what were worthwhile benefits and believed that "[…] the best way of encouraging the funds to be used well is to ask young people themselves what is in their best interests."[28] We also asked the Treasury whether

21 Q 329

22 Q 328

23 Qq 349–353

24 Q 401

25 Q 402

26 *Children's Savings Research*, prepared by Brahm Research for Homeowners Friendly Society, March 2003

27 Q 316

28 *Ibid.*

they had considered introducing an incentive to use the Child Trust Fund for educational purposes, to which the reply was that "we have not ruled out some kind of benign encouragement."[29]

Conclusions on the objectives

21. **The Child Trust Fund is an ambitious, pioneering programme which seeks, through a significant long term investment by the Government, to provide a financial asset to all children when they reach the age of 18, and to change people's behaviour towards saving. Whilst those with higher income may make most use of the opportunity, we feel that this gives less well off families an unprecedented chance to build up a tax-free sum for their children.**

22. **We note the Treasury's figures showing the potential significance of additional contributions from family and friends to the value of Child Trust Fund accounts at maturity. The Government is right to acknowledge the possibility that some families could lock away funds unwisely in Child Trust Fund accounts in the belief that this was in the best interests of their children. We therefore welcome the commitment to provide advice in both the information pack and promotional literature. We endorse the proposal to set out a hierarchy of savings objectives that promotes firstly paying off debt and secondly saving for a rainy day, ahead of any additional contributions to the Child Trust Fund. This information and advice needs to be clear and unambiguous.**

23. **The Government has decided not to place any restrictions on the use of Child Trust Funds when they mature at age 18. We endorse the Government's hope that the funds will be spent on worthwhile projects, and acknowledge the practical difficulties of devising a scheme to ensure that this is the case.**

24. **We note the Government's intention to monitor and publish regularly reports on the progress of the Child Trust Fund programme. We may wish to return to this subject in the light of the information these contain.**

The Proposals

25. Entitlement to a Child Trust Fund account will automatically be linked to child benefit, which reaches virtually all children living in the UK. There will be no need to make a claim for the Child Trust Fund – the notice of the child benefit award will automatically trigger the issue of a Child Trust Fund voucher.[30]

26. Child Trust Fund accounts will be available in 2005 "from a wide range of providers, including banks, brokers, building societies, friendly societies, investment managers and life insurers. The Government wants to ensure the development of a competitive Child Trust Fund market that provides simple, good value and accessible Child Trust Fund accounts with adequate incentives to save."[31]

29 Q 21

30 *Detailed proposals for the Child Trust Fund*, para 1.7

31 *Detailed proposals for the Child Trust Fund*, para 1.12

27. Parents will invest the Government endowment for their children with the provider of their choice. The Government will issue an information pack to help parents to choose a provider and decide what type of investment would suit their circumstances best. Where parents do not exercise this choice, the Inland Revenue will instruct a provider to set up an account for the child.[32]

Entitlement to a Child Trust Fund

28. Although children born from 1 September 2002 are eligible for Child Trust Fund accounts, the accounts themselves will not be available until April 2005. The proposals recognise that for these children there will be less time for their Child Trust Fund to grow in value before maturity. Accordingly, the Child Trust Fund voucher issued to children before the operational date in 2005 will have a higher value than the standard voucher to recognise this fact. The additional amounts will be set out in regulations.[33]

29. The Treasury explained that 1 September had been chosen as the qualifying date for Child Trust Funds as it is the date of the school year in England and Wales. This would ensure that in classes dealing with financial education all the children would have Child Trust Fund accounts of a similar age.[34]

30. The Association of British Insurers noted that "while we recognise that Government were faced with a difficult choice in deciding on a specific date from which children would receive a Child Trust Fund account, we consider that children born before 1 September 2002 are being unnecessarily excluded from the benefits of the Child Trust Fund. Even if the Exchequer rejects extending the distribution of the Government endowment to more children, we consider that a strong case can be made for extending the Child Trust Fund regime so that parents could open a Child Trust Fund account in their child's name even if they did not receive Government money [...]"[35] The Association of British Insurers told us that they were suggesting that the opportunity for parents to be able to contribute £1,200 a year on a tax-free basis to children born before 1 September 2002 should be available for those children. They thought doing so "should help encourage take-up because if you are a family with children born either side of the cut-off date then that may well put you off actually contributing more to the Child Trust Fund for a child born after September 2002."[36]

31. The Financial Secretary told us that there were already significant tax incentives in the system for children which parents could use for elder siblings not entitled to a Child Trust Fund account.[37] There were no proposals to extend the Child Trust Fund regime to other children, but the Financial Secretary thought it "highly likely, if demand exists, that the industry will offer a very similar product."[38] The Association of British Insurers considered

32 *Detailed proposals for the Child Trust Fund*, paras 1.17, 1.18

33 *Detailed proposals for the Child Trust Fund*, para 1.8

34 Q 46

35 Ev 23, para 27

36 Q 259

37 Q 354

38 Q 357

that the industry's capacity to innovate was "limited by the rules […] set round tax break contributions."[39]

32. **We recognise that a cut-off date for entitlement to Child Trust Funds is required and consider that the choice of 1 September seems sensible. We note that the Government plans to recompense children born between 1 September 2002 and April 2005, when Child Trust Fund accounts are due to be available, for lost growth in their accounts by means of higher initial Government endowments, and that the additional amounts will be set out in regulations.**

33. **We consider that the natural reaction of parents with children born on either side of the cut-off date will be to try to see that they are treated equally. This may mean that those parents with sufficient financial resources will make additional provision for children who do not qualify for a Child Trust Fund account. We believe they would be encouraged to do this if Child Trust Fund accounts, identical in all respects save the absence of a Government endowment, were available for their other children.**

34. **In the light of the evidence that the costs to the Treasury of the extra tax relief afforded by Child Trust Funds is negligible, we recommend that consideration be given to extending the availability of Child Trust Fund accounts but without Government endowments, to children born before 1 September 2002.**

Advice to parents

35. The Child Trust Fund account will be a "wrapper", in a similar way to Individual Savings Accounts (ISAs), that can be wrapped around a variety of products such as cash, unit trust or life insurance products. The proposals note that the Child Trust Fund information pack will highlight sources of information, education and advice to help parents in the decision making process and that:

- The Government will require all providers to offer a stakeholder Child Trust Fund account which will follow the principles of Sandler[40] stakeholder investment products – simple, low cost, accessible and risk-controlled. As the initial contribution in a Child Trust Fund account stays invested for 18 years and there is no access to the money until the child reaches 18, this account should be considered as a long-term investment.

- The Government wants all families to benefit from the potential higher returns that might be achieved through equity investments.

- The stakeholder Child Trust Fund account should be designed to spread assets between stocks and asset classes to balance risk and return with regard to the expected maturity of the investment. A lifestyling approach should be taken, where the proportion of less risky investments should increase as the stakeholder Child Trust Fund account reaches maturity.[41]

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39 Q 267

40 HM Treasury, *Medium and Long-Term Retail Savings in the UK, A Review*, July 2002

41 *Detailed proposals for the Child Trust Fund*, paras 3.13–3.16

36. The Building Societies Association noted that the requirement that all Child Trust Fund providers offer a stakeholder account would mean that more than a quarter of all building societies (17) would not be able to offer Child Trust Fund accounts because they do not have the necessary regulatory permissions under the Financial Services and Markets Act 2000.[42] The Association believed this aspect of the proposals "to be perverse"[43] and considered that it would "inhibit consumer choice, by reducing the number of providers; and drive consumers to invest in equity-based investments, of which they may have no experience and in which there is a risk of capital loss, rather than capital-certain building society savings accounts, where their savings are safe and with which they may feel much more comfortable."[44]

37. The Building Societies Association also noted that "the rationale for the Government's proposal is that every child should be able to benefit from the higher returns which are associated, historically, with equity investment. However (as the Financial Services Authority requires firms to point out to prospective customers), past performance is a fallible indicator of future returns. Although returns on equity investments have tended to out-perform returns on cash deposits in recent decades, these have been periods of relatively high inflation and it is not clear how markets will adjust over the medium to longer term to sustained periods of low inflation. Moreover, equity investment carries with it the risk of significant capital loss."[45]

38. The Association of Investment Trust Companies told us that it "does not support the decision to force all providers to offer a default [stakeholder] Child Trust Fund as a precondition to providing their preferred investment approach. It may exclude many providers from this market (and we believe the objective should be to maximise choice and competition)."[46] The Association of Investment Trust Companies also pointed out that personal pension providers are not required to provide a Stakeholder Pension as a prerequisite for entering that market.[47]

39. Asked about the decision to make provision of a stakeholder Child Trust Fund a requirement for entering the market, the Inland Revenue told us that "one of the things we are trying to do is to encourage families to take out equity accounts, so that they can realise the benefits of that. Our worry if we do not make the equity account a prerequisite is that there will be cherry-picking: that low income people will only be offered cash accounts and that some financial providers may refuse to deal with some customers. We think that, this way, we can ensure that everybody does have access to an equity account. […] it does mean that some very small building societies are excluded, but that is a commercial decision for them. We are not excluding them […]."[48]

42 Ev 100, summary and Ev 101, para 4

43 Ev 101, para 5

44 Ev 101, para 6

45 Ev 101, para 7

46 Ev 79, para 12

47 *Ibid.*

48 Q 127

40. The Financial Secretary told us that the Government were very keen to promote an equity product "because people tend to do better with equities than when they place their money in cash […]"[49] and noted that "if somebody invested in equity 18 years ago they would have had a real return of I think 6.6%, that is despite the fact that equity markets have fallen in recent years. If you look at the period from 1918 to 2002 the mean return has been exactly that, 6.9%. Over a period of 18 years it is reasonable to expect a healthy return in the equity market. Obviously there are years when it will not achieve that amount but over the period from 1936 to 2002 there has been no 18-year period in which the cumulative return has been negative."[50] The Financial Secretary said that "we will certainly be promoting the stakeholder product. We will be encouraging people to put their money into stakeholder accounts, illustrating in the information and advice pack that will go to parents after the time when a child is born the merits of investing in an equity account compared with putting the money in cash."[51]

41. **We support the proposal that simple, low cost, accessible and risk-controlled stakeholder Child Trust Fund accounts should be developed. We note the Government's firm preference that Child Trust Funds be invested in equity-based accounts on the grounds that these are likely to generate higher returns over the longer term than cash accounts. However, we also note that the potential for higher returns from equity based accounts is accompanied by a higher degree of risk that some families may not wish to face. We recommend that this be made clear to all parents in the information pack so that they can take into account their individual circumstances when deciding. If an easily understood risk evaluation can be designed, it should be provided with the information pack.**

Revenue allocated accounts

42. Some parents and guardians might not open a Child Trust Fund account. In these cases the Inland Revenue will open an account for them to ensure that their children are not disadvantaged. The Revenue will open an account when a Child Trust Fund voucher has not been used within 12 months of it being issued, where a child is in care, or where there is no one with parental responsibility for the child. Revenue allocated accounts will always be stakeholder Child Trust Fund accounts. Providers will not be required to accept Revenue allocated accounts. There will be a list of providers willing to do so and the Revenue will ask these providers in turn to open an account for the child.[52]

43. In England, Wales and Northern Ireland, where a person under 18 has a child who is eligible for a Child Trust Fund account, it will not be possible for that parent to manage the account for their child as under the Children Act 1989 they do not have the legal capacity to enter into binding contracts to acquire equities. In these circumstances the Revenue will open a stakeholder Child Trust Fund account on behalf of the child and once the parent reaches 18, responsibility for managing their child's account will pass to them. The law is

49 Q 381

50 Q 420

51 Q 382

52 *Detailed proposals for the Child Trust Fund*, paras 3.20, 3.21; Q 167

different in Scotland, where a parent aged between 16 and 18 will be able to manage their child's Child Trust Fund account.[53]

44. We asked whether, given that Revenue allocated accounts will be stakeholder accounts opened by the Revenue on the child's behalf, the Revenue might be open to accusations of mis-selling. The Financial Secretary told us that "we do not think there is a market relationship between the Revenue and the individual who is being allocated the account in the traditional sense at all so we do not think any such allegation could be followed through. […]"[54] In the case of parents under the age of 18, the Financial Secretary noted that "the fact remains that as soon as they reach the age of 18 they can switch to a different provider, there is still not that fundamental relationship that one would expect if there were to be accusations of mis-selling. As far as I understand it the Revenue could be accused but those accusations could not be stacked up."[55] The Inland Revenue told us that they had received legal advice that they could not be accused of mis-selling."[56]

45. **We support steps to ensure that no child loses out from parents, or someone acting in that capacity, not opening a Child Trust Fund account on their behalf. In such cases the Revenue will open an equity based account and choose, albeit by rota, the provider to manage that account. We note the evidence from the Treasury and the Inland Revenue that they have obtained legal advice to the effect that in the event of any subsequent difficulties any accusations of mis-selling would be unsuccessful.**

Interaction with the welfare system

46. Asked how the Child Trust Fund would interact with income-related benefits, the Treasury stated that "it has no impact on income-related benefits of the parents, as the fund is developing on behalf of the child as it grows. When the child reaches 18, were nothing to change between now and then, then the normal rules would apply. It would be part of the child's assets."[57] We asked whether the effect of this could be that parental contributions to a Child Trust Fund could prevent their child claiming Jobseeker's Allowance. The response from the Treasury was that "we are aware of the implication and we cannot say at the moment what exactly we plan to do about it […]"[58]

47. The Financial Secretary told us in relation to the interaction of Child Trust Funds and the benefit system that "there are already some disregards in the system, even for means tested benefits, Jobseeker's Allowance and Income Support, and so forth. We are acutely aware of the signals that any capital limits have in the system. The points that were made earlier were ones that we had already been thinking about. I do not think it would be appropriate for me outside the ordinary PBR/Budget timetable to make any further comment."[59] The Financial Secretary confirmed that there would be no impact on the

53 *Detailed proposals for the Child Trust Fund*, paras 3.29–3.31

54 Q 429

55 Q 430

56 Q 144

57 Q 158

58 Q 159

59 Q 407

family tax credits and family benefits that a family receives while capital is accumulating within a Child Trust Fund account. The separate issue as to what happens on maturity and how it would affect the benefits to which an 18 year old would be entitled would be clarified before the scheme started.[60]

48. We also asked whether contributions to Child Trust Fund accounts by people in receipt of benefits would be regarded as an appropriate use of capital, or an inappropriate use seen as depriving themselves of capital to gain more benefit which could affect their entitlement.[61] The Financial Secretary told us that "in the end it is a matter of judgement to decide whether the intention was to increase entitlement to a particular Social Security benefit or credit. There is an element of discretion here. The fact of the matter is that it is very unlikely that a modest contribution to the Child Trust Fund would fall into that category."[62]

49. **There is a potential interaction of the Child Trust Fund with the welfare system (or any other entitlements that might be affected by possessing an asset) which might deter additional contributions to Child Trust Fund accounts from family and friends, if the result were to be a potential reduction in benefits for the child in the future, or an actual reduction in benefits for the contributor.**

50. **The Government therefore needs to clarify the extent of this potential interaction, in order to overcome fears of potential disadvantage to the child in later life. We believe it is essential that this is done before the scheme starts, and we therefore welcome the statement by the Financial Secretary that this will be the case. We believe it would be helpful if these matters were clarified and resolved during the passage of the Bill through the House.**

Providing Child Trust Fund accounts

51. The proposals note that there are potential benefits to the savings and investment industry from the introduction of Child Trust Funds. These include cross-selling opportunities to parents and relatives and guardians of the child and the opportunity to gain and retain lifelong customers. The Government believes that the Sandler philosophy of tight product regulation leading to reduced regulation of the sales process could lead to lower up-front marketing and distribution costs, and that the advertising campaign it will use to launch Child Trust Funds will give firms a head start on the marketing required to inform the public of the availability and nature of the product. According to the proposals a key aim of the design of Child Trust Fund accounts and the system needed to support them is to build as much as possible on the systems providers already have in place for ISAs with a view to minimising costs. But the proposals also recognise that there could be additional compliance costs due to the nature of Child Trust Funds as they will allow multiple savers and involve a voucher system.[63]

60 Qq 410–413

61 Qq 414–416

62 Q 417

63 *Detailed proposals for the Child Trust Fund*, paras A18–A20

52. The Government wants "to ensure that charges are set at levels that are good value for savers while also allowing efficient providers to make adequate returns. The Government has stated that there is a high threshold of persuasion for any move from a 1% charge cap for stakeholder products."[64] The Government has appointed Deloitte & Touche to conduct independent research on price caps for the Child Trust Fund. The proposals note that the economics of the price structure may also depend on the cost and nature of the sales regime being designed by the FSA who are currently researching the sales process for all the products within the stakeholder product suite. The Government will issue a report detailing the charge cap for the Child Trust Fund (including specifying whether a charge cap will apply to non-stakeholder Child Trust Fund accounts).[65]

53. The evidence we received from the financial services industry and consumer organisations supported the introduction of Child Trust Funds. The Association of British Insurers viewed it "as offering the possibility of creating a savings culture among the next generation and, in so doing, building a mass market for financial services."[66] The Association of Investment Trust Companies said that it "wholeheartedly supports the creation of the Child Trust Fund [which] offers the prospect of a new 'asset-based' approach to welfare that could be extremely beneficial to many young people who might otherwise start adult life without any assets and consequently suffer from poorer life chances."[67] The Building Societies Association said they were "a strong supporter of the Child Trust Fund"[68] and the Association of Friendly Societies considered that "the Child Trust Fund is a good idea [and that] it is fundamental to the future welfare of the country that young people become involved in the savings habit as early as possible."[69]

54. The National Consumer Council also welcomed the Government's proposals for the Child Trust Fund noting that "it is an excellent far-sighted policy, of particular benefit to low-income families [that] will eventually extend access to an accumulated asset to all young adults [and] may trigger additional individual private savings by parents."[70] The Consumers' Association supported the concept of the Child Trust Fund "as a means of building assets and encouraging greater savings amongst consumers [and supported] the principle of encouraging consumers to use the capital markets and stockmarkets as the most efficient method of maximising the total amount of assets generated through the Child Trust Fund."[71]

55. The industry's concerns centred round details of the scheme that have not yet been finalised. These were summed up by Norwich Union who noted that "one critical factor is certainly the level at which any price cap is set. It will need to be set at a level where it is economic for us to write this business. Coupled with that is the regulatory environment within which these products sit and any advice requirements that may sit alongside them,

64 *Detailed proposals for the Child Trust Fund*, para 4.1

65 *Detailed proposals for the Child Trust Fund*, paras 4.1, 4.2

66 Ev 20, para 5

67 Ev 77, para 1

68 Ev 100, para 2

69 Ev 93, para 2.1

70 Ev 65, Summary

71 Ev 71, para 2

because that obviously impacts on the costs of distributing the products. Third, but by no means least, I think, is the way in which these products interact with the wider initiatives that are being taken by the Government on raising awareness of the need to save."[72] The Association of British Insurers considered that vital details included "the price cap, the sales regime and the advice regime [and that] unless those things are got right, there will not be a sufficient number of providers in the market,"[73] views shared by the British Bankers' Association.[74] The Children's Mutual believed that "keeping administration […] as up to date and simplified as possible, and setting a price cap which allows it to continue to serve middle and lower income savers [was] the most critical thing of all."[75]

56. Questioned on the likely impact of a price cap of 1% on charges the British Bankers' Association said that "at the moment our members are looking at the scant information that they have with respect to the administration costs, particularly at a viable product where the customer feels they are getting value for money and where there is sufficient incentive for the company to invest on a commercial basis, they are looking at closer to 2% and with some consideration of a front-end charge […]."[76] The Association of British Insurers noted that "if the price cap is kept at a flat 1% that leaves very little margin for advice, very little margin for information and education to encourage more contributions in, very little margin for investment advice, […] and very little incentive to us in the market."[77] Norwich Union told us that they were not "in a negotiation, we are pointing out the fact that we cannot raise the capital to write this business if the price cap is at 1%."[78] The Children's Mutual were not sure whether, if the charge cap was set at 1%, there would be any providers in the market at all, and considered that the danger would be "at best, that you would force people to cherry-pick at the rich end of the market [to] cover their costs, and therefore, the lower income groups would be left out."[79]

57. The National Consumer Council argued that "the Child Trust Fund is a unique opportunity for the financial services industry. Normally the industry states it has to spend considerable amounts to stimulate demand for savings products. In this case, each year over 700,000 vouchers worth £230 million will be made available to parents to chose a Child Trust Fund. It is important to bear this in mind should the usual complaints about charge-caps start to dominate the debate on the Child Trust Fund. There is no reason to start from the assumption of a 1% price-cap for the Child Trust Fund, because this currently applies to the stakeholder pensions. Given the low costs of demand generation and the certainty of high persistency rates, a cost-based price-cap might be set at a lower level than for other stakeholder products."[80] The Homeowners' Friendly Society told us that it would be "happy to meet the 1% price challenge […] however we do accept that 1%

72 Q 198

73 Q 196

74 Q 197

75 Q 198

76 Q 280

77 *Ibid.*

78 Q 286

79 Q 212

80 Ev 68

would be impossible, or unacceptable for many providers and there is, therefore, a concern that a 1% cap would unnecessarily restrict the market."[81]

58. The Financial Secretary told us that the price cap "has to be set at a level which will allow competition to develop in the market but which also gives good value for money to the consumer"[82] and noted that "removing the need for everyone to go through a sales process makes it much more economic to provide the product [but compared with] other stakeholder products there are much lower levels of contributions and less regular contributions into the fund, which makes it less economic. There are forces pushing in both directions."[83] The Government has commissioned research by Deloitte & Touche which "has involved talking directly to potential providers of the fund about their contribution mechanisms, about […] the amount of capital they need to put behind these products when introducing them, and so forth, and we will make a judgement in due course on the basis of the evidence."[84] The Financial Secretary confirmed that "during the passage of the Bill we will make it clear what that charge will be so Parliament will have time to debate it."[85]

59. The industry were concerned at the potential administration costs of the scheme. The Association of British Insurers believed that to allow the Child Trust Fund to be delivered in a cost-effective way the costs involved in offering the product must be reduced, and cited the use of and need to retain paper vouchers as an example of a requirement that negated the possibility of providers keeping costs to an absolute minimum by enabling accounts to be opened over the telephone or on the internet.[86] The Children's Mutual considered that electronic top ups should be made available and that vouchers should be accepted via the internet.[87] The British Bankers' Association noted that the fortnightly reporting requirements proposed would "place additional burdens and require changes to internal systems capable of accommodating both fortnightly and current quarterly returns for ISAs."[88]

60. **We consider that the success of Child Trust Funds will depend in part on attracting a wide range of providers. Whether sufficient providers enter the market will depend on the level of any charge cap and the regulatory regime that applies to Child Trust Funds, factors on which decisions are still awaited.**

61. **We note that some key players have indicated that they are unlikely to provide Child Trust Funds if charges are capped at 1%. We consider that low charges will be important to ensure that adequate returns are generated from sums invested in Child Trust Funds.**

81 Ev 106

82 Q 404

83 Q 405

84 Q 406

85 Q 404

86 Ev 21, para 13, Ev 22, para16

87 Ev 32, para 5.16, Ev 33, para 5.17

88 Ev 27

62. **The Child Trust Funds Bill was introduced into the House without the relevant regulations covering important aspects including the proposed sales regime. We consider that these must be produced in time for the standing committee to consider them thoroughly.**

Conclusion

63. **The Child Trust Fund programme has the potential to make a significant impact, particularly on people's attitude to saving. But the Government is committing itself and its successors to significant expenditure under this initiative, potentially over £4 billion over the next 18 years. It must therefore get the details of the scheme and its implementation right.**

Conclusions and recommendations

The objectives of Child Trust Funds

1. The Child Trust Fund is an ambitious, pioneering programme which seeks, through a significant long term investment by the Government, to provide a financial asset to all children when they reach the age of 18, and to change people's behaviour towards saving. Whilst those with higher income may make most use of the opportunity, we feel that this gives less well off families an unprecedented chance to build up a tax-free sum for their children. (Paragraph 21)

2. We note the Treasury's figures showing the potential significance of additional contributions from family and friends to the value of Child Trust Fund accounts at maturity. The Government is right to acknowledge the possibility that some families could lock away funds unwisely in Child Trust Fund accounts in the belief that this was in the best interests of their children. We therefore welcome the commitment to provide advice in both the information pack and promotional literature. We endorse the proposal to set out a hierarchy of savings objectives that promotes firstly paying off debt and secondly saving for a rainy day, ahead of any additional contributions to the Child Trust Fund. This information and advice needs to be clear and unambiguous. (Paragraph 22)

3. The Government has decided not to place any restrictions on the use of Child Trust Funds when they mature at age 18. We endorse the Government's hope that the funds will be spent on worthwhile projects, and acknowledge the practical difficulties of devising a scheme to ensure that this is the case. (Paragraph 23)

4. We note the Government's intention to monitor and publish regularly reports on the progress of the Child Trust Fund programme. We may wish to return to this subject in the light of the information these contain. (Paragraph 24)

Entitlement to a Child Trust Fund

5. We recognise that a cut-off date for entitlement to Child Trust Funds is required and consider that the choice of 1 September seems sensible. We note that the Government plans to recompense children born between 1 September 2002 and April 2005, when Child Trust Fund accounts are due to be available, for lost growth in their accounts by means of higher initial Government endowments, and that the additional amounts will be set out in regulations. (Paragraph 32)

6. We consider that the natural reaction of parents with children born on either side of the cut-off date will be to try to see that they are treated equally. This may mean that those parents with sufficient financial resources will make additional provision for children who do not qualify for a Child Trust Fund account. We believe they would be encouraged to do this if Child Trust Fund accounts, identical in all respects save the absence of a Government endowment, were available for their other children. (Paragraph 33)

7. **In the light of the evidence that the costs to the Treasury of the extra tax relief afforded by Child Trust Funds is negligible, we recommend that consideration be given to extending the availability of Child Trust Fund accounts but without Government endowments, to children born before 1 September 2002.** (Paragraph 34)

Advice to parents

8. We support the proposal that simple, low cost, accessible and risk-controlled stakeholder Child Trust Fund accounts should be developed. We note the Government's firm preference that Child Trust Funds be invested in equity-based accounts on the grounds that these are likely to generate higher returns over the longer term than cash accounts. However, we also note that the potential for higher returns from equity based accounts is accompanied by a higher degree of risk that some families may not wish to face. **We recommend that this be made clear to all parents in the information pack so that they can take into account their individual circumstances when deciding. If an easily understood risk evaluation can be designed, it should be provided with the information pack.** (Paragraph 41)

Revenue allocated accounts

9. We support steps to ensure that no child loses out from parents, or someone acting in that capacity, not opening a Child Trust Fund account on their behalf. In such cases the Revenue will open an equity based account and choose, albeit by rota, the provider to manage that account. We note the evidence from the Treasury and the Inland Revenue that they have obtained legal advice to the effect that in the event of any subsequent difficulties any accusations of mis-selling would be unsuccessful. (Paragraph 45)

Interaction with the welfare system

10. There is a potential interaction of the Child Trust Fund with the welfare system (or any other entitlements that might be affected by possessing an asset) which might deter additional contributions to Child Trust Fund accounts from family and friends, if the result were to be a potential reduction in benefits for the child in the future, or an actual reduction in benefits for the contributor. (Paragraph 49)

11. The Government therefore needs to clarify the extent of this potential interaction, in order to overcome fears of potential disadvantage to the child in later life. We believe it is essential that this is done before the scheme starts, and we therefore welcome the statement by the Financial Secretary that this will be the case. We believe it would be helpful if these matters were clarified and resolved during the passage of the Bill through the House. (Paragraph 50)

Providing Child Trust Fund accounts

12. We consider that the success of Child Trust Funds will depend in part on attracting a wide range of providers. Whether sufficient providers enter the market will depend

on the level of any charge cap and the regulatory regime that applies to Child Trust Funds, factors on which decisions are still awaited. (Paragraph 60)

13. We note that some key players have indicated that they are unlikely to provide Child Trust Funds if charges are capped at 1%. We consider that low charges will be important to ensure that adequate returns are generated from sums invested in Child Trust Funds. (Paragraph 61)

14. The Child Trust Funds Bill was introduced into the House without the relevant regulations covering important aspects including the proposed sales regime. We consider that these must be produced in time for the standing committee to consider them thoroughly. (Paragraph 62)

Conclusion

15. The Child Trust Fund programme has the potential to make a significant impact, particularly on people's attitude to saving. But the Government is committing itself and its successors to significant expenditure under this initiative, potentially over £4 billion over the next 18 years. It must therefore get the details of the scheme and its implementation right. (Paragraph 63)

Formal minutes of the Committee and the Sub-committee relating to the Report

Sub-committee

Wednesday 19 November 2003

Members present:
Mr Michael Fallon, in the Chair

Mr Nigel Beard	Mr John McFall
Mr Jim Cousins	Mr James Plaskitt
Norman Lamb	Mr David Ruffley

Mr Michael Fallon declared a potential pecuniary interest in connection with the inquiry into Child Trust Funds as director of a company which is a member of the National Day Nurseries Association whose major members have been approached by the Children's Mutual with a view to distributing information on their Child Trust Funds products in due course.

The Sub-committee deliberated.

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[Adjourned till Wednesday 3 December at a quarter-past Two o'clock.

Wednesday 10 December 2003

Members present:
Mr Michael Fallon, in the Chair

Mr Nigel Beard	Mr John McFall
Mr Jim Cousins	Mr George Mudie
Angela Eagle	Mr James Plaskitt
Norman Lamb	Mr David Ruffley

The Sub-committee deliberated.

Draft Report (Child Trust Funds), proposed by the Chairman, brought up and read.

Ordered, That the Chairman's draft Report be read a second time, paragraph by paragraph.

Paragraphs 1 to 63 read and agreed to.

Ordered, That the Chairman do make the Report to the Committee.

Several papers were ordered to be appended to the Minutes of Evidence.

Resolved, That the Report be the First Report of the Sub-committee to the Committee.

Ordered, That the Appendices to the Minutes of Evidence taken before the Sub-committee be reported to the Committee.—(*The Chairman*.)

[Adjourned to a day and time to be fixed by the Chairman.

Main Committee

Wednesday 10 December 2003

Members present:
Mr John McFall, in the Chair

Mr Nigel Beard	Norman Lamb
Mr Jim Cousins	Mr George Mudie
Angela Eagle	Mr James Plaskitt
Mr Michael Fallon	

The Committee deliberated.

Draft Report from the Sub-committee (Child Trust Funds), brought up and read.

Ordered, That the draft Report be read a second time, paragraph by paragraph.

Paragraphs 1 to 63 read and agreed to.

Resolved, That the Report be the Second Report of the Committee to the House.

Ordered, That the Chairman do make the Report to the House.

Ordered, That the provisions of Standing Order No. 134 (Select committees (reports)) be applied to the Report.

Ordered, That the Appendices to the Minutes of Evidence taken before the Sub-committee be reported to the House.—(*The Chairman*.)

[Adjourned till Monday 15 December at a quarter past Nine o'clock.

Witnesses

Wednesday 12 November 2003	*Page*
Mr Nicholas Holgate, Director Welfare Reform, **Mr Mostaque Ahmed**, Policy Adviser, Pension and Savings Team, HM Treasury, **Ms Caroline Rookes**, Business Director, Pension and Share Schemes, **Ms Liz Welsh**, Deputy Director, Savings Policy, Inland Revenue	Ev 1
Wednesday 19 November 2003	
Ms Joanne Segars, Head of Pensions and Savings, Association of British Insurers, **Mr Ian Mullen**, Chief Executive, British Bankers' Association, **Mr David White**, Chief Executive, The Chidlren's Mutual, and **Mr Robert Fletcher**, Director of Distribution Strategy, Norwich Union Life	Ev 34
Wednesday 3 December 2003	
Ruth Kelly MP, Financial Secretary, **Mr Nicholas Holgate**, Director Welfare Reform, **Mr Mostaque Ahmed**, Policy Adviser, Pension and Savings Team, HM Treasury, and **Ms Liz Welsh**, Deputy Director, Savings Policy, Inland Revenue	Ev 49

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Norwich Union	Ev 34; 106
National Consumer Council	Ev 65
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Association of Investment Trust Companies	Ev 77
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PEP & ISA Managers' Association	Ev 90
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Investment Management Association	Ev 97
Institute for Fiscal Studies	Ev 99
Building Societies Association	Ev 100
Tax Faculty of the Institute of Chartered Accountants in England and Wales	Ev 102
HM Treasury	Ev 106; 107

Oral evidence

Taken before the Treasury Sub-Committee

on Wednesday 12 November 2003

Members present:

Mr Michael Fallon, in the Chair

Mr Nigel Beard
Mr Jim Cousins
Angela Eagle
Norman Lamb
Mr John McFall
Mr James Plaskitt
Mr David Ruffley

Witnesses: **Mr Nicholas Holgate,** Director, Welfare Reform, **Mr Mostaque Ahmed,** Policy Adviser, Pensions & Savings Team, HM Treasury; **Ms Caroline Rookes,** Business Director, Pension and Share Schemes, **Ms Liz Welsh,** Deputy Director, Savings Policy, Inland Revenue, examined.

Q1 Chairman: Mr Holgate, can I welcome you to the Committee? Could you identify yourself and your colleagues, please?
Mr Holgate: I am Nicholas Holgate, Director of Welfare Reform in the Treasury. On my left is Caroline Rookes who is Director of Savings, Pensions and Share Schemes at the Inland Revenue. On Caroline's left is Liz Welsh who is Deputy Director of Savings Policy at the Inland Revenue, and on my right is Mostaque Ahmed who is Head of the Savings Policy Branch in the Pensions and Savings Team in the Treasury.

Q2 Chairman: Your consultation document received a leader in the *Sunday Times*, describing it as "a half-baked piece of social engineering that will cost taxpayers hundreds of millions of pounds, stack up countless more civil service jobs to administer and then achieve little". How did you achieve that kind of headline?
Mr Holgate: It is a free press, Mr Chairman, and they are entitled to their view.

Q3 Chairman: How do you respond to it?
Mr Holgate: I would completely reject the notion of social engineering. I think that social engineering carries the imputation of heavy-handedness. The Child Trust Fund is extremely light touch. We are not mandating or requiring anybody to do anything at all. We are teasing and encouraging them into thinking about whether they wish to establish a savings habit for their own sake and for their children's sake, to set an example for their children so that their children can see the benefits of saving, so that at age 18 they have a fund which they can use both to take advantage of opportunities and to withstand vicissitudes throughout much of the rest of their lives.

Q4 Chairman: What in fact is the administrative cost or the number of jobs that will be created to administer it?
Ms Rookes: The numbers have not been finalised yet. We are looking at probably around £90 million cost to develop and implement the Child Trust Fund. There will be a small number of people needed to administer it. We do not know precisely how many, but it will be small because most of the administration will be run off the child benefit system and the tax credit system.

Q5 Chairman: You have consulted on the design and detail of the scheme, but have you consulted on the principle of asset-based welfare? I was quite struck by the Institute of Fiscal Studies who pointed out two years ago, just after you started this, that asset-based welfare was not the only option available to help people on low incomes: that an alternative would be to provide low-income individuals with greater income.
Mr Holgate: The IFS is entirely right. What the Government is doing is establishing what I might describe as a portfolio of interventions to assist those on low incomes in a variety of different ways, where we hope the whole will be greater than the sum of the parts. As you know, we have introduced new tax credits this year which are more generous than the Working Families' Tax Credit, so that I think it is the case that someone on half average earnings with two children is over £2,500 better off now than they were five years ago. From the point of view of the creation of equal opportunity, which is, as it were, the long-term counterpart of trying to reduce poverty, education spending has gone up very considerably. It is a question of what gap in the portfolio might be filled by an asset-driven policy like this. We think that there is a gap. Those who have researched the National Child Development Study data suggest that there is an independent effect of the presence of savings, and quite small stocks of savings, on people's future outcomes—across a range of social and economic outcomes. It is also encouraging that other countries round the world have been experimenting with what you might call save-to-invest funds. Ours is more ambitious than nearly all of those because it is lasting much longer, but it is interesting that the United States has almost simultaneously launched something called the Savings for Education, Entrepreneurship and

Down-payment initiative, or SEED, which seems to have quite a lot in common with the Child Trust Fund.

Q6 Chairman: It is a scheme that will last longer. It is also universal, is it not? Perhaps you could help us here on the detail. If your poorer third of children who will have the £500, not the £250, make no contribution to it—if they are in a household where there is no other saving and nothing added to it—they will end up, 18 years later, with £911. However, somebody from a better-off family who does top up even the lower amount of £250, if they top up at £40 a month, will end up with £14,000. How logical is that?
Mr Holgate: Whatever they end up with, of course, will depend on what they invest in over the meantime, so—

Q7 Chairman: But are not people from middle-income families more likely to invest in it than precisely the sort of people you are trying to help?
Mr Holgate: If we look at savings behaviour across income quintiles, then I think you are quite right that better-off people tend to save more. However, I think the question is what are the tax receipts forgone should better-off people choose to use the Child Trust Fund? The fact is that, because children have their own personal allowance and because we are not match-funding incremental parental, grandparental or other contributions to the fund, we are not incurring expenditure in terms of encouraging the better-off to contribute. What we are doing—and commentary round various bursts of publicity rather confirms this point—is setting people off. We are giving them a start. It is interesting to see the reactions that we have received to that. People have said something along the lines of, "As someone has chipped in to begin with, it is more realistic for me to think about contributing something because, between me and the Government, as it were, or the taxpayer, it will add up to something more than I could otherwise imagine possible". So I do not think that there is a sort of nugatory expense being incurred here, related to the scale of contributions from better-off families. They would have to contribute an enormous amount for us to start losing tax receipts.

Q8 Chairman: The experience of ISA is surely that those people are more likely to do that and therefore, if you like, middle-income children are more likely to end up with £14,000 and those who have not had the habit of saving are more likely to end up with £900?
Mr Holgate: I think it is a fair test for the Child Trust Fund. Given the extent to which the pack of information that we send parents when the Child Trust Fund is used, the annual accounts, the education in school and through other means, it will be interesting to see whether it affects people's behaviour and whether the potential gap that you correctly identify will be closed in any way through less well-off people contributing more than we might otherwise have expected them to do.

Q9 Chairman: You said that it will be interesting to see. You are the man running this experiment. Have you done any research? What proportion of the bottom third of children do you think will actually take up the full possibility of family, parental, grandparental contributions? What proportion do you think will top it up?
Mr Holgate: What we know at the moment—and this is from the Institute of Fiscal Studies and work they have done on the British Household Panel Survey—is that the median savings for those aged under 25 is precisely zero. So one point we should make is that any increment to the position of those people may be quite significant from the point of view of taking up opportunities later on in life. What we also have are surveys conducted by people quite independent of government, like Virgin Money. They say that very large proportions of parents are attracted to and interested in the possibility of saving in the Child Trust Fund—much higher proportions than you might infer from the outcome as reported in the British Household Panel Survey. For instance, in September 2003 the Children's Mutual—who are represented behind me—showed that 79% of parents with children eligible for the Child Trust Fund are likely to top up government monies. Were we to achieve 79%, that would be a very good start indeed.

Q10 Chairman: But you have not done any research of your own as to what the proportion is likely to be?
Mr Holgate: There are quite a number of variables that we have to take account of, which we have not yet created. There is the question of what is the power of the information pack that we shall send all parents. To what extent are financial service providers going to advertise—because it is in their interests to do so? What sort of effort are they going to put in, once they see the full details, once the Act is passed, when they know that it is all systems go? I think that there is quite a lot that would make such a projection extremely unreliable, frankly.
Ms Rookes: One of the important elements of the Child Trust Fund is not just creating the asset, but the financial education side. As Nicholas says, we are going to create an information pack which will go out with the voucher at the start of the Child Trust Fund. That will be based on research into what the parents need. We are going to work with and have started talking to voluntary and community organisations. We are going to be looking at resources in schools. There is a whole effort going into creating a financial education initiative to run alongside the account so that, at the end, it is probably true that children from poorer families will have less money but we hope that they will be provided with financial education and a better understanding of how to interact with financial services.

Q11 Chairman: So you are accepting from the start that children from poorer families will probably end up with less money?
Ms Rookes: I think it is a fact of life that, at the moment, they will probably not end up equal, but there are a few things I would say with that. We are

starting off with an endowment, but that is a foundation on which we want to build. We will be taking powers in the legislation to enable the Government to make top-ups in the future, if that is deemed necessary. So the story does not end here. This is just the start of it.
Mr Holgate: It is fair to add that the significance of even £911 to someone who might otherwise have zero might actually be very great indeed. It is what the fund might be used for which is quite a big long-term test.

Q12 Chairman: However, you understand the concern of those of us who seem to have heard all this before—stakeholder pensions, ISAs and so on—and the criticism that they do not yet seem to be reaching those whom they are designed to reach?
Mr Holgate: With respect to ISAs, I think it is the case that they have done slightly better than previous schemes, but I take your point in principle that there is still quite a skew to beneficiaries. The position with ISAs is slightly different, however. There is a much higher cap there than with the Child Trust Fund and, at least until 2004, there is a payable tax credit to them and there is relief from capital gains tax. One would expect better-off people to be piling into those, in the way that indeed they have done. I think that this is a simpler proposition with a lower cap and, potentially, a very powerful dynamic in terms of ensuring that your children go into adult life with something behind them.

Q13 Mr Plaskitt: When you were designing the scheme, did you give any consideration either to imposing restrictions on what the funds could be used for at maturity or to building incentives in for particular uses?
Mr Holgate: It is very difficult indeed to envisage any feasible restrictions on the use of funds at maturity. First of all, most people might accept implicitly that the great majority of people want to make the best of their lives. So I think that there is quite a fund of wanting to do well with this product—or there will be when it comes to begin to spend money, and not necessarily to spend it at 18. Of course, the test for us and our colleagues, and for schools and others, is to have inculcated the idea that this is something that will be spent on something that will make a real difference to one's life: not just something rather frivolous. Then you get into a problem that were you, for example—and this is only a crude example—to draw up a list of virtuous expenditures from this fund, you could easily imagine items which would appear virtuous but which would not be so in practice. If I were to spend my Child Trust Fund on a computer and do nothing but play *Quake 39* on the computer—which would be a very sad outcome—then that would appear good but would not actually be good.

Q14 Angela Eagle: What have you got against computer gaming?
Mr Holgate: I am all in favour of computer gaming myself, but I am just saying that you could appear to find things which were virtuous which, in practice, did not have quite the kind of investment aspect that you might hope they would. Fourth, in a situation where the 18-year-old is possessed not only of a Child Trust Fund but also a credit card, you could imagine that—if we had some committee of the great and the good vetting people's applications to spend money, or however you set it up—the young person would direct the virtuous expenditure towards this committee and keep the less virtuous, or apparently less virtuous, expenditure off balance sheet with respect to such a committee. If you delve into it, you find that it is really very difficult to set anything up which would not be other than something a little bit like—was it the Lord Chamberlain who used to vet plays before they were put on? You would end up with a system a bit like that.

Q15 Mr Plaskitt: Is it so difficult? Look at all the other countries round the world. You mentioned one yourself earlier in this evidence that had set up funds that quite closely parallel this, but they do have incentives built in for particular use at the end. I cite, for example, funds designed to support further education. It is not so difficult, is it?
Mr Holgate: What one would want to do is to ask what the conditions were round, as it were, the most obvious opportunities on which one might spend money. You mention further education. Plainly, some 18-year-olds may be in further education. The question then is what is the role of education maintenance allowances, for example, in 18 years' time? There may be other things that the Government is doing which take care of some of the most obvious options. The broader problem is that we live in an ever more diverse, multicultural, mobile society. It is increasingly unrealistic to imagine that we can predetermine what is in young people's best interests—anyone's best interests in some respects. They have a lot of pathways open to them at that age and thereafter and, in one way or another, we would be trammelling that choice. If you accept my starting hypothesis, which is that people in the great majority do want to make the best of their lives, then we are putting an unnecessary constraint on that choice when it comes to having access to the funds.

Q16 Mr Plaskitt: What did the Prime Minister mean at the launch of the fund when he said that it provides, "a real financial springboard to better education"?
Mr Holgate: There are all sorts of ways of achieving a better education than you might otherwise do. He could have had any number of things in mind.

Q17 Mr Plaskitt: What contribution to better education will £911 provide for a youngster from a low-income background?
Mr Holgate: To return to the subject of computers, it might, for example, provide either hardware or software which would otherwise have been beyond them.

Q18 Mr Plaskitt: Look at the reality here. Whatever the outcome of the current debate, it is likely that we are moving to a situation where students have to

contribute significantly to the cost of their university education at some point in the future. Does it seem so unrealistic to join these things up and say that here is an opportunity for someone to start a long-term investment to meet the cost of their university education? Have you looked at the parallel example you mentioned—the SEED one in the United States? Have you looked at and dismissed all these other examples of ways in which you can encourage or incentivise people to use this to meet that very significant cost, which they will incur shortly after becoming 18?
Mr Holgate: With education as a specific example, you have to ask what are the other surrounding circumstances and the help that we are providing people at differing levels of income, with different household backgrounds, to do that. I think that therefore there may not be such a good parallel with the United States.

Q19 Mr Plaskitt: There is nothing targeted specifically at the cost of a university education. We are clearly embarked in that direction. Did you not see in this an opportunity to help people build up the resources to help meet that cost?
Mr Holgate: Precisely because there is no restriction on the use of the Child Trust Fund, plainly they could use the money should they wish to; but I think that the prior requirement upon the Government is that, in order to meet whatever higher education objectives are present at the time, there is a system for funding students through higher education which is equitable—and that is the prior requirement.

Q20 Mr Plaskitt: Are you telling us that incentives within this scheme which would encourage its use for that purpose are being ruled out?
Mr Holgate: I would not rule them out 100%, and I will offer you an example. It is not inconceivable, depending on how the scheme progresses, depending on people's contributions into the Child Trust Fund and the quantum of money available there, that the private sector might say something to 18-year-olds along the lines of, "We know you have this money available. Here is something which we think is a very good investment for young people, or at some later age, and we are going to give you a discount if you buy". They may see that the economics of it might work out for them. So it would not surprise me if providers of goods and services did not see some gain to trying to latch onto the emergence of fully-fledged Child Trust Funds, when the first cohorts or later cohorts reach 18. It is possible that some such linkage would be made. However, I think that it is much more likely to be either one of private sector initiative or one of an incentive of some kind. What we are very adamantly against, for the reasons I set out earlier, is a prohibition on this or that kind of spending.

Q21 Mr Plaskitt: But you have not ruled out an incentive?
Mr Holgate: We have not ruled out some kind of benign encouragement—yes.

Chairman: That would turn it into a Child Tuition Fund, would it not?

Q22 Mr Ruffley: Mr Holgate, obviously your figures show that those children who have parents and relatives who want to kick in money and make regular contributions will be better off. Is it not the case that these proposals benefit proportionately the financially literate middle-class children?
Mr Holgate: I think I probably dispute that.

Q23 Mr Ruffley: Why?
Mr Holgate: Because if you wish to save on behalf of your children, you can do so anyway and you can do so to the extent that you can put aside money, such that if you do not achieve more than £100 income a year then that is fine. At current interest rates I suppose that is of the order of £3,000.

Q24 Mr Ruffley: Everything over that is taxable, is it not, and this is not?
Mr Holgate: That is right.

Q25 Mr Ruffley: So this is a tax break that is not otherwise available.
Mr Holgate: That is true, but you have to—

Q26 Mr Ruffley: For financially literate middle-class parents who are not getting that tax break at the moment. Is that not the case?
Mr Holgate: Only if you are prepared to put aside something of the order of £4,200 a year to make that use of it.

Q27 Mr Ruffley: Exactly. You make my point rather well. I think that we are in agreement so far. You have answered the question in the affirmative that financially literate middle-class people, making contributions of that magnitude, will be getting a tax break under these proposals that they do not currently enjoy. That is correct, is it not?
Mr Holgate: Yes, I think that is right.

Q28 Mr Ruffley: What is the deadweight cost of these proposals?
Mr Holgate: I think that it is extremely small.

Q29 Mr Ruffley: Why is it extremely small?
Mr Holgate: Because if you go back to the table to which I was referring earlier when I said that the median savings of someone aged 25 or below were zero, you find that at the 75th percentile their savings are a princely £400. It is extremely unlikely that you will find anyone—apart from inheritances where other forms of tax avoidance or tax management come into play—you will find a remarkably small number of people who will make any significant tax saving out of this.

Q30 Mr Ruffley: Could the Revenue speak to that, because if the £1,200, the full amount, is kicked in by a lot of rather wealthy people you are actually giving a tax break to people who do not need it? Is that not the case?

Ms Rookes: You may well be to start with, but I think—

Q31 Mr Ruffley: You might well be to start with?
Ms Rookes: I would come back to what I said earlier. We want to put these children who are in low-income families, who do not have as much to start life with, in a better position. We want to educate them—

Q32 Mr Ruffley: I am not talking about those people. I am talking about, for want of a better term, the middle-class families getting a tax break. It is the case, is it not, that it will help people who do not really need it? This is not targeted in favour of those—
Ms Rookes: It is not targeted—

Q33 Mr Ruffley: You said "it is not targeted"?
Mr Holgate: It is targeted. It depends—

Q34 Mr Ruffley: No, with respect, Mr Holgate, I asked the question. You said, "it is not targeted"?
Ms Rookes: The Child Trust Fund is universal—
Mr Ruffley: Can you please answer the questions? Not the ones you want to answer: the ones I am asking.
Chairman: Let her answer.

Q35 Mr Ruffley: Did you say "it is not targeted"?
Ms Rookes: The £1,200 limit is not targeted—

Q36 Mr Ruffley: I want to clarify on the record just what you said a few minutes ago. Did you say, "it is not targeted"?
Ms Rookes: I said the £1,200 was not targeted.

Q37 Mr Ruffley: It is quite easy. If you just listen to the questions, you can answer them.
Mr Holgate: There are two bits which are not targeted. There is the £250 for all children and there is the £1,200. There is one bit which is targeted, which is the additional £250. I think that where you are at risk of painting an unfair picture is when you say that this is a tax break for the middle classes. If you allow for the fact that the 75th percentile of those aged under 25 have all of £400 savings by then, you are well into any definition of middle-class territory. You are nowhere near the sums of money that you need to be contributing in order to make any significant inroad into tax payments under this scheme. It is a hypothetical example. There will, I am sure, be a few specific individuals, but it is a very small minority.

Q38 Mr Ruffley: Can you put a figure for the deadweight cost? In other words, the cost of the tax break you are giving to people. They would otherwise have saved anyway. This is a tax break you are giving them for something they would have done anyway. In other words, the deadweight cost. What is the figure in millions for that? Your best estimate, Mr Holgate?
Mr Holgate: We have a convention in the Budget document and others called "negligible" and—

Q39 Mr Ruffley: It would be that, would it?
Mr Holgate: My starting bid to you would be "negligible".

Q40 Mr Ruffley: Starting bid?
Mr Holgate: Yes, and we will see as time goes by.

Q41 Mr Ruffley: We certainly will. Can I ask what, over the time horizon you have, the Budget, is the actual annual cost to the Treasury? Not administering the scheme: the actual cost of the proposal.
Mr Holgate: We had money in the Budget document where, for instance, in 2004–05 it was £230 million and, in 2005–06, £235 million.

Q42 Mr Ruffley: So it is a third to a half of a billion PR stunt, is it not? It is not properly targeted—to use your own words.
Mr Holgate: No, it is a quarter of a billion non-PR stunt.

Q43 Mr Ruffley: It is obviously the case that additional contributions from lower-income families are not that likely to be forthcoming, because they will not want to tie up this money in contributions over an 18-year period. That is a fair assumption, is it not?
Mr Holgate: Again, I think that you are begging the question of how effective financial education will be and what else is going on over this period. For example, we are associated with a survey called the Families and Children Survey, which includes measures of hardship amongst lone parent and low-income couple families. What we have seen, probably through the growth in tax credit payments over the last three years, is a quite significant reduction in the proportion of families that are in severe hardship. So it does depend somewhat on what is happening elsewhere over these years.
Ms Rookes: From the research we have been doing on the Saving Gateway—which is at a very early stage and we do not have the final conclusions from it—two-thirds of the people involved in that claim that they would continue saving. These are people on very low incomes. Clearly, what they say they will do is not necessarily the same as what they will actually do, and we will need to look at it in time—but that in itself is also encouraging.

Q44 Mr McFall: Mr Holgate, I am quite fearful about saying that I quite like this. I thought that it was a good idea. With regard to that, reassure me that it is not off the top of your head. From your paper, I believe that you had quite a long period of formal and informal consultation. Could you tell me what the various providers, trade bodies, consumer groups and others said about this?
Mr Holgate: They have offered a variety of reasonably complimentary remarks. The director-general of the Association of British Insurers, for example, has said that the Child Trust Fund is "a new and imaginative way of helping children as well as their parents to get into the habit of saving". The chief executive of the Investment Management

Association said, "The need for a new financial initiative, coupled with steps to improve financial literacy, has never been more necessary".
Ms Rookes: We have plenty of "delights" sprinkled through the comments as well—generally very positive.

Q45 Mr McFall: Could you give us a flavour of some of them in writing and send that information to the Committee?
Mr Holgate: Certainly. We will send you a set of quotations.[1]

Q46 Mr McFall: On the issue of entitlement, I note that there is a cut-off date for eligibility. That is understandable, but is there any rationale behind the cut-off date of 1 September 2002? Have you considered making some provisions for children born before this date?
Mr Holgate: The date of 1 September is primarily to do with the school year. I acknowledge, because I know you represent a Scottish constituency, that it is not the date of the school year in Scotland. However, in England, Wales and Northern Ireland it is. Our attempt was to make sure that as many children as possible, in any class which deals with financial education and the Child Trust Fund in particular, would all have Child Trust Funds and that they would all have had a reasonably similar amount of time to mature. Of course children are not obligingly born around 1 September, and different things will happen to different Child Trust Funds as they mature. Nevertheless, it is a grouping together and something that links across to the financial education side of the story. On your second point, the problem is simply that we have to start somewhere. As we were saying in conversation with Mr Ruffley earlier, there are other ways that parents can save for their children. There is quite a variety of accounts that the private sector and others already offer. It is a case, therefore, of do we start with something that makes a mark and then occurs for all subsequent cohorts or do we say, "Here is where we are putting some money, but here is a sort of vehicle for others"? For the sorts of reasons that we were exchanging earlier, it does not make that much sense to offer a sort of vehicle without the money before 1 September.

Q47 Mr McFall: It could mean that families face a situation where one child receives an endowment whilst another does not. As a father, I would not like to be explaining that to their siblings. I would probably be asked to take something out of my own pocket to make up for that. Could the Child Trust Fund be used to promote accounts for children born before 1 September, but without a government endowment?
Mr Holgate: Again, one is relieved to say that the private sector may well take the initiative away from us. They may well invent things which serve that purpose, for practical purposes.

Q48 Norman Lamb: But without tax relief?
Mr Holgate: Indeed. It would not have tax relief. However, I do think that for the great majority—as we were saying to Mr Ruffley earlier—that will not be a problem at all.

Q49 Mr McFall: It would be reassuring, however, if you were thinking about this over the coming months. The point was made about tax relief and some of the issues. If you were thinking about that, then I think that it would bring a bit of equity to it. My last question is this. All children born before 1 September are eligible for the Child Trust Fund but accounts will not become available until 1 April 2005. You have stated that children born between these dates will receive a higher value voucher to recognise the lost potential growth in the value of the fund over the period. How will that be determined? It is a very complex area.
Mr Holgate: We have not fastened upon a figure, and I am conscious that—

Q50 Mr McFall: So you will write to us?
Mr Holgate: You readily remind me that, when we come to a figure, we will have to have a good reason for picking that figure rather than any other figure, and we will need such a rationale.

Q51 Mr McFall: The answer is in the post?
Mr Holgate: It will not be in the post just yet, because we do not have the number. I remember the conversation that the Chairman and I had about this some months ago, and I hope you will have noted that we are paying more than £250 for the first accounts.
Chairman: Mr Holgate, we now have a division of the House.

The Committee suspended from 3.06 pm to 3.16 pm for a division in the House.

Q52 Mr Plaskitt: In your early consultations you were floating the possibility of additional top-ups to these funds at ages five, seven, 11 and 16. The final consultation or the outline document just has the top-up at the age of seven. What happened to the other possibilities and why did you choose seven out of all of those ages?
Mr Holgate: Seven strikes a reasonable balance, we think, between making a further contribution to the Child Trust Fund which has a chance to mature between seven and 18, and also siting it at a time when the great majority, if not all children, will have a rapidly growing understanding of money, what its uses are, saving it, and so on. Seven had those merits. With respect to other ages, I think that we are reasonably clear in the recent document that we have not necessarily uttered our last word on when other top-ups may or may not be established and under what terms.

Q53 Mr Plaskitt: Do you envisage that the top-up at seven will also be means-tested?

[1] Ev 106

Mr Holgate: Yes.

Q54 Mr Plaskitt: Do you know yet what sort of scale you are thinking that top-up might be?
Mr Holgate: No, we have not settled upon a figure for that, but it will be means-tested relevant to the age.

Q55 Mr Plaskitt: Will it be means-tested in exactly the same way that the initial £250 extra is means-tested?
Mr Holgate: Yes.

Q56 Mr Plaskitt: It will be?
Mr Holgate: Yes, in exactly the same way.

Q57 Mr Plaskitt: Can we take it therefore that the growth projections you have in the document at the moment will not look quite as they do there, once you take into account the top-up at seven? Our concern about the maturity being just £911 could therefore be misplaced because, by the time you have sorted out the top-up at seven, that will be a bigger figure?
Mr Holgate: Yes, that is quite fair.

Q58 Mr Plaskitt: But you cannot tell us yet how much difference it will make to that?
Mr Holgate: No, that will be a matter for the Chancellor in some future Budget judgment, around 2009 maybe.

Q59 Mr Plaskitt: When the funds finally get going and the vouchers go out, parents will not know at that stage what the top-up at seven is going to be?
Mr Holgate: Obviously they will need to know by then but, in the same way as the Chancellor gave some indication before the Child Trust Fund came in this time as to what the amounts would be, who knows at what point between now and then he will be able to take a view on that?

Q60 Mr Plaskitt: When the thing goes live in 2005, will everyone then know what the top-up at seven is going to be?
Mr Holgate: We do not undertake that now, and it is possible that the Chancellor will decide to make an announcement of that kind then; but we have given no indication that he will.

Q61 Mr Plaskitt: Also on the age-related contribution, the industry has been recommending to us that it should be at least £250. Their argument for that is if the contribution were to be smaller than that, the Government would be better off making the contribution at the outset—since it has the advantage of maturing more. Can we take it therefore that the contribution will not be smaller than the £250 bonus added at the outset?
Mr Holgate: I do not think that I can give any indication at the moment as to the scale of the contribution.

Q62 Mr Plaskitt: Another question in relation to the proposals you have published so far. The additional £250 endowment at the outset, for those who qualify for it, is determined by Child Tax Credit. However, we know that can take up to 18 months to determine. The child will therefore have been in existence for 18 months before the status is known as to whether the extra £250 goes in. Will there be some recognition for the lost 18 months' potential growth of that £250 or not?
Mr Holgate: We do not plan any such compensation, no.

Q63 Chairman: So the child will be penalised for the administrative delay in assessing the Child Tax Credit?
Mr Holgate: I think that is a rather tough way of putting it.

Q64 Mr Plaskitt: It is what you are saying, is it not?
Mr Holgate: Not really, no. The child is getting an extra £250 in the account. We could have presented that as £247 plus interest, if you wish. It is an amount, and that is what will be paid in.

Q65 Mr Plaskitt: There is a problem here, because it will not take 18 months to determine every Child Tax Credit application. Why should those who do have to wait a long time to have it determined effectively lose some potential growth in this fund, whereas others whose status is determined quickly gain? That does not seem very equitable.
Mr Holgate: Frankly, I think that it is a relatively small factor. What is important is whether the household gets the £250 or not.

Q66 Mr Plaskitt: Some will and some will not, effectively. In terms of what it can grow into, you are offering different amounts.
Mr Holgate: Only very marginally so and there at a slight degree of abstraction, if I may say so. It will be much more important what the household does with it over the remaining $16\frac{1}{2}$ years, minimum, than whether it is £247 or £250 or £253.

Q67 Mr Plaskitt: So you are content that some are going to miss out on 18 months' worth of growth of that fund while others do not?
Mr Holgate: I think that in the context of an overall payment of £500 plus, as you say, a further unknown amount at age seven, it is a relatively minor matter.

Q68 Mr Plaskitt: Can you not make an extra payment? Just work out what the deferral has been and give a compensating factor? After all, it is only because of the time it takes to work out tax credit that the problem has arisen. It is nothing to do with the family themselves or the child. Can you not therefore compensate for it? It would not be a large sum of money but it would at least demonstrate equity.
Ms Rookes: It would demonstrate equity but at quite a considerable administrative cost. We would have to look at every individual case and work out what was lost, because they will be assessed and finalised

at different times. As Nicholas says, it is really a consequence of the system. We have opted to use child benefit as the passport to the Child Trust Fund and use tax credit as the passport to the higher endowment for ease of administration, to prevent us having to deal with extra applications and to prevent us having to add complications to the system. I think that to go down the route you are suggesting would add considerable complication.

Q69 Mr Plaskitt: So it is administrative complexities within the calculation of Child Tax Credit which can in effect cause the problem, and you do not want to fix it by an additional payment because that would also create administrative difficulties for you. Is that what you are saying?
Ms Rookes: I do not think that is exactly what we are saying. I do not think we accept that there is a significant problem here because, as Nicholas has said, the loss of growth over a period, which is not necessarily going to be 18 months but could be up to 18 months, will be very small.

Q70 Norman Lamb: Could I return to a question that was put to you, Mr Holgate, by John McFall about the situation of families where you have one child who will benefit and the other who will not? Has the Government specifically ruled out any tax relief for older children—children born before 1 September 2002? Can we just be clear on that?
Mr Holgate: I am not conscious of a specific statement to that effect but I think that it would be, as it were, a further discretionary addition to what has been announced were we to suggest that. I do not think that it is consonant with the scheme to do so. Essentially, we are launching a product that takes effect from 1 September 2002, where the accounts will come in in 2005 and it has the characteristics that the Sub-Committee has explored this afternoon. So to go back and, as it were, create a second family or a branch of the same product would be rather confusing.

Q71 Norman Lamb: In effect it is ruled out? In reality?
Mr Holgate: I think so.

Q72 Norman Lamb: Can I move on to the propensity for people to make additional contributions and how it impacts on different income groups? Amartya Sen has made the point that savings, particularly for poorer households, "can reduce people's vulnerability" by providing them with a buffer to fall back on in difficult times. The Treasury itself has argued that, "regular saving provides individuals with a pool of financial assets for times of adversity". This fund, of course, is tied up for 18 years and so it cannot be used as a buffer in times of adversity. Will not the fact that it is tied up for so long act as a disincentive for poorer households to make use of it—on the Government's own judgment?
Mr Holgate: Again, I would say that you have to site the Child Trust Fund amidst the other things that the Government is doing. As we were discussing earlier, we are also piloting the Saving Gateway which has shown, albeit at early stages, quite promising results in the extent to which people on very or quite low incomes are able to save, are interested in saving and, reassuringly, as far as we can tell, very few of them are borrowing in order to save—which would have been a worry if that had been the case. The Government also introduced Individual Savings Accounts, which are another means of giving people a relatively tax-privileged savings vehicle but with instant access.

Q73 Norman Lamb: However, this policy in itself does not achieve the specific government objective of providing savings as a buffer against times of adversity.
Mr Holgate: Manifestly, it is not directed towards that end. The other thing I want to remind you of is the introduction of tax credits. Again, that acts as quite an important buffer for many households' incomes. If they are in and out of work and needing extra help, then that is a role that tax credits will play. It is also permissive, as it were, looking upwards. We allow households to keep money where there have been increases in their income within certain limits from the previous year, but we step in to help where there is any reduction anticipated on that. This is changing the environment in which low-income households have to make these decisions and it may or may not enable some of them to do more, as they would probably wish to, by way of investing in the Child Trust Fund.

Q74 Norman Lamb: Can I explore a little further what we were discussing earlier, about why the Government has opted for this approach to helping particularly low-income families to get into the habit of saving and whether it is targeted in achieving that objective? I think I understood you to say earlier that the Treasury has not actually done any modelling of who will take up the opportunities for making additional contributions across the income bands. Is that right?
Mr Holgate: Yes, that is all to play for. We are not putting out the Child Trust Fund, as it were, and then hoping that someone will pick it up. We are creating this product with the help of the financial services industry and we will be helping and encouraging parents to appreciate the opportunity this provides them, in conjunction with other things we have discussed.

Q75 Norman Lamb: We are talking here about the commitment of a fair amount of government money to a policy whose impact you have not actually assessed. Is it not just aspirational? It is not based on any evidence that you have.
Mr Holgate: I would take you back to what I said near the start of the hearing on the National Child Development Study and the association that some researchers have found there between stocks of assets and what happens to people across a range of social and economic outcomes. There is a gap and an opportunity there, where something like the Child Trust Fund may make a difference and a difference

that represents value for money. I would also point out that this is an investment. It is an investment both in terms of the way we classify it; it is an investment in terms of what households are obliged to do with it and the default purchase, as it were, will be a stakeholder Child Trust Fund which will have a considerable equity content to it—so investment there.

Q76 Norman Lamb: We are hoping that education for instance—as you referred to earlier—will encourage people to change their habits but, as things stand at the moment, the expectation must be that it will be middle-class families that benefit much more significantly than poorer households—unless you are able to change habits. That must be right, must it not?
Mr Holgate: I think that is a reasonably fair description.

Q77 Norman Lamb: There may be arguments either way, but you could have found other ways that would have targeted the benefit more closely to poorer families.
Mr Holgate: Undoubtedly we could have made the Child Trust Fund more progressive in its progressive bit and less universal in its universal bit; but all of these things are about a balance. One of the things which is important to the Government from the perspective of tax credits and the tax and benefits system as a whole is that, as far as possible, people are in one system. The idea of progressive universalism is that everyone is one system, but you provide more help to those who need it the most when they need it most. It is essentially a judgment that ministers have reached—to have this ratio, if you like, between £500 for, roughly, the lowest third of household incomes and £250 for others.

Q78 Norman Lamb: We have heard earlier, however, that the tax break help that the Government provides goes to the better-off homes.
Mr Holgate: I remain of the view that the "tax break", as you put it, will be negligible and therefore the Child Trust Fund, to the extent to which it involves any form of redistribution, is progressive in its redistribution.

Q79 Norman Lamb: You have shown a table of how much you would end up with, based on a nominal rate of return of 7% and inflation at 2½%. We have heard that someone from a low-income family getting the £500 will end up with £911.
Mr Holgate: Yes.

Q80 Norman Lamb: A family that is able to make monthly contributions of £40 on top of the £250 will end up with £14,399. That is a pretty substantial gap. The reality, however, is that the gap will be even bigger than that, will it not? The £911 is based on this nominal rate of return of 7%, which would assume investing money, at least in part, in equities. You would not get that rate of return on the basis of a cash investment, which is the likely form of investment for low-income families.
Mr Holgate: I would argue that, actually.

Q81 Norman Lamb: Is that not the evidence?
Mr Holgate: I think that the evidence could mislead us on this particular point, such as it is. First of all, I think we did acknowledge Mr Plaskitt's point earlier that there will be this extra contribution related to income at age seven. So that will narrow the gap a bit, when we find out what that amount is. Second, the information pack and the fact that this is a long-term investment—no one can get their hands on it until age 18—means that we have a very good opportunity, to my mind, of explaining to people the virtues of investing in an equity-dominated vehicle compared to the deposit account which, you are quite right to say, is what lower-income households tend to invest in, for instance with respect to ISAs. That is why I say that the evidence such as it is might mislead us on this point. I think that there is much more to play for than that and we ought to be able to explain to them that, over long runs of years, even if returns are volatile year on year—

Q82 Norman Lamb: You would then be expecting the lower-income families to take a risk and, if they had taken the risk over the last few years, they would have suffered quite a big hit—which could result in a loss of confidence, could it not?
Mr Holgate: It could do, but it would also be a fact of life that, over a run of 18 years, the stock market is quite likely to go down one, two or more years in that run. However, if you take 18 years—and we have looked at returns from 1918 to 2002—then we see that the mean return is 6.9% and the median return is 6.4%. I am not sure whether those are in real terms or not. They are in real terms.

Q83 Norman Lamb: Both lower than the 7%.
Mr Holgate: No, because the 7% here is nominal and the real returns here are real. So actually we have slightly understated what you might anticipate on a very central view, if you thought the past represented the future, over the next 18 years.

Q84 Mr Beard: I believe, Mr Holgate, that earlier you quoted 79% in the survey as an indicator of how many people would top up the fund. Is that correct?
Mr Holgate: That is one that the Children's Mutual conducted. There is another one that Virgin Money conducted, saying that 92% of parents will consider investing.

Q85 Mr Beard: How do you reconcile that with the survey that was done by Mintel which showed that 35% of parents with children under 15 are not saving anything at all for the children's future and that 26% of parents only save rarely or when they have spare money? There is a big gap between these findings.
Mr Holgate: That is absolutely right: there is a very large gap. That is precisely the gap that we seek to fill through the measures that we have been discussing this afternoon.

Q86 Mr Beard: They are also endorsed by the Child Poverty Action Group who say, "the reality is that many families are too poor to contribute".
Mr Holgate: At times, I am sure the Child Poverty Action Group is right, but there are 18 years over which contributions can be made to the Child Trust Fund and the Government has other policies in place to ensure that households make the most of their opportunities, for instance with respect to employment over that period. So at times over that period even families that appear very poor now may actually be in a position to contribute.

Q87 Mr Beard: It rather implies, does it not, that you pick the statistics that indicate you are going to achieve the objectives of the fund?
Mr Holgate: No, I think that there are statistics on the one hand which say exactly as you say—that the propensity to save at the moment is very low—and there is the prospect of increasing that. There is plenty of room to increase it, I think we would all agree. The pressure is on ourselves, the financial services industry and from the financial education strand through schools, to see what we can do about that.

Q88 Mr Beard: It means that no one has access to the fund, if it is topped up, until the child is 18 and yet the Alliance & Leicester, the Britannia Building Society, Abbey National and the Children's Mutual, all have funds which give instant access and which could be the means of saving for a child. Why would a parent or grandparent pay into this fund when the money would be inaccessible for 18 years, when they could pay into one of these funds and it could be accessible when it was wanted?
Mr Holgate: The answer is that households should diversify between the funds to which they think they might need instant access and other funds which they can leave aside for much longer. There is a virtue to leaving a fund aside for longer. As we were saying to Norman Lamb, if it is then equity-based—which instant access funds cannot be—you may achieve a higher rate of return. That is something we need to explain to people deciding what sort of fund to put it in. There is the point I made near the start of the hearing, which is that it may be a powerful motivation for some parents to say, "This is something which is going to be there for my child when he or she reaches adulthood". It is, as it were, a discipline upon me not to raid it for some other purpose before then.

Q89 Mr Beard: You are putting an awful lot of emphasis on financial education when you are dealing with families who, as you have just said, have no record or history of saving at all. Then you are going to get them to distinguish between a fund like this which has no access until 18 and all these other funds that are there, when their inclination if they are on low incomes is to hedge their bets and keep the money available.
Mr Holgate: I accept the question. The question is how far can we be persuasive in getting them to consider that there are other alternatives to the predicted course of action they might take.

Q90 Mr Beard: You mentioned the Saving Gateway earlier, which is targeted at the low-income earners that we are talking about and which is aimed at increasing incentives to save through government funding matching whatever money is saved, and which is covering very similar ground to this Child Trust Fund. Why is there no mention of this in the document?
Mr Holgate: With respect, it is not really covering the same ground.

Q91 Mr Beard: The same objective.
Mr Holgate: They are complementary objectives, I would say. It is back to the point that your colleagues have made about instant access versus long term. The Saving Gateway has instant access. It is a rainy-day fund. People have been drawing it down in the pilots and have been paying money back in again when they can afford to. That is what it is: a revolving door, essentially, giving a much better rate of return than they would get in other, not very competitive accounts; whereas the Child Trust Fund has quite a different philosophy behind it. It is saying, "This is a discipline. You must put the money aside. It is for your child when he or she reaches adulthood". Depending on what we do with the Saving Gateway and how that is mediated, one could imagine, were that also to appear more broadly, low-income households having one of each and using them in such a way that they know the money that they cannot rely on putting away is in something like a Saving Gateway and, where they think they can make that commitment, they put some money in the Child Trust Fund instead—because the rate of return, other things equal, is likely to be greater and because it is there, waiting for the child at 18.

Q92 Mr Beard: Why should not the Saving Gateway arrangement be applied to the top-up fund for people who are eligible for a Saving Gateway? That would overcome at least some of the differential between families that have a history of saving and are relatively better-off than those who have not.
Mr Holgate: If you are suggesting that we allow what are discretionary withdrawals from the Child Trust Fund—

Q93 Mr Beard: No, I am not suggesting that at all. I am suggesting that in the Saving Gateway you match, pound for pound, what people save. Why can that not apply to lower-income parents who are putting top-up funds into the Child Trust Fund?
Mr Holgate: That is a question of balancing the incentives and other pressures, encouragements, upon parents—notably parents in low-income households—as to what they should do with any discretionary margin to their living costs. If we were to incentivise savings of that kind, assuming that we

targeted them quite narrowly on low-income households so we would not get into trouble on the deadweight cost that Mr Ruffley was raising, what we might run the risk of is going too far—and it would be possible to go too far—in encouraging low-income households to put too much money into a fund from which they could not then withdraw it. This is about a balance. There is the intrinsic attraction of a relatively high rate of return—though a rate of return which is unlikely to match that on debt. It is therefore another area where we have to be very careful. We do not want to say, "This is such a good thing that you should borrow in order to put money in here".

Q94 Mr Beard: The families that would be eligible for the Saving Gateway could do this anyway. So why are you precluding them from doing it in the context of the Child Trust Fund? They could just as well open an account in the Saving Gateway and then be encouraged to save there. That is the objective. Why is it so wrong when you put the two together?
Mr Holgate: These are two different things. First of all, the Saving Gateway is only a pilot. It has a relatively high rate of reward for putting the money in, but it has instant access. In that sense, the individual is not risking very much.

Q95 Mr Beard: It would be different in that respect in this context?
Mr Holgate: Absolutely.

Q96 Mr Beard: But that is not a major factor?
Mr Holgate: These are two products, one of them in only the pilot stage, intended to serve two quite different but complementary purposes. One is, can low-income people save? Are they prepared to get into the banking system, into the financial services system, when they have not had any contact with it before? That is another aspect of that story. The Child Trust Fund has a financial education element to it as well, but the financial education is brought both to the parents and the children and it is long term.

Q97 Mr Beard: Are you going to consider this or is it the end of the argument?
Mr Holgate: When you say am I going to consider it . . .?

Q98 Mr Beard: Putting the two together, so that low-income families can use the Saving Gateway as a means of boosting whatever they can afford to put into the Child Trust Fund.
Mr Holgate: Were the Saving Gateway to be developed further, one way in which the two could be made more complementary is that if you have saved some money in your Saving Gateway and you have earned a bonus on that, as it were, you could then decide—if you have reached a point where you know you do not need that money for a long time—to roll that into the Child Trust Fund, provided you have not exceeded the £1,200 and, again, that is very unlikely to be a problem for a low-income household. You could imagine a future situation, were we to develop the Saving Gateway further, where the two would complement in that rather more practical way than the slightly more theoretical ways I have been talking about—yes.

Q99 Mr Beard: The objective behind this Child Trust Fund is to encourage the savings habit.
Mr Holgate: Yes.

Q100 Mr Beard: How are you going to measure whether you have succeeded or not?
Mr Holgate: We have been developing some criteria of that description. It will not surprise you to learn that one of them is that we test parents' understanding of the Child Trust Fund and how it works. We need to get feedback and test to see whether the way in which we have explained the Child Trust Fund has succeeded, particularly with those who may not have much contact with the financial service providers. We will look to see, for example, whether people have chosen to take out stakeholder accounts compared to cash deposit accounts—which relates back to a point which Mr Lamb made. We will be looking to see whether parents take up accounts or whether, in the last analysis, the Inland Revenue has to allocate accounts where it is not done. We will obviously look at the level of contributions by families. We will see whether the Child Trust Fund has increased savings for children compared with now. In the longer term we will look at the level of awareness amongst children of Child Trust Funds and then, in due course, I expect to be inundated with research requests to see what it is that young people actually do with Child Trust Funds.

Q101 Mr Beard: Mr Lamb made the point about this being used as a wrapper round equities, like the ISA is. That presumes a certain amount of financial sophistication, to be doing that. Yet, if you do that, it is what is going to give the advantage. A lot of people recently have suffered financial loss from investing in equities. So how are you going to give even the financially literate the confidence to put the money into equities?
Mr Holgate: I suspect that the financially literate will not need a lot of encouragement, because they know that they have the better part of 18 years to ride out the swings and roundabouts. The challenge is there, however, for those on lower incomes who do not have a track record with investing through unit trusts or whatever, and we will have to see how well we do. It is in the taxpayers' interests and the Government's interest on behalf of the taxpayer that as many people as possible become adequately financially literate for the 21st century—not least because it is cheaper to pay them benefit through bank accounts than through certain alternatives. So there are certain allied causes in this, which means that there are benefits beyond the specific ones for the Child Trust Fund itself.

Q102 Mr Beard: If this had been around 10 years ago and people had put the money into equities, they would have made a substantial loss by now. So you could well have the perverse consequence of having put a whole generation off investing, because they would have lost substantial amounts of money.
Mr Holgate: Yes, that is quite possible if we had accounts, say, five years ago. Maybe, 10 years ago, the money at the start of that period might still be showing some gain: it will depend on exactly where you invested. If there is a loss, then I am afraid that is a fact of life. If it were 10 years ago, there would be another eight years in which to make up that loss. You can get into a slightly arcane argument. If parents have a set target for the value of the Child Trust Fund at a given age, you might argue that, perversely, if the value goes down they may put more in. I readily concede, however, that there will be other households where the experience of a loss will be mortifying and they would not wish to go further with it.

Q103 Mr Plaskitt: Potentially, there could be a whole range of vehicles providing these trust funds. As part of assisting with financial education, do you want to see the vehicles risk-branded so that people can see at a glance just how much risk, if any, they are embarking on—depending on which vehicle they choose?
Mr Holgate: We will certainly want parents to understand if they are getting into a relatively high-risk vehicle.

Q104 Mr Plaskitt: How will you do that?
Mr Holgate: That is a good question.

Q105 Mr Plaskitt: That is why I am asking it.
Mr Holgate: This is something which there is some time to sort out with the financial services industry—how we agree. All of these Child Trust Funds have to be authorised by the Inland Revenue, so what restrictions and what health warnings are put on the marketing of relatively high-risk funds versus other funds are something that we will have to work on.
Mr Plaskitt: You could consider a simple "traffic light" system. Something that is cash based and carries no risk gets a green blob on its promotional literature. Something which is almost exclusively based in equities gets a red blob, which means that you could lose the lot. Things in between could have an amber blob. Are you going to consider something fairly straightforward and readily recognisable by people, so that they can start assessing the degree of risk on the various products?

Q106 Mr Beard: Rather like Sandler recommended?
Ms Rookes: That is exactly the sort of thing we are looking at. I cannot guarantee that we will come up with something of the sort you have said, but we are actively discussing with the FSA exactly what the sales regime should be, what advice people should have.

Q107 Mr Plaskitt: It will have to be something other than small print.
Ms Rookes: Yes.

Q108 Mr Plaskitt: It will have to be something very transparent, very clear, readily identifiable, readily recognisable and something all consumers immediately look for, first probably, before they consider anything else. It will have to be that up-front. Do you agree with that?
Ms Rookes: Yes, I do. One of the things we are going to do early next year is to carry out some research to find out exactly the sort of information that parents need and how they need it. So that will help us in our discussions with the FSA and in putting together the education and the information round the Child Trust Fund.

Q109 Mr Beard: The financial service industry is developing so-called CAT standard products for all sorts of other things, like mortgages, insurance and so on. It would not be beyond the possibility of ingenuity to develop one that would take some of the risk out for parents who are putting money into here.
Ms Rookes: The standards on the equity account will be risk-controlled. The standard Child Trust Fund account—this is the account that all providers have to offer—will be a risk-controlled equity-based account.

Q110 Mr Plaskitt: What does "risk-controlled" mean? I do not understand.
Ms Rookes: Risk-controlled means that there has to be a diverse range of investments and that the account has to follow lifestyling, which means it needs to move out of the higher-risk investments into lower-risk investments as the account moves towards maturity.

Q111 Mr Beard: Like a low-risk unit trust?
Ms Rookes: Yes.

Q112 Angela Eagle: I think that this is a very imaginative idea which could be extremely exciting, depending on whether we can move from income support to wealth support, and this is a first and very interesting attempt to do that. Can you confirm that the idea is to change behaviour in savings and actually to create attitudes to savings, especially amongst those for whom it is particularly difficult, which do not exist at the moment?
Mr Holgate: Yes.
Ms Rookes: That is absolutely the intention. We are not only talking to financial organisations: we are talking to voluntary organisations and community organisations, and working with the DfES and the Social Exclusion Unit, so that we can cover all bases, if you like. We can do it through schools and through other information sources as well.

Q113 Angela Eagle: On changing behaviour as well, what about ethical investment? The UK Social Investment Forum have argued that Child Trust Funds should not be invested in areas that are damaging to children. One thinks of things like

tobacco—cigarette manufacture, for example. Do you have any views on this? Will you be taking particular, positive action to promote the choosing of ethical funds?
Ms Rookes: We understand that people do have objections to certain accounts and there has been a growth in recent years in ethical funds. We want providers to produce a range of products that will meet people's ethical and religious beliefs. We do not think that it would be right to require providers to do that, but we are starting to talk to providers about the sort of accounts that they might introduce. People with Child Trust Funds will be able to transfer accounts at any time. They will be free to make transfers to the sort of account that they want.

Q114 Angela Eagle: How will that be transparent? For example, if a particular provider has a diverse portfolio, it might include tobacco manufacture, and it would take a pretty sophisticated level of financial education to appreciate the mix in some of those. How are you going to make that transparent?
Ms Rookes: I think this comes back to the point that Mr Plaskitt was raising. We have not yet decided exactly the requirements for presenting and selling these accounts. We have to talk that through. We have to work it out and we still have work to do on that.

Q115 Angela Eagle: Do you agree that it would be rather odd to allow Child Trust Funds to be invested in tobacco manufacture or cigarette manufacture, for example?
Ms Rookes: I think that parents will be free to decide on the sort of account that they think is best for their children, whatever it is.

Q116 Angela Eagle: You have really opted for open market competition rather than a system of licensed providers, which you could have. Why have you done that?
Ms Rookes: Because we think that will provide more choice and more competition. Open market competition has served well through the provision of ISAs, and we think that is the best way to ensure that we do get a competitive market for the Child Trust Fund and a wide range of accounts that meets everybody's needs and requirements.

Q117 Angela Eagle: What is your view of the Consumers' Association, who have told us that they are firmly of the view that the collective approach, using not-for-profit organisations, delivering economies of scale by having licensing, will allow charges to be kept to a minimum so that reasonable and efficient access to Child Trust Fund accounts can be generated? That if you have an open market competition you just get some of the "confusion marketing", as they put it, that we already see in existing insurance product markets—and credit card product markets, for that matter.
Mr Holgate: There is one consolation. I take your point about confusion marketing, but the fact is that—assuming that the household makes a claim for child benefit or, in certain other instances, for instance for looked-after care, the local authority does—then the Child Trust Fund does have to be open. So there is not a danger of walking away from a product entirely, where sometimes there is a profusion of products.

Q118 Angela Eagle: I want to ask you more explicitly about charges, but the idea is to keep charges as low as possible. That has to make sense in trying to include people on lower incomes. If charges go too high, it clearly renders the whole thing meaningless because they lose their savings in charges. There have to be economies of scale, given the size of providers, to keep charges low. So how do you achieve that balance? Would it be better met with licensing, so that large companies could provide those economies of scale, rather than just flinging it into the market and seeing what emerges?
Mr Holgate: We think that competition will provide some reassurance on this point.

Q119 Angela Eagle: Why does competition lower charges though? There is not much sign of that in the insurance industry.
Mr Holgate: There will be some cap on charges anyway, but competition will provide pressure between providers to ensure that we can set as low a cap as possible. Another source of reassurance on this is that there will be getting on for 700,000 accounts a year, so it is going to be very big business. It is not clear to me that one needed only a subset of providers, given that scale of potential custom.

Q120 Angela Eagle: You have not made a decision on charges yet. There is some rather predictable lobbying coming from the supply side of the industry, which is trying to avoid a cap which they would regard as too low. Clearly, there is already a precedent for capping with stakeholder pensions, which is beginning to make a few of them scream. Are you worried that, if you managed to set a cap which allows people with low incomes to save reasonably and not see their savings eaten up by charges, you will restrict those who provide such savings vehicles?
Mr Holgate: You are absolutely right and there is plainly a balance to be struck there. We have undertaken some independent research to provide evidence on which to set the charge cap. The other component to the decision is the Financial Services Authority's work on the sales process. Plainly, the charge cap must fit alongside the sales process so that the two are consistent and, for example, we do not have too expensive a sales process for the charge cap or vice versa.

Q121 Angela Eagle: What about the deadweight of advertising? The more competition there is in a market for those products, the higher your advertising costs are likely to be.
Mr Holgate: The larger your market in certain respects, maybe the lower your other operating costs are.

Q122 Angela Eagle: That makes an argument for licensing again and having the big providers do this.
Mr Holgate: Depending on how many you think the 700,000 is spread amongst free market providers, albeit authorised by the Inland Revenue, compared to a licensed provider setting.

Q123 Angela Eagle: When are you likely to make a decision on the charges and particularly the capping of charges, because clearly you have not made one yet?
Mr Holgate: That is right. We will do so, I imagine, as soon as we can after the Financial Services Authority have determined the sales process.

Q124 Angela Eagle: When is that likely to be?
Mr Holgate: I think they have sent the Committee some evidence which suggests, ". . . in early 2004".

Q125 Angela Eagle: So some time shortly thereafter we will have the Treasury's view on charges?
Mr Holgate: That is right.

Q126 Angela Eagle: Can you tell me why you decided to make provision of a stakeholder Child Trust Fund a prerequisite for entering the market? That looks like it is restricting some people, such as building societies, who may wish to enter the market but do not actually provide a stakeholder. That seems at odds with what you have just said about it encouraging thousands of flowers to grow in the market.
Mr Holgate: That brings us back to the likely validity for many households of an equity-based vehicle. We want the default option to be the one which appears to be the most sensible. It also has a possibility of simplifying the process of making decisions for those who might find it more difficult.

Q127 Angela Eagle: According to the evidence we have, you are excluding 17 building societies by this, I think, odd proviso—this restriction—when you have just been talking about not having restrictions. You have actually excluded 17 building societies and, of course, building societies have traditionally been particularly strongly represented in children's savings. That seems rather odd.
Ms Rookes: One of the things we are trying to do is to encourage families to take out equity accounts, so that they can realise the benefits of that. Our worry if we do not make the equity account a prerequisite is that there will be cherry-picking: that low-income people will only be offered cash accounts and that some financial providers may refuse to deal with some customers. We think that, this way, we can ensure that everybody does have access to an equity account. Yes, you are right, it does mean that some very small building societies are excluded, but that is a commercial decision for them. We are not excluding them. If they want to come into the market, that is a commercial decision for them.

Q128 Angela Eagle: I understand what you are trying to do by avoiding cherry-picking, but I do not really understand why insisting on the stakeholder provision achieves what you are intending to do.
Ms Rookes: Our worry is that if we do not insist on that, certain financial providers will only offer cash accounts. As a lot of people have expressed concern today, lower-income people are less confident of financial products and particularly equity products. If that is all they are offered, they are not going to push for an equity account—which is what we want them to have because we want them to have the higher returns.

Q129 Angela Eagle: Why do you not make it a proviso that Child Trust Fund accounts have to be offered in all of their types, from equity onwards, rather than specify the stakeholder provision? I am not sure how specifying a stakeholder provision achieves the laudable aim that you have set out as the reason for it. Why not simply make it impossible for a potential provider to restrict what they provide simply to savings?
Ms Rookes: If we said that you could provide any and all stakeholder accounts, the building societies that you have mentioned would still be excluded because they would not be able to provide the range of accounts. The only way we could operate it is to say they are free to offer whichever Child Trust Fund accounts they want to, and we are back to the position where organisations such as them will only be able to offer cash accounts.

Q130 Angela Eagle: Given that the provider is not an irrevocable decision and, as you said earlier, people can switch across, why is that a problem at the beginning as this process evolves?
Ms Rookes: We think that people who start off with equity accounts are more likely to maintain them than if they start off with cash accounts and move into equities. Those people that are less financially sophisticated, less financially literate—we just believe that it is the best way of making sure they get equity accounts and access to the better returns. As I said earlier, the building societies are free to take on this business if they wish to.
Angela Eagle: There are some interesting value judgments there, which I may have some discussion with you about.
Chairman: We want to turn now to regulation and financial education. Let us start with regulation.

Q131 Mr Ruffley: Your proposals, Ms Rookes, state that "firms with the relevant FSA authorisation will be able to enter the market by application to the Board of the Inland Revenue, subject to meeting the requirements of the CTF regulations". Can you describe what those CTF regulations are and what they cover?
Ms Rookes: In the context you have just mentioned they will be required to meet the same sort of requirements as ISA providers, the main one being that they are FSA authorised and that their investments accord with the regulations on permitted investments. The regulations we are

anticipating will cover a number of areas. Investments will be one of them; another will be the requirements of the equity stakeholder account and how it works. We expect to take regulations covering the amounts involved, whether these are the government endowments, the age-related top-ups or the level of tax relief. We will have regulations covering the appeals process and regulations setting out the information requirements of providers. We will also need regulations to cover special circumstances, such as how we deal with children in care, in the unfortunate event of a child dying before the account has actually been opened—in certain circumstances like that.

Q132 Mr Ruffley: You also say that CTF providers will be "audited by the Inland Revenue on a regular basis to ensure that they have maintained their FSA authorisation". Who exactly is responsible ultimately for regulating these Child Trust Funds? Is it the FSA or is it you, the Revenue?
Ms Rookes: It is a joint responsibility.

Q133 Mr Ruffley: Why? Why complicate it?
Ms Rookes: We are following very much the model that we use for other financial products. If you take ISAs, for example, the FSA authorise firms, make sure that they are running prudently, regulate their practices; but we ensure that they are complying with our own particular rules which relate to the ISA account, and we will operate very much in the same way with the Child Trust Fund account. They will have to meet the general financial requirements of the FSA but we will want to ensure that they are complying with our own specific requirements on the Child Trust Fund account.

Q134 Mr Lamb: The nature of the fund, the universalism and the lifespan of it, clearly makes regulation incredibly important. Given the experiences of people over recent years, particularly in scandals such as Equitable Life, how can we reassure people that their money will be safe in the fund in which they invest?
Ms Rookes: They will be protected through FSA regulation. They will have recourse to the Financial Ombudsman and, as we have just said, the Inland Revenue will also be carrying out audit checks.

Q135 Mr Lamb: Equitable Life had a regulator. It did not stop it going under.
Mr Holgate: Other parts of the protection come from the nature of the product again. Equitable Life—about which I have to say I know absolutely nothing—is probably quite a complicated product. The Child Trust Funds are a relatively simple product and what you buy is what you own, in terms of the equities underpinning the Child Trust Funds.

Q136 Mr Lamb: If the institution that you invest with goes under, however, you lose the money.
Mr Holgate: Then various rules apply to do with compensation limits and deposits and the Financial Services Compensation Scheme. So there is some protection.

Q137 Mr Lamb: There will not be any specific protection, however, for Child Trust Funds. It will be a fallback to the existing framework?
Mr Holgate: That is right.

Q138 Chairman: So if the equity element is lost, there is no compensation? There is no guarantee on that?
Mr Holgate: It depends if it is mis-selling or not.
Norman Lamb: We then get into the whole Equitable Life problem. All those people who have not been able to demonstrate mis-selling lose the money.

Q139 Chairman: Is that the position? There is no government guarantee to the equity element?
Mr Holgate: No.
Mr Plaskitt: Hence the importance of risk-branding these things.

Q140 Mr Cousins: How many of these things do you expect to allocate yourself?
Ms Rookes: We hope that it will not be huge numbers. We still have to do some more work to refine our estimates. There will be 700,000 accounts a year, but I cannot tell you precisely at this stage how many we will be allocating.

Q141 Mr Cousins: For the accounts that you allocate yourself, do you regard yourselves as having the responsibilities of a sort of financial intermediary?
Ms Rookes: We will not be responsible for managing the account and will make that clear.

Q142 Mr Cousins: That is not what I said. For the accounts you allocate yourself, will you accept the responsibilities that a financial intermediary would? You will be placing the money where you choose to place it.
Ms Rookes: We will not be choosing the provider. The account will be the standard stakeholder equity account and we will be picking the providers at random. As soon as the account has been allocated, we will be writing to the parent of the child and making it clear that, from here on in, it is for them to manage the investment. All we are doing is allocating it.

Q143 Mr Cousins: That process in itself—you are going to place money on people's behalf and you are going to do it randomly across a section of providers—is quite an interesting process in the sense of the Financial Services Act.
Ms Rookes: It will be of authorised providers. All the providers that are on the list of providers that we can choose from will be authorised providers for the Child Trust Fund. They will then be picked at random and, as I said, the parent will then be informed that the account has been opened but it is up to them to manage it from here on in, and to make a decision whether they want to leave it with the initial provider or to move it on. The arrangement we have come to, however, is to ensure that those children whose parents do not choose to open an account do not lose out.

Q144 Mr Cousins: I am not being funny about this, but have you taken legal advice to see whether you could be accused of mis-selling?
Ms Rookes: Yes, we have. Our legal advice is that we would not.

Q145 Mr Cousins: I wonder if we could have access to that advice? This is quite a bold step—for a government to place people's savings with a particular provider. To say that you are doing it on a random basis makes me worry more.
Ms Rookes: Perhaps "random" is the wrong word. "Rotation" might be a better word.
Mr Ruffley: What about "random rotation"?

Q146 Mr Cousins: I am sorry, I preferred "random"!
Ms Rookes: We are not selecting the account and we are making that absolutely clear.

Q147 Mr Cousins: But you are selecting them. Of course you are.
Ms Rookes: We are selecting the type of account.

Q148 Mr Cousins: If you are placing the money with somebody, that is a selection process. It is inescapable.
Ms Rookes: We are specifying the type of account. We are going to a list of authorised providers who will deliver the account that meets these tight specifications and, on that basis, we will be selecting from a list of providers on a rotating basis; but we are not actually investing people's savings there.

Q149 Chairman: That is not how they will see it, is it? They will say, "The Government has allocated our fund to . . .", whatever it is.
Mr Holgate: Could I point out one or two numbers which I think may be relevant to Mr Cousins's question and also the previous one? If I understand it correctly, the compensation scheme—I am now talking about equity investment, so it is on the point that you are raising—covers two kinds of losses: when an authorised investment firm goes out of business and cannot return your investments or money, or a loss arising from bad investment advice or poor investment management. It says that the maximum level of compensation you can receive from the scheme for a claim against an investment firm is £48,000, which is 100% of £30,000 and then 90% of the next £20,000 per person. So there would appear to be a quite respectable degree of cover from the FSCS when we are talking about the particular case you are raising, I think, of either £250 or £500.

Q150 Mr Cousins: Obviously you are intending these to be advised products and not treated as execution-only ones.
Mr Ahmed: They would be a mixture—advised sales and execution only.
Mr Cousins: A mixture?

Q151 Norman Lamb: How does that work?
Mr Ahmed: Some families may want to take professional investment advice; others will be happy to take on board information and education in the information packs and be confident enough to choose a provider themselves.

Q152 Angela Eagle: What will be the cost of switching from one sort of Child Trust Fund across to another?
Mr Ahmed: This is tied up as part of the work on the charge capping. As was mentioned earlier, we have commissioned independent research into the charge cap.

Q153 Angela Eagle: There will be a cost, presumably. If someone wishes to shift from the trust fund that you have allocated them—albeit that they have omitted to be proactive to begin with—that will cost something. We do not yet know what.
Mr Ahmed: That is true. There is a cost to firms of transferring accounts. It is whether that cost gets rolled up into the overall charge cap or we allow them to charge separately for transfers, and that decision has yet to be made.

Q154 Mr Cousins: Can I play back to you something that your colleague from the Inland Revenue said and see if you identify yourself with it? "We want them to have equity products because we want them to have high returns." Do you associate yourself with that thought?
Mr Holgate: I think that is the starting point, and I do associate myself with it. That is the starting point. There will be households for whom that is a more forbidding choice and they will have alternatives; but the starting point, because it is a product which is lasting 18 years, is that probably much the best thing that the great majority of people can do is to go into a not very high risk but certainly an equity-driven product.

Q155 Mr Cousins: Sure, but there is a good deal of certainty built into that thought—"Because we want them to have higher returns". Markets can go down as well as up.
Mr Holgate: Indeed. As we were discussing earlier, however, I think you will find that over any respectable length of time equities have, on the whole, produced better returns. I should again enter a caveat here that I am not qualified to offer financial advice, but I can read the numbers off a table.

Q156 Mr Cousins: You might have put yourself in a position where you have to be able to give advice.
Mr Holgate: As the numbers that I supplied earlier indicate, the returns on equities over the last 80-odd years have been of the order of 6.4, 6.9% real.

Q157 Mr Cousins: You should read the FSA on caution about projection rates.
Mr Holgate: Indeed. It is a very good point. Nevertheless, I think that most professional advice would suggest that if you had 18 years over which to

invest some money, and the sort of charge for the sum of money is not disproportionate, then that is where you should put it.

Q158 Mr Cousins: How does this Child Trust Fund interact with income-related benefits?
Mr Holgate: It has no impact on income-related benefits of the parents, as the fund is developing on behalf of the child as it grows. When the child reaches 18, were nothing to change between now and then, then the normal rules would apply. It would be part of the child's assets.

Q159 Mr Cousins: So my parents have saved this money for me and, as a result, I cannot claim Job Seeker's Allowance?
Mr Holgate: We are aware of the implication and we cannot say at the moment what exactly we plan to do about it—but we are fully aware of the implication that you draw.

Q160 Angela Eagle: Are you saying that you might be considering doing something about income-related benefits and the way that the benefit rules interact with savings at that point of 18? It does seem absurd.
Mr Holgate: The problem is obvious. The problem has occurred to us but we cannot say this afternoon what we are going to do about it.

Q161 Angela Eagle: You are looking at it, however?
Mr Holgate: Yes.

Q162 Mr Cousins: Let us take something nearer term. The rules of Pension Credit mean that you cannot deprive yourself of capital. One of the ways you deprive yourself of capital is by giving it to somebody else. So if some very well-meaning grandma puts money into this Child Trust Fund for their grandchild, could they put themselves in a position of depriving themselves of capital?
Mr Holgate: That is a very good question. I am conscious of parliamentary questions and answers going on at the moment with various, as it were, permutations on the theme. I think, yes, that is a possibility.

Q163 Mr Ruffley: How long have you been working on this proposal? The Child Trust Fund—the whole thing?
Mr Holgate: We have been working on it for, I should think, about two years.

Q164 Mr Ruffley: After two years, with some of the greatest minds in HM Treasury and the Revenue, you have not come up with a solution? It is pretty pathetic, is it not?
Mr Holgate: No, because the Committee has not yet seen the Bill; Parliament has not yet discussed the Bill, and the accounts—

Q165 Mr Ruffley: This is a flaw at the heart of the structure.
Mr Holgate: It is a flaw at the heart of the structure only if it is still there in 18 years' time. I think that you have to wait and see what ministers say when it comes to a later point in your deliberations.
Mr Ruffley: I find that breathtaking.

Q166 Angela Eagle: You might admit at least that there are some issues of concern round the interaction between these old benefit rules and the more innovative systems being brought forward to deal, for example, with wealth allocation. It is something you have to look at, or you might end up looking rather silly at the end of the day.
Mr Holgate: Yes, we are alive to that.

Q167 Chairman: We want to move on to financial education but, before that, I want to ask Caroline something on the allocation of the Revenue accounts you were talking about. Am I right that provider firms do not actually have to accept your allocation?
Ms Rookes: If they have agreed to be providers on our list, then they will have to—yes.[2]

Q168 Chairman: They will have to accept, even though they may fear that those might be more likely to be low-income accounts?
Ms Rookes: Yes, that is one reason why we wanted to raise it, so that there was not cherry-picking.

Q169 Mr Cousins: Clearly—and this has been made absolutely plain to us this afternoon—this is strongly biased in favour of equity products and you want people to take out equity-based products.
Mr Holgate: We think that is the most sensible thing for the great majority of people to do.

Q170 Mr Cousins: There could be the possibility of, to ordinary people, some really quite complex issues involved and some quite complex products involved. How are you going to make sure that people get proper financial advice to make sensible choices?
Ms Rookes: We are going to do that through a number of routes. I cannot give you absolute chapter and verse today because we are still working on it, but we are looking at all possible ways of ensuring that people have access to the financial information and education that they need: whether it is through schools; whether it is through our own website, leaflets, information; whether it is through the FSA's guidance and information, or through other means that are perhaps more accessible to low-income people, such as Citizens' Advice Bureaux. We are exploring all avenues. However, we will start all of this off with some research to identify the sort of information that people will need and how they will need it.

Q171 Mr Cousins: How can you satisfy yourself and protect yourself against postdated accusations of mis-selling?

[2] *Note by Witness*: CTF providers will not have to accept Revenue-allocated accounts unless they have agreed to be on the Inland Revenue's list of providers prepared to do so.

Ms Rookes: Are you talking about the accounts that we allocate?

Q172 Mr Cousins: There is an interesting issue there which we have already covered, and you are hopefully going to give us the advice you have had about that. No, I am talking more generally now.
Ms Rookes: I am not quite clear why we would be accused of mis-selling. The individual parents will have freedom of choice as to what account they will want.

Q173 Mr Cousins: Let me put it very simply. You have indicated here this afternoon—and you have justified it in some terms—a very strong bias in favour of equity-based products. There is no doubt about that. People are going to get annual statements before the maturity of these products in the rolling 18 years. If in the course of that time we get a considerable reversal in the markets, so that people see the value of something they have been putting money into going down sharply—as indeed would have happened over the last three years if such things had existed—how are you going to protect yourself against the accusation that you have encouraged people into something that appears to have lost them money?
Ms Rookes: We may not be able to protect ourselves against the accusations, but I think we would counter them by saying that we will be providing parents with information to understand how accounts operate and to understand that, yes, the value may go down as well as up; the markets are volatile. However, we would hope that they would understand enough to know that, over the longer term, equity accounts do tend to provide higher returns; but, when all is said and done, they will still have the opportunity to move to a cash account if that is what they feel more comfortable with. Although we would like them to get the best returns from an account, we want them to have accounts that they feel comfortable with and that they will engage with and manage. If that is a cash account, then that is what they will be free to take out.

Q174 Mr Cousins: Yes, indeed, but the bias in favour of equities that you have declared this afternoon does seem to me to be fraught with dangerous possibilities for you. You are saying that you are going to use schools, Citizens' Advice Bureaux, websites, and whatever, but in conventional financial advice there would be quality checks on the quality of that advice. It is not reasonable to put schools into that kind of position, is it?
Ms Rookes: I do not think that we will be expecting schools to provide financial advice. We will be expecting them to provide financial education, to develop an understanding of how financial markets work, rather than specific financial advice. One of the things we will have to make absolutely sure, however, is that all the information, literature, education, makes clear that parents have choices. That is the key to the Child Trust Fund. We want them to realise that there are choices, and that they make informed choices and manage the account.

Q175 Mr Cousins: Have you considered the possibility that, accompanying this—and this would be another considerable innovation—you could actually offer people the possibility of going to a financial adviser and getting financial advice in a conventional sense, and bearing the cost of that up to a figure?
Ms Rookes: We have not made any provision for that. Providers will be able to offer financial advice. We are looking at all possibilities.

Q176 Mr Cousins: If a network of financial advisers came forward to you and said, "We are prepared to advise this product for a fee. Can you build the fee into the provision you are making for the Child Trust Fund?", how would you respond to that?
Ms Rookes: I do not think that we can make any response until we are clear what the FSA sales regime is going to be. As Nicholas said earlier, it will not be until early next year before that is clear. Once the sales regime is clear, we can then more clearly start building exactly what sort of provision we need to make.

Q177 Mr Cousins: Your mind would not be closed therefore to the idea that you could start offering fees, within a fixed limit, for financial advice—to enable people who are not well informed about these things to make sophisticated choices?
Ms Rookes: I do not think I can make any commitment on that.

Q178 Mr Cousins: Mr Holgate, it is consistent with Treasury ideology though?
Mr Holgate: I am not sure about that.

Q179 Mr Cousins: Progressive universalism?
Mr Holgate: I think that we would have to wait and see, as Caroline says. Part of the answer in substance to your point, however, goes back to Mr Plaskitt's point about traffic lights and risk in this. Many of these products, in the scheme of things, looking across the spectrum, will be relatively low risk. The potential for disappointment is certainly there, cannot be discounted, but should not be so large that financial advice has necessarily a very big margin to play with, frankly.

Q180 Chairman: I would like to wrap up now with two questions. We have heard today quite a bit about the regulatory structure. You have talked about the charges, controlling the marketing, controlling the risk towards the end of the product's life, directing the provision, the allocation accounts, regulations, appeals, and all of that. You began, however, by saying this was all going to be light touch.
Mr Holgate: The incentive to add into the Child Trust Fund is light touch. That was the precise point I was making.

Q181 Chairman: The contribution is light touch?
Mr Holgate: Exactly. You were saying social engineering, to which my response was that we are not strong-arming people into adding more money.

Q182 Chairman: The regulatory side is not light touch: it is heavy touch.
Mr Holgate: We need a well-regulated sales process. That is what the FSA is looking at—so that customers can be confident of their money being protected.

Q183 Chairman: Finally, can we be clear about what happens from now on? You kicked this off in April 2001, so we are two and a half years down the road. You spoke about a sales regime appearing next year, is that right? How does that mesh with the legislation?
Ms Rookes: We are hoping that the legislation will be introduced towards the end of this year. The details of the sales regime will not impact on the primary legislation. That will be able to go through without waiting for the FSA sales process.

Q184 Chairman: And the whole thing will then be finalised in a year's time?
Ms Rookes: We expect the Bill to be introduced later this year. We would expect regulations to be produced during the Commons' stages of the Bill, and accounts to start being opened in April 2005.

Q185 Angela Eagle: Could I ask one, not very pleasant, question? What are you thinking of doing for those children who unfortunately die before their eighteenth birthday? What then will happen to the asset?
Ms Rookes: The money will go into the estate of the child.
Mr Cousins: People on income-related benefits must be protected from the consequences of that.
Angela Eagle: There is an issue with benefit interaction there.

Q186 Norman Lamb: Do you have any plan to address this problem?
Mr Holgate: Again, I am afraid you will have to wait and see. There is nothing that I can say to you this afternoon.

Q187 Norman Lamb: You have a plan but you cannot talk about it?
Mr Holgate: It is an entirely valid point to raise and, if we do not have a plan to settle it, then I expect the point will be raised again very frequently.

Q188 Norman Lamb: So you do not have any plan at the moment?
Mr Holgate: I am not saying that. I am saying that there is no assurance I can offer you this afternoon as to how we will sort out something like that.

Q189 Chairman: Did not the interrelationship with the benefit system occur to anybody back in 2001 and 2002?
Mr Holgate: I am sure that the interaction with the benefit system has occurred to people. It has certainly occurred to me.

Q190 Mr Ruffley: Did it occur to the Chancellor of the Exchequer?
Mr Holgate: I would be amazed if it did not occur to the Chancellor of the Exchequer.

Q191 Norman Lamb: Have you talked to him about it?
Mr Holgate: My conversations with the Chancellor are not for regurgitating to the Committee.

Q192 Norman Lamb: But you have talked to him about it? I am not asking for the detail; I am just asking whether you talked to him or not.
Mr Holgate: I am not regaling the Committee with what the Chancellor and I may have said. The critical point is this. For the time being, except for the very pertinent point made about the child dying, there is no interaction between the Child Trust Fund and the social security system at all; but when they get to 18 there certainly would be one, if nothing changed between now and then. All I can do by way of reassurance to you this afternoon is to observe that there is a very long time between now and then, and there is ample opportunity for us to make sure that parents, for example, are not put off saving into a Child Trust Fund because of that eventuality occurring.
Angela Eagle: So there are two points at which there is a problem here which you have to look at. One is in the unfortunate happenstance of a child dying, when there is an immediate issue if the money returns to the estate of the child. The second is when the trust fund matures. Clearly, you have to think a lot faster about the first one than the second.

Q193 Norman Lamb: The second one is a flaw at the heart of the policy.
Mr Holgate: I would disagree with that. It would be a flaw were we to do nothing between now and 2020. It would be a flaw if parents had this very fixed view that their child was going to start drawing income support at the age of 18. I hope that in many cases they might imagine there was more going for the child than that.

Q194 Chairman: With respect, you cannot necessarily leave it until 2020. They may well have a perception when this starts that they might be disadvantaged later on. You will actually have to sort this a little earlier.
Mr Holgate: I entirely accept the point that the sooner we cast further light on this the more reassured parents might be that they are not, as it were, putting their savings into a vehicle which will deny their child social security. I absolutely accept that point.
Chairman: We will leave it there for today. Thank you very much.

Wednesday 19 November 2003

Members present:

Mr Michael Fallon, in the Chair

Mr Nigel Beard
Mr Jim Cousins
Norman Lamb
Mr John McFall
Mr James Plaskitt
Mr David Ruffley

Memorandum submitted by the Association of British Insurers

Executive Summary

1. The Association of British Insurers (ABI) welcomes the Government's proposals for the Child Trust Fund (CTF) and commends the Government for its willingness to embrace radical thinking in an effort to extend a savings culture to those that until now have been unable to save.

2. The proposals for the CTF are ground-breaking. They offer the potential of furnishing every 18 year old with a sizeable sum of assets and, in so doing, bringing into being a more financially confident generation that is aware of the benefits of saving and is suitably empowered to buy appropriate financial products to meet their needs.

3. A radical proposal like the CTF deserves to work, so it is important that the details are right from the outset. HM Treasury have worked closely with the industry to develop the product details of the CTF that have already been announced, but the crucial aspects are not yet known. We need to see Government make the right decisions on:

— **the application, and level, of any charge cap**. The charge cap must be set at a level which represents good value for money for consumers but which also enables providers to cover their costs;

— **the sales regime and administration of the account**. These should be kept as simple as possible. Unnecessary and burdensome regulatory requirements will add significantly to the costs of providing the CTF, discouraging firms from entering the market and reducing the final fund value available to the CTF account holder;

— **the means of encouraging additional contributions**. Additional contributions from parents and relatives are the key to boosting the value of the fund for young adults, and also to improving the economics of offering CTF accounts. To build on the groundswell of popular support for the CTF, innovative approaches are required to encourage such contributions.

Whatever the final decisions taken on these matters, we urge Government to make clear and early decisions to allow providers sufficient lead-in time to prepare for the introduction of CTF accounts.

4. If the product and regulatory details are set appropriately, we should witness the creation of a vibrant market. But for the CTF to bring about a new savings culture, additional ingredients are required. Firstly, a high-profile Government-backed advertising campaign to supplement the marketing efforts undertaken by industry and ensure widespread awareness among all potential beneficiaries. Secondly, to make the most of the opportunities presented by the CTF, we need a long-term strategy to build financial awareness among both children and their parents. Co-ordination with the National Curriculum and the FSA's Financial Capability Strategy is essential.

General Comments

5. The ABI views the CTF as offering the possibility of creating a savings culture among the next generation and, in so doing, building a mass market for financial services. For this reason we, along with several other organisations, contributed to the initial work carried out by the IPPR on this subject. Our support for this innovative policy remains strong.

6. By giving people assets in their formative years and, in conjunction with this, formulating an education process that teaches young people basic financial literacy, it is hoped that future generations will be more aware of the need to save and, crucially, suitably empowered to buy appropriate financial products. Given the low levels of financial literacy among the UK population—and the costs to individuals and the nation at large[1]—this policy should be welcomed.

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[1] According to the Institute of Financial Services (IFS), poor financial literacy standards cost the UK more than £2 billion every year.

The Development of the Child Trust Fund

7. The manner in which HM Treasury has developed the framework for the CTF has been exemplary. Consultation has been held at each stage of the policy's development and the industry has been pleased that its comments have been taken on board, for example in the decision that the stakeholder CTF account should invest in equities in order to benefit from the potentially higher returns that might be achieved.

8. The recent document *"Detailed proposals for the Child Trust Fund"* (published 28 October 2003) contained useful and eagerly awaited information on many aspects of the CTF but was silent on the critical factors—the price cap and the sales regime which will determine whether the policy is a success and is embraced by both consumers and the financial services industry. It is imperative that these decisions are carefully considered so it is right that both areas are to be the subject of extensive research.

9. However, we would urge Government to make any announcements on the price cap and the sales regime as early as possible in order to give companies sufficient time to make a measured decision on whether to enter the CTF market and to begin to prepare the systems, personnel and marketing material. Given that life insurers will have to contend with numerous other fundamental changes during 2004 (for example making major changes to their systems in accordance with the simplification of the pensions tax regime), early sight of the total package of CTF specifications will be vital if they are to participate in the phased launch of CTFs which may be as early as January 2005.

10. The following section puts forward the ABI's views on the key outstanding design issues which have not yet been decided.

The Application and Level of Any Charge Cap

11. The Government has stated that it wants to make sure that the charge cap for the CTF is set at a level which represents good value for money for consumers but which also enables efficient providers to make adequate returns. The ABI concurs with this goal. We have therefore welcomed the appointment of Deloitte and Touche to conduct independent research on price caps for the CTF, as the imposition of any price cap must be based on a thorough analysis of the economics of offering the product. If the charge cap is too low to allow for a commercial return, providers may be unlikely to enter the market, or they may find it difficult to devote their efforts to encouraging take-up and contributions from those at whom the CTF is explicitly targeted.

The Administration of the Account and the Sales Regime

12. Another, perhaps complementary, means of ensuring value for money for consumers would be to focus on making the CTF so simple that costs are kept to an absolute minimum. A simple product sold through the simplest possible process would:

- help the economics of delivery;
- offer the best way to engage with the vast majority of consumers who are put-off by complicated products which require advice; and
- ensure that consumers have access to products which represent good value for money.

13. To allow the CTF to be delivered in an extremely cost-effective way the costs involved in offering the product must be reduced. In this regard there are important lessons to be learned from other financial products. Some of the typical cost components involved in offering a product include:

- distribution costs including advice to customers where necessary;
- marketing costs involved in promoting the product;
- set up costs, which represent the one-off cost involved in setting up systems and developing procedures to process the new business;
- compliance costs generated by the need to comply with anti-money laundering and other regulatory requirements;
- costs associated with annual account maintenance, which includes sending out statements, handling enquiries from policyholders and meeting Inland Revenue requirements;
- transaction costs for receiving and administering payments in;
- transfer costs associated with processing switches from other providers and the administration involved in arranging transfers out;
- fund management costs for the expense incurred for investments; and
- termination expenses including receipt and processing of requests, compliance with legal requirements, realisation of funds, payment of policy and updating of records.

14. For stakeholder pensions, for example, ABI work shows an annual fund charge of 1% is needed on a monthly premium of around £150—or 2% if the premium were only £80pcm—simply to meet those costs, which are substantially influenced by legislation and regulatory requirements.[2]

15. The CTF offers an opportunity for much lower costs per account than stakeholder pensions. Yet, capped at just £100 per month, contributions are likely to be much lower than to a pension. So it is even more vital that Government, the regulator and the industry work together to design the CTF so that costs are minimised. Each area of the sales regime and administration of the account needs to be scrutinised to establish the minimum activity needed to give the customer good service and to ensure that legislative and regulatory requirements do not add unnecessarily to the costs.

16. One minor example may help to ilustrate the way that additional and unnecessary costs may be imposed which deliver no obvious benefit to the consumer. Box 6.1 of the *"Detailed proposals for the Child Trust Fund"* describes the process for opening a CTF account, with Step 3 stating "on receipt (and retention) of the voucher the provider opens an account". This negates the possibility of providers keeping costs to an absolute minimum by enabling parents to open CTF accounts by more cost-effective and customer-friendly means—eg over the telephone or on the internet. The requirement to collect the vouchers means that even if such methods are used to register an account, it cannot be authorised unless the voucher is physically sent to the provider. This, in turn, creates additional administrative complexities (and associated costs) for providers who must (i) make sure that the voucher has been received; (ii) chase individuals who fail to send it in; (iii) cancel accounts where the voucher is never received; (iv) store the vouchers for no discernible purpose. Although a very minor example, such requirements make it more difficult for providers to operate efficiently and offer consumers value for money. Moreover, such requirements may also have an adverse effect on take-up, given that it is generally true that the more complex the procedure to open an account the higher the drop-off rate.

17. If the Government gets the sales regime right, then that should also greatly reduce distribution costs. We were encouraged to note that Government has stated that "the Sandler philosophy of tight product regulation leading to reduced regulation of the sales process could lead to lower up-front marketing and distribution costs".[3] We understand that the Financial Services Authority (FSA) is to conduct research into this area, alongside its work into the sales regime for other stakeholder products. We welcome the investigation to determine the most appropriate methods for accessing a CTF account but would point to a number of factors unique to the CTF which we believe should result in a light-touch sales regime; lighter even than that for other stakeholder products.

18. Firstly, the CTF is a universal account. Every parent must open a CTF account on behalf of their child or they will have one opened for them. The mandatory nature of the product suggests that conventional notions of a "sales regime" are not applicable. The question is not "should one invest in a CTF?" but "*where* should one invest in a CTF?". Moreover, Government donates the initial endowment so an individual's competing financial priorities do not need to be considered. Questions around the type of CTF would obviously remain but we would suggest that it would be sufficient for an individual to identify the appropriate CTF through answering a small number of filter questions, relating to attitude to risk.

19. If the Government is keen for all families to benefit from the potential higher returns that might be achieved through equity investments these questions will need to be carefully framed. Additional information and/or advice may be necessary for individuals who choose to invest in anything other than the stakeholder CTF account.

20. Secondly, we come to the issue of the regulation of additional contributions from relatives and friends. The Government "is keen that families...should play an active part in building the accounts themselves" and has demonstrated the major impact that additional contributions can have on the final size of the CTF account.[4] The ABI views additional contributions as critical to the success of the CTF, and we analyse the major impact they can have in more detail below.

21. To encourage additional contributions to flow into CTF accounts, the means of contributing must be simple, straightforward and readily accessible to all sections of society. For these reasons we are attracted to the potential offered by the idea of "tokens" which could be bought in the same way as book or phone tokens from high street outlets, newsagents etc. Yet such a system is incompatible with the imposition of a rigorous sales regime—for example, there is no scope to determine whether the individual concerned would be better served putting the money in a cash ISA rather than putting it in to a child's CTF. Perhaps some form of "Financial Health Warnings" to be included with the token could alert people to other, potentially more important, financial priorities. In addition, one other potential stumbling block is that CTF accounts will be owned by the child and be in the child's name so it is not clear how the FSA might attempt to regulate people making gifts to children.

[2] ABI Response to HM Treasury *Consultation on Sandler Products*, May 2003, p27.

[3] *Detailed proposals for the Child Trust Fund*, HMT, October 2003, p31.

[4] *Detailed proposals for the Child Trust Fund,* HMT, October 2003, p11.

ENCOURAGING ADDITIONAL CONTRIBUTIONS

22. As mentioned above, additional contributions are vital to make a real difference to the size of the final CTF account. The initial Government contribution, to be paid at the birth of the child, will kick-start the CTF and the additional Government contribution to be paid at age seven will rekindle interest. But for the CTF to make a real difference to a young adult's life chances, additional contributions from parents and relatives are vital and should be encouraged. The stark difference that even relatively small additional contributions can make is shown by the fact that a Government contribution of £500 would produce a fund worth only £900 in today's prices at age 18. Yet a modest additional contribution of £10 per month from parents would boost this figure to £5,000 (or £2,800 in today's prices).

23. To further illustrate the profound effect of additional contributions, a child who receives the lower endowment from Government (£250) but whose parents pay their Child Benefit into the CTF might look forward to receiving a fund in the region of £19,000 *in today's prices*. Table 1 below gives further details. The large difference that can be made by saving even a proportion of Child Benefit in a CTF suggests that the link between the two should be solidified and it should be possible for parents to automatically divert a proportion of their Child Benefit straight into their child's CTF account.

Table 1

PROJECTED CHILD TRUST FUND VALUES AT AGE 18

£, today's prices

Parental contribution (per month)	*Balanced fund Government contribution*	
	£250	£500
£0	£452	£904
£10	£2,791	£3,243
Child Benefit (£63)	£19,221	£19,673

NB: fund growth assumed 7% pa, AMC assumed 1% pa

24. It is encouraging that already people appear to be keen to contribute to their child's CTF account. Research conducted by YouGov for the ABI in September 2003 revealed that 82% of parents would contribute to their child's Fund. This includes 75% of those parents who do not currently save for their children. The poll showed that 6% would pay in the maximum amount allowed, 55% would pay in regular amounts each month and 21% would contribute occasionally or annually. To harness this enthusiasm, it must be as simple as possible for family's relatives and friends to contribute.

25. Rather than unnecessarily restricting parents' contributions to their child's CTF account to £1,200 per year—a limit which is unlikely to produce a fund large enough to cover the costs of university fees[5]—it may be preferable for Government to extend the contribution limit to £3,000, in line with the annual limits for a cash Mini ISA (which is available to young adults aged 16). Alternatively, a simple, easily understandable incentive (eg matching up to a prescribed limit) with which all consumers (including those on lower incomes) are well acquainted might encourage all parents to give serious consideration to making regular additional contributions and, in so doing, help foster a savings habit.

26. Of course, additional contributions not only boost the final lump sum that the young adult will receive at age 18 but also help the economics of delivering the CTF, assisting in the creation of a vibrant market which will ultimately benefit the consumer.

27. While we recognise that Government were faced with a difficult choice in deciding on a specific date from which children would receive a CTF account, we consider that children born before 1 September 2002 are being unnecessarily excluded from the benefits of the CTF. Even if the Exchequer rejects extending the distribution of the Government endowment to more children, we consider that a strong case can be made for extending the CTF regime so that parents could open a CTF account in their child's name even if they did not receive Government money. With regard to this issue, the Government merely states "some parents may also want to open savings accounts for children who do not qualify for CTF accounts. There is a wide range of accounts on the market for children and in most cases the income will be free of tax".[6] Yet, as we understand it, outside of the CTF parents can invest up to only £25 per month on a tax-free basis (from income tax and capital gains tax). Introducing the CTF necessitates the adoption of an arbitrary date after which children will receive CTF accounts. Children born before that date will be penalised as they will not receive the Government endowment. They should not be doubly penalised through an unnecessary restriction on their parents' ability to save for them in a tax-free environment which is available to those born after 1 September 2002.

[5] Source: *National Union of Students Press Pack 2002–03*. Estimated average expenditure (for students resident in England and Wales and studying outside of London) of £7,317 for academic year 2002–03, including tuition fees at a maximum of £1,100, assuming inflation at 2.5% a year for three years (September 2002).

[6] *Detailed proposals for the Child Trust Fund*, HMT, October 2003, p16.

28. To recap, it is clear that additional contributions are vital to allow young adults the opportunity to accumulate funds large enough to make a real difference to their life chances. Such contributions also enable providers to better cover the costs involved in offering CTFs, enabling them to provide a better service to the consumer. So it makes sense to facilitate, and encourage, parents and other family members to make additional contributions.

High-Profile Government-Backed Advertising Campaign

29. If the product and regulatory details are set appropriately, we should witness the creation of a vibrant market. But for the CTF to bring about a new savings culture, additional ingredients are required. The Government has undertaken to launch the CTF with an advertising campaign, and this is to be welcomed, though there may be a need for the campaign to be sustained over a suitably long timeframe. Co-ordination of this initiative with marketing efforts undertaken by providers should help to ensure a high awareness of the product.

30. Such an advertising campaign is likely to prompt a multitude of questions and queries. Government needs to be ready to provide this information, and the development of a dedicated CTF website will help in this regard. Yet if Government is keen to achieve high penetration among those on lower incomes there may be a need for a supplementary CTF helpline to enable those without internet access to request information. As well as the creation of new resources, the Government must also ensure that those who deal with parents and children (eg health visitors, nursing staff) are sufficiently aware of the CTF, its aims, eligibility, means of applying etc. The Government's proposals for Inland Revenue awareness-raising roadshows are a step in the right direction.

A Long-Term Stratety to Build Financial Education

31. CTFs will furnish young adults with a pot of assets at age 18, but they also offer the potential to meet social policy goals, in terms of the provision of personally relevant financial education. Cleary, there is a wish for such education, with nearly 9 out of 10 adults agreeing that there is a need for more education and training in financial matters.[7] To make the most of the opportunities presented by the CTF, we need a long-term strategy to build financial awareness among both children and their parents. To achieve this, it will be imperative that Government works closely with the FSA as they discharge their statutory objective to promote the public understanding of the financial system.

32. Government has stated that CTF-related learning will build on existing practice in schools, and has undertaken to produce a range of teaching and learning resources which will assist in teaching children about different aspects of finance. Support for teachers in this endeavour is essential, and we are pleased to learn that Government will consult with organisations which carry out valuable work such as PFEG (Personal Finance Education Group) in order to produce relevant information.

33. However, we would suggest that there should be a step-change in the approach to teaching financial education in schools, tied in to the introduction of CTFs. At present, 6 out of 10 adults (59%) feel that their education did not sufficiently prepare them to deal with their personal finances.[8] So more needs to be done. We would suggest that careful consideration be given to take advantage of the interest generated by the CTF and making financial education a statutory part of the National Curriculum. It is clear that there is a great cross-generational appetite for such an approach, with 85% of 15–19 year olds stating that they would like to receive personal finance education in school, with 78% of grandparents agreeing, and more than 80% wanting it to be examined and compulsory.[9]

Conclusion

34. The proposals for the CTF are ground-breaking. They offer the potential of furnishing every 18 year old with a sizeable sum of assets while creating a more financially aware generation, one which is aware of the need to save and which is suitably empowered to identify their needs and take decisions to buy appropriate financial products.

35. Government, the regulators and providers must not dash the hopes for the long-term effects of the CTF by over-engineering the product. Complicated products are more costly to produce, sell and regulate and put people off, particularly less financially sophisticated consumers. A simple CTF which is easily understandable to the general population and which can be sold with a minimum of regulation offers the best hope of enabling the CTF to achieve its potential and playing a leading role in the creation of a nation of informed and empowered consumers.

November 2003

[7] *"Prudential's new Financial Literacy Survey reveals overwhelming need for a National Financial education Strategy"*, Press Release, 13 October 2003.

[8] *ibid.*

[9] *"AITC finds overwhelming enthusiasm for personal finance education at school"*, Press Release, 27 August 2003.

Memorandum submitted by the British Bankers' Association

Introduction

The BBA is pleased to provide evidence to the Treasury Select Committee on the Government's plans for introducing the Child Trust Fund (CTF). With over 240 member banks from over 60 countries, the BBA is the authoritative voice of the banking industry in the UK, and represents members' interests in both wholesale and retail markets. BBA members have a particular interest in the CTF in their capacity of distributors but also owing to the potential interface with the Sandler recommendations on which key decisions are still awaited.

- We urge the Government to make a decision on the price cap at its earliest opportunity.
- We are concerned that the government considers that the CTF, even though a mandatory product, could be built in to the simplified sales process being developed by the FSA.
- Government information packs should play a key role in presenting the issue of risk in a balanced way, highlighting that there are both risks to saving in equity based CTF as well as in a cash CTF.
- Education initiatives are viewed by our members as important and the CTF should form part of the government's broader financial capability strategy moving forward.

The views and comments expressed below cover four main areas: Government aspirations, the regulatory framework, consumer education and technical issues.

Government Objectives

BBA welcomes the Child Trust Fund, the first plank of the Government's strategy for delivering savings and assets for all. The CTF brings an important "early" focus to saving. We agree that by focusing the need to save around key life stages, the CTF will act as an important incentive for parents and young people to take care of their finances and to plan for their children's futures. Providing a "nest egg" for young people should also actively encourage children and their families to save for the future.

The savings market is an important part of our members' business and when integrated along side other savings products, the CTF will complement the cradle to retirement approach already taken by our members in providing for their customers needs. Without doubt the banking industry with its high street presence and physical accessibility is well placed to play a key role in the delivery of CTF and, generally speaking, is keen to do so. Many of our members have already expressed interest directly to the Government of their wish to be involved in the CTF initiative, particularly given the long term nature of the CTF, personal tax concessions and current consideration of lifelong learning that is anticipated will be attached to it. We consider that education initiatives aimed at young people throughout the life of the CTF will play a significant role in educating children of the need to take adequate care of themselves financially in the future, as well as raise levels of financial awareness. We look forward to working with the Government on these initiatives as they develop.

Long Awaited Decision on the Price Cap

Industry concerns about the current restrictive price cap are well documented and we do not wish to labour our concerns about the level of the price cap/charging structures for the Child Trust Fund. Having already made representation to Treasury as part of its consultation on Sandler "stakeholder" products, however, we would stress that given the low entry point of £250, capping of the annual level of contribution and that equity based products are generally more expensive to run than cash based ones, the level of price cap will be a significant influencing factor. Unless the price cap for "stakeholder" products is raised to a more realistic and economically viable level, it is unlikely that a wide range of CTF will become available.

Putting a 2% price cap in context, the £250 endowment would attract a total of £5.00 per year, whereas additional contributions of £20 per month would amount to a 40 pence per month charge deduction.

As many of our members are keen to deliver CTF, we would urge the Government to make a decision on the price cap at its earliest opportunity. Without a decision being taken it will not be possible to (i) assess whether the economics will stack up, and flowing from this (ii) to design the product or necessary IT systems or (iii) plan how the CTF can best be "rolled out".

It is worth noting that during 2005, the date earmarked for the launch of Sandler products, our members are committed to a number of projects that will operate out of core systems. Basle II changes, for example must also be implemented during 2005 along with new FSA requirements for mortgage and general insurance regulation.

Product Design

From a customer perspective, we support the Government's decisions that the "default" fund will comprise equity based investments and for default CTF accounts not to fall immediately into cash. This is appropriate given the long term nature, asset class diversification and "life-styling" requirements for the CTF. It is also consistent with the underlying rationale for Child Trust Fund which is to increase the levels of long term saving, consumer awareness and consumer sophistication of financial services.

We also support the Government's decision that providers will be able to provide a cash based CTF product, on a voluntary basis, should they wish to do so. We recognise that there should be provision for customers who are risk adverse. However, having to provide an equity based stakeholder CTF, before being able to offer a cash CTF, may potentially pose difficulties for those of our membership who no longer have a manufacturing capability. Equity based savings, require substantially more in terms of operational systems, so, whether our members finally decide to offer stakeholder CTF, may also largely depend on how they choose to organise themselves.

We agree that providers should not be compelled to run both equity and cash CTF products which would require the running of additional or dual systems.

Given that CTF requirements have been prescribed by the Government and the underlying premise of "simplification" throughout the Sandler proposals, we were surprised that the Government will also allow the introduction of non-stakeholder CTF. We are not clear whether, and if so, how the price cap would operate for both stakeholder and non-stakeholder CTF, as the price cap will determine the extent to which it is possible to design a bespoke CTF fund. As a consequence, we currently consider it unlikely that providers will offer non-stakeholder CTF.

The Government is currently reviewing the minimum £20 contribution level and an announcement will be made in the new year. We estimate the current savings levels for children's accounts to be on average to be £18 to £20 per month and so consider £20 to be broadly in the right area.

Sales Process

We are particularly concerned that the Government is currently giving thought to how the CTF might be made available to customers under the simplified sales process being developed by the FSA. Unlike other products being proposed for inclusion in the Sandler suite, the CTF is a mandatory product with customers only being able to lay claim to the Government provided endowment through the opening of a Child Trust Fund account, also in a form prescribed by the Government (which sets the investment parameters).

Current development of the FSA simplified sales process, however, centres around identifying financial need and screening out those for whom an investment product is less likely to be considered by the customer. In its broadest sense, the simplified sales process is of an advisory nature, but with the essential difference that it is specifically designed to cater for "every day" needs and products, for example, whether to consider a protection product or a unit trust ISA as opposed to differentiating between products with different risk components but are in the same group. It is therefore difficult to see consideration of these could be built into the simplified process without this becoming overly complex and unwieldy. Furthermore, this would appear to be overkill, given the unlikelihood that providers would offer bespoke non-stakeholder CTF products.

Owing to the mandatory nature of CTF, and that customers will also be provided with a comprehensive Government pack as they become eligible for CTF (see also below), we consider that consumers are more likely to want an opportunity to discuss the features of CTF and will be put off, frustrated or view the simplified sales process as something more sinister should they have to first sit through a lengthy process of (currently) twenty minutes before being able to open a CTF account. Our strong preference would be for the CTF not to fall under the simplified sales process.

Information and Education

We welcome the Government's proposal to issue a comprehensive information pack to each eligible family. This will assist with the promotion of CTF.

When making decisions about which CTF product to invest their savings, we agree that consumers should have clear information about what the CTF is designed to do as well as the risks of either investing in an equity based CTF or of saving solely through a cash based CTF.

Government information packs should play a crucial role in enabling customers to making informed choices, with the packs presenting the issue of risk in a balanced way. For example, whilst there is a risk to saving in an equity based CTF, saving in a cash CTF runs the risk of being eroded in the long term by inflation. The FSA is currently testing risk warnings and statements as part of the FSA simplified sales process which we consider could similarly be contained within the Government's information packs. Queries arising out of the packs could then be dealt with during the CTF account opening procedure.

In addition, the FSA is also soon to publish its consultation on a financial capability framework which will seek views from across the industry, consumer groups and others about what is needed to raise current levels of financial awareness amongst consumers and we consider the CTF should form an essential part of this broader strategy. Whilst launch of the CTF should provide impetus to saving in the short term, on-going initiatives will be required if young people are to gain a full appreciation of their CTF as well as to develop financial planning skills in the future. CTF annual statements, for example, could provide a useful peg on which to hang further education as well as providing specific information about the growth of a child's CTF account.

Banks have put significant effort into work on schools education, and at the BBA we support and are closely involved in the work of the Personal Finance Education Group—a charity promoting financial literacy in schools. The Committee may consider that Pfeg's chair, Ron Sandler, would be an appropriate witness to discuss how education on CTF could link with other financial literacy education in schools.

Operational Considerations

Money Laundering Regulations

The Government has proposed that CTF accounts will be opened in each child's name and funds in the account will belong to the child. Additionally no withdrawal will be permitted until a child reaches 18 where the child will need to verify their identity. Given the annual contribution limit and long term nature of the CTF, we consider CTF generally to be low risk in respect of the Money Laundering Regulations, but further consideration of the treatment of additional contributions (up to £1,200 per annum until the child reaches 18) will need to be undertaken.

We agree that the account should be held in the child's name but will be operated by an adult with parental responsibility. However, difficulties may arise in respect of verifying who has parental responsibility, particularly where this changes over time. Clarification on this issue is being sought but we consider that additional ID and V will be required in these circumstances.

CTF Tokens

We consider it unlikely that CTF tokens will become widely available unless these were run centrally.

Data Protection

With respect to data protection, we would advocate an agreed hierarchy of information and databases being run between banks and the Inland Revenue. Not all banks have a single view of their customers. Furthermore, banks will need express consent if they are to be able to disclose personal information about their customers to the government.

Compliance Considerations

As the CTF is a similar proposition to an ISA tax wrapper, the argument goes that providers operationally will be able to align CTF with existing systems. This is true in so far as there is already a reporting requirement to the Inland Revenue, but CTF will differ from existing ISA provisions given that all children in the UK will be entitled to CTF endowments irrespective of whether the CTF account is opened by the parent or "by default" by the Inland Revenue. This will require a much closer working arrangement than hitherto between the Inland Revenue and providers and which will extend beyond reporting to actual verification and administrative cross checking of the CTF voucher. Unique identification numbers will aid this process but the claims process itself will be more labour intensive and will require IT systems build. Systems enhancements will also need to be built around each child's birthday.

The Government proposal that providers increase their reporting requirements from the original monthly return to fortnightly will place additional burdens and require changes to internal systems capable of accommodating both fortnightly and current quarterly returns for ISAs.

12 November 2003

Memorandum submitted by The Children's Mutual

1. Introduction

1.1 The Children's Mutual welcomes the Treasury Select Committee Sub Committee inquiry into the Government's Child Trust Fund proposals. This is an opportune time to address issues that are of concern and those which are still to be concluded in final legislative proposals. We welcome this opportunity to engage further on the proposals.

1.2 The Children's Mutual is the country's only specialist dedicated to the market for long-term savings for children. We serve more than 325,000 members, the vast majority of whom are saving for children's futures using our Baby Bonds®, University Bonds and Children's Portfolios. We estimate that more than 10% of all new regular savings for children plans are initiated with us (approx. 25,000–30,000 a year in recent years).

1.3 Our research and experience leads us to conclude that consumers are most concerned about four criteria when it comes to choosing a provider for their children's future:

- Expertise;
- Value for money returns;
- Value for money prices;
- Excellent service.

Our record in each of these disciplines is shown at Appendix I.[10]

1.4 The Children's Mutual provides access to saving for children for consumers through recommendation from Independent Financial Advisers, via the internet and through partnerships with family oriented retailers such as Boots, Mothercare and Huggies Nappies Mother & Baby Club.

1.5 The Children's Mutual is a supporter of the Personal Finance Education Group (pfeg), the respected charity that provides free support for teachers in the preparation and delivery of lessons in personal finance.

2. Summary

2.1 The Children's Mutual fully supports the Government's key policy objectives for the Child Trust Fund. These include reducing the poverty gap for children, particularly those from homes with low incomes, and ensuring sufficient funds at 18 to create meaningful life opportunities. An important feature is that financial education sits alongside encouragement to save and this education should be both for the children and the parents.

2.2 In order for the Child Trust Fund (CTF) to meet its objectives there are elements within the structure and provision of the CTF that are essential:

- that the CTF does not lie dormant—it is important that families and friends are encouraged to "top up" the Government Endowment (GE) so that at the age of 18 the CTF will help to maximise the opportunities available to youngsters. In an ideal world The Children's Mutual would recommend that top ups from £10 a month should be accepted by the providers as our experience is that even the least well off families want to save for their children. It is important that less well off families can top up if they wish. Though the GE is a welcome amount, if it is not added to over the length of its life, it is likely to attract warranted criticism that it's potential to provide life changing opportunities for young people has not been fulfilled. Providers cannot realistically be expected however, to operate at savings levels which are not economically viable. The minimum amount acceptable will be dictated by the price cap not consumer needs;
- that setting up and topping up of the CTF is easy. Visibility of the CTF is essential and this means that providers from banks, building societies and friendly societies, to retail stores should be able to provide consumers with the opportunity to top up the CTF. The process by which top ups can be taken should be as simple as possible;
- that the CTF is promoted widely—by both Government and providers: demand needs to be created. Evidence below shows that from past experience consumers are not motivated to initiate saving much less explore different means of saving—they need support and encouragement to understand the importance of saving and the contingent options available to them. Not only do they need to have visibility of the CTF from various access points but they need to receive information from publications, advertising and other forms of education driven by competition between providers;
- that financial education must be included. The need to provide support and encouragement for families to learn about the reasons to save for their children is of paramount importance. The Government has rightly said that the GE will initially be placed in lifestyle funds. Family and friends therefore need to understand that year on year their CTF pot might go down as well as up. Managing the expectations of the CTF is essential. Additionally, this is an ideal opportunity to encourage children to take an interest in saving and will assist in improving life savings habits.

3. The Child Trust Fund—The Key Issues

3.1 Saving by more families for more children is good as it:

- reduces the poverty gap and equalises (upwards) access to opportunities for young people;
- meets families' strong emotional desire to give their children a financial headstart;

[10] Not printed.

— opens up the opportunity to educate families and children in particular about finance helping to develop the savings culture for future generations.

3.2 The current market lacks demand—parents need to be encouraged to save:

— today 1:5 of families save regularly for their children;

— the emotional desire amongst almost all families is not matched by proactive steps to meet the desire;

— those who do save tend to be from better off families.

3.3 The Child Trust Fund is a real opportunity. It can be the catalyst to improve the outlook for our youngsters—potentially (see 3.6 and 3.7 below):

— it is crucial that the reach of the Child Trust Fund progresses down the income scale to middle and lower income families;

— it is crucial that the Child Trust Fund does not become a regressive policy where only the better off have access.

3.4 For the Child Trust Fund to be a success education of children and parents in personal finance matters must be a vital component:

— families should be supported and encouraged to understand the need to save for children;

— children should be engaged in the savings process—pfeg have a key role to play here;

— families must be helped to understand the pros, cons and risks associated with the different investment options (for many this will be the first experience of the stock market).

3.5 Administration of children's savings products is more complex and therefore more costly than other (adult) savings products:

— there will be multiple savers (a positive) requiring multiple bank collections and collation facilities;

— a new and (in our view) more complex than necessary voucher system for the Government Endowment will need to be introduced—something we believe should be changed;

— family break-ups—which in our experience can lead to extra administration. For example, dealing with two parents separately regarding one child's savings.

3.6 The nature of savings for children results in different economic dynamics than seen in other markets:

— savings for children is more complex and requires more educational support than other markets;

— contributions compared to other markets will be modest given the maximum of £100 a month (which few families will be able to afford for each of their children);

— families will "split" any disposable income available for their children between their children leading to low contribution rates compared to say stakeholder pensions where the average is reported to be £140–£150 per month;

— the price cap needs to be set so as to recognise the economic dynamics.

3.7 The level of any price cap (we remain unconvinced of the need or evidence to support a cap) needs to support demand creation and engage a wide spectrum of the nation's families:

— saving is not an automatic discipline for the public—demand has to be created;

— the longer term solution to demand is education;

— price caps set initially at 1% had theoretical advantages. The effect of price caps on consumers needs to be judged now on actual experience in the market. Our conclusion is that low price capped products—Cat ISAs and Stakeholder pensions—are the preserve of the better off;

— independent research summarised in this paper shows that the effect of low price caps will be to exclude middle and low income families from saving (see Appendix II[11]);

— for CTF the price needs to balance the needs of consumers and providers and a 1% cap does not achieve this balance.

4. Recommendations

The key elements of the CTF that will assist in achieving the objectives of the Government are:

4.1 The setting of a price cap that recognises the empirical evidence now available as to the effect of price caps and one that will ensure providers are encouraged and able to:

— create demand for the CTF;

— administer the unique complex elements of the CTF, covering the back room expenses;

— make the CTF easy for consumers to access through lots of provider participation;

[11] Not printed.

- make it viable and attractive for all providers to encourage less well off families to top up their CTF at amounts to include £10;
- encourage reach as low down the income scale as possible.

The CTF must ensure that providers see less well off families as good customers.

4.2 A sales regime that is light touch—as easy as saving in a deposit account. For instance we believe that electronic top ups should be made available, vouchers should be accepted via the internet. This is a prime Government initiative that can be included in the EGovernment objectives. We disagree with the current proposals that only allow for registration of paper vouchers for the CTF GE rather than using secure unique reference numbers where claimants have already been vetted by the IR for child benefit purposes.

4.3 It is important that a progressive approach is taken. We believe that those receiving the £500 GE should be charge capped on this capital at 1%. We do not believe the rest should be capped at this level due to the remarks made earlier. The Children's Mutual recognises there is concern that for families who will never be able to top up, it is important that their GE is allowed to mature to the fullest extent possible. These families might not ever benefit from the expenditure being made by providers and therefore to cap their GE is fair. However, the current process proposed for payment of the GE by the Inland Revenue would make this progressive idea difficult to administer because the £500 payment will come in two tranches.

5. How to Meet the Policy Objectives and Get Over the Barriers

Reach

5.1 Our key point is that if the price cap for charges applied to the CTF is set too low, less well off families will miss out because providers cannot realistically be expected to engage with them to show the benefits of saving.

Acceptance of Low Contributions

5.2 It is clear that the administration of children's savings is more complicated compared to other markets—more has to be done to make the savings vehicle work. We believe that CTF providers should take in relatively low contributions. Families want to be able to save as little as £10 a month for each child as opposed to average contributions of £155[12] a month for stakeholder pension plans or ISAs where generally large lump sum investments are made. For a family with two children or more, who will want to save equally for each child, the CTF needs to operate at a low contribution level. Providers must be encouraged to supply this facility. It is better to have less well off families saving £10 than have them being ignored because a charge on the product has been set below an amount that makes them sought after customers.

5.3 We commissioned independent research from Charles River Associates (see Appendix II[13] for more of the research). The following is one extract from that research which shows the effect of price caps on the CTF's ability to reach lower income level groups:

All Socio Economic Groups	*Skilled Manual*
1% price cap = 8% take up	1% price cap = 2% take up
2% price cap = 42% take up	2% price cap = 66% take up

5.4 It is clear that the more sensible the price cap the more chance the CTF has of reaching the middle and lower income households.

Encouraging Saving for Children

5.5 Savings for children is not on top of the To Do list for the majority of families—only one in five[14] families save regularly for children at present and it tends to be the better off[15]. A key policy objective is to inform the savings habit. Families will need to be encouraged to save, demand for the CTF will need to be encouraged and this will come at a cost. We are interested in hearing what the Government will do to promote the CTF however as we have seen from other savings vehicles, it will remain with providers to ensure maximum demand creation and motivation to top up the CTF.

5.6 A key policy objective is that the CTF accounts do not lie dormant—this is a kick start to savings and an educational opportunity to increase financial literacy both for the children and their parents.

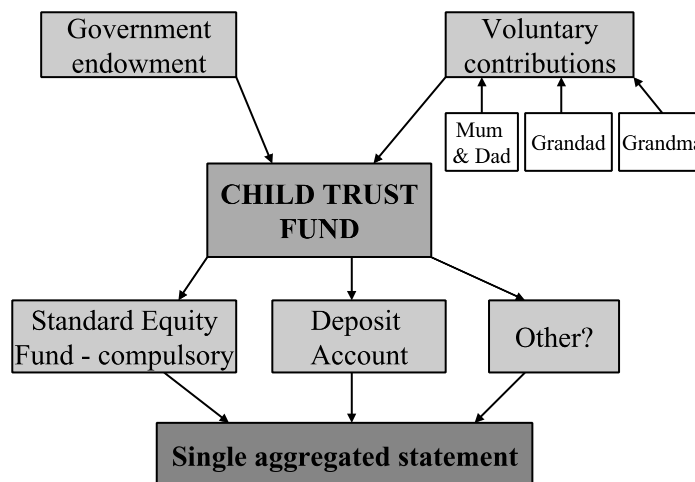
5.7 Why savings for children is unique:

- more than one person may be saving for the child;

[12] IMA presentation to AFS 9/10/03.
[13] Not printed.
[14] Tunbridge Wells Equitable research.
[15] But note that even the least well off are keen to save for their children as they want to "make a difference".

— due to more than one person saving for the child, statements need to show which family members and friends have saved during the course of the year;

— families sadly break down—providers will need to ensure the correct parental responsibility rules are followed.



5.8 All of these complexities can be coped with and indeed the Children's Mutual has over 40 years' experience. However these unique administrative features do mean that the cost of running children's savings is proportionately higher compared to other savings markets and in proportion to the modest amounts being invested.

Access

5.9 In order to create demand, raise awareness and make savings for children easy, the Government needs many providers in the market and choice of access from traditional Banks, Building Society and Friendly Societies to High Street stores and internet access.

5.10 The danger of setting a price cap that is close to a 1% price cap for the CTF is that:

— only those children from high income households will have additional contributions made to their CTF;

— providers will be unable to compete for the market;

— the target market will not be served;

— HM Treasury will have missed the opportunity to stimulate savings and financial education for generations of children.

Working Example of the effect of minimum top ups

5.11 As the grid below shows, children who receive £250 from Government at birth but whose families, through lack of sustainable encouragement from providers, do not top up will, after 18 years, have a fund estimated to be worth £808 if the cost of provision is limited. The progressive nature of the Child Trust Fund will benefit most the least well off families, who will be receiving the £500 and make up 30% of all families in the UK. But if these families are not provided with the choice of access or ability to save small amounts the head start they have been given by Government will be eroded. Providers managing the CTF must be able to encourage less well off families to add top up savings to their CTF.

5.12 Children of better off families who can afford (and are therefore targeted by providers) to top up in full and therefore save £100 a month could receive a fund of £39,090 at the age of 18 years.

5.13 If providers can provide a Child Trust Fund top-up facility that accepts £10 per month the fund at the age of 18 years for those who received the full Government Endowment is estimated to be £4,755.

5.14 Additionally, the Children's Mutual proposes a built in progressive element to charging. Those families who originally receive the Government Endowment of £500 could have their charge capped on this amount at 1% while those who receive £250 would have a cap of say 2%. The effect would be that those from the least well off families (some 30% of families) will be receiving their Government Endowment at minimum cost. (Note: this would be problematic given the current proposal for IR administration procedures)

SCENARIO 1		SCENARIO 2	
Child	*Fund at 18*	*Child*	*Fund at 18*
A	£39,090	A	£35,354
B	£808	B	£18,020*
C	£1,522	C	£4,755**

Assumptions—Scenario 1

1. Government Endowment of £250 (A and B, £500 for family C) at birth, plus £50 at age 7.
2. 7% fund growth.
3. 1% price cap
4. Family A are well off, this is known to providers who actively market to them encouraging the maximum saving of £100 pm
5. Families B and C are ignored by providers as there is insufficient margin to cover costs.

Assumptions—Scenario 2

1. Government Endowment of £250 (A and B, £500 for family C) at birth, plus £50 at age 7.
2. 7% fund growth
3. 2% price cap
4. Providers actively market to all families
5. Family A saves £100 pm, Family B £50 pm***, Family C £10 pm

* 51% of the estimated cost of funding university (living expenses and tuition fees) in 18 years' time

** 40% of the estimated deposit on a house in 18 years' time

*** Family can afford £50 pm on a multiple saver (eg Mum, Dad and Grandad) basis

A Light Touch Sales Regime

5.15 The Children's Mutual supports a light touch sales regime. There should be no barriers to saving. The CTF is unique compared to others savings mechanisms since:

— top ups can be stopped and started as and when a parent or friend wishes—there are no barriers to putting savings on hold if the money is needed elsewhere;

— parents can switch providers when they wish—this transaction should be made easy rather than more difficult to do. A strict sales regime would make switching providers more time consuming;

— choosing the investment fund—we believe that for standard and deposit funds, no advice aside from financial education is needed;

— the CTF will require new system builds and new reporting systems. The reporting requirements are more regular and more complex than those related to other products. These new systems in themselves will ensure checks are in place to keep track of the savings.

The Voucher System

5.16 We were very disappointed to learn that, in contrast to the view expressed by many commentators, the vouchers will have to be collected physically. Requiring paper vouchers every time will not only increase basic costs but will necessitate expensive reminder systems to cater for circumstances where vouchers fail to materialise. We ask that consideration again be given to allowing collection of unique CRNs by internet and over the telephone. This will allow lower unit costs overall which in turn will mean we can serve those who do not have access to the internet, many of whom will come from lower income families.

Top up Vouchers

5.17 We think that the best idea would be to allow each provider to issue its own vouchers. We repeat our request for consideration to be given to bar-coding the information held on the Inland Revenue database. Scanning bar-codes will be less expensive than manual inputting of data.

5.18 We are in the world of EGovernment and ECommerce—surely a new product for the twenty-first century should embrace new technological advances?

Financial Education

5.19 The requirement to put monies into the "standard fund" creates a dilemma. We believe that this is the right *investment approach* as the money is tied up for 18 years and exposure to equities should provide better returns. We also support the "lifestyle" approach. We are concerned, however, that as all members of the community will be involved, including those who have not had exposure to shares before, there may be potential for some not to understand why the value of the CTF has fallen in any given year. It will also be important for education (particularly about saving in shares) to be made widely available, however we see that the provision of this kind of information would be likely to be sparse if margins are very tight.

5.20 We are concerned that the term "lifestyle funds" is used regularly. It is not possible to have a lifestyle fund other than one that "matures" on a specific date. Clearly the maturity date being targeted is different for each child, or, at best, is the same for a very small cohort of children. Lifestyle therefore involves a system of operating (at least) two funds (normally, one investing wholly or largely in equities, the other in gilts and bonds) and moving money from one to the other.

5.21 We support this investment strategy but point out that individually targeted lifestyling for each child carries a higher administration cost than other operations.

5.22 We are concerned that we will have to wait for the results of the DWP's work in 2004 to learn how lifestyling is to work under the CTF. At present we are offering a "lifestyling" option (by switching money between different funds) within our Children's Portfolio service and see no issues with simply following that model.

6. The Ideal World

Parents will understand and act upon figures like these:

Why Save for Children?

	Today	*In 18 years*
Gap year	£10,100	£15,800
Three years at University	£23,150	£36,100
Deposit on first home	£15,434	£24,072
Driving lessons	£800	£1,248

The Hard Facts

	Save from Birth
Gap year	£50
Three years at University	£110
Deposit on first home	£75
Driving lessons	£5

7 November 2003

Memorandum submitted by Norwich Union

THE CHILD TRUST FUND INITIATIVES

Norwich Union believes that society as a whole would gain from the establishment of a better long term savings culture. A successful partnership between industry and Government is a key part of any strategy to achieve this.

We echo the sentiment of the ABI's submission to the Treasury Sub-committee enquiry. The Child Trust Fund has the potential to enable young adults to appreciate the benefits of a prudent savings ethic, and allow them to take more opportunities in adult life.

This needs to be viewed, however, within the context of the wider range of initiatives that are currently being considered by the Government. Key to the success of the Child Trust Fund as part of a sustainable strategy to build financial awareness among both children and their parents is co-ordination with the FSA's Financial Capability Strategy and the National Curriculum. Equally a sustainable financial model that is capable of providing a product that represents good value for money to the consumer and an economically viable basis of operation to those involved in its manufacture and distribution will be needed. International businesses must have regard for their international competitiveness and their ability to remunerate capital which is internationally mobile both within its business and beyond, ie by the judgments shareholders make.

We understand that the Child Trust Fund will sit within the "stakeholder suite of products" currently being proposed by Government. At the current time an announcement on the charge cap applicable to these products has yet to be made and as such it is not possible for Norwich Union to decide whether it will be a participant in this market.

NORWICH UNION

Norwich Union is the UK's largest Insurer and Provider of Life, Pension and Investment products. We distribute our products through a diverse range of channels. IFAs provide around 70% of our long-term savings business. We also have strategic alliances with over 20 building societies and other leading UK brand names including Tesco Personal Finance. In addition to this we have a Joint Venture with Royal Bank of Scotland for the provision of Life, Pension and Investment products through their retail banking network.

As the UK's largest provider of Life and Pensions and Investment Products, Norwich Union is keen to work with Government to help increase consumer confidence in long term financial products and to encourage more people to provide for their own financial security through saving.

14 November 2003

Witnesses: **Ms Joanne Segars,** Head of Pensions and Savings, Association of British Insurers, **Mr Ian Mullen,** Chief Executive, British Bankers' Association, **Mr David White,** Chief Executive, The Children's Mutual, and **Mr Robert Fletcher,** Director of Distribution Strategy, Norwich Union, examined.

Q195 Chairman: Could I welcome you to the sub-committee. I should explain that there is about to be a division in the main House any moment, so we will have to suspend for at least 10 minutes, having only virtually started. But we could try to start. Could you introduce yourselves, please.
Ms Segars: My name is Joanne Segars. I am the head of pensions and savings at the Association of British Insurers.
Mr Mullen: Ian Mullen, the chief executive of the British Bankers' Association.
Mr White: Good afternoon, I am David White, chief executive of The Children's Mutual.
Mr Fletcher: I am Robert Fletcher, director of distribution strategy for the Norwich Union.

Q196 Chairman: We will make a start but as soon as the division starts we will have to suspend. Not surprisingly, the financial services industry seems to be a strong supporter of Child Trust Funds. How big an opportunity is this for the industry?
Ms Segars: We do see this as being potentially a good opportunity and a good way of ensuring that young people can build up a pool of assets and can have the opportunities which that affords them. So potentially it does offer many opportunities; however, that will depend on some vital details of the products being got right. Of course, many of these details we do not know at the moment but they include, obviously, the price cap, the sales regime and the advice regime that goes with that. Unless those things are got right, there may not be a sufficient number of providers in market.

Q197 Chairman: Thank you very much. We are going to suspend until 14.44, 10 minutes exactly, then we will resume.

The Committee suspended from 14.34 to 14.44 for a division in the House.

Mr Mullen, do you want to add to that?
Mr Mullen: Yes, I will. I will not re-cover that which Joanne has said, but we agree entirely with that which she has said. I would look at the Child Trust Fund, from the banking perspective, as a continuation, a continuum, of what we have been doing with government in finding common cause

around the universal bank. The introduction of the basic bank account—if you would state that as being the family working capital and the introduction of lower income families to a bank account in the use of their working capital—in introducing more than six million people into banking has been an enormous success. That will extend and increase with the universal bank. When we are looking at medium to long-term capital requirements, then the Child Trust Fund is a continuum of that initiative. The concept is excellent but, as Joanne stressed, the devil will be in the detail. It is the implementation that is the issue, I think.

Q198 Chairman: Fine. Let us hear from the two firms represented here. What are the critical factors for you in deciding whether or not to enter this market?

Mr Fletcher: I think there are a number of critical factors for us. One critical factor is certainly the level at which any price cap is set. It will need to be set at a level where it is economic for us to write this business. Coupled with that is the regulatory environment within which these products sit and any advice requirements that may sit alongside them, because that obviously impacts on the costs of distributing the products. Third, but by no means least, I think, is the way in which these products interact with the wider initiatives that are being taken by the Government on raising awareness of the need to save.

Mr White: We think that the opportunity here lies with the youngsters. We think assets will become more and more important as the years go by for youngsters to have access to, because that will give them the widest possible opportunities. But we also recognise that people do not save unless they are encouraged to save and it takes quite a bit of encouragement. If we look at the market today, we find that we think resources will be made to youngsters from better-off families one way or another. We think the opportunity here lies in making sure that, as we are able to do today, we can reach middle and lower income families whose children will perhaps need this discipline of building an asset more than anything else. So keeping administration up to date, as up to date and simplified as possible, and setting a price cap which allows us to continue to serve middle and lower income savers is the most critical thing of all.

Q199 Chairman: Given your own experience, the four of you, of the savings market, how successful do you think the Child Trust Funds will be in actually encouraging the savings habit, in encouraging the acquisition of assets?

Ms Segars: Perhaps I can give you some information from a poll we conducted quite recently. When we asked parents whether they would be likely to contribute to the Child Trust Funds, 82% of parents said they would certainly consider making a contribution, an additional contribution, above the initial endowment, into a Child Trust Fund. It was quite interesting that across all the social classes that number was above 80%. The omens, therefore, are quite good. But of course it does depend on the points my colleagues were making about whether or not there is enough margin there for providers to encourage those contributions in, and to market the benefits of saving additionally.

Mr Mullen: The FSA is soon to publish its consultation on a financial capability framework. When it does that and has wide consultation with industry and consumer groups and others, then it will tease out that which is required to raise current levels of financial awareness. We would see that the Child Trust Fund would be an integral part of that initiative.

Q200 Chairman: The Child Poverty Action Group, for one, have suggested that this will not actually encourage savings, asset accumulation by lower income families, that a parent in those cases will simply be too poor to contribute whatever the level of contribution is fixed at.

Mr White: Perhaps I can answer that, Chairman. There is a permanent balancing act, just like being a parent, between trying to provide for today and trying to provide for tomorrow. That applies to all families and all sorts of different groups will lobby for how money that is available should be diverted. In our experience, the difference between the market that is for savings for children and the adult savings market, is that even people who do not have a propensity to save for themselves will try to find a way to save for their children. Perhaps I can give you an example. Of people who come to us to save for their children in our Baby Bonds(r), who do not come through the advised route, some 20% of them have household income below £15,000 a year; a third of them have household income below £20,000 a year. That means we are managing to reach those people, because very often it is people at the lowest end of the income scale who can see that having an asset will make the biggest difference to their children.

Q201 Chairman: Mr Fletcher, how keen will the Norwich Union be to provide accounts for the lower income families?

Mr Fletcher: Provided that the economics make it viable for us to manufacture the products and distribute them, we would be very keen to do it. If I could, Chairman, just go back to your previous question, I think the success or otherwise of this initiative will very much hinge on whether there is a joined-up approach that picks off the thorny problem of where should the price cap be set and the overall promotion of the need to save. I think that is much wider than just the issues pertaining to the Child Trust Fund.

Q202 Chairman: Is there not a risk that the size of the endowment, whether it is £250 or £500 for lower income families, will be an effective way of screening accounts and you will avoid those that are likely to be less profitable?

Mr Fletcher: I think it would be correct to say that a lot of accounts that just contain £250 to us would be quite a challenge to write that business and provide

the return that we require ultimately for our shareholders. If we saw that the market was going to develop in that way, I think we would choose not to enter the Child Trust Fund arena.

Mr White: Chairman, may I add to that. I would come back to my central point, which is that people even at the lowest end of the income scale do want to save for their children. One of the advantages of the Child Trust Fund and the way it is proposed that it is structured, is that it will be easier than currently for other members of the family to be involved. There may well be a grandparent or a godparent or another member of the family who can help out a family when they are not able to save for themselves. Also I think it is important to realise that things can change over 18 years. People's circumstances can change quite significantly over 18 years.

Q203 Chairman: How will the industry go out there to attract additional contributions from lower income families? What kind of tools will you develop to do that?

Mr White: We do this now. This is what we do. The reason I mentioned those statistics earlier was to show that we get to people from all walks of life. There is a whole range of ways of doing it. Some people have access to the internet and they can find out about us there; we have arrangements in Boots stores up and down the country, where people who would not have access to other forms of advice or help can find our Baby Bond(r) material and start to save with us; and we also have arrangements with Mothercare, with the Huggies Nappies club that mother's join when they have had young children. So there are various ways of getting to people. The important thing is that we are *able* to get to them. That will come back to one of the central points, which is having the resource to be able to get to them, to support and encourage them.

Ms Segars: I think also there is a partnership approach in this. It is about a partnership between the financial services industry but also government. The Government has done a good job in advertising, for example, the National Minimum Wage, Working Family's Tax Credit. We would be looking for that similar kind of advertising campaign and information campaign which can show the great difference that even a modest contribution of, say, £10 a month could make to the ultimate size of the Child Trust Funds. We are looking for a partnership.

Q204 Chairman: You are looking to the Government to do the advertising?

Ms Segars: Certainly to do some of the advertising. The Government has done, as I say, a very good job in advertising something like the National Minimum Wage, the working families tax credit.

Q205 Chairman: That would be generic advertising.

Ms Segars: Yes, but you could quite easily show within that: The benefits of saving an extra £10 a month would mean that your Child Trust Fund would be worth X and not Y.

Mr Mullen: The economies of scale will be very important in the implementation of this. One of the biggest costs that the industry will face or that the industry needs to deal with—and this is a debate and discussion that we must have with government—is the cost of advice. This is probably the largest cost. At the moment, with the advice regime that we have with the FSA you are talking about a minimum of 20 minutes up to one hour of advice time in selling a product. The Government will be putting out an information pack on the Child Trust Funds and the contents of that information pack and the way in which it sets out the amount of advice that can be drawn from the pack will be extremely important. There, if you can reduce the amount of face-to-face advice and increase the amount of knowledge and information that is contained in the pack, that will be important.

Q206 Mr McFall: Will the Government decision to require all providers to offer a stakeholder Child Trust Fund restrict competition in the market.

Mr White: I do not necessarily think it will restrict competition. In an ideal world there would not be a need for such things, because we would have got personal finance education so high up the agenda that people would understand and be able to make informed choices.

Q207 Mr McFall: How many years will it take to get personal financial education up to standard?

Mr White: We certainly have an opportunity in front of us, that is for sure, and it is going to take some time. But one of the key important aspects of the Child Trust Fund is that we can use it as a tool to help generate the next generation of informed consumers. The key there is that people are able to make informed choices. We want people to be able to understand the pros and cons and risks of investing in different types of things so that they are making informed choices, but it is important that we have the resources to be able to do that.

Q208 Mr McFall: Norwich Union, Mr Fletcher, is that factor, the stakeholder Child Trust Fund, in your decision whether to enter the market or not? You make it clear in your submission that ". . . the charge cap applicable to these products has yet to be made, and, as such, it is not possible for Norwich Union to decide whether to participate in this market."

Mr Fletcher: Yes, it is the cap and the regulatory environment within which the product will sit; that is, the sales or conduct of business environment within which the product will sit. Because that will have a direct impact on the operation and the costs of distributing the product. I think, equally, there are points on which we still seek clarity around the actual administration of the business. Things like the use of vouchers could, under certain scenarios, be quite an expensive way to administer this business. That, again, will lead back to the need for an adequate price cap to enable us to generate the required rate of return to attract the capital.

Q209 Mr McFall: So at 1% you would not enter the market.
Mr Fletcher: I think it is very unlikely that at 1% we would be able to.

Q210 Mr McFall: At 2% would you enter the market?
Mr Fletcher: Without having the wider detail that I have already explained, I think it is difficult to be definitive about the level of price cap we can do it at.

Q211 Mr McFall: Could I ask others on the price cap of 1%.
Mr White: We have set our current charges out in our submission. We feel that if we are able to charge around that level, which is broadly around the 2% mark, we would be able to carry on what we are doing now, and that is serving people right across the socio-economic scale.

Q212 Mr McFall: But 1% would be detrimental.
Mr White: I think it will. If the charge cap on the Child Trust Funds were reduced as low as 1%, so the current market would need to go as low as 1%, I am not sure, in our view, there would be any providers in the market at all. I think the danger would be, at best, that you would force people to cherry-pick at the rich end of the market in order that they feel they could cover their costs, and, therefore, the lower income groups would be left out. That is the danger of low price caps.
Mr Fletcher: It is perhaps worth highlighting that we—we and a number of other providers—have on an open-book basis provided a lot of information to BW Deloitte, who have been carrying out research for the Treasury into this issue of the price cap. Hopefully that will inform the end decision.

Q213 Mr McFall: Back on the point of the stakeholder Child Trust Funds, we have received evidence from a number of societies. Nationwide, for example, note that "it may make it difficult for many smaller building societies to participate in the market" and the Building Societies' Association themselves say "more than a quarter of building societies will not be able to offer CTF accounts". Is that a feeling across the board?
Mr Mullen: I cannot speak for the building societies, but as far as banks are concerned, as I say, one of the major issues for us is this question of advice, that this is a mandatory product. We would think that there would be a lesser advice regime, that there would be a discussion between the individual and the bank. If that is the case, then of course the overall cost of delivery comes down fairly dramatically.
Mr White: I think it is also important to recognise that the Government and the Financial Services Authority are changing the rules on what is currently called polarisation. That means that different kinds of firms will be able to link up with others to better serve their customers and offer them a wider range of different types of things that they cannot currently do because of the rules.

Q214 Mr McFall: To the ABI and BBA in particular: the Government is keen to attract specialist firms entering the market who may prefer ethical funds or investments accommodating their religious beliefs. Do you think the requirement to provide a stakeholder Child Trust Fund will deter such players?
Ms Segars: I think the arguments are much the same as my colleagues have outlined to the previous question really. We are seeing more providers tying up with other providers. I think that might be the conduit through which we see the Child Trust Fund work. We have seen, for example, company A's stakeholder pension with five or six different companies' investment options on the table, and one could see that the Child Trust Fund might develop in the same way.
Mr Mullen: Competition is giving wider choice. The concept of open architecture (that is, where a product provider is not just providing its own products but using the products of others in order to give their clients the best possible choice) is now widely accepted and there is a very competitive market there. I would see that the type of services you have stated would expand.

Q215 Mr McFall: The UK Social Investment Forum have argued that the Child Trust Funds should not be invested in areas that are damaging to children, such as tobacco manufacturers. What are your views on that?
Mr Fletcher: To be honest, I do not personally have a strong view on it.

Q216 Mr McFall: You would be quite happy for Norwich Union to invest in tobacco.
Mr Fletcher: No, if I could finish, I think that is probably a decision that fits into the wider social framework and would possibly need to be defined as part of the product advice area.

Q217 Mr McFall: But Norwich Union surely have an ethical perspective on things.
Mr Fletcher: Yes, we operate a range of socially responsible investment funds.[1] Generally speaking, however, I would say that the cost of operating those funds, due to the specialist nature of them, is slightly higher than the more generalist funds that we operate. But I believe that investment choice is a matter of personal preference at the end of the day.

Q218 Mr McFall: Okay. I will come back to you on that. David?
Mr White: I have sat in some interesting discussions with groups of people where trying to decide what socially responsible is becomes interminable. Having said that, we want to give people choice. We have talked to the Islamic community. We are talking to them, because they need special kinds of funds in which they can invest owing to their religious beliefs. The danger is that if we do not have

[1] Ev 106

the resources to provide specialist funds, we will be down to this sort of "vanilla" product that everyone will have to have.
Mr Mullen: To represent the industry, the *sine qua non* is that there should be consensus on such issues. There is not a consensus, so the BBA does not have a view.
Ms Segars: Again, David has hit on a very important point there: how do we define what is ethical? What you might think is ethical may not necessarily concur with what I think is ethical.

Q219 Mr McFall: That does not to say you would ignore the ethics, then?
Ms Segars: No, absolutely. You do not necessarily ignore the ethics, but I think competition would deliver those socially responsible ethical funds.

Q220 Mr McFall: I will put one question to all of you: Given we are dealing with children here, is it not important that the issue of ethical investment is paramount in your decisions? It is no good just to sit back in this particular one. I am looking for a clear answer from you. Do ethics matter in this? Are you going to have an ethical policy on this? Norwich Union were very fuzzy there. Would you like to expand on that?
Mr Fletcher: Yes, certainly. I think ethics are right at the core of all of the business interests that are represented here today. I think it is an interesting question, I suppose illustrated by the point David made about what is socially responsible: What is an ethical investment? People have different views. As I say, I personally do not have a firm view because I have not given it much thought in this context.

Q221 Mr McFall: So you would be quite happy to invest in tobacco companies, then, Norwich Union. It would not really matter to you what your investments were? We have seen the debate where the Co-Op introduced ethical investments. The Co-Op recently announced their Fair Trade products: their coffee, their beverages, all contain the Fair Trade products. That is a start of ethical behaviour. Is Norwich Union going to take this on board?
Mr Fletcher: I feel like you are questioning the ethics of Norwich Union, which, given the—

Q222 Mr McFall: No, this is to the future, because you are dealing with children.
Mr Fletcher: Yes. As I say, I think it is a matter of personal choice. I do not personally have a view on it. I am not aware—

Q223 Mr McFall: So I can take from that that Norwich Union does not have any ethics, then?
Mr Fletcher: No, Norwich Union does have ethics.

Q224 Mr McFall: If you could explain it to me, it would help. David?
Mr White: We are investigating socially responsible and ethical funds. We are investigating funds for specific religious denominations. We want to give people choice. Yes, I think ethics will become more and more important, so it will be more and more important that we give people the choice.

Q225 Mr McFall: Do you think some in the ABI and the BBA would consider that as well when we are dealing with children?
Mr Mullen: It is quite clear that it is at the forefront of some of our members' thinking.
Ms Segars: Certainly from the ABI's perspective. From my personal perspective, I hold my pension funds in ethical funds, so it is certainly something that I feel is extremely important. As far as the ABI is concerned, as institutional investors, we have, as you know, been very, very active on the corporate governance front and on the whole social responsibility front in any case.

Q226 Mr Plaskitt: Could I ask about a particular category—and we do not at this stage know the size of the numbers involved, it could be small, it could be larger—but those are the Revenue allocated funds, where a parent chooses simply not to take up or implement the option. After 12 months has elapsed the Government is proposing that it will simply then allocate the amount to one of the approved providers and will do it randomly between you, but you are not at liberty to take it. Could I ask those of you representing the organisations, first of all, do you think your members would accept revenue allocated trusts?
Ms Segars: At the risk of becoming somewhat repetitive on this issue, I think it does depend on the things we do not know about yet, which are about the price cap and cost of administering those schemes and so on.
Mr Mullen: I agree with Joanne, but, just to expand on that, the difficulties in administration or the burden of the administration will not be small. Sadly, it is the fact that in our society almost 40% of marriages end in divorce, therefore you will have a position where you may have two parents, each not agreeing on who would look after the trust fund. Who would have responsibility in looking after the administration? This means a further burden on the bank or the other financial services institution. You could have a situation where there are seven or eight individuals contributing to the fund. So there are real issues of administration in the complexity of that. But, as I indicated in my opening remarks to the Chairman, the concept is excellent; it is on the implementation that we must focus. There is a will by the industry to make this work.

Q227 Mr Plaskitt: But there is nothing in what you have said that is uniquely about the Revenue allocated bonds. The issues you have raised could apply across the board in all circumstances.
Mr Mullen: Indeed.

Q228 Mr Plaskitt: Mr Fletcher, speaking on behalf of one of the providers, how would Norwich Union feel about receiving Treasury allocated funds? Would you take them?

Mr Fletcher: First of all, we would have to take a decision to participate in the Child Trust Fund market. As part of that, we would have to see that the terms and the administration and the costs of doing so meant that it was a viable for us to accept that business economically.

Q229 Mr Plaskitt: Again, that would be true across the board.
Mr Fletcher: Yes.

Q230 Mr Plaskitt: It is not specifically the issue about whether the Treasury allocates it.
Mr Fletcher: No.

Q231 Mr Plaskitt: So there is no inherent problem, so far as any of you are concerned, in the fact that the revenue might allocate the fund to you; your issues are about other things and they are the ones that are going to determine your position. Is that right?
Mr Fletcher: Yes. I think it is fair to say that it is possible in certain circumstances, depending on how everything pans out, that it will be more efficient to receive the business direct from the revenue than deal directly with a range of individuals.

Q232 Mr Plaskitt: Is there this risk of cherry-picking? That is what we want to get to. If you were in a position to choose, would you assume that a fund that was coming to you via revenue allocation was one that was going to be less likely to be topped up by friends and family and therefore you would opt to steer away from it and you would rather go for the ones where you think they would not be taking that approach.
Mr White: I think in an ideal world there will not be many of these because we will have the resources to get education and choice right, backed up by the kind of marketing by the Government that we would want to see to make people aware of this. Some of our research was mentioned last week in terms of 79% of families saying they would like to top up the Government endowment. The other piece of that research which was not mentioned last week says that 92% of families had not heard of the Child Trust Fund and did not know about it. So it was not until it was explained to them that they then found a way of thinking, "Yes, we could afford to top this up." So that is where we need to get. We need to put the focus into getting as many people actively involved in the market and topping up. If I may just come back to the cherry-picking point, the thing that is most likely to cause cherry-picking is a very low price cap that does not work.

Q233 Mr Plaskitt: Is it in your interests, all of you, I think, to have people in the savings habit. That is why you have all given the nod towards this innovation. But what incentive can you yourselves put into it? To some extent, you are sitting back waiting to see what the Government puts in the small print, but what are you all planning to do on your side of the equation? Suppose, Norwich Union, that for the sake of argument you do decide to do it, and suppose one of these revenue allocated bonds lands on you and you accept it, you are not going to do very well out of it if it just sits there as £500 for 18 years. Do you not think there is a role for you then to play to, to contact the parents associated with this trust fund, and start encouraging them to save? Is there not a role for you to be proactive in this?
Mr Fletcher: I think there is a great role for the industry to play in partnership with government in encouraging people to save more. I think there is a range of initiatives that could be pursued, could be taken, if we can come up with a workable solution, whereby it is cost-effective for us actually to manufacture these products in the first place.

Q234 Mr Plaskitt: That takes us back the initial issues you put down on the table.
Mr Fletcher: Yes.

Q235 Mr Plaskitt: Could I finally ask each of you: the Government has not yet said what it is going to do with these funds when the child reaches the age of seven, but it has said it intends to do something at the age of seven. From the industry's point of view, what do you think they should do?
Ms Segars: We are expecting, we are hoping for, an additional top-up, so an additional piece of endowment, government endowment go into the—

Q236 Mr Plaskitt: Structured how? Do you have any views?
Ms Segars: I am not certain we do have views at the moment. It may be that, again, there needs to be the redistributive element built into it, but we are hoping that that additional endowment would be significant enough to boost savings again and act as another kick-start to people starting to save into Child Trust Funds on a regular basis.

Q237 Mr Plaskitt: Do you see the additional government top-up at seven as indicating to you an opportunity in the way that you market these products?
Ms Segars: Certainly it does. For the same reason that an employer's contribution into a pension scheme does. It is extra money. It is a good way of additionally marketing and showing the benefits of a particular product.

Q238 Mr Plaskitt: Seven top-up?
Mr Mullen: Quite clearly, to be pragmatic, as Joanne says, the larger the contribution, the more likely the fund would be successful, so we would support that.

Q239 Mr Plaskitt: And on the supplementary question that it would be creating an opportunity for you to do something for the customer, do you see that in there as well?
Mr Mullen: In so far as it would make it more desirable, it would enhance competition, and therefore that is a benefit to the recipient and to the market as whole.
Mr White: We want to carry on doing what we are doing now and add to it, which is to help, support and encourage people every year with statements,

with access to saving in Boots and the other places I mentioned. I think that over 18 years is what is going to be the real encouragement. From our point of view, as a provider, if more money comes along at seven, that is great, but I do not think it makes a big difference in terms of the opportunity for us. It will give, particularly if it has a progressive element, the Government another opportunity to take account of any changes in people's circumstances. Most government benefits are for immediate consumption; this (CTF) lasts over 18 years and people's circumstances can change quite a lot in that time. It may be that one family is not as well off or as low an income household as they might have been—that might have changed by seven—so there is more opportunity for the youngsters, I think.

Q240 Mr Plaskitt: Seven top-up?
Mr Fletcher: In an ideal world, you would hope that in seven years time you would not need to put more money in to remind people of the need to save, because hopefully we would have moved the whole agenda on. However, from an economic standpoint, the more money that goes in the better because it makes the charging of these products easier to get lower. From, again, an idealistic point of view, perhaps one way to encourage people to put money in would be to link the amount somehow to the amount that had been put in on a voluntary basis. However, I think the danger of that would be that it would favour those who already have and would not favour the have-nots. So it is a very difficult question to come up with an answer to.

Q241 Mr Plaskitt: Do any of you see a relationship between the seven top-up and your views about the cap charges? Or are they two entirely separate issues?
Mr White: I think they are separate issues.

Q242 Norman Lamb: Could I first go back to what you, Ian Mullen, were saying earlier about the important issue of advice to the people taking out these products. The FSA is reported this morning as having doubts over light-touch investments in the Sandler basket of products generally. We were hearing from Treasury and revenue officials last week that they very much hoped that people across the income range would be taking out equity-based products rather than cash-based products. Do you have a concern that this will work? I realise companies are concerned that they will be left holding the baby in terms of accusations of mis-selling—I am sorry, "holding the baby" is rather an inappropriate comment! Do you have concerns that this all stacks up and that it will actually work? Do you share the concerns of the FSA on this?
Mr Mullen: It is a very difficult subject, in so far as you have heard Callum McCartney say, I think, that there is no such thing as a riskless investment. The expertise that the professionals can bring to the considerations of investments will affect the profitability and, therefore, one would imagine, the diminution of risk. But the other side of it is that you have the appetite of the customer, as to what their risk appetite is. It is contemplated within Sandler, as you are well aware, that you can design a product in such a way that the risk would be contained to allow less advice to be required and therefore the customer would be adequately protected, given the light-touch advice. I would say, as a financier, that that really depends on major cardinal decisions. Are you going to put the capital at risk, the principal. If you put that capital or principal at risk in any way, then clearly the risk is heightened. If you have an equity investment, then, with the few exceptions that test the rule, you have a heightened risk. If it is a bond or a fixed income instrument and it is kept to maturity, then the investment risk is the risk of the company issuing the bond and that is governed by or has a rating agency that will classify, a respected classification of an investment grade bond. Your risk is on the principal and very, very small on the interest, so therefore there you have more of a "less risky product". But it is the case that over tens, if not hundreds of years, a riskless return has hovered around the three to $3\frac{1}{2}$%, and we can see that that figure obtains today. If people are looking for a return, discounting inflation, then if they want a return of more than $3\frac{1}{2}$%, of course it is the risk that comes with it.

Q243 Norman Lamb: We will be encouraging people who have not taken out financial products before to go for these risk products.
Mr Mullen: Within risk management, you can insure, diversify or hedge. These are the three elements of trying to lower financial risk, particularly with regard to investments. There are well-practised ways of ensuring that that happens, but underlying all of this is the fact that the principal is at risk.

Q244 Norman Lamb: If I may come on to ask a question of Norwich Union and Children's Mutual. If this all works and gets up and running, there will be opportunities for the cross-selling of products. You will build up a substantial database of information about people and their saving and spending habits. Do you think it is important that there should be restrictions on what you are able to do in terms of marketing products to the children and their parents based on the information that you will have?
Mr Fletcher: The majority of Norwich Union business is actually written through intermediaries, so the control of any data sits with that intermediary, it does not sit with Norwich Union. In general, though, I think it should not be restricted. I think there is probably a lost opportunity if it is, because we are trying to widen out the provision of saving. I think that it should be permitted, that cross-selling should be allowed.

Q245 Norman Lamb: So no real restrictions at all on that area of activity.
Mr Fletcher: We are already restricted by the data that we can hold and how we can use it. I think that the existing guidelines are probably strong enough.

Q246 Norman Lamb: Mr White?
Mr White: We are a specialist, so the extent to which we will be thinking about cross-selling perhaps does not apply as much as some others. I think we will want to use this as an educational tool to get families and their children inculcated in the savings' habit. That is the biggest potential extra benefit that I think we have with Child Trust Funds. It is perfectly possible that through Child Trust Funds actually it will be the parents initially who get the most education because they will start to see what is happening with their children's Child Trust Funds and start to understand the benefits of long-term saving. We did put in our submission that the kind of costs that one faces as youngsters at age 18 these days are pretty daunting. It is a more daunting prospect being a parent. I think we can use this to inculcate the savings habit. If that pays off in terms of more parents saving more in pensions and such like with other organisations, well, I think that can only be a good thing.

Q247 Mr Ruffley: I want to raise some questions about what looks to me like a set of proposals which amount to a paper chase both for parents and providers alike. I was very struck by the evidence the ABI gave. Ms Segars, I wonder if you would flesh out the comments you have made. You talk about the receipt and retention of the voucher when the provider opens an account. You are referring to box 6 of the proposals that the Child Trust Fund that the Government published. You go on to say on this voucher, "This negates the possibility of providers keeping costs to an absolute minimum by enabling parents to open CTF accounts by more cost-effective and customer-friendly means—eg, over the telephone or on the internet. This requirement to collect the vouchers"—which I take it to mean paper vouchers—"means that even if such methods are used to register an account, it cannot be authorised unless the voucher is physically sent to the provider." This seems lumbering and bureaucratic. Could you just tell us how this is going to affect the costs. It is going to be counterproductive, is it not?
Ms Segars: I think "lumbering and bureaucratic" summarise that point rather well, actually.

Q248 Mr Ruffley: Those are my words.
Ms Segars: Your words, yes.

Q249 Mr Ruffley: I do not want to put words into your mouth.
Ms Segars: It is extremely time-consuming and costly. If we are looking at a 1% charge cap, and all the providers can raise on an endowment of £250 is £2.50, by the time you have written to the parents, phoned them, written to them again, written to them again, written to them again, phoned them and then you have to cancel the account, you have spent your £2.50 and more. That really is our concern and it seems to us that there really ought to be much simpler methods of being able to take the vouchers out of circulation. There seems to be no reason why the vouchers have to be returned and retained by the providers.

Q250 Mr Ruffley: What do you think the Government is on? Why do they make things so difficult? It seems a shambles.
Ms Segars: The Government are clearly concerned about the vouchers being used and reused. Fraud, I guess you would call it. It seems to us that in these high-tech days there ought to be a way of taking the vouchers out of circulation.

Q251 Mr Ruffley: Providers are going to have extra costs, which is going to be counterproductive in getting this thing off the ground. It is going to be more difficult for parents, though, is it not?
Ms Segars: That is absolutely right. We would prefer to spend the money that we have within the charge cap that is allowed to market the schemes, to encourage more contributions in and so on and so forth, and spend it on productive things that meet the Government's objectives.

Q252 Mr Ruffley: You also say that the requirements we have just talked about "may also have an adverse effect on the take-up, given that it is generally true that the more complex the procedure to open an account the higher the drop-off rate."
Ms Segars: Yes.

Q253 Mr Ruffley: So parents are going to be put off by this paper chase. Would that be a fair summary?
Ms Segars: Yes, we think that that may well be the case.

Q254 Mr Ruffley: Could I follow this theme and ask the Children's Mutual, in your submission to us you say the sales regime should have a light touch, "For instance, we believe that electronic top ups should be made available, vouchers should be accepted via the internet." And you helpfully remind us that this should be part of the Government's initiative for a drive on EGovernment and getting into the 21st century. You go on to say, "We disagree with the current proposals that only allow for registration of paper vouchers for the CTF GE rather than using secure unique reference numbers where claimants have already been vetted by the IR for child benefit purposes." Why does the Government not think this is true? Would you like to expand on your comments?
Mr White: We have made these points to the Inland Revenue.

Q255 Mr Ruffley: What did they say?
Mr White: I think the Inland Revenue—and I do not want to speak for the Inland Revenue—my guess is that they are concerned over time to build a system. I am not sure that we accept this one. We supported the Government throughout this initiative. On this specific I think we would like to see some movement. The right mechanism has been chosen because virtually everyone qualifies for Child Benefit. In terms of vetting if the Inland Revenue or the Government is paying Child Benefit I guess we can accept that these people are legitimate. We would like not to have to accept the vouchers for administrative reason but also for the ease of

parents. If you are a very busy parent these days—you do strange things like going on the internet at 11 o'clock at night when you manage to get the children to bed and you have a few minutes to yourself—busy parents like the idea of being able to pick up the telephone and have their enquiry dealt with as opposed to a paper voucher. On this specific we would like to see some movement for cost purposes which benefits everyone and for ease which benefits busy parents.

Q256 Mr Ruffley: This parental paper chase is really not on, is it? Could I ask the BBA—I know these are not your representations—if I may quote the Institute of Investment Management where they talk about the need for more to be done to ensure that the costs of administration are kept as low as possible. This is a theme we have been exploring on specific points raised. I wonder if you or your members would have a view on this? They say that the Government are proposing an initial contribution and an additional top-up at seven years of age. The IMA believe holding that back would reduce the investment that could be achieved over the lifetime of the fund resulting in a reduced payment on maturity. Do you recognise those comments? Is that something that you would like to address?

Mr Mullen: Clearly it is the time value of money. The longer the funds are invested—

Q257 Mr Ruffley: Why is the Government doing it that way?

Mr Mullen: I think for the reasons that David mentioned, perhaps they want to investigate some form of incentive whereby they can induce the parents, the grandparents to put in funds. The more funds they put in perhaps that will influence the Government's additional contribution.

Ms Segars: Maybe it is worth adding that the Government have recognised the point Ian made about the time value of money. Initially the endowments were going to be made at five, 11 and 16. We also need to look at Child Trust Funds in the round and the wider picture. Much of this is about personal financial. Seven is quite a good time if you are going to school I guess. I think seven partly picks up those points too.

Mr Mullen: The age of reason!

Q258 Mr Beard: The Association of British Insurers in your evidence say that children born before 1 September 2002 are being unnecessarily excluded from the benefits of CTF and you go on to strongly argue for extending the CTF regime so that parents could open a CTF account in their child's name even if they do not receive Government money. I wonder how people would respond to that? Would providers of Child Trust Funds actually use the brand name to promote something equivalent for children that were born before 1 September?

Ms Segars: We and our member companies feel quite strongly that Child Trust Funds should be available to those born before September 2002 and we recognise it may be very costly for Government.

Q259 Mr Beard: Without the Government endowment?

Ms Segars: Yes. What we are suggesting is for the opportunity for parents to be able to put in £1,200 a year on a tax-free basis for children born before September 2002 to be available. We think it should help encourage take-up because if you are a family with children born either side of the cut-off date then that may well put you off actually contributing more to the Child Trust Fund for a child that was born after September 2002. David will know more about this than I do. The alternative tax favoured children's savings are much lower than £1,200.

Mr White: Given that the Baby Bond(r) brand is registered to us I am not too worried about the brand name of the other things. All children who are born before 2002 can save or have saved for them up to £25 a month tax-free at the moment.

Q260 Mr Beard: Under ISA?

Mr White: No, under a tax exempt savings plan, a qualifying policy with a friendly society. That exists now and has existed for some years. The limit has been £25 since 1995.

Q261 Mr Beard: £25!

Mr White: £25 a month, £300 a year. You do have a situation where for children born before and after the cutoff date there will be different incentives for different families and if they could be equalised that would make sense.

Q262 Mr Beard: How do you equalise them?

Mr White: There are two obvious ways you could do that, one would be to extend the £1,200 with tax-free growth of the Child Trust Fund, so the voluntary part, backwards.

Q263 Mr Beard: That becomes an open-ended commitment from Government.

Mr White: Not really. The big cost to the Government would be the government endowment of £250 and £500. I think the Treasury officials said last week that the tax break element was in the negligible box, so extending it to the edge of the negligible box to get more people saving for more children would be good.

Q264 Mr Beard: Are you suggesting that the endowment should be extended?

Mr White: No. I do not think you will never get the cut-off date right. The way that the cut-off date has been handled is reasonable, it includes a whole school year cohort. What you could do is extend the tax break on the £1,200 a year voluntary top-up back for some years.

Q265 Mr Beard: Why would that not be an ISA? Could you not do that through an ISA?

Mr White: I think that the other rules relating to Child Trust Funds, the way that the money is invested, the way that it is in the child's name, the way that it is locked up until 18, those things which are right for the children's market and would still apply.

Q266 Mr Beard: When we put this point to Treasury they said, "the private sector may well take the initiative away from us. They may well invent things that serve that purpose, for practical purposes". The question is to you and Mr Fletcher, would you be interested in providing accounts such as this?
Mr White: We do and we have been doing so for many, many years. We have been putting on new customers, more people saving for their children's future at a decent rate. The thing is that you are going to have this great difficulty in parents' minds because you are going to have parents in three cohorts, one whose children are born since September 2002, so they are eligible for the Child Trust Fund, some who have children born before and after so they will probably think that they have to do something for the older child—no family will do something for one child and not the other—then you are going to have people who are going to have older children. I hope that the whole noise round Child Trust Funds will encourage those people to save. Whether you extend the £1,200 or whether you keep the £300 current limit going, or extend the other £300 those are all options available.

Q267 Mr Beard: You would be ready to use the brand of the CTF to promote that?
Mr White: I certainly would be ready to use the Baby Bond(r) brand, the extent to which you use the Child Trust Fund brand for that cohort is something that we will have to consider.
Mr Fletcher: I echo the comments of David next to me. We do not provide children's savings plans at the moment because we are not a friendly society, that is the remit of the specialists such as David's organisation. It seems to me sensible if we proceed with the Child Trust Fund it should be extended in that way and utilised in the way that David explained.
Ms Segars: I think it is important to remember that the industry's capacity to innovate is limited by the rules the Inland Revenue set round tax break contributions. I think the industry would like to step up to the plate but we are somewhat limited unless the Inland Revenue themselves—

Q268 Mr Beard: You are inhibited by the Inland Revenue rules?
Ms Segars: Because the limit is £25 a month.

Q269 Mr Beard: Mr Mullen, in your evidence you argue that fortnightly returns will place additional burdens and require changes to internal systems capable of accommodating both fortnightly and current quarterly returns for ISAs, what do you think the appropriate reporting requirements would be?
Mr Mullen: The reporting requirements would be those that allow the current systems to be used, so either monthly or quarterly.

Q270 Mr Beard: Either monthly or quarterly. Have you put this to the Inland Revenue?
Mr Mullen: We have in our submission.

Q271 Mr Beard: What was their response?
Mr Mullen: We are awaiting their response.

Q272 Mr Beard: Moving to minimum contributions. The stakeholder pension has a minimum contribution of £20 and the National Consumer Council suggested that the minimum should not be greater than that and there are advantages in it being less. Then the Association of Investment Trust Companies argue that a minimum contribution of £20 is too low. Do you think it is necessary to have a minimum contribution level at all?
Mr Mullen: Our members would say that there is a necessity to have a minimum contribution, where you set it is difficult to reach consensus on. With our members they feel that by and large the £20 minimum is about right.

Q273 Mr Beard: What is ABI's reaction?
Ms Segars: This is an issue that is very much bound up with a decision round price cap and the costs and complexity of administration, as has been the case with stakeholder pensions. We certainly do not want to see a minimum below £20.

Q274 Mr Beard: You would not want to?
Ms Segars: No.
Mr White: Our view is that whatever the rules are the effective minimum will be determined by the price cap. At the moment we go down to £10 a month. It seems slightly illogical that the higher price cap gives rise to a better deal for consumers. The issue is if you have a very low price cap as a percentage of a very, very modest saving amount the actual number of pounds you have to deal with and cover costs are very, very low. The price cap will determine where the effective minimum is, as it has done with stakeholder pensions. Stakeholder pension averages are higher. The actual contributions are higher than personal pension average contributions were before the introduction of stakeholder pensions, which means that providers have to move up market because they have to do that to cover their costs.

Q275 Mr Beard: If the cap is anywhere near the 1% that has been suggested where does that leave the minimum subscription?
Mr White: In our submission we have been quite clear, given the complexity of saving for children which is relatively more complex than adults saving because you can have a number of members of the family involved, people separate and divorce which means you have two people to deal with after the separation or divorce and we think that at 1% it would be unprofitable to our members, in other words our members would have to subsidise anything below £122 a month.

Q276 Mr Beard: Assuming it is going to be round 1.5% what is the minimum contribution you would advocate in those circumstances?

Mr White: We would like to be able to do what we do now, which is go right down to £10 a month to allow people who cannot afford much to save for their children's futures.
Mr Fletcher: We will only write business only if it is economic for us to do so. At 1% it is very difficult for us to see any scenario where it would be economic for us to do so. We have done some modelling round the wider issue of pension pricing and savings pricing in connection with the wider issues of stakeholder pensions and products that have been proposed and we feel on balance that a minimum that is more between £50 and £100 a month is more in the region where it becomes economic to write these type of contracts.

Q277 Mr Beard: If that is the minimum at that level you will wipe out all of the very low income families?
Mr Fletcher: I think that is the challenge at the end of the day as to how we make these products economic. If we are going to have a price cap to screw down the absolute minimum—

Q278 Mr Beard: From what you say about the charge cap are you ruling out Norwich Union joining the scheme if the charge is about 1%?
Mr Fletcher: As we view the facts at the moment we see it as very difficult to manufacture a Child Trust Fund protection at a 1% price cap.

Q279 Mr Beard: Are you ruling yourself out of taking part?
Mr Fletcher: We never say never but we do not see how we can make it work.

Q280 Mr Beard: On this price cap what is likely to be the impact of 1% cap on charges?
Mr Mullen: At the moment our members are looking at the scant information that they have with respect to the administration costs, particularly at a viable product where the customer feels they are getting value-for-money and where there is sufficient incentive for the company to invest on a commercial basis, they are looking at closer to 2% and with some consideration of a front-end charge, and that can vary depending upon the detail of the cost of the advice and the arrangements that can be made round the administration particularly.
Ms Segars: If the price cap is kept at a flat 1% that leaves very little margin for advice, very little margin for information and education to encourage more contributions in, very little margin for investment advice, where people might want to consider the ethical funds that Mr McFall outlined earlier, and very little incentive to us in the market.

Q281 Mr Beard: There seems to be a paradox, if these Child Trust Funds are to be reasonably safe, and you would expect them to be for a national scheme of this kind, they are going to have a fairly low return, if you then take the bigger slice for charges the actual return on these funds is going to be unattractive compared with other forms of investment, is it not?
Ms Segars: It is about balance. We want to deliver value for money to all consumers and make sure that low income families get served through this product as well as those higher up the income scale. What we do not want to be in is the business of 'throwing the baby out with the bath water'. Unless the price is right we cannot provide any type of service to consumers and providers will not enter the market or they will move into servicing higher income consumers only.

Q282 Mr Beard: Do your answers on this question of the charge take into account the fact that the Government will be doing a substantial amount of promotion and advertising for these Child Trust Funds?
Mr Mullen: Whether we are fully assured of that, that is one factor. I say again that the single most important factor my members are concerned about is the advice regime surrounding the sale of this product. It is a mandatory product and if it requires the current sales regime then it will be uneconomic.
Mr White: The key to lower prices, the real key to lower prices is to create demand. The Sandler Report concentrates on the supply side and very often the work that is done always looks at the supply side. The key is, if we can create demand. Consumers do not wake up on a Saturday morning and think "we will sort our personal finances out this weekend", it is not at the top of their minds. If it were and consumers bought more then prices would fall and that would be the most efficient way of getting prices as low as possible. I accept it is an illogical point when one first looks at it but the simple answer is the lower the price cap goes the more providers cherry-pick richer people. That is what we do not want to happen, particularly when you are talking about children's futures.

Q283 Mr Beard: Mr Mullen, in your evidence you say that unless a price cap for stakeholder products is raised to a more realistic and economic level than 1% it is unlikely the wide range of Child Trust Funds will become available. What are your views on what is realistic and economically viable?
Mr Mullen: As I said a cap of nearer 2% and some latitude on the front-end fee. This is based on, as I say, a repository of information we have round the costs of administration and the cost of advice.
Mr White: Our prices are broadly 2% now and we would like to be able to carry on giving support and encouragement to people from all walks of life that we do now, we do not want to have to go upmarket.
Mr Fletcher: At the risk of sounding repetitive we need to take account of the cost of the regulatory environment in which we operate. The cost of running the book of business needs to be reflected in any pricing regime that is subsequently adopted. We can only do that through consultation on an open book basis with policy-makers, which Norwich Union is happy to do. We can draw some parallels with the experience we have had with the stakeholder market. In 2001 we spend £10 million advertising stakeholder pensions and we created a successful entry into that market place. What we

found from experience is that the level of awareness has not led to people seeking out opportunities to take out pension contracts, they still require advice, they still require encouragement and more often than not on a face-to-face basis. That requires to be costed to the cost of the overall product. The end result has been we are now concentrating in terms of developing our stakeholder business away from individuals and towards corporate groups, employees, company, sponsored arrangements because we can get the efficiency and get the dynamics right to write the business and stand a reasonable chance of making some money at the end of the day.

Q284 Mr Beard: What is the percentage that you are talking about?
Mr Fletcher: If we are talking about stakeholder pensions—

Q285 Mr Beard: No, Child Trust Funds.
Mr Fletcher: At the moment we cannot say this is where the charge cap should be because there are so many unanswered questions. When we know what the design of the fund needs to be so that we can gauge the level of queries we have to deal with when the stock market goes down, when we can see the regulatory environment in which they will sit, the requirements round advice, we will be able to costs all of this and come up with a reasoned view as to where we see the price cap sitting.
Ms Segars: I agree with that final point, it does depend crucially on the sales process, it does depend crucially on how much complexity can be stripped out of the administration process, and we have given you some examples of that already, it does depend on how simple this product can be kept, the simpler it is the lower the price cap can be.

Q286 Mr Beard: Are you saying that you are in the middle of negotiations and you are not going to concede very much until you have got well into it?
Ms Segars: The Financial Services Authority are looking at this. The Treasury are looking at this and we are expecting their announcement shortly.
Mr Fletcher: Could I answer that. I do not think we are in an negotiation, we are pointing out the fact that we cannot raise the capital to write this business if the price cap is at 1%.

Q287 Mr Beard: How would you justify having Child Trust Funds with a charge cap of 2% against a stakeholder pension capped at 1%?
Mr Fletcher: The stakeholder price cap needs to move as well if we are going to make inroads into the pensions market.

Q288 Norman Lamb: The impression I get at the moment is of a fair dose of pessimism as things stand at the moment, although it all stacks up if you talk about the complexity of the product as currently designed, if you talk about the advice regime and the potential for 1% cap. Unless those factors change this is not going to get off the ground, is it?
Ms Segars: As I said at the beginning we are optimistic about the potential this product can offer.

Q289 Norman Lamb: But there has to be a lot of re-thinking
Ms Segars: We do not know the answers yet so we do not know whether they need to be re-thought or not. There are certain key details that do need to be got right, if they are got right then we are very optimistic that this as a product will help to develop a savings culture that we need in the United Kingdom and that we are lacking at the moment. I would not want you to go away with the impression we are completely pessimistic about this product. We are optimistic about the potential but it does need to be got right.
Mr White: We think it is a huge opportunity. At the moment one in five families save regularly for their children's future. In my mind five out of five youngsters need the best possible head start in life so we need to close the gap between one in five to five in five, and this can be the catalyst to do it. Yes, it has to work. I think that someone has attached some magic to 1%, it was a theory, it has been introduced, we have seen the effects of it, it has had positive effects, it has brought some prices down and I think prices will stay down, generally speaking. We now have a number of years of actual evidence of what low price caps do. What low price caps will do, I know we must sound like a gramophone record, is mean lower income families and middle income families will be excluded.

Q290 Norman Lamb: If it stays at 1% Norwich Union and presumably other providers will not enter the market.
Mr Fletcher: It will restrict the ability of the provider to enter the market because we cannot raise the capital to justify and manufacturer the products to our shareholders.

Q291 Norman Lamb: Can I put something to you that the National Consumer Council said "given the low cost of demand generation and the certainty of high persistency rate the cost base price cap might be set at a lower level than for other stakeholder products" do you reject that view as unrealistic?
Mr White: I think the National Consumers Council and the Consumers' Association and us are all as one because we all agree there needs to be more demand creation. That demand creation we think should come from the industry, and the industry working in harness with the Financial Services Authority and the Government. The NCC would like to see face-to-face advice provided. The Consumers' Association would like to see a national network of financial advisers and I think both of those things are good ideas but it is not entirely clear who will pay for it. If 1% plus a national network of advisers paid for by somebody else happened—

Q292 Norman Lamb: We are not going to get to that, are we?

Mr White: In which case we come back to the central point, there needs to be the resources to put support and encouragement into middle and lower income family areas in order that they can engage in the savings habit.

Mr Fletcher: What I can say, and this is a more positive spin—I should not use the word spin—if Norwich Union can see an opportunity within the market where we can write business and we can get a good value product out there that will attract savings into us and we can get a fair level of remuneration for the manufacture of the product we will go after it whole-heartedly. We went after the stakeholder pension market whole-heartedly and it has not worked. Why has it not worked? It has not worked because elements of it are ill-thought out, it is price capped in a way that you cannot invest to actually reach the Government's target market.

Q293 Norman Lamb: Are you saying you learned lessons?

Mr Fletcher: I think we can learn lessons from that. It was capped at 1%, 1% is too low, it does not allow you to reach the consumer at the end of the day. If we can see an opportunity to do that we will pile in and we will make it happen.

Q294 Norman Lamb: The question concerning the proposals from The Children's Mutual, you suggested that the charging structure could be progressive with a 1% cap for those receiving initial Government endowment and 2% for those receiving £250. Would that be workable in practice? You have put it forward so I guess you believe that it is workable in practice, what are the views of the others?

Mr White: Can I say why we put it forward, the reason we put it forward was because we did not want people who are at the lowest end of the income scale to be disadvantaged because they happened to be there. This is the problem with percentages. It is that 1% of £500 is the same as 2% of £250, it costs the same to administer the voucher system and such like, so they would have been disadvantaged. That is why we put that there.

Mr Fletcher: One per cent of £500 is still only £5, £5 is not a lot.

Q295 Norman Lamb: Not enough, I would suggest. Do you agree with Mr Fletcher?

Mr Mullen: Our members are commercial organisations.

Ms Segars: Yes.

Chairman: Let us turn to our last topic.

Q296 Mr Cousins: The impression I have had from the discussing this issue this afternoon is that what you are seeking is for the Government to bear the cost and indeed the responsibilities of the promotion of this and that you want the existing products sales regime lifted from this product and that you want the charge to be lifted from 1 to 2%. Would that be a fair summary of your position?

Mr White: No.

Ms Segars: No. The word that we all use is one of "partnership". What we want is to work in partnership with Government to promote these Child Trust Funds. The industry does a huge amount on the education front, David and I are trustees of the Personal Finance Education Group for example, and a number of our members contribute to that. It is about partnership. I am not entirely certain that we agree with what you just said.

Q297 Mr Cousins: Partnership is an excellent concept to start with but once one translates it from mood music to actual functional responsibility and cost I have to say the impression I have had this afternoon is that your objective would be that the costs and responsibilities of financial education for this should be borne by the Government.

Mr Mullen: I think the problem that we have in coming here today is that there are two issues that are outstanding and decisions are required. We will have those decisions hopefully within a few months' time, one is the Government's decision with regard to polarisation and how that will be effected. The other, and as important, and closely analogist to the Child Trust Fund is the whole question of Sandler and the Sandler products. Once we and the Government know that the decision as to how these two initiatives will move forward then the Government and ourselves in reality will have a much better view of how we can take forward the Child Trust Fund. Therefore without that knowledge we are coming here to you somewhat cautious because we do not have all of the information and neither does the Government. Indeed as you know with regard to Sandler there is open debate within the Government between the FSA and Treasury. Until such time as they agree, and then they have an agreement with the industry or the industry it serves that which they impose upon us then it will be difficult for us to really engage with you in a constructive way on this particular subject.

Q298 Mr Cousins: Of course I understand that, the implication of that is that unless you get a change on point of sale regimes within Sandler and unless you get a the change that you are seeking on the lifting of polarisation that you maybe would not be too happy to recommend participation in Child Trust Funds?

Mr Mullen: And presumably the Government knows that so there will be movement on both sides. Our role is one to put forward an argument and win that argument by the strength of it and put it forward with some tenacity, that is what we are doing at the moment with Government.

Q299 Mr Cousins: I understand.

Mr White: I think the expression you used was we have asked for the charges to be lifted. I want to make our position quite clear. We know what charges work currently in the children's market, we know that allows us to encourage and support families to save for their children's future right down to the £10 a month level and we want to continue to do that. We are not looking for increased charges,

we do not want them to be lifted, we want them to remain where they are so that we can keep serving everyone in society as opposed to what the definite evidence we have is in stakeholder pensions market, that the lowering of the percentage price cap forces provider to move upmarket.

Q300 Mr Cousins: Mr White, can I pick this up with another point you made this afternoon which struck me as an interesting one, you referred to base contribution from the Government, whether it be £250 or £500 as mandatory products on which it would be, from your point of view, entirely sensible to have it with minimum advice and within a 1% charge cap. You have drawn a distinction between what you referred to as a mandatory product to the contributed product which the Government hopes will sit on top of the mandatory product on which a different regime might apply. Do I have that right?
Mr White: I do not think I talked about mandatory products. What is going to happen is that the Government are going to make payments, they are going to give information packs and allow parents to make a choice as to which provider they use for their Child Trust Fund. We will only have youngsters with the best possible opportunities at 18 if we manage to use those payments from Government as a catalyst to get people saving more for their youngsters.

Q301 Mr Cousins: My question to you is, do you and your colleagues see a distinction that may be worthwhile to be made between the mandatory product of £250 and £500, the contributed product which is catalysed by that and sits on top of it, so to speak.
Mr White: A distinction in terms of price cut?

Q302 Mr Cousins: Price cut and sales regimes and advice regimes.
Mr White: The sales regime for what comes from the Government will work in a number of ways and people will have an information pack and there will be some people who will make a choice from the list of providers that is out there. For those people who want explanation and advice as to how the markets work because they are worried about whether they should put money into deposit or money into equities and then lifestyle then I think we are going to have to have people who can help them. Whilst the money might initially come from Government I do not think that takes away the need for people to be able to make informed decisions about the pros, cons and risks of different types of saving and different types of investment.

Q303 Mr Cousins: That is an interesting point to tease out.
Mr Fletcher: I think it adds a layer of complexity if we have different regimes and different charging structures for different parts of the products. Consumers are generally confused enough about the existing products that are round and in our experience when you put layered charges in it all get very fussy for consumers. We have to keep it simple, straightforward and easy to transact. I think one charge structure, one business regime right the way across the product is the best way to go.

Q304 Mr Cousins: I do see that, of course, does that mean to say that you would be happy to see a product into which somebody or a whole set of somebody is putting £1,200 pounds a year to be sold across the checkout as Huggies without any advice on a tick box basis, without advice?
Mr Fletcher: I think it depends on the person who is buying it. There are some consumers who currently buy on an execution-only basis because they are financially astute enough to understand what they are buying. I think there is a whole host of consumers that are in a position where they can be given a pack that explains plains the basic information, background information and points them in the direction as to whether they need to go for further information and are then capable of making an informed choice. There is another section of consumers who will not do anything unless they have an opportunity to sit down and talk to people and get some reassurance round the decisions they are dealing with. It is very difficult to pick on individual examples and say, is that the right way to distribute these products?

Q305 Mr Cousins: We do know that the Government are very keen that people should buy equity-based products and should invest in equity-based products which, as we heard earlier, inescapably raise the element of risk. We heard this afternoon balancing that against your desire to sell products on the basis of minimum advice, how do we resolve that contradiction? How do we make sure that people who are walking into this without a lot of sophistication and a lot of knowledge?
Mr Mullen: We will have considerable guidance on that once we have come to an agreement with Government on the Sandler product. Once that debate has run its course and we have come to an agreement with Government then we can look to how we might deal with Child Trust Funds.

Q306 Mr Cousins: Do you visualise the industry compensation schemes dealing with Child Trust Fund set ups that go belly up?
Mr Mullen: If it is within the banking regime that would be the case.

Q307 Mr Cousins: What about the ABI?
Ms Segars: The Government made clear that the schemes and the providers will fall under the FSCS.

Q308 Mr Cousins: Do you not see a bit of contradiction between the two?
Ms Segars: I am slightly worried about the portrayal that is happening here. We do not want to play fast and loose with people's money and that of the new savers that Rob has outlined to us. We do want to make sure that people can get advice where they need and want advice and the information pack that the Government is preparing will be a key element of that. The Government talked about that being part

of an ante-natal education process as well. What we are not wanting to do is just leave consumers without any information.

Q309 Mr Cousins: The crucial thing is this, some people may choose to have a lot of advice and some people may choose to have none but will the cost of that advice be contained within the product or will it be an externality?

Mr White: We are in danger of mixing up two things here. The two things we are in danger of mixing up is the comparison of the current sales process, the full advice process, with what is being termed the simplified sales process for Sandler products and Child Trust Funds and the issue round whether money should be invested in equities or other types of things. It is absolutely crucial we have enough resource to be able to explain the pros and cons and risk to consumers, Mums and Dad's and grandparents of investing in different types of things. I do not think that the Government is on a campaign to encourage people to invest in equities, what the Government had to do is make—

Norman Lamb: It specifically said that last week, they want parents across the income range to go the equity-based products way.

Q310 Mr Cousins: It was the Inland Revenue who said that.

Mr White: It is an interesting distinction! My understanding, having worked on this over a period of years, is there was a paradox. For people who were unsure as to where to invest their money the natural inclination, particularly when markets have gone down, might be to put money on deposit. Deposits have charges, just as other products do, and also deposits, history would suggest, do not necessarily and will not always necessarily give the best returns over an 18 year period. We are talking about an 18 year period here. The Government had a paradox to consider to give the children the best potential return. Some exposure to equities is probably right but the life styling approach, which is something that we lobbied for from day one, protects the youngsters from downturns in the market. The paradox had to dealt with. I want people to make informed decisions between those two different things. I want them to understand there are charges on deposit accounts. I want them to understand that there are risks in terms of the value of your money in terms of investing in deposit accounts. I want them to have a choice of investing in deposit accounts. That is one aspect. The simplified sales regime that we are talking about is the difference between the full advice process, which will go into a complete review of your financial circumstances on absolutely everything, company pensions, how much debt you have, how much life assurance cover you have, how much critical illness cover you have and can take at least a couple of hours. Simplifying that process down to something which is risk controlled, price controlled and contribution controlled and allowing a simpler process to exist there is a halfway house in the middle which will work.

Q311 Mr Cousins: The point is this, are you happy for up to £1,200 year to be thrown tax-free into this product on top of the mandatory contribution, if we are going to call it that, without that point of sale advice regime being in place?

Mr White: I am not happy for anybody to chuck anything into anything without understanding what they are doing, that is why we want the resources to support, educate and encourage them.

Q312 Mr Cousins: Who will pay for the advice?

Mr White: We will be happy to support consumers, we will be happy to support intermediaries if we have the resources to able to do it.

Mr Fletcher: Ultimately your question about who pays for, it is ultimately the consumer who has to pay for it, it cannot be provided for free. Government cannot pay for it. We cannot pay for it. The consumer has to pay for it. The traditional way this has been done has been through product charges, that is built in through the product. The sad fact is, and I am not sure this is where you were questioning, the research that I have seen carried out about fees versus commission is that everyone says they like fees, they do not like commission but nobody is prepared to pay fees for financial advice, they prefer to go down the commission route because it is perceived to be painless. I do not think there is anything wrong with commission providing that the consumer understands it is in there and it is funding the advice that they are receiving.

Q313 Mr Cousins: What process is going on to be present when people take out products into which they could be putting £1,200 a year tax-free?

Mr Fletcher: I do not necessarily extend that to the extent everyone requires face to face financial advice I think that there are alternative means of providing the information to put the consumer in position where they can make a decision. I would hope that these products will be relatively simple and straightforward so that some form of guided self-help principle that moves away from the current definition of advice and gets us into a low costs regime which can therefore be reflected in the pricing of the products.

Mr Cousins: Thank you.

Chairman: We are going to leave it there. Thank you very much.

Wednesday 3 December 2003

Members present

Mr Michael Fallon, in the Chair

Mr Nigel Beard
Mr Jim Cousins
Angela Eagle
Norman Lamb
Mr John McFall
Mr David Ruffley

Witnesses: **Ruth Kelly,** a Member of the House, Financial Secretary, HM Treasury; **Mr Nicholas Holgate,** Director, Welfare Reform and **Mr Mostaque Ahmed,** Policy Adviser, Pensions and Savings Team, HM Treasury; and **Ms Liz Welsh,** Deputy Director, Savings Policy, Inland Revenue, examined.

Q314 Chairman: Financial Secretary, welcome to the Committee. We are particularly grateful you have come at a busy time. We too are busy because we are trying to produce this report in time for Second Reading to assist the House so you will appreciate our agenda as well. Can I start by asking you to introduce yourself and your officials?
Ruth Kelly: I am Financial Secretary to the Treasury, and I have with me Liz Welsh, Deputy Director of Savings Policy at the Inland Revenue; Nick Holgate, Director of Welfare Reform at the Treasury; and Mostaque Ahmed, who works in the Pensions and Savings team at the Treasury.

Q315 Chairman: Can we start with the objective of this particular Fund? You have said, I think, that the object is to ensure that every child will have access at the age of 18 to a stock of assets they can invest in their future. If you want people to use the funds when they mature to invest in their future, why are there no restrictions on how the funds can, in fact, be used?
Ruth Kelly: In fact, Chairman, there are multiple objectives for the Fund. One is to encourage people to build an asset up so they can think about their future in a different way; another is to encourage people to understand the benefits of saving and investment; a third is to encourage a savings habit to be developed, and the fourth is to build financial education around the product and to use it to help people make informed choices and become responsible for their own decisions, so when you look at the objectives across the piece I think you will see that the aim to encourage responsibility for people to think through choices in an informed way really ties in with allowing them a fair degree of freedom at the age of 18 to make those choices for themselves.

Q316 Chairman: Are you aware of the Home Owners' Friendly Society survey on children savings research which says, "People feel strongly that the proceeds of the Fund should be spent on a worthwhile purpose. 64% said education was by far the most desirable use for the Fund, whether higher or more vocational". Have you not listened to that?
Ruth Kelly: Absolutely. We think the funds ought to be spent on worthwhile projects. I think the question for Government is who is best placed to make those choices. Is it really up to us to decide what is in the best interests of a young adult at the age of 18, or do we think that by encouraging the savings habit, by increasing financial education and awareness, by maintaining an engagement with the financial services sector and so forth they will be in a better position to judge projects on their own merits at the age of 18. Far be it, I would say, Mr Chairman, from me to tell a young person at the age of 18 that they should not use this asset to buy, for example, a computer which they may need in order to further their educational career or for some other reason, or perhaps to invest in a van which they may need to start a small business. Those are the sorts of things that it would be quite difficult for us to capture if we were to sit down and try and design a scheme which captured, as it were, worthwhile benefits from our point of view but could clearly be of great importance to a particular young person at the age of 18. So the choice really is who makes the decision, and I think the best way of encouraging the funds to be used well is to ask young people themselves what is in their best interests.

Q317 Chairman: Now, in the Explanatory Memorandum to the Bill you say the Fund will involve significant public expenditure. Our calculation is that if you put in £235 million a year, that is £4 billion in total over the next 18 years, is that about right?
Ruth Kelly: I have not done that particular calculation over 18 years but the figures are well set out in the detailed proposals for the Child Trust Fund document, and I think the figure in 2005–06 is £235 million, and then it mounts slightly in the following two years. Clearly, the future development of those finances will depend on what the Government decides to do on further endowments, and we have already said that we intend to put more money into the Fund at the age of 7.

Q318 Chairman: But if we assume it is a minimum of around £4 billion of public expenditure—
Ruth Kelly: As I say, I have not done that particular calculation but I am sure you have so I would not doubt the accuracy of the figures.

Q319 Chairman: You are not disagreeing what 18 times 235 is?

Ruth Kelly: No.

Q320 Chairman: If one third of children are to get the £500 and the other two thirds only get £250, it follows therefore, does it not, that around half the £4 billion will be spent on the children who do not need it most?
Ruth Kelly: I think that is completely the wrong way of looking at this policy—

Q321 Chairman: First of all, is it factually right?
Ruth Kelly: If you will allow me just for a second, the idea behind this policy is one of what we call progressive universalism, which means we have a universal system in which everybody benefits no matter what their family circumstances, but children from poorer families who need it most benefit most. Now, it is a way of making sure that, as it were, everybody has a stake in the system. Now, you can argue when you point to particular figures that there will be some children who do not need the money at the age of 18, but the fact is if we are to have the universal system it would be completely wrong to try and pick out individuals who we think will not need the money and family circumstances change over the years and so forth, so we have tried to build a system which is both progressive and universal.

Q322 Chairman: I understand that, but you have decided that one third should get the higher amount as against two thirds getting the universal amount, and it follows that half your £4 billion of expenditure will then go on the two thirds of children who are in the upper income category. That is at the same time as the Mintel survey shows that two thirds of parents are already saving for their children. So what presumably you have to explain is why you are spending £2 billion on parents who are saving anyway?
Ruth Kelly: I think at the latest count 40% of all children will benefit from the higher endowment, but if you look at figures on savings of young people under the age of 25 which is the best proxy we have for 18 year olds, the British Household Panel survey suggests that the average young person has zero financial assets. Now that is across income groups. When you get to the 75th centile, the person three quarters of the way up the income distribution, their financial assets are £400, so this policy could make a very significant difference to the vast majority of young people.

Q323 Chairman: So you are not concerned that any proportion of this £4 billion of public money will go to those who are saving anyway, or having savings made for them by their parents or grandparents?
Ruth Kelly: What I am suggesting to you is there is not a tradition of people putting money away over the long term for their children. They may save on a day-to-day basis, or they may save up for a present for their child or some particular purpose, but they do not tend to save up to build a financial asset at the age of 18, and the evidence from the British Household Panel survey supports that.

Q324 Chairman: But the Home Owners' Friendly Society told us that 71% of parents and grandparents currently save. The Mintel survey says that one in three do not have any saving but two thirds do.
Ruth Kelly: I had the benefit of meeting the Home Owners' Friendly Society yesterday, in fact, and I asked this particular question about their survey evidence and they put it to me that that suggested that people were putting money away on a short term basis for particular needs for their children.

Q325 Chairman: Mr Holgate gave evidence to us a week or so ago and he described the Child Trust Fund as [part of] "a portfolio of interventions to assist those on low incomes in a variety of different ways, where we hope the whole will be greater than the sum of the parts." Apart from the hope, is there any evidence that asset-based welfare actually works?
Ruth Kelly: As I set out at the beginning, there are at least four objectives underlying this policy and I think it is fair to say this is a really ambitious policy; it is a long term project and is not one that has been tried in its current form, as I understand it, anywhere else in the world. We are at the forefront in thinking on these issues. We do have certain categories of evidence that we can point to on each particular count. To name a few sources of evidence, for example, research based on the National Child Development Study in 2001 suggested that holding assets had a positive impact on health, the labour market, and educational attainment. Now, the amount of assets needed to achieve those outcomes was very low, in the order of £300–600. Further research from the DWP suggested more work ought to be done to prove really that was the case. I became interested in this area long before becoming a minister at the Treasury because of the experience of Individual Development Accounts in the United States where I believe about 20,000 people have the opportunity to benefit from matching schemes and can see assets accumulate over a certain period, and the evidence there was that incentives were very beneficial in encouraging even poor people to put away money. We also have interim evidence from the Savings Gateway which we are piloting in five areas across the country which we will be publishing very shortly which shows that, again, people on low incomes—and there is an earnings cap of only £11,000 in those projects—save significantly and that two thirds of them intend to continue to save regularly after the end of the project, even when the match disappears. There is also evidence from a variety of surveys that have been carried out about the Child Trust Fund itself, particularly from friendly societies and others in the industry, which shows very enthusiastic support among parents for this policy, and that the majority of them think they would add further contributions to an initial Government endowment. So there is evidence from a variety of sources but, as I really want to emphasise, this is a very ambitious proposal. It brings together a number of different strands and we are at the forefront in thinking of these issues.

Q326 Chairman: Sounds like you are on your own! But the Child Poverty Action Group who deal with low income made the point that, if you really want to help children in low income families, the best thing to do is help them with more income and not in 18 years' time?
Ruth Kelly: The Child Poverty Action Group is understandably particularly interested in how we combat child poverty, and we have a clearly laid out strategy on child poverty: we are on track to meet our targets: the new tax credit I believe is probably the single biggest investment in young people and families that we have ever seen in this country. What I think and what the Government thinks is right is to complement a direct full frontal attack on child poverty with other strands of welfare policy, one of which is to build assets.

Q327 Chairman: Can we look further at your description of progressive universalism? One of the criticisms of this proposal is that, for somebody who does save in line with the Government from a middle income group or whatever, their Child Trust Fund can end up as much as £15–14,000 whereas for somebody from a lower income family, even with a greater contribution from the Government, that £500 only becomes £900 in 18 years' time, so you have this difference between £15,000 and £900. Mr Holgate told us he accepted that the Treasury had done no modelling of who will take up the opportunity to make additional contribution across the income bounds. Why is that?
Ruth Kelly: Actually we have commissioned independent research looking at the Child Trust Fund and how we should structure the stakeholder account which has been very widespread and has talked to people in the industry and has made various assumptions about what they think is likely to happen. What I would say is that clearly both extremes are possible, the ones you have put forward of someone putting in the maximum to take advantage of the tax limits and someone not putting any in and leaving the initial endowment for 18 years with a top-up at the age of 7, but we have certain evidence that suggests to us that that is not likely. The extreme case of people putting in right up to the limit is not going to happen very often, partly because there are very significant tax breaks already in the tax system that parents could use for their children. It is a fact that each child has a tax free allowance each year of I think around £4600 that very few people currently take advantage of, and they could in children's savings accounts, so quite why, if they do not take advantage of it at the moment, they would choose to take advantage of it through the Child Trust Fund, I do not know. The fact is that this policy which gives most to those who need it most could, for the first time, make a really significant difference to people who have never had any financial asset behind them at all. If you add even £5 a month which is something that most families could afford or perhaps grandparents or friends' contributions could make up, that will mean that even on the basis of just an initial endowment that would be worth almost £2,600 and £10 a month would be worth £4,400 approximately at the age of 18, so it really is giving people an opportunity to build up assets in households where they have not had that opportunity before.

Q328 Chairman: Mr Holgate told us no modelling has been done, but you are now telling us research has been commissioned?
Ruth Kelly: We have asked Deloitte & Touche, an independent consultancy, to carry out detailed quantitative and qualitative research to allow us to inform the decisions we take when designing a stakeholder Child Trust Fund product.

Q329 Chairman: When did you commission this?
Ruth Kelly: Many months ago.
Mr Holgate: What it does not enable us to do is show an array of valuations of Child Trust Funds at some point in the future, so this research informs the decisions we have to take in the near term. It has to make some assumptions, as the Financial Secretary has said, about how people behave—we do not know how they behave—and, as I said to the Sub-committee before, everything is to play for in the sense that we cannot model the efficacy of our financial education and what the financial services industry may or may not do to encourage savings.

Q330 Chairman: But to spend £4 billion without being sure who is going to make the additional contributions is rather a leap in the dark, is it not?
Ruth Kelly: As I say, this is a very ambitious, long-term project. The Deloitte & Touche research has made various assumptions on the basis of their conversations with the industry about what they think will happen but actually we hope we will be able to do even greater things on the basis of this policy than perhaps they are assuming. If our financial education programme really works, if we can really raise awareness of the policy and the merits of building up a particular asset, then people will take advantage of the opportunities provided and we will transform the opportunities of children who come from poor income families.

Q331 Angela Eagle: Rather than a leap in the dark, do you agree with me that this is actually an exciting new policy initiative?
Ruth Kelly: Absolutely.

Q332 Angela Eagle: Are you going to be looking at how perhaps we can extend this first foray into wealth support rather than just income support in some other ways?
Ruth Kelly: I think you are absolutely right. Too often welfare policy in the past has looked purely at income distribution and we have now to think also about other factors that make a real difference to young people's opportunities. Clearly we have agendas on skills, agendas on education more broadly, we think about the resources going into housing and transport and infrastructure projects, but what we have not really done systematically to

date is look at the importance of assets in changing people's opportunities and broadening their horizons.

Q333 Angela Eagle: So the Government may well be looking in the future at other innovative ways to look at wealth support rather than merely income support, and extend opportunities much more widely, especially into those areas of people on low incomes where they have not had that kind of backing?
Ruth Kelly: It is certainly a possibility. I would not like to say now what the Government is going to do in the future, and we will wait to see how this develops, but in its own terms even as the Child Trust Fund develops we may think about how to broaden its appeal and increase its potential and spread assets more widely. Indeed, we have left the regulations quite flexible so we can introduce a top-up at the age of 7: we could introduce further top-ups along the way if we thought that was desirable. Other people—academics and think tanks and so forth—have suggested we may be able to combine the Child Trust Fund with our credits for voluntary work, for example. There are proposals out there for how local authorities acting as corporate parents could use the Child Trust Fund to really make a difference to the young people they are looking after and their future prospects, so I would say we are at the beginning of a journey, but this is a really important and exciting plank in that.

Q334 Mr Ruffley: We have had lots of evidence, Financial Secretary, which no doubt you have seen already, but these proposals are not helping the people. You say you are trying to help most, ie the poorest and the most vulnerable. Let's just look at the practical effect of an endowment for a child that gets £500 at birth. After 18 years, assuming no contributions, what does that child get at the end of 18 years?
Ruth Kelly: On very cautious assumptions it is just over £900 but the exact figure is set out.

Q335 Mr Ruffley: It is about £900.
Ruth Kelly: Yes. That is purely the initial endowment, of course.

Q336 Mr Ruffley: True. Absolutely. Now, suppose you have a middle class family, for want of a better word, who take advantage of the £1,200 contribution in total each year for 18 years, and the assumptions in your document of 2.5% inflation, and making some assumptions about them getting a good equity return they put it in an equity-based product, what is the maximum you think in today's money that that pot would be worth?
Ruth Kelly: We have an illustration in the document of a lower endowment of £250 at birth and a £40 per month contribution which would build up to £14,339—

Q337 Mr Ruffley: No, I did not say that. I said £1,200 a year, every year. What is the answer? It is not fourteen grand, I can tell you that. Mr Holgate?
Mr Holgate: I am sure you have done the calculations so I am eager to find out what your conclusion is.

Q338 Mr Ruffley: Why do you not know? With respect, Financial Secretary, there is a key point we are driving at because in your typical New Labour way your Chancellor is saying, "We are helping the most vulnerable". We have had loads of evidence that at one level this could be a help to the financially sophisticated, middle class family and if friends and family kick in £1,200 a year, they are going to get a big return. The child is at 18, what do you think the figure is?
Ruth Kelly: With respect, I think I have dealt with the point—

Q339 Mr Ruffley: No, you have not. You are not giving me the answer. What is the maximum amount? It is not £14,000. What is the answer?
Ruth Kelly: With respect, there are very significant tax breaks already in the system—

Q340 Mr Ruffley: You do not know the answer.
Ruth Kelly:—that, as you term it, "middle class" parents do not use.

Q341 Mr Ruffley: You do not know the answer. The answer is it can get up to £34,000 a year. Now, that is quite a differential. £911 versus around £34,000 a year. That is quite a gap, is it not? Would you not say that is extending an equality rather than reducing it?
Ruth Kelly: I would point out that 5 years of maximum contributions into an equity ISA would total £34,000 already. We are not giving huge extra tax breaks to the so-called "middle classes" that you refer to. What we are doing is extending opportunity for people who currently do not have any financial backing behind them and making sure that they have the opportunities at the age of 18 that only a very few 18 year olds currently have.

Q342 Mr Ruffley: I just quote what the Prime Minister said when he first launched this—and you have had quite a few launches of this—which was that the Trust Fund would "provide a real financial springboard to better education, a better job, a better home, a better life"—classic New Labour gibberish. Do you really think that the difference between £911 and what a financially sophisticated family can hope to earn out of this bond is an acceptable level of inequality that you will generate?
Ruth Kelly: As I said, an additional contribution of a mere £5 a month would lead to an asset over £2,500 without any additional top-up from the Government, a sum which is significant enough to transform people's opportunities at the age of 18. Having said that, this research data from the National Child Development Study survey actually suggested that an asset of between £300 and £600 was material enough to affect future outcomes, so I

would not be so quick to write off the policy that is putting money behind people at the age of 18 for the very first time.

Q343 Mr Ruffley: Now, you are spending a quarter of a billion a year public spending—it is a quarter of a billion PR stunt this, is it not? You cannot tell us how many lower income families are going to be saving additional amounts because the research has not been done yet. How can you construct a policy without having a clear idea of the amount of extra saving for lower income families? However you want to define it, you cannot give us numbers. I find it absolutely extraordinary. Mr Holgate said the research had not even been started and now you are telling us it has. What is going on?
Ruth Kelly: What we cannot do is bring together the separate strands of this policy and say when they are put together we have evidence which suggests it will come from X to Y—

Q344 Mr Ruffley: But you have not even done the basics.
Ruth Kelly: But we do have evidence on individual strands of the policy and at the beginning of this session I pointed to the evidence we will shortly be publishing from Savings Gateway where people on very low incomes, a cap of £11,000 a year, are choosing on the whole to make the maximum £25 a month contribution most months in order to take advantage of the incentives in that system, and that has built up over 18 months. Two thirds of them, even without the Government match, say that having developed a savings habit they want to continue to make regular savings after the end of the project. This suggests to me that, when you really encourage people to develop a savings habit, they are more than happy to take advantage of that opportunity.

Q345 Mr Ruffley: What form is this research taking and why did you not do it before doing this PR stunt? Why did you not do this work beforehand?
Ruth Kelly: With respect, the Savings Gateway pilots run for 18 months and we are only now at the stage of carrying out the interim evaluation—

Q346 Mr Ruffley: No, I am talking about the piece of work that Mr Holgate did not seem to think existed, and you are telling us it has been going on for a bit.
Ruth Kelly: No. I am saying point to one of the strands that we think will make a difference to young people's lives and opportunities. We have evidence to suggest that people on lower incomes will want to save. In fact, the Chairman pointed to the Friendly Society research earlier. I think they found that 62% of people among DE socio economic groups said they would be likely to contribute to a Child Trust Fund when it came into operation, so all the evidence we have suggests that people will want to take advantage, even among the lower income groups. Now what we cannot do is say that there is an exact replica of the policy we are introducing somewhere else, that we have in economist terms a counterfactual—something we can compare it with or whatever—

Q347 Mr Ruffley: A pity you had not done this first—
Ruth Kelly:—because this is a new, innovative, ambitious policy which I believe will transform people's opportunities.

Q348 Mr Ruffley: And the basic groundwork has not been done. Finally, when is the Chancellor going to stop this fiddling with the tax system? When is he going to stop this addiction to social engineering?
Ruth Kelly: I cannot understand what you are referring to. It cannot possibly be the Child Trust Fund.

Q349 Norman Lamb: You mentioned that you commissioned some research from Deloitte & Touche.
Ruth Kelly: Yes.

Q350 Norman Lamb: Could you provide the Committee with details of the brief that you gave them so we can see clearly what the research project is?
Ruth Kelly: We can certainly give you the remit that we asked them to consider.[1]

Q351 Norman Lamb: Can you say what the timeframe is? When are you expecting them to report back?
Ruth Kelly: They have given us their initial findings already.

Q352 Norman Lamb: So could we have those as well?
Ruth Kelly: Part of the problem is that the work they have been doing ties into the research they are also carrying out for us on the general Sandler stakeholder product design which we are committed to publishing after the FSA have finished their research work on the sales regime which will attach to that. Now, clearly the sales regime will apply in a different fashion to the Child Trust Fund. It would be very likely that most people will take it up through direct offer rather than through the sales process, but I do not think it would be appropriate to publish one in the absence of the other.

Q353 Norman Lamb: But, given that we are looking at this specifically, can you give us some information on what they have reported back to you on this part of their work?
Ruth Kelly: I do not think it would be appropriate actually, and I do not think they would appreciate it if I took their comments out of context without putting a piece of research in the public domain but, clearly, we will do that when we are able to publish the full piece of research.

[1] Ev 107.

Q354 Norman Lamb: Just going on to some of the details of the proposals, there is the cut-off date of 1 September 2002, and children born before that will not benefit from the endowment. Various witnesses have said to us that they would like to see children born before that, siblings perhaps of children who will benefit, at least able to benefit from the tax free vehicle so that parents could set up a fund for the older child as well as the younger one. Now, Mr Holgate when he gave evidence to us said that effectively that had been ruled out. Is that correct? Is that your view or is it something you are still looking at?
Ruth Kelly: I will put my own angle on Mr Holgate's comments and he can certainly come back and respond on what he said earlier when I was not present, obviously. The fact is there are significant tax incentives or tax breaks already in the system for children. Parents can save on behalf of the child I think up to a maximum of £4,600 or thereabouts without incurring any tax charge, so parents who have siblings of a child who is going to get the Child Trust Fund will be able to take out a children's product on behalf of those elder siblings.

Q355 Norman Lamb: But you could provide the same vehicle, could you not, with the same extent of tax free saving for older children, if you wanted to?
Ruth Kelly: What we are not going to do is put an endowment into those vehicles. We have to have a cut-off point. But I would be surprised, if there is a demand for a read-across vehicle for older siblings, if the market did not provide an almost replica vehicle for people to take out.

Q356 Norman Lamb: But do you rule out the Government providing for the exact equivalent without the endowment but for older children?
Ruth Kelly: The Government is not providing the Child Trust Fund accounts. The industry is.

Q357 Norman Lamb: But you are providing the tax saving free vehicle, are you not? I appreciate there are other mechanisms that stand alongside that, but you could opt to provide precisely the same tax free vehicle as for the younger children. Can I just have a clear answer on that?
Ruth Kelly: We are not proposing to do that but I think it is highly likely, if demand exists, that the industry will offer a very similar product.
Mr Holgate: I also think you are overestimating the call or the need for a tax relief vehicle for that particular purpose or, indeed, any other. As we were trying to explain in response to Mr Ruffley, there will be remarkably few people bumping their heads on other ways of providing tax relief savings, either for themselves or their children—remarkably few people indeed.

Q358 Norman Lamb: But you are expecting this to change habit. You are expecting people to behave differently once this comes in so why are you assuming that current practices will be replicated once this comes in? Surely you want people to be saving using this vehicle. You are almost suggesting it will not be used.
Mr Holgate: No, I am expecting that many people will use this vehicle for the reasons I gave in my evidence session, not least because, as people have said to us in response to questionnaires and so on, if the Government puts some money into this vehicle, then there is a point in me adding to it and there will be a non negligible sum at the end of it. Even £911, for the reasons we referred to earlier with respect to the National Child Development Study, could be a very far from negligible sum, and could well be more. So we are expecting many people to use the vehicle but I doubt the need for, as it were, backwards-looking tax relief because anyone wanting to set up some money alongside a fund for a younger sibling who qualifies for the endowment is very unlikely to hit their heads on the ceiling.

Q359 Norman Lamb: Mr Holgate, when he gave evidence last time, said that the amount of tax foregone as a result of this tax free vehicle was "negligible"—that was the word he used. What assessment has been done? You must have done some analysis of the tax foregone under different scenarios. What have you come up with as a result of any such research?
Ruth Kelly: I think our assumption is that if it is less than £10 million it would not be—

Q360 Norman Lamb: But have you done the research, the analysis, to see what the tax foregone would be?
Mr Holgate: It depends on the same problem that in a sense we were talking about with Mr Ruffley. We do not know and we cannot possibly know exactly how many people are going to put in exactly how much—

Q361 Norman Lamb: So there have been no scenarios tested?
Mr Holgate: You can extrapolate—

Q362 Norman Lamb: Have you extrapolated?
Mr Holgate: You can say were it the case that so many people were going to use, for example—

Q363 Norman Lamb: Have you done that extrapolation?
Ruth Kelly: Of course we have thought through these issues because we had to make a costing assumption for the purposes of the Red Book, and we came up with a conclusion that the cost of the extra tax relief would be negligible.

Q364 Norman Lamb: But could you provide us with those extrapolations that you have done so that we can see the tax that is foregone?
Mr Holgate: Essentially the assumptions are quite arbitrary, so—

Q365 Norman Lamb: Could you share them with us?
Mr Holgate: To offer you something would be to pretend to have a degree of wisdom on this subject which nobody possesses.

Q366 Mr Cousins: You are specifically excluding the Child Trust Fund from what, after all, is a major principle of preventing tax leakage, the income tax settlements provisions?
Mr Holgate: That is right.

Q367 Mr Cousins: I think you must acknowledge that there is the potential, by not applying the income tax settlements provisions, for creating some tax leakage and for some tax advantage and, indeed, you must have intended that tax leakage and tax advantage by not applying the income tax settlements provisions.
Ruth Kelly: If the point you are making is that we expect some people to use to the full the tax incentives in the system, then there probably will be a very few people who do that, but the cost of any tax relief or tax advantage or tax leakage is negligible compared with the value of the initial Government endowment.

Q368 Mr Cousins: I think you will accept that, by not applying the income tax settlements legislation which is embedded in income tax practice right across the board, for every kind of savings provision you can make for your children a major step has been made, and it is not just an issue of the sums of money involved but also the question of equity. There is a specific provision in the Bill to exempt the income tax settlements legislation and you do have to take that on board as being a significant step.
Ruth Kelly: We decided to give the Child Trust Fund accounts the same tax treatment as an ISA account more or less, and by implication we are doing something very radical that has not been done before on behalf of children.
Mr Holgate: It may be worth offering a bit more arithmetic on this point. If somebody puts £1,200 into a Child Trust Fund when they have completely exhausted all other means of finding tax relieved savings either for themselves or their children, so we are already assuming £2.5-3,000 has been handed over to the child that year in order to trigger the settlements legislation, assume for the sake of argument it earns a 7% return as we show in the table 3.1 illustrative projections, that is £84 that the child has earned in the Child Trust Fund. Assuming that the parents are 40% taxpayers, as I think they very probably would be if we have got this far, they have avoided quite legitimately £33.60 of tax. So the question, as it were, the judgment underpinning my advice that the cost was negligible is how many lots of £33.60 are we likely to incur year by year, and this is cumulative so it will certainly, undoubtedly get bigger over time. But if a family ruthlessly pursues this line of minimising its tax liabilities, as the Financial Secretary said compared to an ISA allowance of £7,000 a year falling to £5,000 shortly, given its pension tax relief which has far bigger sums and if the Government were to legislate along the lines it has advised you could put up to £200,000 into a tax relief pension vehicle every year or the limit of your salary, so there are many other much bigger players in this forest, but were a household ruthlessly to pursue the tax-relieving possibilities of the Child Trust Fund then it would level off at about £600 by the age of 18, and I have to say that is very small indeed compared with all the other alternatives open to those households. Not many households do bump their heads on the ceilings of the other tax relief vehicles that the Government offers, and there are very few households indeed that will be able to do all this. That is why we think that, as it were, the risk of an extra cost in this side is very small.

Q369 Mr Cousins: Given the availability of these other devices which you have correctly pointed to, like stakeholder pensions for children and so on, surely not applying the income tax settlements legislation and creating this issue of equity—and it is the question of equity more than the sums of money that I am concerned about—you may have slightly damaged the presentation of the scheme?
Ruth Kelly: I do not think the scheme is damaged presentationally by the fact that the tax settlements legislation has been disapplied—in fact, in some respects it has been made presentationally more advantaged. The point you make is should we not look at this perhaps in different areas if we have looked at it here. That is something I will certainly take away, Mr Cousins, to think about more generally in the context of where the income tax settlements legislation should apply and where it does not, but the fact of the matter is, in the context of the Child Trust Fund, a decision was taken partly for the point of simplicity that in this particular vehicle it was appropriate to disapply the income tax settlements legislation.

Q370 Norman Lamb: Finally from me at this stage, on the age-related contribution which would come in at age 7, the industry has suggested that it should be a contribution of at least £250 and that, if it was smaller than that, it probably would not be worth the hassle of having a separate payment and it would be best to put it upfront. What is your view on this? What is your range that you are looking at for the age-related contribution at age 7?
Ruth Kelly: It comes back to the point about what are the objectives behind the scheme. One of the objectives is for a young person to see an asset develop and to be able to have access to that asset at the age of 18, but another objective of the scheme is to encourage people to see the benefit of saving, to see what difference having something added to their account means and to build financial education and awareness around the particular endowments. Firms have suggested to me, for example, that they would use a top-up of any size to promote the virtues of the savings habit to the people who hold a Child Trust Fund account with them. As far as I am aware, the various surveys we have from the industry suggest that when you ask parents the largest group of parents who come back with an answer say that they like the idea of there being additional top-ups

rather than there being a one-off lump sum at the beginning, and that the account may not be reactivated, as it were, by the Government for 18 years. So there are many policy reasons behind the decision of giving an additional top-up at the age of 7.

Q371 Norman Lamb: What is the range of figures you are looking at?
Ruth Kelly: We have not discussed the size of the endowment at 7. It would be a decision for the Budget in the year before.

Q372 Norman Lamb: You have not discussed it at all? You do not have any range of figures in mind?
Ruth Kelly: We have left the regulations for the Child Trust Fund as open as possible to give us the maximum amount of freedom over the development of this policy over the next 18 years and beyond. When the time comes we will make a decision about what that endowment should be. It could be that we come back and we say there should be a further endowment to those children further along the line, but it would not have been appropriate to try now to say what we would like that endowment to be at the age of 7.

Q373 Norman Lamb: So you have in mind the possibility of another one at the age of 12, 13 or something?
Ruth Kelly: No. We are committed to one top-up at the age of 7 but there is the flexibility for us to try and develop this policy in the future if we think it is appropriate.

Q374 Norman Lamb: For a further top-up?
Ruth Kelly: The flexibility is there in the regulations.

Q375 Mr Cousins: Can I ask you why you did not make some provision for a drawdown facility under specified circumstances for the contributions that low income families might make to top up the base contribution?
Ruth Kelly: When we initially consulted on this and we had a range of options that we put to people including the financial services industry, one of the strongest comments I got back from the financial services industry is they would like the scheme to be as simple as possible. Simplicity was absolutely paramount firstly to the costs of administering the scheme and also to explaining the scheme to people. It is also the fact that there is a pool of people out there which thinks that the fact that the assets are tied up until the age of 18 is good and that they would be more likely to contribute to a fund because they know that those funds cannot be drawn down, either by the children themselves or, indeed, if it is relatives and friends, by the parents. So we took all of those factors into consideration and made the decision that the Fund should be locked up.

Q376 Mr Cousins: I can see why the providers of the Child Trust Funds would prefer not to have a drawdown facility—that is a very unsurprising result of the consultation—but I think we can both see that there would be circumstances where low income families faced with a radical change in circumstances, faced with maybe accumulations of debt or the need to make certain crucial investments or to move house from one end of the country to the other as part of the Government's flexible labour markets—
Ruth Kelly: I can understand your point with relation to an individual's own contribution to the scheme, but the Government endowment is provided for a purpose.

Q377 Mr Cousins: My question was about the individual's own contributions, and not the base contribution.
Ruth Kelly: Effectively you would have to operate two parallel schemes for an individual, one which had the Government endowment and one which had the individual's own contributions that a person would then have access to an apply to a financial services provider to be able to release, and this is something we considered. For the purposes of simplicity, however, we decided that it would be much easier to administer a scheme with those contributions tied up as well as the other factors that are taken into account. It is also the case that evidence from the United States, for instance, on the operation of 401K accounts in their pension system suggests that when people do have access to funds they do tend to draw those funds down, and one of the primary purposes behind this policy is to encourage the building up of a savings habit to enable lower income people to benefit from a significant asset at the age of 18. So there are other vehicles in which they can save for a rainy day or when something goes wrong—vehicles such as ISAs which provide immediate access to liquid savings. But the Child Trust Fund has a different purpose, a different policy priority, and it was not judged appropriate that the same considerations should apply.

Q378 Mr Cousins: On other occasions I think I pointed out to you that I think the drawdown facility is a strength of the 401K, but that is another argument for another occasion! In this particular respect, have you completely closed your mind? Is there provision in the Bill to create a drawdown facility at a later date?
Ruth Kelly: You would have to have a fundamentally different product to accommodate it within the regulations. It is not the product on which we have consulted with the financial services industry.

Q379 Norman Lamb: I have one or two questions on the final values. You give your illustrative example of the £500 for a low income family with a nominal rate of return of 7% and inflation of 2.5%, ending up at £911. As I understand it, that is based on it being invested in an equity-based product. What is the final figure if it is invested in a typical cash product?
Ruth Kelly: Before coming here I did look at the typical returns on £100—not on the particular value you are asking—over the last 18 years of a sum of

money invested in the stock market and a sum of money placed in a building society account, and over the last 18 years, from 1984 onwards, £100 invested in the stock market would have yielded £321, whereas the same sum of money invested in a building society account would have yielded £171 so there is a very significant difference.

Q380 Norman Lamb: But the chances are again, unless we can change habits as a result of this, that low income households may well opt for the safer savings cash route rather than going for equities. Would you share that assumption that that is quite likely? That people would not want to necessarily gamble with that money?
Ruth Kelly: I would not share that assumption, and I think it an undesirable consequence if that is what turns out to be the case.

Q381 Norman Lamb: You are very keen to promote the equity product?
Ruth Kelly: Absolutely, because people tend to do better with equities than when they place their money in cash, which is one of the reasons why we have designed the stakeholder product as an equity-based account which will come with a very strong brand, and we are asking that everyone who offers the Child Trust Fund account offers the stakeholder product as part of their range.

Q382 Norman Lamb: But there may still be plenty of people who do go for the safer cash option and, if they do, then the figure they end up with starting at £500 is significantly lower than the £911?
Ruth Kelly: We will certainly be promoting the stakeholder product. We will be encouraging people to put their money into stakeholder accounts, illustrating in the information and advice pack that will go to parents after the time when a child is born the merits of investing in an equity account compared with putting the money in in cash.

Q383 Norman Lamb: You gave an illustration earlier of a family paying in £5 a month and ending up with £2,600 or something like that. That is based on an equity product again, is it?
Ruth Kelly: That is right. In fact, to add to that, we are commissioning research about the best way to communicate these sorts of quite difficult concepts to people who have little experience of engaging with the financial services industry, so we can put the best information pack together that we possibly can to send out to people when they first receive the voucher for the Child Trust Fund.

Q384 Norman Lamb: Given the amount you end up with largely depends on the additional contributions that parents put in, are you not concerned that the information pack and the publicity from providers could create unrealistic expectations about what they are going to end up with when their child is at the age of 18?
Ruth Kelly: Even £911 is a significant increase on the current situation where the average young person has no financial assets whatever. I think it is enough to change their prospects. What we will be trying to do is make them more aware of how a modest contribution can increase that sum, but this is a real challenge for us as a Government. How do we improve financial awareness? How do we make people understand the merits of an investment and savings habit, and we will be working very closely, not just within the Treasury but also with the DfES and the FSA, trying to think through a financial strategy which will really help people to negotiate what are quite difficult areas. In fact, the FSA has recently set up a financial capability steering group, of which I am a member, thinking at quite a high level about how we improve financial awareness and education, and one of the things that I very much hope that it does consider—and I will be arguing for it—is how we can make the most of the Child Trust Fund.

Q385 Norman Lamb: But are you concerned that you might end up in a situation where you put undue pressure on parents to save through this route? There may well be some low income families where it might not be good advice for them to be putting money in a fund that is locked up, taking Jim Cousins' point, until the age of 18. As I understand it, evidence suggests that one of the biggest incentives for low income families to save is that you have money available for a rainy day. Well, it will not be available for a rainy day in this particular savings vehicle; it will be tied up until the age of 18.
Ruth Kelly: They are not mutually exclusive but one of the things we will be pointing out in the information pack is what we call a hierarchy of savings objectives; that it is most important, first of all, to pay off a debt. That is it is then most important to try and save a small pool of assets for a rainy day, and that long-term savings for a pension or in the Child Trust Fund are, as it were, slightly further down that hierarchy. But the best way of communicating is, as I say, what are quite complex decisions and we will be commissioning research into how to do that most appropriately.

Q386 Mr Ruffley: Can we go back to this concept of increasing the savings habit and how you are going to measure whether or not you have been successful in delivering this objective? Are you going to publish this research that we have talked about earlier on numbers of lower income families that are likely to benefit, and what kind of increased amount of saving they are going to be making?
Ruth Kelly: All lower income families will benefit from the policy; that is part of the idea that it is universal—

Q387 Mr Ruffley: Yes, but the number of families that will be saving what extra amounts. Presumably that is part of the research?
Ruth Kelly: It is one of the objectives we have in the policy. A priority after the passage of the Bill as we develop the policy will be to develop indicators of success so that we can evaluate the policy as it progresses. Partly it will be the assets at the age of 18 which back children across the income distribution;

partly it will be the level and regularity of additional contributions; partly it will be whether people feel they have been properly informed about the Child Trust Fund in the decisions they have made.

Q388 Mr Ruffley: But are you going to make any of this interesting work available, and when are you going to make it available? I understand it is on-going—you have made that quite clear in your last answer—but are we going to get a snapshot of the kind of variables you are looking at and the kind of targets you might be setting going forward?
Ruth Kelly: At the moment we are working on a detailed evaluation plan, some of these factors will be impossible to assess, some of them, until 15 years from now, and we will be in a position to assess others on a much shorter timetable. I clearly take your point that if we are ready to put this into the public domain at what stage do we do that. At the moment we are just building up the evaluation.

Q389 Mr Ruffley: When do you expect to give us something publicly on this no doubt valuable research work?
Ruth Kelly: We will obviously have to make that decision when we have looked and developed the evaluation fully.

Q390 Mr Ruffley: I am not trying to trick you, Minister, I am just trying to understand how you measure the success. You make a perfectly fair point that ultimately this will have to be up and running for a bit. Clearly you will have some policy work done in advance as to what you think might happen, what the different scenarios are. I am really trying to understand when you are going to publish this work, or some of it, and you are being a bit reticent.
Ruth Kelly: Clearly you would expect information to be published on a regular basis about the level of take-up of the Child Trust Fund, about the additional contributions being made to it and in due course the income distribution across which those contributions are viewed.

Q391 Mr Ruffley: My final question, you like measuring things as a Government, PSAs, SDAs and all manner of targets, and you have your own reasons for doing that, are you going to have any similar targets for this policy? Are you going to publish in any of your departmental reports or any of the Prime Minister's documents about improving public services and improving the tax system, are you going to set any quantifiable targets?
Ruth Kelly: We do not have any plans to set targets at the moment but of course we will continually bear that in mind.

Q392 Mr Ruffley: You are not committed to the principle of targets? Your policy is increasing savings, are you saying you are not measuring it, you do not intend to measure it with quantifiable targets?
Mr Holgate: I think actually—

Q393 Mr Ruffley: I would like the Minister to answer, she is scowling.
Ruth Kelly: We are trying to encourage a behavioural change. We are trying to make people think differently about themselves and their future.

Q394 Mr Ruffley: You can measure that, can you not?
Ruth Kelly: It is almost impossible to measure how confident people feel, whether their horizons have been—

Q395 Mr Ruffley: You can measure whether or not they are making extra savings, of course you can measure it.
Ruth Kelly: Fundamentally the beneficiaries we are talking about are children, most of whom have not yet been born.

Q396 Mr Ruffley: You are going off on a tangent here. Your objective, which is perfectly well set out, is to increase the amount of saving. Okay?
Ruth Kelly: No, that is not right.

Q397 Mr Ruffley: It is not?
Ruth Kelly: No. As I explained at the beginning of the session there are a number of objectives.

Q398 Mr Ruffley: It is an objective.
Ruth Kelly: If you look at the vision behind the objective, the vision is to make young people think differently about themselves so at the age of 18 they are able to take advantage of opportunities which they currently do not have.

Q399 Mr Ruffley: You want families to make contributions.
Ruth Kelly: Including the children themselves

Q400 Mr Ruffley: Okay, we are getting there. You want people to save more, not the vision, people looking at savings—
Ruth Kelly: I am sorry that you are not interested in the vision because this is about fundamentally changing the way that people think about themselves.

Q401 Mr Ruffley: The question is, have you set any targets that you can quantify for the amount of extra saving low income households will be executing?
Ruth Kelly: It is a very different thing, what we do not want to do is distort saving priorities that are currently there. In answer to the previous question there are a number of objectives and a number of reasons why people should be saving, first of all to pay off debt; secondly to build up funds for a rainy day and thirdly for the long term. I think it would be wrong of us at the expense of others to say somehow we think people ought to be putting a set level of savings into the Child Trust Fund which is then locked away for 18 years for the benefit of somebody who is not themselves but their children. Clearly people may want to do that for a variety of reasons, the children themselves may want to put money aside, their friends, their godparents, their

grandparents may want to put money aside for a child's future, but that is not the sort of thing that we as the Government should be setting a target for.
Mr Holgate: It is an opportunity that is being offered, and very extensively for many, many households. It is an open-ended opportunity and I do not think that is the sort of thing for which a target is appropriate. Actually targets are more appropriate where there is a very clear need. There are needs here but they are not as clear, they are for people to make their own minds up about the balance between current consumption and investing for the future. It seems to me to be odd to try and set a target for something which is essentially an open-ended opportunity.

Q402 Norman Lamb: You want to encourage low income households to save for their children, that is one of your objectives, surely you ought to be planning to monitor whether it is happening?
Mr Holgate: We would be monitoring it but there is a world of difference between that and setting some benchmark where people may have reached very sensible decisions household by household as to what it is that they can put money into. If they have heeded the advice and paid off debt as opposed to putting money into a Child Trust Fund that would be a great success.

Q403 Norman Lamb: If low income families do not save through this vehicle you will regard it as a failure, will you not? What is the point of it?
Ruth Kelly: No, I have already made the point that it does not take a very substantial size of asset to make quite a big difference to people's opportunities and outcomes. It is one aspect of the policy, encouraging a savings habit, but by no means is it the only one.

Q404 Angela Eagle: It appears, and I do not know, I am the only one that is enormously enthusiastic about this very innovative approach to welfare support. Could I encourage you, Minister, to persist with it. I think it has very interesting and wide-ranging potential which I would like to see the Government explore further. Would you say something about simplicity? Clearly it is important to try to create a low cost saving opportunity which does not see quite low levels of assets, albeit well above what people save now, taken away in charges? There have been some predictable squeals from the financial service industry about the potential of 1% cap, what are your views on that?
Ruth Kelly: We have to have a charge which reflects the economics of the distribution of the product. During the passage of the Bill we will make it clear what that charge will be so Parliament will have time to debate it. It has to be set at a level which will allow competition to develop in the market but which also gives good value for money to the consumer, unlike other stakeholder products it is much less dependent on the type of sales regime that is on offer.

Q405 Angela Eagle: Effectively the Government will be sending a voucher to everybody, this is not going to have to be sold in the usual way. I would have thought, do you agree with me, Minister, this actually makes it easier to have a lower charge?
Ruth Kelly: Certainly removing the need for everyone to go through a sales process makes it much more economic to provide the product. Unlike other stakeholder products there are much lower levels of contributions and less regular contributions into the fund, which makes it less economic. There are forces pushing in both directions.

Q406 Angela Eagle: Could I also encourage you to facedown any of the lobbying you might be getting from the financial services industry. I think it would be very difficult or almost impossible for me to believe they would not provide products when they would be put in touch with the next generation of users of financial services, when we know that people who establish bank accounts when they are at school tend not to change them very often and they can gain customers for life. Could I ask you to take with a pinch of salt some of lobbying you are no doubt getting now about how these prices and charges have to be more than 1%.
Ruth Kelly: I take all lobbying with a pinch of salt and a healthy scepticism. What I did say is that we have commissioned independent research to look at the level of the charge cap. Deloitte and Touche have done a really thorough piece of research which has involved talking directly to potential providers of the fund about their contribution mechanisms, about the capital strain or the amount of capital they need to put behind these products when introducing them, and so forth, and we will make a judgment in due course on the basis of the evidence.

Q407 Angela Eagle: Can I also ask you about interaction with the benefit system, which is an issue that needs to be sorted out prior to the fund being set up, there are only two areas where this might happen, when a fund matures at 18 but also, and sadly, the death of a child. We did discuss this with Mr Holgate when he gave evidence to us at an earlier hearing. My own experience of the Treasury as a minister is that they do not like exempting means testing for benefit purposes. I would suggest that if there is not some disregard on this occasion on Job Seekers Allowance or Income Support it rather defeats the object of the whole policy. I wonder if you might want to enlighten us as to the Treasury's view on disregards to the benefit system.
Ruth Kelly: There are already some disregards in the system, even for means tested benefits, Job Seekers Allowance and Income Support, and so forth. We are acutely aware of the signals that any capital limits have in the system. The points that were made earlier were ones that we had already been thinking about. I do not think it would be appropriate for me outside the ordinary PBR Budget timetable to make any further comment.

Q408 Angela Eagle: Could I finally ask about ethical and fair trading and whether there can be good labelling of products in order to enable people to choose either unethical or a fair trade based fund for their child rather than suddenly finding out to their horror they have been investing in British and America tobacco.
Ruth Kelly: Absolutely. I am sure there will be firms out there who market their funds on the basis of the fact that they need certain ethical criteria and I am sure there will be parents that want to choose their fund on that basis. We are actively considering whether funds should be forced to make a statement as to what their policy is so that parents are fully informed when they come to make that decision. That is one of the announcements that we will be making as the Bill progresses through Parliament.
Angela Eagle: Can I encourage you to take that extremely seriously indeed because I would certainly like to see that in the legislation.

Q409 Mr Cousins: Can I come back to what you have just said about the interaction with benefits and try and put the best possible spin on what you have told the Committee, are you saying, Minister, that in the Pre Budget Report there will be a clear statement about the interaction of the Child Trust Fund with the benefit system?
Ruth Kelly: Far be it from me to take decisions which are rightly the Chancellor's, what I am saying is we are very aware of the fact we need to send appropriate signals to people who are putting assets in a Child Trust Fund and it is one of the issues that we are looking at. We are very aware of the interaction but normally we would consider issues of that type in the PBR or Budget.

Q410 Mr Cousins: Can I go very quickly through some of the range of possible interactions, one is about the capital in the fund, the next is the income that that capital will generate and the third is the status of the fund and how it will affect people's benefit situation when the fund matures. Are you telling us that you are thinking about all three aspects?
Ruth Kelly: Some of them have already been decided. It has already been announced that capital in the fund will not count for the purpose of family benefit entitlement while that fund is in operation and before it matures. You have already made the point about the income tax settlements legislation, and there has been an announcement on that. You are also interested in the status of the fund at maturity and how that interacts with JSA.

Q411 Mr Cousins: If I can stop you there, Minister. Yes, there are income tax settlements, but here we are talking about income within the fund, will that income within the fund be treated as income in the assessment of family benefits?
Ruth Kelly: No, tax relief will apply but there will be no impact on the family tax credits and family benefits that a family receives while that capital is accumulating within the fund. There is a separate issue as to what happens on maturity.

Q412 Chairman: Before you leave the point on maturity, have you yet come to a decision as to what happens when you are 18 as a student and there are various benefits you might not be eligible for?
Ruth Kelly: I am saying it would not be appropriate for me to make any announcements on those issues to this Committee. Those are issues which we are currently very well aware of and it is not appropriate for me to, as it were, go further than that outside the usual PBR Budget round.

Q413 Chairman: We will be clear about them before the fund starts?
Ruth Kelly: Absolutely.

Q414 Mr Cousins: The other point that concerns me is contributions to the fund from people who themselves are in the benefit system, will they be regarded as being appropriate uses of capital or will they be regarded as an unacceptable use of capital?
Ruth Kelly: I think you must be referring to pension credit rules.

Q415 Mr Cousins: It is not just a feature of the pension credit rules but that is a good example.
Ruth Kelly: For example the pension credit rules it is the case, I believe, that fewer than 15% of pension credit recipients have capital in excess of £6,000, which is the current capital limit in the pension credit system, if they were to give money to a Child Trust Fund this could potentially apply to a minority of recipients of the pension credit. Having said that, a small contribution to a Child Trust Fund would be looked at by the Department of Work and Pensions, they have a policy which is a humane one, a reasonable one.
Mr Holgate: There is case law and past experience, as you imply, where people may appear to be depriving themselves of capital in order to increase entitlement to Social Security benefit. Inevitably, if uncomfortably, there has to be some discretion for the Department for Work and Pensions to ask itself and ask the claimant whether the deprivation of capital has been in order to increase the entitlement to that benefit or not. That is the test they seek to apply. I think they have also indicated with respect to pension credit in particular that if a pensioner is trying to repay debt or trying to replace a capital good then these are perfectly acceptable reasons for someone to drawdown their savings. I am afraid essentially I think the answer is that the DWP has to decide whether there has been an intent on behalf of the person giving the money to deprive him or herself of the capital with a view to increasing their benefit, their pension credit entitlement.

Q416 Mr Cousins: Within pension credit the gift of money to a relative is not regarded as being an acceptable use of capital, it is regarded as being deprivation of capital.
Mr Holgate: That is the risk that person is running.

Q417 Mr Cousins: Will a gift to the Child Trust Fund be treated as if was a gift to a relative, which plainly it might be, and caught by those regulations?
Ruth Kelly: In the end it is a matter of judgment to decide whether the intention was to increase entitlement to a particular Social Security benefit or credit. There is an element of discretion there. The fact of the matter is that it is very unlikely that a modest contribution to the Child Trust Fund would fall into that category.

Q418 Chairman: Minister, you referred at some point to your feedback from providers, that they wanted this whole thing kept as simple as possible. One of those providers, the Children's Mutual, has criticised the proposal for using paper vouchers and say, "in an electronic age surely a new product should embrace new technological advance". Have you made any progress on that?
Ruth Kelly: I do not think that it is a question of making progress. One of the objectives of this whole project is to increase financial awareness among parents, some of whom have not been exposed to the financial services industry in any meaningful way before. One of the means of highlighting the fact that they are entitled to an initial endowment and future endowment is the mere fact of receiving a voucher for a concrete sum of money from the Government, I think it will encourage people to use that voucher much more quickly than they otherwise would and to think about the options available to them. I think the voucher is justified in its own terms. It will also be available when combating fraud and so forth. The voucher in itself is desirable.

Q419 Chairman: There still has to be a paper element: you do not think that will discourage people from operating these things over the internet or the telephone?
Ruth Kelly: They could but they would have to send the voucher into the financial services provider after that had been done.

Q420 Mr Beard: In the document on the Child Trust Fund it says, "the choice of product will be key to determine the rate of return on the fund. The Government wants all funders to benefit from the potential high returns that might be achieved through equity investment". Equities have gone through a rather turbulent time, some people have lost out substantially on them and if somebody put money into equities 10 years ago they might have made substantial loses by now. How are you covered against that when you are making that sort of recommendation?
Ruth Kelly: If somebody invested in equity 18 years ago they would have had a real return of I think 6.6%, that is despite the fact that equity markets have fallen in recent years. If you look at the period from 1918 to 2002 the mean return has been exactly that, 6.9%. Over a period of 18 years it is reasonable to expect a healthy return in the equity market. Obviously there are years when it will not achieve that amount but over the period from 1936 to 2002 there has been no 18-year period in which the [cumulative] return has been negative.

Q421 Mr Beard: Cash or bonds could be alternatives to this.
Ruth Kelly: We have also decided to incorporate into the stakeholder product design a requirement to lifestyle, which is a method of controlling for risk for the individual person over the 18 year span, which would mean that you would move progressively from equities in the early years towards something much freer of risk in the later years of the account, so from equities into cash or bonds as the child approaches the age of 18 which should stabilise returns in those final years.

Q422 Mr Beard: How will they get that advice?
Ruth Kelly: That is a requirement on the provider to lifestyle on behalf of their client in the stakeholder product.

Q423 Mr Beard: Minister, referring to the provider, we have had some of the providers here before us and they were obviously very concerned about the possibility of a charge cap being applied. The essential complaint was that they would not be able to sell these at a 1% charge regime.
Ruth Kelly: The decision on the charge cap has not been made and it will be based on the evidence from the independent research we have commissioned which will look at the economics of the industry and how viable it is for them to provide the funds.

Q424 Mr Beard: The point they were making to us was it was not a thing that really stood just on its own, there was the charge, the 1% or whatever, there was the extent to which Government itself might promote these, which would relieve them of some of the advertising expenditure, and there was the possibility of standardising the product to a certain extent so it did not require so much sales. That also interacted with the minimum payment that was to the made, the smaller the payment the more administration they have to do. Are all of those factors going to be taken into account in dealing with the industry in trying to settle this issue?
Ruth Kelly: They are all being taken into account, most of them through the independent research that has been commissioned, some of them, for instance the amount of Government advertising, are not appropriate for independent consultants to go out and research. It will be a factor in our own decision-making. We will make the decision on the charge cap on the basis of the evidence.

Q425 Mr Beard: When will these decisions be made?
Ruth Kelly: During the passage of the Bill so that Parliament has an appropriate time to debate the charge cap.

Q426 Mr Beard: The explanatory notes to the Bill state that the potential benefit to the savings and investment industry from the Bill include cross-selling opportunities to parents and relatives and the opportunity to gain life-long customers. Do you see any need to regulate the extent to which this sort of information on children is used for other purposes?
Ruth Kelly: We are not proposing to restrict the use of the information by individual providers and, as it were, banning cross selling. It is quite possible to argue, as indeed we have, that it is good to engage people with the financial services industry even if people have not had much contact with the industry before. This is an opportunity to increase financial awareness and to get people follow to think through about their financial needs.

Q427 Mr Beard: The other issue that was raised with the industry was this question of the provision of the Child Trust Fund through the Inland Revenue where the parents or guardians had not provided it themselves. The industry told us that their decision on whether or not to provide that Revenue allocated account will depend on the price cap and the cost of administrations. Several people said that both the stakeholder element of it and that issue would exclude them from the scheme, how confident are you that there will be sufficient providers?
Ruth Kelly: It is not the case that providers will be forced to provide the Revenue allocated account, that is the first point to make clear. We will be looking for volunteers to administer Revenue allocated accounts. I have already had one firm come to me saying they would be enthusiastic about providing the Revenue allocated account even with the charge cap set on basis that you have suggested, clearly we hope that other firms will come forward.

Q428 Mr Beard: The firms could cherry pick those accounts because they will take the ones where there is most likelihood of parents and grandparents paying in, and these Revenue accounts might have the least likelihood of that and they are less likely to get business out of it. You do not see any possibility you will have difficulty right across the board persuading companies to take those on.
Ruth Kelly: There are certainly companies who think it is worth their while taking on Revenue allocated accounts.

Q429 Mr Cousins: So far as the Revenue allocated accounts are concerned I can well understand that there will be providers who will be interested in, so to speak, buying the bulk and accepting the accounts. My concern is really about the Revenue allocating the money to that particular provider or set of providers, are you sure that you can protect yourself against future allegations of mis-selling?
Ruth Kelly: We do not think there is a market relationship between the Revenue and the individual who is being allocated the account in the traditional sense at all so we do not think any such allegations could be followed through. Partly it is the fact that we are not proposing this to people. In fact our first preference is for them to make a choice of provider. They will in every sense be better off than they were initially having been allocated the account. As you know we are proposing to allocate them on a basis of rotation between our providers and at any point the individual family can choose to switch providers to one more to their preference.

Q430 Mr Cousins: Can I pursue that point a bit further, in a way this seems a pernickety point but since it is provided specifically for the Bill it is legitimate to ask about it, there is a specific category of person for whom all accounts are going to allocated, that is parents who are under the age of 18 themselves. The Bill provides that for parents under the age of 18 in England and Wales the Revenue will allocate all of the accounts. There is one category of person for whom the Revenue is allocating all of the accounts. Are you sure you can protect yourself against any suggestion of mis-selling for that category of person?
Ruth Kelly: The fact remains that as soon as they reach the age of 18 they can switch to a different provider, there is still not that fundamental relationship that one would expect if there were to be accusations of mis-selling. As far as I understand it the Revenue could be accused but those accusations could not be stacked up.

Q431 Chairman: Could we just be clear about this, in the document you say that some parents guardians will not open a CTF account, which is why you are going to allocate; they might choose not to open one because they disagree with it and fundamentally do not want to participate in the scheme. You are then taking the responsibility of saying you must participate in the scheme and we will allocate "your account". Presumably the Revenue does have the responsibility in market terms?
Ruth Kelly: People can opt out of the system through by not claiming Child Benefit.

Q432 Chairman: The fact they can switch at 18 does not quite get you off the hook, does it?
Ruth Kelly: If they are a parent when they reach the age of 18.
Ms Welsh: The proposal document explains that there are difficulties with young people under 18 being able to contract to hold equities, so the law allows that person to take investment choices at 18, or 16 in Scotland. The proposal is that they will be able to exercise their choice as soon as they hit that age, as provided for in general law.

Q433 Mr Cousins: To follow that for one moment, for this particular category of person if they wanted to open up a cash version of this they would able to do that under the age of 18, would they?
Ms Welsh: At the moment we are looking at the situation where there is no ability to exercise choice under 18 because the Revenue will set up a stakeholder account for those underage parents. They will be able to let us know that there is no one with parental responsibility who is of the age of 18

so that we can set that account up for them quickly, and we will do that on an exceptional basis. The stakeholder account will be set up for them.

Q434 Mr Cousins: Let us be very clear about this, I want to be completely clear about it in my own mind, the Revenue allocated accounts will all be equity-based accounts, will they?
Ms Welsh: They will be the stakeholder account.

Q435 Mr Cousins: The Revenue will be making a choice on behalf of all of people for whom it allocates accounts not to use the cash option. The Revenue will be making a deliberate choice on behalf of people.
Ms Welsh: The Revenue will not be making a choice, it will be under obligation according to the legislation to open up a tightly specified account, which is the stakeholder account, that is what it is required to do under the legislation. It is not a question that the Revenue is making a choice.

Q436 Mr Cousins: Hang on, I do want to get this clear in my own mind. Incidentally when we refer to the legislation it is proper to recognise that it is not legislation of, it is only a proposal which has yet to come before Parliament and on which Parliament will exercise its own judgment.
Ms Welsh: Absolutely.

Q437 Mr Cousins: So far as those proposals that you are putting before Parliament are concerned do I understand that to mean that the accounts that the Revenue allocates will all be faced with equity versions of the Child Trust Fund and not with cash versions?
Ms Welsh: Yes.

Q438 Mr Cousins: Even though cash versions will be available?
Ms Welsh: Yes.
Ruth Kelly: The proposal is that the stakeholder product should be an equity based account.

Q439 Mr Cousins: I think that is something that you ought to think about very, very carefully. I would assume that you have taken legal advice that by making a deliberate category choice between the sort of funds that are available that you are going to place this money into equity based accounts and not into cash accounts, that that deliberate category choice is not something that will expose you to charges against selling?
Ruth Kelly: It is something that we have actively considered. The fact of the matter is when this policy came to me to be decided it was on the basis of largely thinking about a large category of people who would benefit from this would be children in care because children in care would be allocated an account by the Revenue automatically. It is my view, and one with which you may disagree, that children in care are a particularly vulnerable group who need more than any other group, perhaps, arguably, to have a substantial asset behind them at the age of 18. Given the known returns between cash based accounts and equity accounts I thought it was only right that they should be afforded the maximum likelihood of building up a significant asset at the age of 18.

Q440 Mr Cousins: Minister, did you take that decision not just for that particular category of children in care but for all of Revenue allocated accounts?
Ruth Kelly: We think it is highly desirable that people should invest over an 18 year period in equity based products rather than a cash based product. There are going to be particular categories of people out there who perhaps for religious reasons do not want to take out an equity product and it is primarily for those people that cash based accounts will be available. There will be another category of people who decide for whatever reason that is what they want to do. The fact remains is that over 18 years the best bet is to invest in equities rather than cash.

Q441 Angela Eagle: The counter example to this is if somebody invested automatically in a cash account, which the Bill does not allow as currently written, when they were under 18, and there was a very nice return on the equities in that period they would equally have cause for worry because they would end up with less return at the end. This cuts both ways. Simply what you have done is make a choice based on the average returns, as you told the Committee today, which are a fact of life since 1918 and the fact there has also been no negative numbers in equity return since 1936.
Ruth Kelly: And the fact that as soon as a young adult is a parent and reaches the age of 18 they can make that choice themselves, they may have had one or two, possibly longer, years in an equity product and they may choose at the age of 18 to move into a cash product, that is up to them, that is their entitlement.

Q442 Mr Cousins: Minister, you would make a very charming and persuasive member of a sales force. What I am concerned about here is that it is one thing to make a judgment now, although I think that might be tested at a later date by legal decision, if it is a requirement in the legislation, because this is what we are being told now, it is requirement of the Bill that all of these accounts should be placed in equity-style accounts, now and forever, until the legislation, if that is what it becomes, is changed. Is that what we are being told? There is no question of judgment here, you are binding your successors, they will not be able to exercise judgment, all this money will be placed in equity accounts come what may. That is the issue.
Ruth Kelly: Up until the point at which that person exercises their own judgment as to where they would like the money to be placed.

Q443 Mr Cousins: That is a requirement of the legislation and it requires legislative change to bring it about.

Ms Welsh: Looking at the legislation I think I am right in saying that there is flexibility for the accounts to be specified. I believe that there will be flexibility if the Government is made over time to see that the nature of that account should be changed that that would be a possibility. The stakeholder product design will be put in regulation rather than in primary legislation. If we were to change the basis upon which stakeholder products were designed then that would obviously impact on the Revenue allocated accounts as well.

Q444 Mr Beard: Earlier when I was asking questions you said that the latter payments could go into bonds or into cash as opposed to equity, where would that be laid down? Will that be laid down in regulation?
Ruth Kelly: In regulation. The design of the stakeholder product will be put down in regulation

Q445 Chairman: In this context can you explain one thing to me, the Ways and Means Resolution that you have tabled asks the House to authorise making provision for securing that losses accruing on the disposal of investments will be disregarded for the purposes of capital gains tax. What are the losses there?
Ms Welsh: Should losses ever arise on that equity based account that provides for those losses to be disregarded for the purposes of capital gains tax so that they cannot be counted against gains elsewhere.

Q446 Chairman: I just read that.
Ruth Kelly: Capital gains are not taxed either, it is the flip side of the coin.

Q447 Chairman: You are providing for the case that some funds may make losses, is that right?
Mr Holgate: You cannot guarantee against a Child Trust Fund not making a loss. We have the historical evidence, which I was rightly told in the previous hearing one must not rely on exclusively, to show that it is very unlikely.

Q448 Chairman: I see.
Ms Welsh: It is a technicality that ensures that losses, should they ever arise, cannot count against gains made outside of the CTF.
Chairman: I understand that it will work, I was just curious as to why you were worried about the losses.

Q449 Mr Cousins: You are sure some sharp lawyer is not going to come back to our exchanges this afternoon in 15 years' time and find a merry quarry to dig at.
Ruth Kelly: We have taken legal advice and we are confident of our position on this.

Q450 Chairman: Finally, Minister, will the Deloitte's research be available for the Committee looking at the Bill? Will it come out in time for that?
Ruth Kelly: The Deloitte's research is part of a wider project on Sandler stakeholder products which will interact with the FSA's work on the sales regime, which was due to be published before Christmas but which now looks like it is going to be published later in the spring.

Q451 Chairman: The answer is no?
Ruth Kelly: The answer is that it will not be available on the passage of the Bill but the decisions which are material to the Bill will be.

Q452 Chairman: When do we expect the Bill to receive a second reading?
Ruth Kelly: Shortly.

Q453 Chairman: Very shortly? You have served on Finance Bill committees. Is this going to be one of these situations where the Committee will have to wait to see the regulations in draft or will you be publishing draft regulations in time for the beginning of the committee?
Ruth Kelly: We will publish them as soon as we possibly can, which I think will be at the turn of the New Year, as soon as we can get them out we will.

Q454 Chairman: Before the committee on the Bill there will be draft regulations?
Ruth Kelly: It will be possible for Parliament to consider the regulations during committee.
Chairman: During committee. Fine. Minister, thank you and your officials very much.

Written evidence

Memorandum submitted by the National Consumer Council

The National Consumer Council (NCC) is an independent consumer expert, championing the consumer interest to bring about change for the benefit of all consumers. We do this by working with people and organisations that can make change happen—governments, regulators, business and people and organisations who speak on behalf of consumers.

We are independent of Government and all other interests. We conduct rigorous research and policy analysis and draw on the experiences of consumers and other consumer organisations. We have linked organisations in England Scotland and Wales, and a close relationship with colleagues in Northern Ireland. And we work with consumer organisations in Europe and worldwide to influence European and global governments and institutions.

We are a non-departmental body, limited by guarantee, and funded mostly by the Department of Trade and Industry.

Memorandum

This memorandum responds to a request from the Clerk of the Committee for a written submission in connection with the Committee's Inquiry into Child Trust Funds.

Summary

The NCC welcomes the Government's proposals for the Child Trust Fund (CTF). It is as an excellent far-sighted policy, of particular benefit to low-income families. It will eventually extend access to an accumulated asset to all young adults. It may trigger additional individual private saving by parents.

The CTF could also aid more informed decision-making on personal finance by both parents and their children. Young people with access to a CTF in future generations, may be less likely to feel the need to access unaffordable credit and get into debt problems.

NCC does however have a number of outstanding concerns regarding the CTF, which we ask the Treasury Select Committee to consider in the course of its inquiry.

In summary, we make the following recommendations to the Treasury:

1. A progressive Government top-up to CTF accounts should be made at age 14.
2. A Government top-up should be added to maturing CTF accounts if a proportion of the account is saved for a further period.
3. The Government should explicitly make clear to consumers that no restrictions will be placed on the CTF at age 18.
4. All CTF providers should be required to supply a CTF to all parents who seek to open one.
5. The scope for the Post Office to provide the CTF should be explored.
6. An independent mechanism for setting the price-cap for the CTF should be established.
7. An appropriate maximum limit should apply to the equity exposure of the stakeholder CTF.
8. The FSA should commission research and consult on the appropriate sales regime for stakeholder and non-stakeholder CTFs.
9. All parents should have access to face-to-face basic financial advice before making their choice of CTF account.
10. Consumer research should test whether the CTF model could be successfully extended to the stakeholder pension.

Introduction

The NCC has a specific remit to represent the interests of low-income consumers, and we consider the market does not always meet their saving needs. The CTF will ensure that more disadvantaged families will have the chance to build up an asset for when children turn 18.

The NCC has responded to Treasury written consultations on this important initiative (National Consumer Council, *Delivering saving and assets*, 2002; National Consumer Council, *Simplified investment products*, 2003). We have often been the lone consumer voice at Government and industry events debating the design of the product. NCC wishes to highlight our support for the open and inclusive manner in which the Treasury and the Inland Revenue have developed policy on the CTF. We welcome this Treasury Select Committee inquiry into the CTF.

Basic Product Design

The CTF, as outlined in a recent Government paper (Inland Revenue/HM Treasury: *Detailed proposals for the Child Trust Fund,* 2003), matches very well with consumer needs. We agree with the approach of offering a "progressive endowment" to all parents. The £250 voucher will act as a trigger to parents to start, and add to, a savings fund for all children born after September 2002. Universal ownership of CTF will in due course make it an effective vehicle for future financial education. Providing an additional Government endowment of £250 to the less well-off, who are less likely to have access to such a savings vehicle today, and may find it harder to add to the account privately, is very welcome.

Much of the detailed product design also reflects NCC recommendations. A price-cap and a risk-control for the stakeholder CTF are essential safeguards for the majority of parents who we expect will opt for an equity-linked product, given the duration of the account. We agree that all providers who enter the market should be required to offer this type of product. But we agree that alternative deposit-based accounts and more risky funds should be available for those who wish to opt for them.

Within this regulated framework, we consider open-market competition between a range of providers to be an appropriate way of offering different choices to match with the different saving preferences or needs of parents. We do not favour the alternative of the Government fixing the number of licensed providers, and preventing potentially more efficient competitors from entering the market and offering CTFs.

Meeting Consumer Needs

Consumer research (see for example, AMP, *Understanding Small Savers*, 2000) suggests that, contrary to some simplistic assumptions, many parents on low-incomes do save. But they may be forced to use informal means to save, rather then the many products on the market. NCC has argued that key features of savings products, such as high interest-rates for Internet-based accounts, or tax breaks that favour and are understood only by higher-rate taxpayers, do not fit well with the saving needs of low-income consumers (National Consumer Council, *Everyday essentials: meeting basic financial needs*, 2003).

Recently published NCC research into the attitudes to saving for retirement of people aged 21–35, on modest incomes, (National Consumer Council, *No Nest Egg*, 2003) suggests CTF will be a more suitable product. While most young consumers do not regard pension saving as a priority, saving for children is often mentioned as a reason to save by parents and prospective parents. Some made positive spontaneous references to the new "baby bond" (as the CTF is often referred to).

It appears the prospect of a voucher with their child's name on it, provided by the Government, helps people feel they are to be given a helping hand in meeting their personal financial needs. The CTF is regarded as providing a framework for giving their family a financial start, in a way they could see as beneficial to them.

NCC's research also found some evidence of an intent by parents to add individual contributions to the account. Recent ABI research (Association of British Insurers, *The State of the Nation's Savings*, 2003) is also very encouraging. They found that 75% of parents who do not currently save for their children say they intend to contribute to their child's CTF.

Top-ups to CTF

The illustrative projections for fund growth provided by the Government, underline how essential additional contributions are to building up a reasonable pot at age 18. Despite the encouraging research, given that families entitled to the additional endowment will have an income below the Child Tax Credit threshold (currently £13,230), the capacity of many families to make large regular top-up contributions to the CTF will probably be quite limited.

So while the NCC does recognise the value of favourable tax treatment of the CTF, the ability to add £1,200 per year to the account will benefit high-income parents, more than the many families struggling on very low-incomes.

For some low-income families, additional contributions may not be an appropriate financial priority. Other more immediate demands on income, such as credit card repayments or covering the costs of essential services for the family today, should be higher up the priority list than a long-term investment. If the Government introduces the saving gateway, which will offer Government matched contributions for small savings built up by low-income adults, then this also will be a better option for meeting the needs of some families than CTF.

Age-related Payments

The Government's belated confirmation that a further top-up to CTF accounts will be made on the child's seventh birthday (as recommended by the NCC) is therefore very important. Some high-income families will no doubt benefit greatly from the favourable tax treatment available for large yearly private contributions. Further public support should also be made available to families on low-incomes to build up the accounts. This boost to the account may also trigger some parents to engage in additional saving for their children, if they are reminded of the benefits, and can see some growth.

It is welcome also that, in addition to a flat rate payment, an extra payment will be made to the CTFs of seven-year-olds in low-income households. The income profile of families will obviously change over a seven-year period, so a boost to the CTF accounts where parents may be unable to make private top-ups is essential (some of whom would not have received the initial progressive contribution).

Given that the first of these top-ups will not be paid until September 2009, we appreciate why the Government has chosen not to determine their value until a later date. However, an indication of intent that both the flat-rate top-up and the additional progressive element will be substantive (rather than token) would be helpful.

A further top-up to the account (with a flat-rate and an additional element) should be made at age 14. Another boost to the account would by then be very timely. At this stage, many young people start to take on part-time jobs, and may have the capacity to add small amounts to their own accounts. They will also be of an age where they have a better understanding of personal finance, so it could complement financial education in schools. In the absence of such a top-up the account could be dormant for 11 years from age seven until maturity at 18.

1. *We recommend a progressive Government top-up to CTF accounts should be made at age 14.*

Finally, we suggest the Government should consider whether a final conditional top-up could be offered to the owners of the CTF accounts as they turn 18. A bonus amount could be made available to young adults who choose not to withdraw all of their funds and retain some proportion for some fixed period—50% for two years for example. In this way, the CTF would incorporate a saving decision to be made by owner of the account, in addition to by their parents.

2. *We recommend a Government top-up should be added to maturing CTF accounts if a proportion of the account is saved for a further period.*

No restrictions

NCC stresses however that we do not favour restrictions on the use of funds when the CTF account matures. Quite apart from the bureaucratic burden of ensuring compliance with restrictions on expenditure choices, we are not persuaded that the Government should make valued judgements about what consumption is "worthwhile".

It is particularly essential that the Government separates this policy from the issue of funding access to higher education. Given the size of CTF accounts will vary considerably, and as many young people do not go into higher education at 18, we do not think it is appropriate to regard maturing accounts as a core funding source for higher education.

The Government has previously stated that no restrictions will apply. But we think additional opportunities to make this clear should be found as the Child Trust Fund Bill is introduced, and there is a case for a clear statement on the face of the Bill.

Another option might be to explicitly state the Government's intent in this regard in the letter sent out to new parents. This could act as an informal agreement between consumers and Government about the basic premise of the product. This would reduce the chance that a future Government of 2020 might view the maturing accounts in a different way from the current Government.

3. *We recommend the Government should explicitly make clear to consumers that no restrictions will be placed on the CTF at age 18.*

Claiming CTF

NCC agrees it is sensible to link CTF entitlement to the award of child benefit, rather than establishing separate arrangements with potential take-up problems. The consultation paper states that child benefit reaches "virtually all children in the UK" though it might be helpful if estimates and analysis were provided of those who might potentially miss out on CTF.

Similarly, we welcome the fact that no separate claim will need to be made to access the additional endowment of £250, the Inland Revenue instead making automatic payments to families receiving the Child Tax Credit (CTC). We note the Government recently announced (Inland Revenue press release, 5.9 million families now benefiting from tax credits, 31 October 2003) that (despite initial difficulties) take-up of CTC

is now exceeding expectations. Clearly, eligibility for the additional payment makes it even more essential to achieve high take-up rates and accurate awards of CTC. The potential implications of any future proposed changes to tax credit arrangements, upon the take-up and coverage of the CTF additional endowment, must be a central consideration.

We are also pleased these arrangements involve all parents being initially offered a voucher with a value of £250, with the additional endowment being added to an opened account separately. This should alleviate the risk that some providers may discourage those with £500 vouchers from opening accounts with them, should they calculate this group may be less likely to make regular additional private contributions and thus be less profitable.

This should be supplemented by rules that prevent providers from seeking such information, and potentially refusing to supply CTF accounts to some consumers. Appropriate measures are obviously necessary to prevent fraud. But given that funds in the account cannot be accessed until the child reaches 18, and thus the minimal risk CTFs will be used for money laundering, we assume that providers will be expected not to apply inflexible identification requirements. NCC is concerned by evidence that these disproportionate requirements are proving to be a major barrier for some vulnerable consumers seeking to open bank accounts. This may partly reflect lack of enthusiasm on the part of some banks to supply accounts to customers that are perceived as unprofitable. It is essential this problem does not extend to the CTF, and instead all parents should have access to the same range of CTF accounts.

4. *We recommend all CTF providers should be required to supply a CTF to all parents who seek to open one.*

Vulnerable groups

We agree with the Government's proposed strategy of automatically allocating stakeholder accounts in cases where parents have not opened a CTF account a year after the birth of their child. No child should lose out on potential fund growth for any longer than this period. Given that we anticipate some equity exposure will be favoured by most informed consumers, we agree this should be a stakeholder CTF. However this adds to our concern about the relatively light risk-control that will apply to the stakeholder CTF (see below).

It will be important too to learn lessons about why some parents have not made a CTF choice. Lack of confidence in financial decision-making, or loss of trust in the financial services industry may be among the explanations.

Minimum contributions

The Government states it will make a decision at a later date on minimum contributions that CTF providers will be required to accept. This should certainly not be more than the £20 minimum that currently applies in the case of stakeholder pensions. Indeed, if the Government wants it to be accessible to disadvantaged families (including children when they get older), then even smaller, over-the-counter contributions will need to be possible. Between 12% and 15% of households have no current account, so some parents will not have the option of direct debit payments into CTF accounts (Economic and Social Research Council, *How people on low incomes manage their finances*, 2002).

Partly to ensure wide accessibility of the CTF, we suggest the Post Office, with its extensive branch network, and its ability to command high levels of consumer trust, might be an effective provider of the CTF.

5. *We recommend the scope for the Post Office to provide the CTF should be explored.*

Product Regulation

The NCC welcomes the core conclusion of the Sandler review (Sandler, R., *Medium and long-term retail savings in the UK: a review*, 2002) that competition often does not work properly in the markets for retail investment products. Consumers are poorly informed and products are excessively complex, and they have often suffered detriment as a result of high charges and over-exposure to the stock market.

In the absence of product regulation, we are convinced the same problems would be replicated in the CTF market. Many of the purchasers of the CTF will not have purchased an investment product before. Some funds could be significantly depleted due to high charges and high-risk investment. The NCC has lobbied for a price-cap and risk-controls for the CTF, so we are pleased they have been incorporated into a "stakeholder" CTF.

Charge-cap

The CTF is a unique opportunity for the financial services industry. Normally the industry states it has to spend considerable amounts to stimulate demand for saving products. In this case, each year over 700,000 vouchers worth £230 million will be made available to parents to choose a CTF. It is important to bear this in mind should the usual complaints about charge-caps start to dominate the debate on the CTF.

There is no reason to start from the assumption of a 1% price-cap for the CTF, because this currently applies to the stakeholder pensions. Given the low costs of demand generation and the certainty of high persistency rates, a cost-based price-cap might be set at a lower level than for other stakeholder products. However, other proposed features of the CTF that the NCC considers essential for low-income consumers—such as small minimum contributions, annual statements, and the ability to transfer accounts—will add to providers' costs.

It is essential the price-cap is set at a level that, taking account of all relevant factors, allows efficient providers to cover their costs and make a fair return. It should not be edged up to offer a return to the least efficient operators. The claims of providers on their costs should be treated with healthy scepticism.

In general, we believe the Government's mechanisms for setting price-caps for investment products are inadequate. We welcome the appointment of a consultant to advise on the cap for the CTF, and urge publication of their report. But this does not constitute a fully independent, transparent and evidence-based process. Lessons should be learned from the mechanisms developed for price-cap setting by the independent sectoral regulators in the utilities sectors. Decisions are based on extensive research, open consultation and clear-time frames. A debate is needed on how the Treasury might improve the process for setting charge-caps for stakeholder products including the CTF.

6. *We recommend an independent mechanism for setting the price-cap for the CTF should be established.*

Risk-control

The NCC previously recommended a "lifestyling" approach—where the proportion of equity exposure should be reduced as the child reaches 18—should apply to the stakeholder CTF. For low-income families in particular, security against loss of most of a valuable asset will be particularly important. We are pleased the Government is incorporating lifestyling, alongside a requirement to diversify the investment, though we are unclear how compliance with these rules will be monitored.

But the Government and the industry needs to be wary about over-stating the safeguards offered within the stakeholder CTF. Consumers will still be exposed to considerable investment risk, and the value of CTFs will no doubt fluctuate significantly across 18-year periods.

Indeed the NCC is concerned that, unlike the proposed medium-term stakeholder investment product, a 60% limit on equity exposure will not apply to the stakeholder CTF. It is disputable that the CTF is a long-term product rather than a medium-term one, as stated by the Treasury.

It is disappointing the Government has not aided informed debate on this matter by providing information about the comparative impact recent stock-market falls would have had if CTFs were maturing between 1999 and 2002.

7. *We recommend an appropriate maximum limit should apply to the equity exposure of the stakeholder CTF.*

Consumer protection

Few details have so far been provided by the Government on Financial Services Authority (FSA) regulation of the selling of CTF accounts.

The NCC is opposed to the proposition made by the Treasury and the FSA that the new suite of stakeholder investment products should all be sold without "suitability controls." We are worried this will lead to future mis-selling of investment products, without rights of redress for consumers.

The suitability issues in relation to the CTF are, however, distinct from other stakeholder products. Unlike opening a stakeholder pension for instance, it is clear that all parents should start a CTF account to access the Government endowment. So light regulation of the sales process does appear to be appropriate.

But not enough attention has yet been paid by policy-makers to consumer behaviour on receipt of their CTF voucher. We understand that many sales of children's saving accounts are currently made on an execution-only basis. Less-experienced investors are more likely to need face-to-face advice before they make their choice, and they could be vulnerable to ill-informed choice.

A "guided self-help" series of questions may play some role in protecting consumers from more risky funds, and raising awareness of the risks associated even with the stakeholder CTF. But FSA research into the necessary level of consumer protection is needed before final conclusions can be reached on this matter.

We are also unclear whether the selling regime for non-stakeholder Child Trust Funds will be distinct from the selling regime for stakeholder CTFs. Though it is not explicitly stated in *Detailed proposals for the Child Trust Fund*, we assume the charge-cap will (and recommend it should) apply to non-stakeholder CTFs, in addition to stakeholder CTFs. However, the absence of a risk-control will require a more stringent approach to be taken to the selling of non-stakeholder CTFs, to prevent consumers from being mis-sold more risky funds.

8. *We recommend the FSA should commission research and consult on the appropriate sales regime for stakeholder and non-stakeholder CTFs.*

Financial capability

The Government has rightly emphasised the importance of financial literacy linked to the CTF. We agree the product will help children to engage in wider financial education in the classroom, including a better understanding of what saving means to them. The NCC has worked with the Personal Finance Education Group (pfeg), the FSA and others on the development of materials to support personal finance education. In time, and provided teachers have the support and training they need, the CTF may lead to a much needed boost to the financial capabilities of future generations of consumers. Though it is some way in the future, we add that all young adults will need tailored information and advice about their financial choices, before they have access to their maturing CTF at age 18.

We also agree that providers may have a role in the provision of financial information to parents and children. Annual statements, presented in a common format, will help to maintain consumer awareness of the product. The FSA and/or pfeg should be asked to offer guidance on the provision of additional educative resources by firms, to ensure impartiality and accessibility.

The most pressing priority in relation to the CTF, is for parents to make informed choices about allocating the voucher. We welcome the proposed provision of an information pack for parents alongside the voucher. The Government's planned research into how to communicate investment decisions to parents will be very important. The Government will need to be particularly wary of the way in which projected fund growth rates are projected. In a report last year (National Consumer Council, *Retirement Roulette*, 2002), the NCC highlighted the need for Government departments and the FSA to improve the quality of their financial risk communications to consumers.

The recent difficulties surrounding the introduction of competition in the directory enquiries market should act as a warning to policy-makers on CTF. Problems can arise in markets where consumers are not familiar with making a choice, and do not have access to the impartial information necessary to make such a choice. They may opt for options on the basis of memorable advertising, rather than on the basis of price and quality of service.

Similar problems could arise when parents are sent a CTF voucher. In this case, while a charge-cap is in place, the potential consumer detriment could be the choice of a fund that does not match their informed risk preference. This may make them vulnerable to risky funds that quickly erode the value of their funds. We are also concerned that some parents may opt for familiar cash-based accounts, without considering other options, potentially missing out on higher returns.

This product actually presents an excellent opportunity to communicate risk issues to a whole generation of parents, in a very tangible way. This will however require the provision of basic independent financial advice services, which are not currently accessible to most consumers on low-incomes. This could help new parents to identify their other financial priorities, such as management of credit card debt or starting a stakeholder pension, to save for their own retirement. This is a key life-stage point, where public and/or private investment in generic financial advice could be useful.

We are concerned that the Government inaccurately states in *Detailed Proposals for the Child Trust Fund* that "The FSA provides people with authoritative, independent information and generic advice." The NCC has welcomed the recent appointment by the FSA of a Financial Capability Steering Group, including the Financial Secretary Ruth Kelly, consumer groups and the industry. The group will develop a national strategy for financial capability, to provide consumers with the education, information and generic advice to make financial decisions with confidence. However, the FSA does not provide generic advice, and many consumers on low-incomes do not have access to its web-based information materials.

The NCC has welcomed the preliminary development of a financial health-check software package by the FSA. But most consumers will need access to face-to-face advice to take advantage of such technology. Options such as workplace-based financial advice, boosted by tax incentives, or a financial planning service, delivered via the Post Office network, should be explored. Given that parents will be making choices about CTF accounts in a little over a year's time, access to advice about it should be a priority for the Steering Group.

9. *We recommend all parents should have access to face-to-face basic financial advice before making their choice of CTF account.*

Lessons for pension saving?

NCC's research, *No Nest Egg,* suggests there may be scope for learning important lessons for wider savings policy from the roll-out of the CTF.

The positive response of younger consumers to the CTF contrasts sharply with their perceptions of pension policy. Consumers struggle to identify Government measures which help them to save more in pensions. Knowledge of stakeholder pensions is low, and many people do not trust the industry or the

Government on pensions. The NCC concludes that the Government's favoured measure of encouraging pensions saving—tax relief—is not only regressive but also inefficient because it is opaque and not well-understood.

Just as with the CTF, we suggest better targeted and simpler triggers for low-income consumers to start pension saving are needed. We believe the consumer response to receiving the CTF vouchers, and future saving behaviour, should be assessed to determine whether a similar approach might trigger additional pension saving.

10. *We recommend consumer research should test whether the CTF model could be successfully extended to the stakeholder pension.*

10 November 2003

Memorandum submitted by the Consumers' Association

1. Consumers' Association (CA) is an independent, not-for-profit consumer organisation with around 700,000 members. It is the largest consumer organisation in Europe. Entirely independent of Government and industry, we are funded through the sale of our *Which?* range of consumer magazines and books. We campaign on a wide range of issues of importance to consumers, including, food, health, retail and financial services.

We welcome the opportunity to provide comments to the Treasury Committee on the Child Trust Fund (CTF).

The Child Trust Fund Concept

2. CA supports the concept of the CTF as a means of building assets and encouraging greater savings amongst consumers. We also support the principle of encouraging consumers to use the capital markets and stockmarkets as the most efficient method of maximising the total amount of assets generated through the CTF. However, we have a number of concerns and comments on the CTF mainly relating to the economics of using the open market competition model, and providing access to the necessary financial education and advice so that consumers can make informed and appropriate choices.

Stockmarket-Based Investments

3. The CTF is designed to be a medium to long-term investment and over such periods we believe it makes sense to allow significant exposure to equities. Clearly, expectations have been lowered and it would be unwise to hope for a return to the double digit stockmarket returns seen in the previous two decades. In addition, stockmarket based portfolios can be volatile. Nevertheless, balanced portfolios (with a mix of assets) are expected to produce better returns over the medium to long-term than deposit-based accounts. For example, the returns on tax exempt portfolios are expected to be in the region of 6.55% a year over the medium to long-term (source *DWP Pensions Green Paper*) compared to the 4% gross available from best buy deposit accounts. Moreover, the long-term nature of the investment, the fact that assets are locked in, and the encouragement to use risk control strategies means that volatility risk can be controlled.

Economics of the CTF

4. However, while we strongly support the principle of using the capital markets to maximise the value of assets, the challenge is to provide access to the markets for consumers in the most cost-effective and fairest manner so that each pound contributed by consumers (and taxpayers) works as hard as possible. Providing access cost-effectively is especially important in a low return environment.

5. CA does not believe that the retail market model chosen by the Government for providing access is the best approach given the comparatively small contributions involved and the low return environment and is not in the best interests of consumers and taxpayers and may be ultimately counterproductive.

6. The Government has opted for the open market competition model where consumers will be expected to choose from providers such as banks, investment firms, insurance companies etc competing in the market to attract business. Providers will have to compete for business and this will involve significant marketing and distribution costs. The structure and processes involved in the CTF model will involve proportionately large administration costs given the size of contributions involved.

7. Providers naturally have to expect to generate charges which will deliver reasonable returns on capital before entering the market. However, the charging structure has to make sense for the consumer and taxpayer as well—what might be called the "equilibrium price". The level of charges providers require to distribute products and provide advice on terms which meet the needs of their shareholders and commercial models would we believe reduce consumers' investment returns to such a degree that the benefits of stockmarket based investment would be effectively wasted.

8. We cannot see how such an equilibrium price can be found for the CTF given the small sums of money involved using this open market retail model. The same problems are occurring in the stakeholder pensions market where the price cap is sustainable at the higher contribution levels. However, retail providers' commercial models prevent them from distributing pensions on commercial terms which suit the needs of their shareholders and lower to medium income consumers. It would be unfortunate to see this fixation with the retail market model undermining the success of another notable policy initiative which could have led to substantial benefits for vulnerable consumers on low-medium incomes.

9. The economics of access in the stakeholder market may provide some lessons for the CTF market. Analysis commissioned by CA[1] to inform its pensions policy development concluded that retail pensions firms selling stakeholder pensions to consumers who can afford to contribute £50 a month would have to charge 3% a year to meet their commercial needs[2]. This would reduce the return to investors from 6.5% a year to 3.5% a year, less than is available on best buy deposit accounts. There is little financial incentive for consumers to tie money in stockmarket based pensions for 30 plus years on those terms.

10. It would not be unreasonable to expect that average contributions to the CTF may be even lower than £50 a month, which would make the economics less sustainable, and could be considered a waste of taxpayers' money. The net effect of the charges industry would have to apply means that children could be better off if the Government just deposited the CTF money in a savings account, or set up a National Savings Account and handed the money to children on maturity rather than create this complex open market structure.

11. For this reason, we would have preferred the Government to opt for a different approach to providing access on reasonable terms. We are of the view that given the small sums involved a collective or public private partnership approach is needed to provide the necessary economies of scale. There are two main approaches.

12. First, the Government could have decided to license a restricted number of approved CTF providers who would be allowed to focus on the market. This would have a number of advantages in that the costs of competing for market share would be reduced and consumers would also find it easier to choose a provider. Choice is important for consumers but it is important not to confuse the illusion of choice with quality of choice. Too much choice can be as detrimental as too little choice in financial services as this can result in confusion marketing.

13. The second option is the competitive tendering approach. The Government could have followed the example of the US Federal Thrift Savings Plan (FTSP) which is a retirement savings vehicle for federal employees[3]. The US Government provides a degree of matched funding for consumers who participate in the plan. The main attraction for the UK CTF is that rather than require FTSP scheme members to choose from numerous retail investment providers, the board[4] which runs the scheme appoints the investment managers on a competitive tendering basis using "beauty parades" usually associated with the employers pension fund market. This provides massive economies of scale and the use of an intermediary in the form of the board levels the playing field between individual consumer and the investment professionals. As a result the fund charges on the FTSP are in the region of 0.35% a year, and the actual investment management charges are around 0.08% a year.

14. We do not argue that such a system could be replicated exactly and immediately in the UK. Nevertheless, we are firmly of the view that the collective approach, using not-for-profit organisations is the only feasible way of delivering the necessary economies of scale to provide access to stockmarkets for consumers on low to medium incomes on reasonable terms. We believe that the retail investment model can work well in many situations but penalises those on lower to medium incomes. The collective approach strengthens the influence of individuals who tend to be at a huge disadvantage when dealing with powerful producer interests in complex markets.

Financial Advice, Education and Information

15. CA welcomes the Government's proposals to link the CTF to financial education and information initiatives. We fully support financial education and information campaigns as a prerequisite for an informed and active consumer population. However, we are of the view that given the legacy problems with financial literacy in the UK it may take a generation for education programmes to pay dividends. What consumers want and need is unbiased and affordable financial advice. The introduction of the CTF provides the ideal opportunity for the Government to co-ordinate a programme to extend access to advice that the market cannot provide.

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[1] *Alternative thinking on pension investment and access to pension products,* Watson Wyatt for the Consumers' Association, June 2003.

[2] This assumed an 11% return on capital (ROC) which is standard for the market.

[3] For details see *Alternative thinking on pension investment and access to pension products,* Watson Wyatt for the Consumers' Association, June 2003.

[4] The Federal Retirement Thrift Investment Board (FRTIB).

Financial Literacy in the UK

16. Financial literacy and education standards affect the capacity and ability of consumers to plan for the future, and also to execute those plans by making rational, suitable, effective and informed decisions. So they are patently an important factor when determining solutions to the pensions challenge.

17. However, literacy and numeracy standards are a major problem in the UK. The *Moser Report* in 1999 concluded that:

— one adult in five in the UK is not functionally literate and more have problems with numeracy;

— one in five adults (7 million adults) have literacy standards expected of an 11-year-old;

— *Moser report* also estimated that 48% have very poor/poor numeracy (*Moser report*).

In a major OECD study into numeracy and literacy, UK came 10th out of 12 major economies. As the famous quote goes, half the population doesn't know what 50% means.

18. *The Financial Services Consumer Panel Annual report 2000* relating to consumer confidence and literacy highlighted the need for advice and the limitations of information solutions in the short to medium term.

Table 1

FINANCIAL LITERACY AND CONFIDENCE

	Considered financially literate	*confident about making own decisions*	*clear idea of products needed*
All	45%	38%	33%
Broken down by social grade			
AB	61%	32%	42%
C1	44%	38%	32%
C2	43%	38%	31%
DE	30%	46%	30%

Source: Financial Services Consumer Panel Annual Survey report 2000, table 1

Less than half the respondents were considered financially literate. Not surprisingly, financial literacy was closely associated with economic circumstances.

19. Less than four in ten respondents were confident about making their own financial decisions, and only a third said they had a clear idea of the products they needed. Confidence and clarity were low even among the higher social grades. What does appear to be surprising in this table is the finding that confidence actually decreased the further up the social grades. The lower income consumers were the most confident. This group also held fewest financial products and one explanation put forward by the panel was that this group was in a "happy state of ignorance". Another possible explanation was that with relatively few options open to them, their decision-making was fairly straightforward, and therefore they felt confident.

20. The *Financial Services Consumer Panel* report also highlighted the difficulties many people have understanding things such as charges and whether it is essential to seek guidance when purchasing certain financial products.

21. Consumers need financial education to help them take appropriate action and make informed decisions, however, information provision can only take them so far. Unless industry is forced to avoid technical jargon then education can do little to improve consumer understanding of financial services and product them from industry abuse.

22. Education is no substitute for effective regulation and should be part of a parallel strategy of cleaning up markets first which then in turn makes it easier for education to have an impact. The impact of financial education initiatives are weakened in the face of complex and rip-off markets. Even the best planned and executed financial education strategy would take a generation to pay dividends given the huge legacy problems we have with poor financial literacy in the UK.

The Need for Unbiased Advice

23. It is our view that the UK faces twin financial crises of record levels of personal debt (including substantial numbers of consumers who face significant shortfalls on their mortgage endowment policies) and massive underprovision for pensions.

24. What consumers want and need is unbiased and affordable financial advice, as information and education solutions are of limited use for these pressing crises. But the industry cannot or should not be expected to provide that type of advice to general population. Many consumers are in need of advice and guidance to help them clear debts or sort out the financial basics. These consumers are in no position to buy financial products and therefore offer little commercial attraction for private sector.

25. The arrival of the CTF adds to the demand for unbiased advice. CA's view is that UK consumers need a National Financial Advice Network (using the existing infrastructure of citizens advice bureaux, local Government advice centres, the workplace, specialist charities, trades unions etc and supported by a dedicated helpline) to provide access to financial healthchecks/guidance but also to work with the FSA to co-ordinate and deliver financial education on the ground. This is built around the existing model of the Community Legal Service which provides access to legal advice for consumers on lower incomes.

26. CA's preliminary estimates are that it would cost about £200 million a year to run. This need not necessarily be new money—it could be funded by redirected resources from the existing fragmented financial education programmes and by fines on industry. There are over 30 different organisations and Government departments and agencies involved in financial education. If consumers are to be truly educated, informed and protected there will need to be a move away from the current fragmented and unco-ordinated approach towards a more coherent and co-ordinated strategy which addresses the different stages of consumer need.

27. Whatever the source of funding, it would be a fraction of the £2 billion a year cost to the economy if the Government gives in to industry blackmail and raises the price cap on stakeholder pensions. As a priority, we think the Government should establish pilot studies with partner groups to test and cost the NFAN properly.

November 2003

Memorandum submitted by Mr Stephen Wynn

1. INTRODUCTION

The introduction of new products such as Child Trust Funds can have embarrassing outcomes. For example in the case of personal pensions there was the mis-selling scandal. In the case of stakeholder pensions, 82% of employer-designated schemes have no members. There are problems with split capital investment trusts, mortgage endowments and so on.

It seems surprising that the report of the Treasury *Detailed proposals for the Child Trust Fund* (2003), makes no mention of "trustees" or different kinds of trust. More generally the Government is seeking to build trust in the market. For example in the green paper *Simplicity security and choice: Working and saving for retirement* (2002) there is a heading Building trust in the market (page 79). But judging from the number of problems, the market does not want to build trust in the Government.

The introduction of CTFs is an opportunity to set up a scheme run by a new institution as an alternative to this market approach, where providers compete to sell "products". These providers are in business mainly to make money for themselves rather than for investors.

2. DISCLOSED CHARGES

The Treasury report says: "The CTF can be wrapped around a variety of products such as cash, unit trusts or life insurance products." (3.13). There could apparently be all sorts of products with no restriction on charges and a poor investment performance. There could be headlines such as: "Zurich Life stole my baby bond." by analogy with: "Zurich Life stole my pension." (www.badpension.com).

There will be "stakeholder CTF accounts" (3.14) which will have a cap on explicit charges. But not all CTF accounts will be "stakeholder accounts" (3.19). The stakeholder CTF accounts will be rather like CAT standards for ISAs. But only a minority, and apparently small minority, of ISAs have the CAT mark.

People are being required to negotiate charges individually with the financial services industry using taxpayers' money. Investors get a better deal where negotiation is on a collective rather than individual basis.

The Consumers' Association has recently publish a report *Blueprint for a national pension policy, Restoring confidence and trust in pensions* (2003) saying that as a method of providing pensions, the retail model where millions of people are left to negotiate individually with pension companies simply does not work. Why should the retail model be any more suitable in the case of CTFs? Individuals are at a disadvantage in negotiations in comparison to groups. This is the reason for example for "share classes" discussed by Fitzrovia on its website (www.fitzrovia.com):

> "There is a rapid movement by many fund management companies towards the creation of new share classes. This allows the segmentation of retail and institutional investors. Institutional classes have lower fees and a better track record of performance."

In the US an example of discrimination in favour of institutional shareholders is the current mutual fund late trading scandal—giving preferential treatment to the largest customers.

But Government policy seems to favour saving on an individual basis. In its report *Standards for retail financial products* (2001) the Treasury states:

> "In the modern world people will increasingly need to look after their own financial interests for themselves." (paragraph 15)

3. Undisclosed Charges

The occasional paper of the FSA *To switch or not to switch that's the question: An analysis of the potential gains of switching pension provider* (2002) by Isaac Alfon, states that personal pensions "tend to have high portfolio turnover and high undisclosed charges" (page 16, footnote 20). Will CTFs also have high portfolio turnover and high undisclosed charges? What is to prevent this? Undisclosed charges are not mentioned in the above report of the Treasury. They are mentioned in FSA publications, such as the report *Comparative Tables* (May 2001), which discusses CAT standards for ISAs:

> "On average, disclosed charges are about 1.4% of the funds under management each year, but disclosed charges on a CAT-marked product are capped at 1%. . . . reduce the amount they pay for annual charges by an average of 0.4 percentage points." (paragraph 55) . . . "We assume here that undisclosed charges remain constant." (footnote 15)

Contradicting the FSA, the Treasury says on its website (eg www.hm-treasury.gov.uk/documents/financial–services/savings/fin–sav–maksum.cfm), that ISAs with CAT standards have "no hidden charges" and "no hidden costs".

The Treasury Committee starts the Conclusions and Recommendations in its report *Split Capital Investment Trusts*[5]:

> "We believe that transparency in all aspects of the charges borne by shareholders should be paramount".

In the case of stakeholder CTFs will parents and guardians be told: "There are no hidden costs". Or will they be told as in the DWP publication Stakeholder Pensions—your guide:

> "As well as the one per cent, the law allows pension providers to recover costs and charges they have to pay for certain other things. For example, when they have to pay any stamp duty or other charges for buying and selling investments for your fund, or for particular circumstances . . . " (page 6)

The FSA states in its 2002/3 Annual Report:

> "The main economic justifications for financial regulation are information asymmetry and externality."

High undisclosed charges are associated with high portfolio turnover. Nevertheless the FSA says in its consultation paper (CP 170):

> "We have decided that we will not bring forward proposals to require disclosure of portfolio turnover." (5.81)

Fitzrovia (www.fitzrovia.com) have published a 234 report *Portfolio Turnover of UK Funds* (2002) giving the portfolio turnover of unit trusts and OEICS.

Many people think that portfolio turnover should be disclosed. The Investors Association has written an open letter to the Minister Ruth Kelly on this topic with a copy to your Committee.

There is a large literature indicating that low portfolio turnover is beneficial for investors. I can supply further information on this topic. A Google search on "portfolio turnover" produces 235 thousand websites. Hidden costs are often higher than explicit charges. For example, Kathryn Cooper writing in the *Sunday Times "Revealed: true cost of stakeholder"* (20 May 2001) reports that the FSA says that stakeholder pensions could have 1.3% of capital per annum of hidden charges:

> "The Financial Services Authority, the City regulator, says dealing costs and stamp duty could add up to an extra 1.3% a year, which means that pension savers could in effect pay 2.3%.

Portfolio turnover should be disclosed in key features documents so that parents and guardians choose funds with low turnover to minimise hidden costs. But then at the stressful time of having a baby parents cannot be expected to address the issue of portfolio turnover. CTFs are a "charter for churners" (www.comparativetables.com).

However the Treasury does think that the trustees of occupational pension schemes should know about dealing costs, especially in view of the recommendations of the *Myners Review*. On the Treasury website it says:

> "Trustees, or those to whom they have delegated the task, should have a full understanding of the transaction-related costs they incur, including commissions."

A national scheme run by a new organisation would be able to have trustees or staff who can look after dealing costs.

[5] Third Report HC 418-I Session 2002–03.

4. How are the Child Trust Funds to be numbered?

The Treasury report says that the CTFs will have:

> "A unique reference number possibly using the same format as the NI number." (6.2)

The "unique reference number" could actually be the NI number—if NI numbers serve as identity numbers given to people at birth, as suggested in the recent green paper of the Treasury on entitlement/identity cards. It is proposed that CTFs should also have a "provider reference number" (6.29). Why is there a need for more than one reference number? Are parents or guardians to be expected to remember or keep a record of these numbers? What happens if they have lost them? Will knowing the name of the provider be adequate? People can be expected to remember their identity number.

Since babies have only one CTF, if identity numbers are introduced which are given at birth, then the unique reference number should surely be this identity number. Numbers on products such as ISAs sometimes change which causes confusion for investors and executors, and may be a reason for the large quantity of unclaimed assets.

NI numbers should arguably be put on all financial products. They are generally not included on life insurance products. All financial products should contain full name, date of birth, NI number. Suppose a provider has lost contact with a CTF holder and wants to contact them when they reach the age of 18. The Letter Forwarding Service of the DWP says that NI numbers are "very useful" for forwarding letters, although name and date of birth may be adequate. Since NI numbers are already used extensively for identity purposes, they should surely be the same as the new identity number proposed by the Home Office.

Someone may have lost the whereabouts of their CTF, and forgotten the name of the provider when they reach age 18. They will not be able to claim unless they can enquire at the register of all CTFs with this information, or the provider contacts them.

5. The Register of Child Trust Funds

Since the Government pays into CTF accounts it seems clear that the Inland Revenue will have a register containing a) name, b) date of birth, c) identity or unique reference number, d) name of the provider of the CTF account.

The Treasury report says:

> "When a child holding a CTF dies the parents of the child will notify the provider." (6.15).

But they might not. The Revenue should know if CTF account holders die and could inform the respective providers.

More generally the main reason for unclaimed assets seems to be financial institutions not knowing when people die. The Inland Revenue knows when people die and apparently informs occupational pension schemes but not, for example, insurance companies.

The Letter Forwarding Service can apparently not at present be used to trace relatives of people who have died, since it does not forward letters to the deceased. It could be required to do so, at least for people who have recently died, as a way of contacting relatives.

Insurance companies could be informed when people die using NI numbers, if they were on insurance policies.

6. "Diversity of Preferences"

Under the heading "Other CTF account preferences" the Treasury report says:

> "The Government recognises the diversity of preferences amongst the population. . . . For instance some consumers prefer to invest in ethical funds or investments compatible with their religious beliefs and the Government would welcome CTF providers including such CTF products in their range." (3.19)

Since these other CTF accounts do not have capped explicit charges, it seems that people with certain ethical and religious beliefs will have to pay extra!

The report of the Sandler review complains about the "proliferation of products and product differentiation that does not reflect true differences in what is being offered" (3.13) suggesting that a large choice of products is largely an unhelpful dilemma. Surely all babies are alike? Those babies with the more astute parents are likely to make a better choice of CTF. Is this fair?

Perhaps parents would like the option of paying only £2 per annum in expenses like the Danish ATP scheme (www.atp.dk). In the year 2002:

> "Pension activity costs were recorded at DKK 27 (about £2) for each member, while investment activity costs were DKK 16 per member."

But then this is apparently not on offer. They are instead to be offered a large choice of relatively expensive "products" from "providers".

A reason why the Danish scheme is inexpensive is that it is compulsory. So is the CTF scheme. An advantage of compulsion is that in theory it eliminates marketing costs. But the CTF scheme will have compulsion and nevertheless have marketing costs.

If a new organisation was set up to manage CTFs, there would be no need to issue vouchers which parents then take to providers. Funds would be paid directly to the new organisation. CTFs could be accessed through Post Offices.

7. Encouraging Saving

The CTF scheme is intended to encourage saving. CTF accounts will need to be easily accessible such as at Post Offices. People should not for example need to write to an insurance company every time they wish to make a deposit. There will be "a wide range of providers" (1.12). Will they all provide easy access to the CTFs?

Tokens are suggested as a way of encouraging saving. (4.5) But surely children and teenagers are too likely to lose them.

Will we know whether CTFs encourage saving or not? Will statistics be collected of the amount of additional contributions into the accounts?

The Treasury report states that the CTF:

> "will ensure that in future all children will have a financial asset at the start of their adult live" (1.6)

But how much? Will we know about the overall investment performance of the accounts? The FSA has been reluctant to monitor investment performance.

8. Conclusion

The CTF proposals will result in hundreds of thousands of people per annum negotiating charges individually with financial institutions. Probably only a minority of CTFs will be stakeholder CTFs in the same way that only a minority of ISAs are CAT-marked ISAs. Most will have explicit charges not restricted by the 1% cap. There will in addition be undisclosed charges.

I am not opposed to encouraging saving and accumulating assets, but have misgivings about the CTFs as proposed because: they present parents with the dilemma of choosing a provider and type of account; probable high and hidden charges for many CTFs; possible inconvenience of making deposits for some CTFs; some CTFs might become unclaimed assets.

The alternative to individually negotiated contracts is to set up a new national scheme run by a new organisation. This would look after the CTF accounts and make investments.

There has been a consultation about CTFs with responses discussed in the report of the Treasury *Delivering Saving and Assets consultation responses* (November 2001). There is a general problem with such consultations. When there is an analysis of the responses we are not told who are the respondents, most of whom are generally from the industry. For example under A3 in the Treasury report it says "over half of the responses were in favour of progressivity". Carrying out the wishes of the majority is then carrying out the wishes of the industry. This is a feature of FSA consultations, which in my opinion makes them largely invalid.

4 November 2003

Memorandum submitted by The Association of Investment Trust Companies

1. The Association of Investment Trust Companies (AITC) wholeheartedly supports the creation of the Child Trust Fund (CTF). It offers the prospect of a new "asset-based" approach to welfare that could be extremely beneficial to many young people who might otherwise start adult life without any assets and consequently suffer from poorer life chances.

2. Investment trusts are equity vehicles that offer savers access to a diverse range of shares at low cost. They are eminently appropriate for inclusion within the CTF wrapper. £250/£500 invested 18 years ago in the average Global Growth investment trust would today be worth an impressive £1,489/£2,978, despite recent equity market corrections. This compares very favorably with competing collective investment vehicles. This performance is a product of investment trusts' low charges and their "closed-ended" structure, which is particularly suitable for long-term investment strategies.

3. Many thousands of parents and grandparents are already successfully using investment trusts for child-focussed savings. The Government should ensure that the CTF rules facilitate the creation of investment trust based CTFs. This paper explores issues that are generally important to the successful development of the CTF, including considerations that have to be addressed to ensure investment trusts can participate in the CTF initiative.

A Suitable Framework

4. The CTF proposals published to date provide the skeleton for a potentially successful CTF. The decision to base Stakeholder CTFs on equity funds is a good one. It should be instrumental in securing a significant "pot" for as many young people as possible when their CTFs mature. The CTF's 18-year investment horizon makes equity exposure eminently suitable, far more appropriate, indeed, than cash-type investments. Would it be right for anyone to put their money in a bank account knowing that it could not be touched for 18 years? In fact, had someone done this with a £250 lump sum 18 years ago, their £250 could now actually be worth less in real terms. (A lump sum of £250 invested in an average UK Savings Account for amounts of £50+ would today have a value of £370, whereas if it had increased in line with inflation it would have had a value of £480. Put another way, the £250 would today only have an equivalent buying power of about £190).

5. Of course, savings accounts providers knowing that money will be held in the account for up to 18 years may well be prepared to offer better rates than a typical "£50+" savings account, and savings accounts obviously come with no risk to capital. However, the problem with having no risk exposure within the Stakeholder CTF will be the likelihood of a small pot on fund maturity, with returns barely outstripping inflation if at all. This would not provide the life-changing opportunities that are possible with the creation of larger pots (which might, say, provide the capital required to put a deposit on a home). Therefore, whilst we understand why the decision was taken to permit cash-type investments, we very much hope that the CTF literature will encourage less experienced investors (particularly those from less affluent backgrounds whose children could benefit most from a larger "pot") to consider appropriate equity products.

6. Equity exposure does mean that there are no guarantees on the return a CTF will make. However, the purpose of these funds is not to provide a financial "safety net" to be relied upon in all circumstances—they are not an equivalent to pensions. To be financially secure, young adults will still have to rely on their skills and make their way in the job market. However, encouraging equity based exposure via the default CTF will increase the chances of a significant fund on maturity and more widely distribute the positive life chances that financial assets can deliver. On the other hand, the Government has also recognised that equity exposure does not mean that any risk is acceptable. CTF managers will be expected to take suitable investment approaches. We fully accept, therefore, that not all investment trusts will be suitable for the CTF. However, large global and UK funds invested widely to offset risk will be eminently suitable.

7. The key reason for basing the Stakeholder CTF option on equities is that highlighting equity choices for parents will maximise the life-changing potential of the CTF. A "cash-only" approach would strangle it. In addition, the educational aspects envisaged for the CTF will help support a stronger savings culture in the UK. Our research has shown that a significant proportion of both school pupils and their parents would welcome personal financial education being taught in schools. The CTF has the potential to bring this to life and be a practical demonstration of how different long term investments can provide substantive financial benefits.

Balancing Consumer Interests and Provider Obligations

8. Some key features of the CTF have been determined. In particular, the Treasury has identified how children in a variety of circumstances will be guaranteed access to the fund. This is clearly very important. The redistributitive ambitions of the CTF make it essential that those in vulnerable circumstances should be able to secure its benefits. However, the proposals published are unclear on some other crucial product details. Getting these right will be fundamental to delivering benefits for young people through the CTF.

9. An effective CTF must balance consumer interests and provider obligations. CTF costs must be kept as low as possible. At the same time a variety of providers must be encouraged to enter the market to give parents a real choice. Choice, and competition, will in turn give providers an incentive to price their products keenly within the cap. It will also give parents options to transfer their child's account if performance in their original choice is poor. Balancing provider and consumer interests effectively will ultimately be good news for CTF beneficiaries. The need to set a realistic charge cap exemplifies the challenge of achieving an appropriate balance.

10. Although the final charge cap has not been set, it is clear that the Government has a high "persuasion threshold" before it moves from a 1% limit. The AITC would expect the final cap to be settled at 1% or 1.5%. However, assuming the cap is at 1% (and has an equivalent structure to other current caps) a £250 endowment would earn a provider just £2.50 in its first year. This is not a huge return by any stretch of the imagination. Set against establishment costs, ongoing management expenses, and the price of sending out annual statements etc, the CTF may be uneconomic for many providers (particularly as we envisage that many CTF accounts will not receive any top-up contributions from parents or grandparents.) The Government is rightly looking at cap structures and levels (see below) but the CTF is highly unlikely to be a bonanza for the City whatever the final charge cap.

11. Simple rules, which incorporate realistic expectations of what providers can do within the returns expected for them, will be crucial to balancing consumer and provider interests and ensuring the development of a vigorous and successful CTF market.

Issues for Further Consideration

12. The priority now should be to ensure that the Government makes appropriate decisions on some key outstanding product issues.

Level of top-up endowment

The intention to pay a second, top-up, endowment at the age of seven is a good one. It will provide the basis for additional fund growth. A secondary benefit is that it will also keep the account "live". That is, it may focus parental attention on their child's CTF and encourage them to make their own additional contributions, if they have not been making them already. It could also serve as a stimulus for parents to consider the performance of the fund and whether or not they should be considering a transfer. Later on in the CTF's life the additional lump sum contribution may provide an opportunity to discuss various investment issues in lessons devoted to personal finance.

The issue to be resolved is how much the additional endowment should be. The AITC recommends a significant contribution of at least £250. This amount has the potential to contribute significant fund growth over the remaining 11 years of the fund. If the top-up endowment is low, say £50 or thereabouts, the Government would be better advised to make a larger initial contribution and not bother with a later endowment. The primary objective of endowments should be to maximise available funds at the end of the period. A small additional contribution does little to achieve this, and other measures could be taken to deliver the secondary benefits discussed above.

Requiring the provision of a Stakeholder CTF

The AITC does not support the decision to force all providers to offer a default CTF as a precondition to providing their preferred investment approach. It may exclude many providers from this market (and we believe the objective should be to maximise choice and competition).

Requiring the provision of a stakeholder CTF alongside other options is a significant decision with wider policy implications. Personal pension providers, for example, are not required to provide a Stakeholder Pension as a prerequisite for entering that market. Does this move signal that this may change in the future? The Government should clarify why it has decided to take this line. Will it extend this approach to other Stakeholder products (the medium term investment product, for example)?

The AITC fears that the provision of a Stakeholder option has been made compulsory for all market entrants because the Government is not confident that there will be sufficient entry into this section of the market. This suggests that the rules will not effectively balance the needs of consumers and providers. This is a serious problem, as without a proper balance being struck the CTF is likely to be a failure in the long term. Providers may not enter the market or will leave it if they cannot find a way to meet their legitimate commercial objectives.

The Government's first objective should be to ensure that the rules for the Stakeholder CTF meet the needs of both consumers and providers. This will ensure sufficient entry into this part of the market. To ensure consumer interests once this has been achieved, the AITC recommends that a provider of a non-Stakeholder CTF be required to highlight in its product's Key Features Document that Stakeholder options exist and that this product is not a Stakeholder version. This approach is already adopted in the CAT Standard ISA market and there is no reason that it would not work satisfactorily in this one.

Life-styling obligations

The AITC understands the Government's decision to include a life-styling option in the Stakeholder CTF. This will protect fund gains in the event that a market falls as the CTF approaches maturity. However, it will also limit gains if markets are still rising. It also assumes that CTF funds will be instantly spent and will not be rolled over into ongoing saving. There are advantages and disadvantages to life-styling, but on balance the Government's decision is appropriate.

The AITC is keen that the life-styling approach required is simple. This will make it both manageable for providers and easy for consumers to understand. We recommend that the life-styling approach adopted simply requires providers to convert 20% of the fund into cash in each of the four years up to the maturity of the CTF. By the CTF holder's eighteenth birthday they will then have 80% of the fund in cash and 20% in equities. The last 20% would be sold when the product is closed. We also recommend that the account holder should be able to opt out of the life-styling process if they wish. Giving consumers the right to convert cash back into equities should not, however, be something providers are compelled to offer within the Stakeholder CTF. This would involve significant costs that are unlikely to be recoverable within the cap.

Charge cap

The AITC supports the creation of a CTF charge cap. If it is constructed in a manner that allows providers to recover their costs, and allows a reasonable commercial return, it would be acceptable for it to apply to the whole CTF market. The condition that it be appropriately constructed is a significant one. Much attention has been paid to a possible increase in the level of the cap. However, before any decision on this issue can be made, a more fundamental decision on its structure should be settled.

To date investment trust based products have tended to be excluded from cost-capped products. This is not because they are inherently expensive or inappropriate but has arisen as an unintended consequence of the way that cap rules have been formulated. This is unhelpful for the investment trust sector and is very unfortunate from the consumer perspective as it excludes a whole class of underlying investments that can both offer attractive investment options and may be cheaper than their competitors. The returns that investment trusts can generate have been discussed above. However, many investment trusts are also less expensive than other collective funds. For example, the 10 cheapest global growth funds (broadly diversified equity funds which would be eminently suitable for the CTF) have total expense ratios between 0.14% and 0.47%. This falls well below the 1% threshold currently envisaged and yet still these funds have difficulty meeting the terms of the current 1% caps.

The problem is that caps currently used achieve a 1% limit by requiring funds to levy no more than 1/365th of 1% of the value of the fund each day. This is fine for vehicles that accrue costs on a smooth basis. It does not work for investment trusts. The reality is that, while the total level of charges is low, they are charged to the fund unevenly. This is not generally problematic for investors. Unfortunately, it is a hurdle that cannot be overcome for the purposes of meeting current cost-cap requirements.

The AITC recommends that a new approach be adopted for CTF cost caps (and other stakeholder products as they are developed). This would involve basing the cap on a Reduction in Yield (RIY) calculation. RIY is a well-established means of measuring costs (it has been used in Key Features Documents since the mid 1990s) and could be easily introduced into the rules. As well as facilitating investment trust entry into the CTF, it would also offer significant advantages for the consumer. It maintains a "one-figure" approach of the current 1% charge caps, enabling costs to be easily compared. (Other proposals for cap reform involve a two-tier cap, which would be confusing for consumers). It can also take into account fixed costs, which is particular important for investment trusts whose costs do not all accrue evenly. It is also based on an established methodology, developed by the FSA for giving consumers clear information. It would be cost-effective for providers to administer, helping providers bear down on charges.

The inherently complex nature of current caps has meant that the regulations drafted to implement them in the past have sometimes been flawed. For example, the Stakeholder Pension rules do not require the underlying costs of running an investment trust to be included in the charge cap, which is completely illogical and against the spirit of the rules. While this has not been a substantive problem for this product to date, this issue should be addressed in future cost caps, including the Child Trust Fund.

Only once the structure of the cap has been revised can proper attention be paid to its appropriate level.

Stamp duty

The treatment of stamp duty within the CTF is particularly important to investment trusts. Stamp duty of 0.5% is levied on the purchase of investment trust shares. For technical reasons other collective investment vehicles do not attract a charge on this scale. The Government should ensure the tax treatment of all vehicles is equivalent.

The AITC recommends that stamp duty should not be levied on investment trust shares purchased within a CTF wrapper. This will maximise competition between vehicles and maximise returns for young people. We also note that the levying of stamp duty within a capped product makes it very difficult for investment trusts to meet the likely demands of a cap. The Government should be serious about including investment trusts within the CTF regime and should address this important issue.

Minimum contributions

The Government has yet to determine the minimum contribution a CTF provider will have to accept. There have been suggestions that it will be as low as £20. We believe this is too low.

The CTF will be most effective if it is designed to fit within parent's broader personal finance arrangements. Encouraging occasional CTF contributions of £20 from those who would be better advised paying off credit card bills or making contributions to a cash ISA is unlikely to be of much benefit to the child if it is done at the expense of a more stable financial environment in the immediate term. It is also unclear that a higher contribution level of, say, £50 would be detrimental to the child. Those able to afford regular savings of £20 a month would, instead, be able to afford £60 a quarter. Those with £30 to save each month would

be able to contribute £60 every two months. Regular savings of this nature could easily be facilitated via feeder accounts and direct debits. Enabling providers to accept slightly larger sums will also help keep administrative costs down.

We recommend that the minimum contribution providers are obliged to accept be set at £50.

Conclusion

13. This paper deals with a number of complex issues. The AITC would be pleased to provide further information on any of the points raised in this note if that would be helpful.

14. We would also welcome the opportunity to provide oral evidence to the Committee to explore key points in public if that would be possible. There are fundamental issues regarding the CTF yet to be resolved and we firmly believe that a public debate could be invaluable in helping the Government finalise its proposals to create an effective CTF able to provide significant assets for young people when they reach the age of 18.

November 2003

Memorandum submitted by Nationwide Building Society

1. Introduction

1.1 We are pleased to have this opportunity to outline Nationwide's views on the Government's plans to introduce the Child Trust Fund (CTF) in April 2005.

1.2 Nationwide is a major provider of children's savings accounts, with 1.5 million children saving in our "Smart 2 Save" (0–11 years) and "Smart" (12–18 years) accounts.

1.3 We have been closely involved with the development of CTF over the past two years, both in responding to formal consultations run by HMT, and in holding meetings with HMT officials to talk through potential issues for providers.

2. Nationwide's Overview on CTF

2.1 Nationwide is very supportive of CTF and intends to be a significant provider in the market. We already offer a range of simple, transparent and good value deposit and equity savings products. We see CTF as a good fit within our product range.

2.2 Our main message to the Government since the concept of CTF was first raised has been "keep CTF simple". Simplicity in the way the account is structured, opened and administered will ensure that the maximum number of parents and children will engage with the initiative. Simplicity will also keep down distribution and administration costs of providers to a level that will allow the Government to levy a fair price cap.

2.3 We believe the concept of providing each child with a financial asset is potentially very powerful in terms of encouraging a wider savings culture in the UK.

- In the shorter term, parents, grandparents etc will feel more disposed to save for children. Parents may also be more prepared to discuss their broader financial needs, given the change in life stage that occurs when they have a child. The Government could link this into their wider plans for "financial health checks" that have been suggested in some preliminary work undertaken with the FSA.
- In the medium term, the CTF will help keep the savings habit alive in the form of Government top ups, annual statements, communications from providers encouraging additional savings and a higher profile for financial literacy education in schools.
- In the longer term, maturity of the CTF will give young adults the opportunity to consider what to use their asset for. We believe there should be encouragement for them (eg tax incentives, further Government endowments, provider incentives) to roll all or part of their asset into another savings vehicle such as an ISA or Stakeholder Pension.

2.4 We believe that CTF will run in parallel to the current children's deposit savings market, where access to funds is a key requirement. CTF is more likely to offer direct competition to other long-term savings vehicles such as Equity ISAs, Stakeholder Pensions, Friendly Society Bonds and unit trusts targeted at saving for school fees, etc. Overall, we believe that with a strong awareness campaign, introduction of CTF will lead to an overall increase in saving for children and increased competition in the market.

3. Comments on HM Treasury's Detailed Proposals for CTF

We have set out below comments on the Government document *"Detailed Proposals for the Child Trust Fund"*. These follow the structure of the report.

3.1 *Key Features of the CTF*

We are fully supportive of the key features of the CTF as outlined. Many are based on the ISA regime, which will allow providers to minimise costs and development time in launching their CTF products.

3.2 *Qualifying for a CTF account*

- The child benefit system seems a sensible platform on which to base entitlement.
- The confirmation of a further Government payment at age seven is welcome. This will help keep the account "live" in the minds of parents and children.

3.3 *Choosing and Opening a CTF account*

- We believe that one of the keys to making CTF a success will be ensuring a clear opening procedure. The sheer volume of potential openings in April 2005, when, as a result of the initiative being backdated to September 2002, there will be circa 1.7 million children eligible for the account, will require a simple streamlined process that meets the need of a very wide range of consumer.
- We intend making use of our "usability" facility to test consumer reaction to various sales process scenarios for opening of CTFs. We plan to invite HMT and FSA officials to view the processes to help them as they put together the detailed rules for opening and running of CTF.
- We note from para 3.8 that the Government is looking to work closely with interested parties in how information and guidance can be provided to parents when they receive their voucher. Given our experience in opening and administering children's savings accounts, Nationwide would be very happy to give assistance as required.
- Whilst not an issue for Nationwide, the requirement for providers to offer a Stakeholder CTF account may make it difficult for many smaller building societies to participate in the market.

3.4 *Charges, Contributions, Tax Treatment and Closure of Accounts*

- We have concerns around the timing of key announcements that will determine the structure of the market. The Government plans to introduce CTF in April 2005, with parents of children born after September 2002 being able to apply for the account from January 2005. Given the likely delay of an announcement of a Government price cap until January 2003, this will give providers only a year to develop systems.
- Decisions are also outstanding around minimum premiums and sales processes. We are keen to encourage the Government and regulator to let providers have as much of the detail available as soon as possible. This will allow the launch of the initiative to proceed smoothly for consumers, providers and Government.
- We believe that providing CTF within a tight price cap will be challenging but not impossible for efficient providers. The Government has a crucial role to play in keeping the account as simple as possible. We hope they continue to liaise with the industry to ensure that final rules around the operation of the account are properly thought through and implemented in good time.
- Participation in the CTF market will require providers to take a long-term view of the opportunities from this market. It is in the interests of both the Government and industry to ensure that the CTF is widely publicised so that more accounts have voluntary contributions. We welcome the commitment of the Government to a major awareness campaign to coincide with the launch of the account.

3.5 *Strengthening the Saving Habit*

- As a savings institution, Nationwide strongly supports the Government's broad agenda to strengthen the savings habit in the UK. We have set out in para 2.3 of this response the potential short-, medium- and long-term benefits this could bring.

3.6 *Operational Details, Reporting and Compliance issues*

- We note that the Inland Revenue are planning to use paper-based vouchers for CTF openings. The ability to use electronic recognition technology (such as bar codes) of key data fields will help providers collate and store data, improving processing efficiency. We would urge the Government to encourage the presence of this technology on the vouchers.
- Given the increasing popularity of the internet, it would be useful if the Inland Revenue could explore ways in which this channel could be used for customers to open CTF accounts.
- We understand the Inland Revenue's desire to keep a tight control on the administration of the CTF. However, we feel it is overly onerous to require fortnightly returns from providers with details of accounts opened, closed and transferred. We believe that this requirement should be monthly.

4. Conclusion

4.1 The Child Trust Fund represents an opportunity for a partnership between the Government and financial services industry to develop a simple, transparent children's savings account. This has the potential to deliver a significant financial asset at maturity and play a central role in raising financial awareness amongst parents and children.

4.2 Nationwide Building Society warmly welcomes this new initiative and intends to become a major player in the market.

6 November 2003

Memorandum submitted by the Personal Finance Education Group

1. Pfeg (Personal Finance Education Group) is an education charity whose mission is for all young people to leave school with the confidence, skills and knowledge they need in financial matters so that they can participate fully in society.

2. It receives cross sector support from education, business and Government and is a leading force in the delivery of personal finance education within schools. It works closely with Government departments, teachers, consumer bodies, the Financial Services Authority and finance sector representatives and is the only charity working within schools across the UK at a strategic level to promote the development of financial capability.

3. The goal of the pfeg is to promote and facilitate the education of all UK school pupils about financial matters so that they can make independent and informed decisions about their personal finances and long-term security.

4. Key elements of pfeg's vision:

- Financial education is essential for all school pupils, regardless of their economic or cultural background or their ability level;
- Active citizenship—personal finance education should equip young people with knowledge and understanding about financial matters so that they can understand how their needs, present and future, fit within the context of their community;
- Cultural diversity—recognition that within society there are different ways of viewing finance;
- Enterprise—personal finance education also needs to assist pupils to think about how money is generated and made through the sale of products or services, and to help them through participatory activities and experiences to become more entrepreneurial and creative in their attitude to and use of money, including the skills to manage risk appropriately;
- Pfeg recognises the many competing demands on the timetable and that many teachers lack confidence in the area of personal finance education;
- Pfeg seeks to provide a variety of solutions to support teachers deliver high quality experiences that are engaging and relevant for young people and that help meet learning objectives in a number of subjects.

5. Pfeg has achieved many successes since it became a charity in 2000 including:

- Becoming an established organisation with a positive reputation and credibility;
- Establishing a profile for its work among industry and increasingly in the media;
- Being well placed to maximise opportunities as personal finance education has strong political "currency";
- Developing and managing a range of effective products which are building knowledge, starting to raise standards and developing best practice including the Quality Mark and Excellence and Access;
- Building an Advisory Group to 57 member organisations;

— Raising substantial amount of funds;
— Attracting a high profile Chairman.

Excellence and Access

6. This innovative project was designed by the pfeg to meet the challenge of raising awareness of financial capability in the classroom and to raise teacher confidence in putting personal finance education into practice. Personal finance can be daunting for teachers and pupils alike so *Excellence and Access* aims to enable teachers to become skilled and confident in teaching it. Many schools choose to include Personal Finance Education as part of the Personal Social and Health Education (PSHE) curriculum and Citizenship but some are teaching it through other areas of the curriculum, such as mathematics, business studies, geography and information technology. Teachers and schools agree to plan around 10 hours work across a whole year group, in an area which matches their priorities and School Improvement Plan, and most programmes begin with pupils' views in deciding the content of lessons. There is an emphasis upon active participatory learning by pupils and upon developing the transferable skills associated with financial capability, rather than upon factual acquisition alone.

7. Between 2000 and 2004 pfeg will have worked with up to 300 secondary schools in England, providing each school with up to three days' training for two staff and four days of the services of a dedicated school adviser. Pfeg school advisers are usually independent consultants, who also work for other clients; most are teacher trained, and a few are serving Local Education Authority (LEA) advisers. They were chosen through a rigorous process of selection and each participated in an initial residential training course, which has been followed up with termly training workshops throughout the life of the project. They engage in curriculum and lesson planning, finding and developing resources, assisting in the classroom and helping schools to evaluate their progress. In most cases, schools find adviser support invaluable in helping them to focus upon personal finance as distinct from other issues covered in PSHE, and to support them in developing lively teaching approaches and using suitable resources, all of which exist already and are accessible, but which hard-pressed teachers rarely seem to find or make best use of unaided.

8. The project has developed the view that for young people there are three essential spheres of activity where they need to develop their financial acumen and capacity to operate effectively. The first of these is in the personal sphere (Do I need a bank account or a credit card? How do I gain best use of these? How do I choose between the competing offers available, eg for credit and loans for major purchases?) The next is in the civic sphere (Why do I have to pay taxes? Do I realise when I am actually paying tax, eg through duty on petrol or VAT? What does the Government do with its money? What benefits may be available from Government to help me financially that I am not currently aware of?) Thirdly, there is the business and enterprise sphere (How can I gain satisfaction and make enough money for my chosen lifestyle? What are the relative benefits of a job or of being self-employed? If I choose to run a business, how do I raise the money needed, and what else will I need to know to manage the finances of my business effectively?)

9. *Excellence and Access* thereby has created a critical mass of expertise and good practice that will be disseminated more widely in each region nationally. Many Local Education Authorities across England have offered their active support and the project works closely with them. A wide variety of school and some colleges are represented, and their students reflect the diverse cultural, social and economic backgrounds found in England today.

10. *Excellence and Access* is funded until July 2004 by four major financial services companies as well as a small amount of funding from the Department for Education and Skills mainly contributing towards the costs of setting up the project. At the present time, it has not been possible yet to identify funding which will allow for similar levels of support for schools and teachers to be continued. There is a danger therefore that in some schools personal finance education will not develop.

11. *Excellence and Access* is now moving rapidly towards its dissemination phase. Pfeg will publish by January 2004 eight Good Practice Guides, which cover the major strands of the project (key stages 3, 4 and 16–19 and generic areas like Cultural Diversity and The World of Finance) as well as develop a larger number of case studies of good practice in personal finance education that will be featured on the website. In addition, from January to May 2004, there will be a national dissemination conference and nine regional dissemination conferences to which key local stakeholders will be invited. The purpose of these will be to celebrate what has been achieved in many project schools (the conferences will have workshops run by teachers and pupils from those schools which have developed exciting approaches) and to encourage those who have not been involved yet to make use of this experience in their own schools. It is hoped that many of the LEAs will be able to offer some support to their schools in doing this.

12. An independent evaluation of *Excellence and Access*, undertaken by Brunel University, has concluded that the project has:

— Raised the profile of personal finance education;
— Reached and influenced a large number of schools and teachers;
— Shown that is possible to improve pupils' financial awareness;
— Developed a rich and extensive source of materials and guidance for new schools and teachers;

— Clearly illuminated the problems involved in introducing this new curricular area in schools;

— Mapped out a challenging agenda for policy makers and practitioners.

13. The project has also learnt some important lessons for the future:

— stronger messages still are needed from Government overall that "teaching for financial capability" should feature clearly in the school curriculum;

— the capacity of many schools in the current climate to cope with further innovation and change is limited, and the pressures of the current curriculum, particularly at Key Stage 4, mean that personal finance can be given very marginal and cursory coverage in some schools;

— the capacity of many schools to work directly and effectively with parents (which is believed to be vital) in this area is limited;

— the need for even more time for school support over a longer period, probably for at least two complete school years, if programmes are to be fully embedded in the curriculum and the school's practice;

— the need for an ongoing and relevant supply of up-to-date classroom resources for financial education, especially relating the personal sphere of financial understanding to the business and enterprise sphere.

The Child Trust Fund

14. Pfeg warmly welcomes the proposals on the CTF detailed in the recent publication by HM Treasury and Inland Revenue, and endorses the view that "the CTF . . . will reinforce and support the delivery of financial education in schools by ensuring that every young person has access to a financial asset, increasing the relevance of financial education for all and helping young people understand the advantages of saving." However, pfeg believes that the CTF will be unable to achieve this by itself, and that it needs to be supported with a stronger view from Government as a whole about the necessity for schools and the education world to develop a coherent approach to the development of financial capability which covers the whole statutory school period and also 16–19.

15. This raises the issue of the optimum age at which education about saving and the CTF should take place. In one sense, the place to start, in 2004–05, with the CTF shortly coming on-line is with older secondary students, 14–19 year olds, as many of them will become parents within five to 10 years, and will have children who are amongst the first cohorts to receive the CTF. On the other hand, if one asks the question where is it best to educate children about the savings habit, with the best chance that it will form attitudes that are consolidated throughout adult life, the answer is undoubtedly, that this should be during the early years of education and in the primary school phase. There are also grounds for believing that crucial lessons are learnt during the early secondary years (11–14) as children move from being dependent to planning for independent lives of their own, along with the associated development of values and attitudes which may differ from those of their parents.

16. Pfeg has the expertise available to support work in secondary schools with the 14–19 age group on the introduction of the CTF in the wider context of teaching about savings and personal finance from 2004 onwards. Consideration of the topic of saving and the ways this can best be achieved, in particular through the products and services offered by banks and building societies, already features in many *Excellence and Access* school programmes. Several schools have also done work either on the cost of weddings, of living independently or of having a baby and bringing up a family, and material on the Child Trust Fund would fit very well in this context also.

17. Pfeg is also currently negotiating a possible project to support financial capability in primary schools, and would hope to be in a position from 2007 to support primary teachers to embed work on the CTF within programmes of PFE.

18. Pfeg would be happy to continue working with HM Treasury and the Inland Revenue, "to assess what additional support will help children engage with their CTF and ensure CTF objectives are met". We agree that the main activities here will be continued professional development of teachers; updated guidance, possibly including a requirement to teach personal finance education, in a similar way to that currently being introduced for work-related education; as well as direct advice and consultancy for school leaders and teachers in the classroom on how this can be best delivered.

19. It would be possible, for example, for pfeg to organise and deliver training for two teachers from every secondary school in England, over say a two- to three-year period, to enable them to introduce the resources commissioned by Government to support learning through the CTF and related topics in the classroom. [It merely lacks the funding at the present moment to do so.] This could be further consolidated by consultancy in-school from an adviser for those schools who wished for more support. We believe that something like this will be essential if the proposed considerable outlay by Government in producing good quality resources is to be cost effective. There are too many examples currently of excellent resources merely being sent to schools, which gather dust on the shelves of a stockroom and are unused in the classroom.

Quality Support for Teachers

20. Pfeg has a well-developed website (www.pfeg.org) which both acts as a source of information on the project and as a guide to teachers what resources are available for teaching personal finance education in each key stage. Pfeg has produced few resources itself, in part because this is unnecessary in the light of the wide range of resources for schools produced by the financial services industry, the FSA and other bodies. Links on the websites give easy access to many of the resources, which have downloadable materials and sometimes also interactive ICT-based activities that can be used in the classroom. Most of the resources are free of charge to schools and paper versions can also be ordered directly through the website. Most have been rigorously assessed against the pfeg Quality Mark criteria and the website indicates those that have met the standard.

21. The pfeg Quality Mark for recommended teaching resources is designed to raise standards and enable teachers to feel confident about the educational relevance of teaching materials. The main principles underpinning the standard are:

— resources are developed in partnership with teachers and tested in schools;
— educational benefits are of prime importance, with resources linked firmly to the curriculum;
— there is no promotion of branded products;
— resources are expected to present a balanced view and a recognition of equal opportunity issues;
— providers are committed to keeping pfeg informed about the availability of resources; and
— providers agree to regular reviews.

22. The Quality Mark is endorsed by the Department for Education and Skills, the Qualifications and Curriculum Authority, Learning and Teaching Scotland, the Northern Ireland Council on the Curriculum, Examinations and Assessments and the Financial Services Authority.

4 November 2003

Memorandum submitted by the Financial Services Authority

A. Introduction

1. The Committee is holding an inquiry into the Government's proposals for the Child Trust Fund (CTF) which were published[6] on 28 October 2003 (proposals paper). The Committee has asked the FSA for a memorandum on the implications for its regulatory responsibilities under the Financial Services and Markets Act 2000 (FSMA).

2. The FSMA gives the FSA four main objectives: to maintain confidence in the financial system, to promote public understanding of the financial system, to ensure the appropriate degree of protection for consumers and to reduce financial crime. The CTF proposals will need to be assessed under the second and third of these objectives.

3. We welcome the concept of the CTF as a means to help consumers, particularly young consumers, appreciate the importance of saving over the longer term and to provide a structure within they can be encouraged to do so.

4. The FSA looks forward to detailed discussions with the Inland Revenue and the Treasury about how the Government's proposals can most appropriately be developed and the product delivered to young people.

5. Our regulatory interest in the CTF proposals can be considered under three main headings:

— inclusion of the CTF in the scope of FSA regulation;
— regulatory requirements; and
— consumer education and information.

B. Inclusion of the CTF in the Scope of FSA Regulation

6. We understand that the activity of being a CTF provider will not be a specified regulated activity in the Financial Services and Markets Act 2000 (Regulated Activities) Order 2001 (RAO). This means that firms will not require the FSA's permission to provide CTFs. Instead, this will be a matter for the Inland Revenue, which mirrors existing requirements for ISA managers.

7. However, the activity of being a CTF provider will entail the carrying on of (regulated) investment and deposit-taking activities, for which firms do require FSA permission. This means that only those firms which are authorised by the FSA and have the relevant permissions will be able to provide CTFs. Again, this mirrors existing requirements for ISA managers.

[6] *Detailed proposals for the Child Trust Fund.* HM Treasury and Inland Revenue.

C. Regulatory Requirements

8. Though our prudential regulation of authorised firms the FSA will need to be satisfied that a firm proposing to provide CTFs can meet its obligations under the FSMA to have the resources to do so.

9. The proposals paper (paragraph 4.2) says "the Government is committed to making the CTF available within the stakeholder product suite". That is a decision for Government, not the FSA. We will now consider what regulatory requirements it would be appropriate to put in place for the various products within the Government's stakeholder suite and will consult on any changes we propose to our *Handbook of Rules and Guidance.* We expect to consult on a streamlined sales regime for stakeholder products in early 2004. We aim to incorporate the CTF in these proposals although the details of the structure of the CTF—and so the potential risks to consumers—have been defined only very recently.

D. Consumer Education and Information

10. We welcome the emphasis that the Government has put on the need for CTF-specific consumer education and information. If the CTF is to achieve its potential then clearly consumers need to appreciate how to maximise that potential for their own benefit. It will be particularly important for young people to be aware of the relevance of their CTF as a vehicle of saving and as an asset from which they can benefit when they reach 18 years of age.

11. On 20 October we announced[7] our Financial Capability Steering Group which, under our leadership, will develop and implement a national strategy for financial capability. The objective is to provide consumers with the education, information and generic advice they need to make their financial decisions with confidence. We will publish shortly a paper setting out the thinking that has led us to adopt this approach. The FSA, advised by the Steering Group, will publish a draft strategy by the end of March 2004. The strategy will set out a co-ordinated approach in the provision of financial education, information and generic advice across Government, the industry, trade and consumer bodies, non-governmental organisations and the FSA itself.

12. The proposals paper makes the point, with which we agree, that appropriate financial information and education linked to the CTF will help children make decisions about the use of assets when accounts mature and that interaction with a real-life saving or investment vehicle will support wider financial education in the classroom. We also agree that parents will require appropriate financial information and education to assist them to make initial choices about their child's account and to assist them in supporting their children.

13. Consistently with the wider initiative we are taking, we will work with Government Departments and other interested parties in developing a strategy for financial information and education associated with the CTF. As part of this, we will consider what role we ourselves will play in helping to develop and deliver material and messages, for example through our financial education work and through our consumer information activities (including our consumer website). As part of the wider initiative, we are investigating the scope for developing interactive generic advice services: and we will take account of the CTF in this work.

7 November 2003

Memorandum submitted by the Homeowners Friendly Society

Executive Summary

- Homeowners is a leading friendly society with over 230,000 members.
- Homeowners believes firmly in the Government's objective of widening the opportunities for saving for all and is committed to being a Child Trust Fund provider as part of our strategy to provide long term, good value, transparent savings for families. This commitment extends to a belief that low charge-capped products deliver value across the social spectrum.
- Homeowners has been working closely with the Treasury Savings policy team since the beginning of 2003 and has provided them with pertinent and well-received consumer research into potential CTF saving. As a result of the CTF, our research shows—72% of people believe that the total level of savings for children would increase—a key Government objective.
- Financial literacy must be established as a key skill and we call on the Government to commit significant public purse resources for the FSA consumer remit.
- Homeowners is happy to meet the 1% price challenge but understands that other providers may have difficulty in meeting the challenge within their current business models. A 1% price cap may therefore, limit diversity and be detrimental to the consumer.

[7] FSA names Financial Capability Steering Group members. Press release 111/2003.

— Homeowners believes all CTF investors should have an equity option promoted in the first instance unless clear ethical, religious or wider social beliefs mean equities are not suitable.
— Homeowners feel strongly that allowing a non-stakeholder version of the CTF to be offered will open the door for many providers to offer, and heavily market, complex CTF variants with high charging structures. This coupled with the fact that providers are not required to accept revenue allocated funds will result in many providers competing to attract the higher end of the market. This does not appear to embrace the original concept and vision of the CTF—that of widening ownership of financial assets to all sectors of society.
— Homeowners also believe that allowing providers to offer "other CTF account choices" provides the potential for many providers to promote a deposit-only investment option for mass-market savings in preference to equities. There is therefore a danger that Government objectives may not be met as the CTF investors who choose the deposit option will not benefit from the potential offered by the equity growth.
— Homeowners launched a 1% charge capped children's savings product in April 2003—Better Start. Better Start has both equity and deposit options.

Homeowners Friendly Society and its Commitment to the Child Trust Fund

Homeowners is a leading friendly society in the UK with over 230,000 members. We are a mutual society owned by our members and not by shareholders who would be entitled to take a slice of the society's profits. Instead, all profits made are put to use for our members' benefit.

As a friendly society, Homeowners is relatively young, being formed in 1980. We see ourselves as a "contemporary" friendly society, still holding true to the traditional values of mutuality, but with an awareness of what it means to live in the 21st century.

Our mission is to help people to protect their welfare, in a world where individuals are increasingly having to provide for themselves what used to be provided by the State. We aim to fulfil this mission by providing accessible, simple, value for money savings and protection products, and we are constantly seeking to expand our product range with relevant offers.

Homeowners believes firmly in the Government's objective of widening the opportunities for saving for all and is committed to being a Child Trust Fund provider as part of our strategy to provide long term, good value, transparent savings for families. This commitment extends to a belief that products with low charging structures deliver value across the social spectrum.

Homeowners and Treasury Child Trust Fund Research

Homeowners has been working closely with the Treasury Savings policy team since the beginning of 2003 and provided them with pertinent consumer research into potential CTF saving in advance of Budget 2003.

We have also shared this work with Deloittes as part of the Treasury's assessment of Sandler pricing within the Stakeholder "suite" of products. The research was commissioned in January 2003. A full copy of the research is available in the annex to this submission.[8] The main points from the research were as follows:

— A high proportion—71% of parents and grandparents currently save for their children/ grandchildren.
— When selecting an investment for a child, the most important factor is return on investment—74%.
— The vast majority—85% of those interviewed rate the CTF as good or excellent.
— Some 81% of people think they would make additional personal contributions to the CTF.
— In socio economic groups D and E—some 62% would make additional contributions.
— As a result of the CTF, almost three quarters—72% believe that the total level of savings for children would increase.
— A high percentage—84% state that the tax-free status of the Child Trust Fund would encourage them to make further contributions.
— The vast majority—88% think that £500 would be a reasonable or generous initial contribution.
— Almost two-thirds—61% would like to view details of the CTF over the Internet.
— A universal flat rate benefit is the preferred approach of 58%.
— Evidence shows parents would like to have some say in choosing how the fund is invested—80%.
— Education is by far the most mentioned end use of the fund—64%.

[8] Not printed.

Education and Information

Homeowners firmly believes that there is an urgent need for the Government to reform financial education. The present curriculum does not prepare children for the inevitable effect financial products and savings will have on their future. We welcome the Government's attempts to promote this agenda, and the actions taken to date, however, if we are to encourage a long-term savings culture through the Child Trust Fund, the Government must commit more funds and review the present curriculum.

The industry approach to promoting financial education within schools, currently being developed by the Personal Finance Education Group (PFEG) has been commendable, however, we understand that PFEG's impact has been limited to date due to a lack of funding.

If CTF is to achieve its potential the Government needs to invest significant resources, and not just in schools. Homeowners believes that the resources should also be extended to promote financial understanding in later life as well. The CTF should be used as an opportunity to improve financial education across two generations. We would also recommend that the FSA ensure that such issues are prioritised as part of their forthcoming consumer strategy.

We are pleased the Government is now focusing on a national education and awareness programme for CTF but more needs to be done—and more quickly. Homeowners would like to see further recognition in the National Curriculum. Financial literacy must be established as a key skill and we call on the Government to commit significant public purse resources for the FSA's consumer remit.

CTF Pricing—Stakeholder and Non-Stakeholder Options

In the Inland Revenue document: *Detailed Proposals for the Child Trust Fund* (October 2003) it is clear the "Government will set out later this year the level of charge cap to be applied to CTF accounts"

Homeowners believes charging remains one of the most important elements in the overall CTF product composition. Why?

Public money is being used to create the CTF and we think this should mean that the financial services industry has a duty to act with responsibility. There is a huge opportunity to instil in young people the savings habit—but this should be done so as to ensure that there are young savers in the future who have confidence in their financial services providers. Homeowners believes this must be a fundamental aim of Government policy.

We are concerned that the Government is set to offer both Stakeholder and potentially non-Stakeholder versions of the CTF to encourage as many providers as possible to enter the market. While this will indeed provide market choice it will open the door for many providers to offer, and heavily market, complex CTF variants with high charging structures. This coupled with the fact that providers are not required to accept revenue allocated funds will result in many providers competing to attract the higher end of the market. The net result could be that the CTF will then begin to stray away from original policy intentions—low cost, good value and transparent products with the aim of widening ownership of financial assets to all sectors of society.

Homeowners believe that we are advantageously placed to offer a stakeholder CTF product at 1% amc with no initial charge, even if the eventual cap is higher. Having said this, we understand that other providers may have difficulty in meeting the challenge or may be prevented from doing so by the nature of their distribution. A 1% price cap may therefore limit diversity and be detrimental to the consumer. An appropriate balance will need to be found.

Below, we outline the effect of charges on a wide range of friendly society products. The Homeowners Better Start child savings plan highlights the impact a 1% Sandler style charging structure can have when compared to the traditional higher charge products. Fundamentally we think children and their investments need to be treated with respect—the CTF is an opportunity to do that.

FSA Comparative Tables by the Financial Services Authority—Tax Exempt Savings Plans

Information taken from the FSA's Comparative Tables database as at 3 November 2003

Provider	*Product name*	*Charges and Deductions (£)*	*Charges in the early years (£)*
Homeowners	Better Start Child Savings Plan	232	15
Homeowners	E-Friendly Savings Plan	395	55
Royal Standard FS	Child Endowment	476	111
Nottingham FS	Second Step	482	216
Homeowners	Friendly Society Savings Plan	499	124
Scottish Friendly	Child Bond	534	218
Royal Liver	Tax Exempt Savings Policy	590	165

Provider	*Product name*	*Charges and Deductions (£)*	*Charges in the early years (£)*
Family Assurance FS	Junior Bond	594	247
Liverpool Victoria	Tax Free Savings Plan (child)	600	228
Healthy Investment	Tax Free Savings Plan (child)	677	421
Children's Mutual	Baby Bond—Exempt	682	311
Children's Mutual	Youngsters Bond—Exempt	682	311
Red Rose FS	Tax Exempt Savings Endowment	719	275
Teachers	Tax Free Savings Plan	759	390

Based on £25.00 per month for a child under 10 years of age, over a 10 year period

Investment Choice

We are extremely pleased the Government has prescribed that all CTF providers must meet the benchmark of providing a Stakeholder CTF account. To quote from the Inland Revenue document: Detailed Proposals for the Child Trust Fund (October 2003): "The Government wants all families to benefit from the potential higher returns that might be achieved through equity investments"

However, we are concerned about the potential for providers to offer "other CTF account choices" (Inland Revenue: *Detailed Proposals for the Child Trust Fund* October 2003). This provides the potential for many providers to promote a deposit-only investment option for mass-market savings. There is a danger therefore that, Government objectives may not be met as the CTF investors who choose the deposit option will not benefit from the potential offered by the equity growth.

This situation is likely to be exacerbated by the fact that the lack of previous involvement in equities means that the majority of savers in the country are likely to opt for a "risk-free" option even over an 18-year investment period.

Crucially, the greater the ability to move from the stakeholder version, the more complex the products designed will be. This will be in opposition to the findings from the Sandler report and will enable opacity and complexity to be an excuse for the industry to over-charge.

Homeowners believes all CTF investors should have an equity option clearly promoted as the first choice unless clear ethical, religious or wider social beliefs mean that equities are not suitable.

Better Start Child Savings Plan

Finally, in the context of the development of CTF policy, Homeowners Friendly Society launched a new child savings plan, Better Start in April 2003. The plan is a Sandler friendly price capped children's savings plan with tax benefits which is designed to encourage parents and grandparents to save for their children's future.

The simple, accessible and easy to understand plan has a low annual management charge of 1% and no opening charges or policy fee of any kind, which makes the charging structure unquestionably the most competitive for a tax-exempt friendly society savings plan.

There are many features of Better Start that make it a unique product in the market:

- Parents have a choice of fund. They can select one of a number of options, including a deposit fund, equity fund and ethical fund in which to invest Better Start Child Savings Plan contributions. However the default fund is the equity based FTSE tracker option.
- Savers are given added flexibility and choice, as Homeowners allow the investors' money to be moved from fund to fund at no charge up to three times per year, which can maximise an investors interests.
- Investors have the choice to save monthly or annually.

Since we launched Better Start some 60% of customers have invested in an equity fund with a further 10% investing in an ethical investment option. The remaining 30% have invested in a deposit fund.

November 2003

Memorandum submitted by the PEP & ISA Managers' Association

Executive Summary

- PIMA (the PEP & ISA Managers' Association) is widely representative of all types of asset managers. We have in excess of 100 PEP & ISA managers as members, representing over 70% of all PEP/ISA accounts.

— PIMA members are committed to the principle of offering the CTF as an important step towards encouraging savings growth but wishes to see all forms of investment choice promoted.

— PIMA recommends that the existing ISA structure, regulations and authorisation are used for the Child Trust Fund and that it should encourage equity based investment (CTF).

— PIMA recommends that providers be allowed to call the CTF a Childrens ISA.

— PIMA has a number of specific issues it wishes this Inquiry to consider: charge capping and its effect on provider take up and investment choice offered; how Inland Revenue allocated CTF accounts for children whose parents elect not to take up their child's CTF should be handled by providers; allowing children who qualify for a CTF—ie those born from September 2002—to start their subscriptions immediately.

— PIMA recommends that the Government's commitment to ISAs should extend beyond the current date of 2010 as means to encourage long term CTF saving in the future.

PROMOTING TAX FREE CHILDRENS SAVINGS

ISAs have proved to be the Government's most successful retail savings initiative. They are continuing to be an accepted and successful savings vehicle, with approaching £30 billion every year of new investment. This trend has continued in recent years despite the fall in the stock market. The persistency of ISAs has been excellent and the figures of new investment just go to prove how successful they really are, particularly among younger and lower income investors, which is the Government's target market. Government figures show that more than 14 million ISA accounts have been opened with in excess of £100 billion invested since ISAs began in 1999. These figures demonstrate how the ISA is now an integral part of many individuals' savings and retirement planning.

Urgent action is required to encourage greater levels of savings and investment, especially with the pensions and retirement crisis now facing the Government. Consultation with our members suggests that little new money is being put into stocks and shares ISAs.

We think the CTF will be a significant step towards encouraging savings growth but we want to see all forms of investment choice promoted.

In the recent Inland Revenue document: *Detailed Proposals for the Child Trust Fund*, (October 2003), "The Government wants all families to benefit from the potentially higher returns that might be achieved through equity investments" PIMA enthusiastically concurs with these sentiments.

ISA Structure

PIMA has been pleased to help support the Inland Revenue and HM Treasury CTF policy development teams throughout 2003 and is delighted with the recent Inland Revenue paper: *Detailed Proposals for the Child Trust Fund*, makes clear the Government intends to use the ISA structure, regulations and authorisation for the CTF.

This will enable CTF providers to quickly integrate their systems to be ready for CTF introduction, in what is a very short timeframe, and to allow consumers a wide choice of providers under the new CTF regime.

A Childrens' ISA

In similar vein, PIMA believes the CTF can act as an excellent means of encouraging longer term savings and is pleased the Government believes the CTF can act as a feeder for ISA accounts.

We think it will be useful for providers to brand their CTF as a type of ISA, capitalising on the considerable consumer acceptance and enthusiasm for the scheme, and allowing consumers to better understand the benefits of longer term investment.

Charge Capping

PIMA does not make comments on the merits of a specific charge cap level—that is a commercial issue for each of our members. However, PIMA members do believe that a flat rate charge will result in some CTF subscribers subsidising those who do not make additional subscriptions to their CTF investment and take only the Government's "Gifts".

We believe this will cause cherry picking by providers and differential service levels and investment offerings for lower value customers—ie low value accounts are likely to nearly always end up in deposit based products thus losing them the potential educational and financial benefits of equity investment.

This will clearly not serve Government objectives to encourage equity investment for all.

Investment Choice

As we have previously argued, PIMA believe all investors should be offered a clear choice.

If cash deposit accounts are to form a part of CTF investments, we urge the Government to consider a minimum interest rate for cash deposit CTF accounts, and to make it clear that the charges for this type of investment are built into the rate.

We are delighted that the Inland Revenue has also said current ISA investment rules will apply and we are seeking clarification that all ISA investments are included—for example—individual equities held on any recognised stock exchange, this would of course include Investment Trusts.

Inland Revenue Allocated Accounts and Education

For investors who choose not to make a provider selection and are then given an Inland Revenue Allocated Account with an approved provider we are keen to ensure consumers are given the service they would expect from PIMA members.

We are looking to the Government to encourage as many people as possible to make an active choice in their CTF investment and call for a properly funded national education campaign to do so.

PIMA is concerned at the problems its members may experience establishing any form of contact with the beneficiaries of these accounts, given that they have failed to respond to a "gift" of £250/£500 from the Government on behalf of their children, and what onus will be placed on providers to establish contact by the Government due to the required distribution of statements or by the regulator under *"Know Your Client"* rules.

Subscriptions from September 2002

PIMA believes it would encourage initial CTF success for the Government to allow children who already qualify for CTF—those born from 1 September 2002—to be allowed to start CTF saving immediately.

PIMA is pleased that the Government has said that those born between September 2002 and April 2005 will be provided with a higher value Government "Gift", but we do not understand why they should forgo their subscription allowance for this period.

This could either take the form of being able to use special feeder accounts or by allowing backdated allowances to be included from the proposed start of CTF subscription—April 2005.

Contribution Levels and CTF Transfers

The Inland Revenue has said minimum contribution levels will be announced in the coming months. PIMA is keen to ensure the minimum monthly contribution is an economically viable one for providers and meaningful for investors' investment growth. Some providers may only wish to offer annual or quarterly contributions, to reduce costs and therefore charges, and we do not see any problem with this.

PIMA is also keen to see a limit on transfers from CTF providers to allow investors to understand the benefits of long-term investment and provide economically viable CTF products.

The PEP & ISA Managers' Association

PIMA (the PEP & ISA Managers' Association) is widely representative of all types of asset managers. We have in excess of 100 PEP & ISA managers as members, representing over 70% of all PEP/ISA accounts. Our members comprise of a broad cross section of retail savings and investment firms including banks, life offices, stockbrokers, fund managers, third party administrators and friendly societies who administrate and manage the investments of the vast majority of PEP and ISA plans.

In promoting long-term tax-incentivised savings PIMA believes that there is a requirement for increased consumer education on financial products and services. PIMA would be delighted to assist with any financial education initiatives that HM Treasury may propose.

PIMA wishes to submit the above paper for consideration in the Chancellors Autumn Statement.

November 2003

Memorandum submitted by the Association of Friendly Societies

1. Introduction

1.1 The Association of Friendly Societies (AFS) welcomes the inquiry by the House of Commons Treasury sub-committee into the Government's detailed proposals for the Child Trust Fund (CTF). The AFS has played a major part in discussions with HM Treasury and Inland Revenue leading to the development of the scheme and appreciates the opportunity of submitting written evidence to the Commons Sub-committee.

1.2 The AFS was formed in 1995 as the main representative body for friendly societies in the UK. Currently it has 61 societies in membership who range considerably in size, shape and activity but all involved with advancing the welfare and well-being of its individual members through the provision of financial services. Between them, these societies manage the savings and investments of over 6 million people and have total funds under management of around £15 billion. As such all friendly societies are registered and regulated by the Financial Services Authority (FSA).

1.3 As will be demonstrated later, AFS members are responsible for 50% of the regular medium and long term children's savings market. As such we have a level of understanding and expertise of this market which is unparalleled in the industry.

1.4 Friendly Societies in general concentrate their activities on the less affluent[9] part of the financial services marketplace—the very focus of the CTF. In having this concentration, Friendly Societies fill the gap between micro-credit solutions offered by small community—based credit unions and the large majority of commercial providers who have either abandoned the less affluent part of their former customer base or who have never tried to service it in the first place.

2. Main Messages and Summary

2.1 *The CTF is a good idea . . .*

It is fundamental to the future welfare of the country that young people become involved in the savings habit as early as possible.

2.2 *Universal reach is vital . . .*

Given our background and expertise we called for open market provision when the idea of a Child Trust Fund was first floated in 2001. We now welcome the Government's intention to proceed with the CTF along these lines and to provide financial incentives to encourage universal reach.

2.3 *Price Caps distort the marketplace and will restrict reach . . .*

The level at which any price cap is set should ensure universal application and must not disadvantage the less affluent or those people on low incomes from active participation in the CTF. Practical experience elsewhere eg Stakeholder pensions) demonstrates that price-capping at 1% has failed to meet its objectives.

2.4 *Administration is complex, make it easier . . .*

The proposed operation of children's accounts is in essence more complex than for other accounts given the potential for family break-ups, changes in parental status and multiple contributors etc. We are therefore disappointed that the Government has rejected the opportunity to introduce simpler and swifter methods of opening accounts via telephone and internet contact of benefit to both consumers and providers. Too much prescription is inappropriate and will increase cost for no benefit.

2.5 *Sales regime must be straightforward . . .*

The precise sales regime, on which a decision from the FSA is still outstanding, must be of a simplified nature to encourage consumer "take-up" and reflect the "low-risk" nature of the product.

2.6 *Consumer education is integral and mutually reinforcing . . .*

Given the right features, marketing by the Government and enthusiastic endorsement by providers, the CTF could be the catalyst to re-building a savings culture in this country thus providing for consumer reach as low down the income scale as possible and encouraging young people to think about savings.

[9] Less Affluent definition: Those people with a household income of between £9,500–25,000 (ranging from a basic subsistence level to the upper limit of mean household income in the UK—2002–03.

3. The Ethos of Friendly Societies

3.1 Although friendly societies are diverse in size and activity as mutual organisations they share the same basic characteristics:

(a) having a purpose which is closely linked to helping the less affluent;

(b) attracting people with these characteristics through targeted distribution channels;

(c) offering products which are geared to such individuals;

(d) operating significantly lower minimum premium levels than PLCs (a few down to £1 per month)[10]; and

(e) operating, in some cases, networks of volunteers or, in other cases, tailored services to people's homes for such items as premium collection or claims payment. Through such direct contact, societies eg Druids Sheffield FS, are able to play a tangible role in the education process.

3.2 In this way, the Friendly Society movement forms a unique relationship with their members in providing products and affordable solutions to meet their needs and helping to promote greater financial literacy.

4. Friendly Societies and Children's Savings

4.1 Friendly societies have over generations been at the forefront of the long-term children's savings market in this country. Through particular schemes parents and other members of the family and friends have been able to save either through small monthly amounts or *ad hoc* lump sum payments building up to a substantial sum on maturity (at various ages and not just 18). Based on 2002 calendar data, AFS members sold an estimated 66,000 new children savings plans during that year. Total children's policies in force with friendly societies at the end of last year was calculated at about half a million.

4.2 According to one previous friendly society-commissioned study,[11] only 1:5 families were found to be saving on a regular, long-term basis for their children, a ratio which has further declined to 1:7 based upon a recent Mintel/NOP survey.[12] Given that on a national scale there were 668,000 live births in 2002, and based on these ratios and the large number of policies taken out in the first year of a child's life, it is estimated that friendly societies potentially represent about 50% of the regular medium and long-term children's savings market.

5. Child Trust Fund—Detailed Proposals

5.1 The AFS endorses the concept of the CTF, as embraced within the Government's detailed proposals, in providing the means by which for virtually every child born in this country (after September 2002) a financial incentive will be given encouraging adults to start saving for their children. This universal approach is to be commended not just for children but for other generations as well in the hope that in harness with financial education initiatives more people will come to value the importance of personal savings given the current widely-acknowledged savings gap nationwide.

5.2 Notwithstanding, we have certain comments on the content of the proposals by reference to the headings and paragraphs in the Treasury/Inland Revenue document entitled *"Detailed proposals for the Child Trust Fund":*

5.3 *Qualifying for a CTF Account*

We endorse the universal nature of the scheme and level of incentives and in particular acknowledge that:

— children in care etc. are often the children in most need of welfare and financial assistance up to the end of adolescence when hopefully they are able either to go on to higher education or start work. (ref 2.5/2.9)

— the additional £250 to families in receipt of Child Tax Credit (CTC) reflects the fact that they will be low-income earners with little or no extra money for savings. (ref 2.17/2.22)

— the further (as yet undisclosed) payment into the fund at aged seven years should act as a further incentive to parents etc to make regular contributions to the fund. (ref 2.23/2.28)

— the special payment provisions for children born between 1 September 2002 and April 2005 should ensure that these children will not lose-out over the lifetime of the fund. (ref 2.29/2.34)

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[10] Article in *"The Mirror"* featuring Kensington Friendly Collecting Society—July 2003.

[11] Research by Consumer Psychologist Leslie Hallam for Tunbridge Wells Equitable FS (now The Children's Mutual)—2002.

[12] Mintel Intelligence "*Saving Products for Children*"—October 2003.

5.4 *Choosing and opening a CTF Account*

The freedom to transfer a CTF investment between providers penalty free and as often as required clearly provides benefits to the investor. The persistency of the CTF will have a very material impact on the financial attractiveness of the investment to product providers and it is important that the Government consider this point carefully when setting any charge cap. (ref 3.3)

We endorse the concept of making the opening a CTF account as simple and easy as possible but encourage the Government to extend electronic processing to include up-front presentation of vouchers. (ref 3.4/3.7) (see also 6.1/6.10)

Information packs to parents will be a vital element of the scheme and friendly societies, with their expertise in this children's savings, are keen to work with Government on this exercise. (ref 3.8/3.12)

Whilst fully supporting the benefits of life styling from the investors perspective it is important to remember that the provision of specific life styling funds is potentially significant. The provision of life style accounts is potentially easier to deliver and Government clarification on this point would be most welcome. We do however note that the approach will not be prescribed but will be principles-based which is to be welcomed. (ref 3.15/17)

5.5 *Charges, Contributions, Tax Treatment and Closure of Accounts*

We note that final decisions on the level of price or charge cap are still outstanding and hope that on this issue the Government will take account of the widespread views expressed clearly and consistently over time that the much-publicised 1% per annum, does not work. Such a price cap will be as much a disadvantage to consumers as to the industry for the following reasons:

— it will not provide sufficient resources to effectively promote and market the product to people on low incomes who are in most in need of savings;
— it has not worked for either stakeholder pensions (nor for the CAT-standard ISA) resulting in average premium levels on pensions of around £150 per month effectively leaving the lower-paid financially excluded;
— cost comparisons with ISA products are furthermore erroneous as investor payments to individual ISAs are often one-off large sums, of four figures. Whatever level of contribution is made to the CTF it is likely that in most families the sum will be divided equally between the numbers of eligible children in turn reducing per capita investment but increasing administration costs.

In effect a LOW price cap will:

— not create demand for contributions;
— will target the more affluent; and
— remove access for low/middle earners.

Indeed, there is no logic for a price cap at all as a straightforward benchmark system will:

— define good practice;
— create competition and demand;
— include low/middle earners; and
— give widest possible access.

Given open market conditions and the scope for different accounts, a price cap should only be appropriate for the Government Endowment or payment. By common consent and practice, the best mechanism to ensure that cost efficiencies are passed on to consumers through low prices and good quality is competition. (ref 4.1/4.2)

Equally, the minimum level of contribution should be determined not by Government edict, but by competition. It will therefore be dependant upon the level of any price cap. (ref 4.3/4.4)

We are prepared to work with Government to establish whether a voluntary tokens scheme is viable. Certain friendly societies, eg The Children's Mutual and Family Assurance FS, have already developed innovative and fruitful relationships with High Street outlets to encourage more savings for children. (ref 4.5)

5.6 *Strengthening the Saving habit*

We fully endorse the need for further consumer information and education to strengthen the savings habit and approve of Government funded moves by which this programme can be further pursued involving a partnership between government, regulator and industry. (ref 5.3/5.5)

Friendly societies already freely participate in industry league and comparative tables published via the media and the FSA and believe that at school level further encouragement should be given to the promotion of personal finance studies in the current curriculum. In this context friendly societies are represented on the

Personal Finance Education Group (PFEG) and take an active interest in its work. Friendly societies often go a lot further in this field in providing bursaries and building special relationships with schools and community groups (Healthy Investment, Royal Liver, Scottish Friendly etc). (ref 5.7/5.12)

5.7 *Operational details, reporting and compliance issues*

We believe that administration procedures should be as simple and straightforward as possible to minimise costs—particularly as the number of adults likely to actively contribute to the fund is at present an unknown factor. A modern-day trend amongst providers is the increasing proportion of accounts being opened over the telephone or via the website which helps to reduce costs. We are disappointed that the Government appears to have rejected the concept of electronic communication between voucher-holder and provider in setting up an account as every additional expense will be to the detriment of consumer reach. (ref 6.1/6.10)

Compliance costs should also be kept within tight margins given that systems need to be designed, built and tested to accommodate CTF procedures. In recent years these costs have accelerated in the light of increases in regulatory obligations and controls which is particularly burdensome for smaller firms. As mutuals, friendly societies are not allowed to raise outside capital and have to fund such facilities and expenditure from their own assets. Two societies, Liverpool Victoria and Family Assurance FS, have already calculated that their own development costs for becoming a CTF provider to be in the region of £750,000–£1 million. (ref 6.30/6.35)

5.8 *Partial regulatory impact assessment*

We urge that the precise sales regime to accompany the marketing and distribution of the CTF must be of a simplified nature appropriate to the product and having regard to any ultimate price cap. The FSA must make this decision soon to enable providers to make the necessary planning and investment to meet the launch date in 2005. (A6)

The Government wants the reduction-in-yield from the charges imposed by providers to be set at a reasonable level and published data suggests (see Appendix) that friendly societies have generally been successful at operating at a lower cost for its products in comparison with other industry providers—without the need for a cap! (A15)

6. Overall Assessment

6.1 The CTF can play a major role in helping to generate and enhance savings for children alongside existing individual schemes provide an object lesson in personal finance and management that can be carried through into later life. It has been recognised that one of the main drivers behind the growth and development of this market to date is in providing the means by which children—from all backgrounds—can be helped in paying their way through further or higher education.

6.2 However for the CTF to be ultimately successful the right framework has to be put in place from the outset which allows:

- the product to be unfettered by inelastic price and sales restrictions;
- the administration be kept as simple and low-cost as possible to engage wide industry participation and to benefit consumers;
- the consumers to be encouraged to make contributions requiring on-going marketing by both Government and industry; and
- the Government to review the workings of the CTF after the first five years to ensure that it has achieved "universal reach" especially to the less affluent.

6.3 Friendly societies remain ready and willing to play a full part in this process.

References:

1. Less Affluent definition: Those people with a household income of between £9,500–25,000 (ranging from a basic subsistence level to the upper limit of mean household income in the UK—2002–03).

2. Article in "The Mirror" featuring Kensington Friendly Collecting Society—July 2003.

3. Research by Consumer Psychologist Leslie Hallam for Tunbridge Wells Equitable FS (now The Children's Mutual)—2002.

4. Mintel Intelligence *"Saving Products for Children"*—Oct 2003.

November 2003

APPENDIX

REDUCTION IN YIELD COMPARISONS[1]
WITH-PROFITS SAVINGS PLANS AT £50 A MONTH

Providers	*Reduction In Yield[2] % 15 Years*	*Reduction In Yield[2] % 20 Years*
Britannic	2.5	1.9
Ecclesiastical	2.0	1.3
Friends Provident	2.2	1.5
Liverpool Victoria	1.7	1.3
NFU Mutual	1.5	1.2
Red Rose	1.7	1.3
Royal Liver	2.5	2.0
Royal London	1.9	1.6
Scottish Friendly	1.1	0.9
Scottish Life	2.2	1.7
Scottish Widows	2.4	2.0
Standard Life	1.5	1.1
Teachers	2.2	1.9
The Children's Mutual[3]	1.5	1.2
Average	1.9	1.5
Friendly Society average	1.8	1.4
Other Providers average	2.0	1.5

1. Figures taken from *Money Management* April 2003. Table shows reduction in yield, based on a gross growth rate of 6% a year, for a male life non smoker, aged 29 years 11 months at entry on 1 February 2003, paying a true gross premium of £50 a month (inclusive of policy fee or other loading where applicable) over 15 and 20 year terms.

2. Reduction in yield is the amount by which the financial regulators prescribed middle rate of return would be reduced to take account of commission, expenses, charges, penalties and other adjustments.

3. Invests in Tunbridge Wells Equitable Life Fund and appeared as Tunbridge Wells Equitable in *Money Management*, April 2002.

7 November 2003

Memorandum submitted by the Investment Management Association

House of Commons Treasury Select Committee Inquiry into the Child Trust Fund (CTF)

The Investment Management Association is the trade body representing the UK asset management industry. IMA members include independent fund managers, the asset management arms of banks, life insurers, investment banks and occupational pension scheme managers. They are responsible for the management of approximately £2 trillion of funds (based in the UK, Europe and elsewhere), including institutional funds (eg pensions and life funds), private client accounts and a wide range of pooled investment vehicles. In particular, our Members manage 99% of UK-authorised investment funds. In managing assets for both retail and institutional investors, IMA Members are major investors in companies whose securities are traded on regulated markets.

IMA member firms have a direct interest in the Government's plans for CTFs, as potential product providers.

The CTF

IMA supports the concept of the CTF, as a bold and radical approach to extending financial empowerment in the future to a much greater proportion of the population. By giving every child access to at least a modest capital sum, the Fund will encourage improved financial awareness from a younger age, and will foster greater self-reliance in the future. It will also provide a focus to encourage parental and grandparental saving on behalf of children, and for improved financial education in schools, which the IMA considers to be an important priority for the future.

Equity Investment

IMA also welcomes the decision to allow CTFs to be exposed to the equity markets. Equities have in general provided a greater return over the medium to long-term than other investment media, although of course they can be subject to negative returns over short periods, notably and recently 2000–02. CTFs are by their very nature long-term investments (with the first accounts not maturing until 2020) and, as such, a degree of exposure to equity investment is appropriate.

Stakeholder Specifications

We believe that the proposed linkage of the CTF to the so-called "stakeholder" product suite is appropriate, and also welcome the option of providing a "non-stakeholder" version to ensure that investors have a choice of product. But, as with the proposed revised stakeholder pension product, the "stakeholder" version of the CTF should be the fund used for the default option.

As regards the proposed price-cap for the "stakeholder" CTF, IMA has consistently argued that the concept of price caps is not appropriate for the financial services industry and that their sole effect is to dissuade firms from offering products, thereby restricting rather than improving access to financial products. This applies with equal, if not more, force to the "stakeholder" CTF, given that investment levels within the majority of funds are likely to be modest. The IMA nevertheless accepts that the Government is set upon a price cap, but is urging the Government to move to a more flexible pricing structure.

Administration

Ensuring that administrative complications are minimised will help providers work within a realistic price cap. IMA has suggested to Government ways to ensure simple administration. The most important is to ensure that the CTF can dovetail with existing systems (notably ISA/PEP systems). Other possibilities include aggregating of accounts, and taking steps to reduce the possibilities for "switching" between funds.

Although we welcome the announcement that the CTF will have one simple annual statement, we believe more needs to be done to ensure that the costs of administration are as low as possible.

Initial Endowment and Additional Contributions

In the interests of simplicity, IMA would prefer a single Government endowment to be made to the fund. Currently, the Government are proposing an initial contribution at birth, followed by a "top-up" at age 7. IMA believes that holding back part of the endowment would reduce the investment return that can be achieved over the lifetime of a fund, resulting in a reduced payment on maturity.

IMA welcomes the proposed provision for making additional contributions to the funds and believes that this significantly boosts their attractiveness for providers. However, in order to keep administrative costs low, IMA considers that providers should be allowed discretion to require a minimum contribution level.

Developing Financial Capability

Should the products be structured in such a way that they attract providers, then IMA believes CTFs will play a major role in encouraging the next generation to save for their future and will aid in the development of a greater understanding of investment products. They will provide a ready made "hook" on which to build the existing financial content of the national curriculum, and will make lessons in financial management much more real and meaningful to schoolchildren when they know they will soon be in the position of managing their own fund.

IMA is already working closely with both the Financial Services Authority (FSA) and the Personal Finance Education Group (pfeg) on extending consumer capability in the UK.

We would be more than happy to provide a panel of experts for the committee to question should they so desire. In the meantime, please do contact me if you require any clarification of the points in this letter, or if you would like to discuss any issues further.

6 November 2003

Memorandum submitted by the Institute for Fiscal Studies

1. The Child Trust Fund was proposed in the lead-up to the 2001 election, and the 2003 Budget announced that any child born since 1 September 2002 will have an account. A Child Trust Fund will be a financial asset, created for each newly born when an endowment is provided by the state. This short submission to the Treasury sub committee enquiry into the Child Trust Fund highlights some of the main issues of concern regarding the design of the policy. Further information can be found on the IFS website.[13]

2. The accounts will have the following features:

— All babies will receive an endowment of at least £250, and those from families with lower incomes will receive £500. The threshold will be linked to the Child Tax Credit, so that households with incomes below £13,230 will qualify for the higher endowment.

— An additional Government contribution will be paid at age seven. The amount is yet to be determined, but those from families with lower incomes will again receive more.

— Children will be given access to the funds at age 18. No restrictions will be placed on how the matured asset can be used.

— Family and friends of the child can make contributions to the account during its 18-year term (subject to a limit of £1,200 a year).

— Account providers will compete in an open market.

3. Criteria linked to the Child Tax Credit are expected to mean that one-third of children will be eligible for the larger endowment. The annual cost to the Exchequer of all endowment payments is estimated by the Government to be around £235 million. This will increase once the additional Government contributions to seven year olds begin to be paid. If savings are held in the Child Trust Fund that would otherwise have been held in a taxed savings vehicle then there will be an additional Exchequer cost of forgone tax revenue. This seems unlikely to be significant.

4. In terms of how the sales process for the Child Trust Fund is regulated it seems clear that all eligible families would be well advised to open an account and think about how they want the Government's endowment to be invested. Given the 18-year horizon it seems appropriate that families are allowed to consider equity based investments.

5. In contrast it is far from clear that many families would be well advised to contribute additional funds to their Child Trust Fund account. The majority of families with children are not constrained by the Individual Savings Account contribution limits. They should consider whether they would rather place any savings for their child in an ISA. This will receive the same tax-relief that is available in the Child Trust Fund but with greater flexibility since the funds do not need to be locked away until their child reaches age 18. This flexibility will be valuable to many families.

6. In addition the Government has a manifesto commitment to introduce a Saving Gateway account. In the scheme that is currently being piloted individuals savings are matched pound for pound by the Government, up to a limit of £25 per month.[14] Lower income families with a Child Trust Fund who are, or expect to be, eligible for a Saving Gateway account will be better off ensuring that some savings are available to be placed first in these accounts before considering locking savings away in a Child Trust Fund account.

7. It is difficult to find a convincing explanation for why the Government has chosen to support young people using this policy. To give youngsters an asset that they cannot access until adulthood is a very different means of supporting them than the existing cash transfers or subsidised public service provision.

8. As the median holding of savings among adults aged under 25 is around £50—or zero if debt is netted off—these payments will have a large impact on the distribution of wealth among 18 year-olds. Even without any additional payments to the fund the initial endowment will, assuming a real rate of return of 5%, be worth £600 or £1,200 at age 18, depending on whether it was £250 or £500. If many spend their funds straightaway, the impact on the wealth of 19 year-olds will be smaller. On the other hand young adults who would not otherwise have had access to these funds will certainly benefit from spending the resources.

9. The rationale for the policy cannot simply come from the impact it will have on the wealth of young adults, or the opportunities that are opened up by giving them spending power, as there would be simpler means to achieve these aims. One alternative use of the money earmarked for the Child Trust Fund that would extend opportunities for young people would be extra spending on education or training. For example the Government could have increased the generosity of the proposed grants for those from lower

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[13] *See* Emmerson, C. and Wakefield, M. (2001), The Child Trust Fund and the Saving Gateway: *Is Asset-Based Welfare "Well-fare"*?, IFS Commentary No. 85 (http://www.ifs.org.uk/pensions/abw.pdf) and Wakefield, M. (2002) in Dilnot, A., Emmerson, C. and Simpson, H. (eds), *The IFS Green Budget: January 2002, IFS Commentary No. 83* (http://www.ifs.org.uk/gb2002/chap7.pdf).

[14] Details of the Saving Gateway account can be found at http://www.hm-treasury.gov.uk/topics/topics—savings/topics—savings—savgateway.cfm?. For a discussion of the issues raised see Emmerson, C. and Wakefield, M. (2003), *"Increasing Support for Those on Lower Incomes: Is the Saving Gateway the Best Policy Response?"*, Fiscal Studies, vol. 24, no. 2, pp. 167–195 (http://www.ifs.org.uk/publications/fiscalstudies/fsabs24emmwake.shtml).

income families who go on to higher education. Another alternative would be to give a lump sum directly to 18 year-olds, contingent on their circumstances at that age; this looks like a much simpler and better targeted way to transfer spending power to young adults than the proposed policy.

10. The best justifications for setting up Child Trust Funds 18 years before the intended recipients can receive the money must lie in the role that such an account could have in teaching youngsters about financial assets and forward planning. Children might learn more from financial education if they are able to see their own account accumulate during the course of their education. Learning about financial planning is an ever more important skill in today's world of ISAs and private pensions. The Child Trust Fund might not be the best way to teach youngsters about financial management and planning: a more effective method might be to use the £235 million earmarked for Child Trust Fund endowment payments to provide extra financial education.

11. The arguments considered do not seem to justify the encumbrance of means-testing payments into Child Trust Fund accounts. Evidence that families move around the income distribution as their children grow up suggests that payments made conditional on parental income at birth and at age seven might not be well targeted against circumstances throughout childhood or at age 18. Such means-testing might also seem unfair to (for example) siblings who get different sizes of endowment because their parents' income changed by relatively small amounts between the birth of their children. Furthermore, the effectiveness of the means-test is drawn into question by the fact that children from richer backgrounds might be better equipped to invest their funds in assets that yield high returns.

12. This issue becomes even more fraught since it is quite possible that the immediate beneficiaries of the Child Trust Fund will be richer families who can substitute the endowment payment for saving that they would have done for their children, and so increase their current consumption. Families who would not have saved for their children, many of whom will be poorer families, will have to wait eighteen years to benefit from their Child Trust Fund. Given the complications of using the Child Trust Fund as a redistributive tool, there is a case for saving on the administrative costs due to the means-testing the policy and using existing policies to achieve redistributive goals.

13. The Child Trust Fund is an innovative means of providing support to young people. Many will undoubtedly benefit from the policy. However the policy has not been satisfactorily justified.

November 2003

Memorandum submitted by the Building Societies Association

Summary

- The Building Societies Association supports strongly the Child Trust Fund (CTF)
- However, we consider the proposed requirement that all Child Trust Fund providers be required to offer the stakeholder CTF product to be misguided.
- It will mean that 17 building societies, ie more than a quarter of the sector, will not be able to offer the CTF:
  - this will restrict consumer choice, and
  - may drive consumers towards riskier, equity-based products, when they may prefer the capital-certainty of deposit-based products.
- CTF accounts that are solely cash deposits should—as low risk products—be regulated under the Banking Code.

Introduction

1. The Building Societies Association (BSA) is pleased to contribute to the Treasury Select Committee's inquiry into the Child Trust Fund. The BSA represents all 65 building societies in the UK. Our members have assets of more than £200 billion, around 15 million adult savers and 2.5 million borrowers. Building societies account for over 18% of outstanding mortgage balances and retail deposit balances in the UK.

2. The Association is a strong supporter of the Child Trust Fund. However, we believe that the potential benefits of the initiative risk being undermined for many by what we consider to be undue emphasis by the Government on equity-based investment.

The Requirement for all CTF Providers to Offer the Stakeholder Account

3. The Government's proposals for the Child Trust Fund, issued on 28 October, include a requirement for all CTF providers to offer the "stakeholder" CTF account.

4. The stakeholder CTF account will be a predominantly equity-based savings product. CTF providers will also be able to offer other forms of CTF accounts, including CTF accounts which are solely cash deposits. However, the requirement that the stakeholder account must be offered as part of any CTF account range will mean that, in practice, more than a quarter of all building societies will not be able to offer CTF accounts. This is because they do not have the necessary regulatory permissions under the Financial Services and Markets Act 2000 (FSMA).

5. This aspect of the CTF proposals is considered by the Association to be perverse. Building societies have, over many years, been among the market leaders in the provision of accounts for children and societies are likely to be the natural first port of call for many parents considering where to open a CTF account.

6. The Association considers the inability of many building societies to offer the Child Trust Fund will:

(a) inhibit consumer choice, by reducing the number of providers; and

(b) drive consumers to invest in equity-based investments, of which they may have no experience and in which there is a risk of capital loss, rather than capital-certain building society savings accounts, where their savings are safe and with which they may feel much more comfortable.

7. The rationale for the Government's proposal is that every child should be able to benefit from the higher returns which are associated, historically, with equity investment. However (as the Financial Services Authority requires firms to point out to prospective customers), past performance is a fallible indicator of future returns. Although returns on equity investment have tended to out-perform returns on cash deposits in recent decades, these have been periods of relatively high inflation and it is not clear how markets will adjust over the medium to longer term to sustained periods of low inflation. Moreover, equity investment carries with it the risk of significant capital loss.

The Charge Cap

8. The Treasury Select Committee will no doubt be receiving representations from the industry about the level of the proposed charge cap for the CTF accounts. The Association supports calls for the charge cap to be set at a level at which it is economic to offer equity-based CTF products, including the stakeholder CTF account. If the cap is set at a level at which many firms consider it uneconomic to offer equity-based CTF accounts, this will clearly reduce the choice of consumers in regard to such accounts. But, more significantly in our view, it will also reduce consumer choice in regard to deposit-based CTF accounts. This is because it will not be possible, under the Government's proposals, for institutions to offer a deposit CTF account if they do not also offer the stakeholder account.

The Sales Process

9. We understand that whilst the detail of the framework for the regulation of the sales process for CTF accounts has yet to be worked out, the Government's working assumption is that all CTF accounts—even those which are solely cash deposits—would fall to be regulated under the conduct of business rules of the Financial Services Authority (FSA). In regard to a cash deposit CTF, this would represent a significant departure from current practice, whereby deposits—as low risk products—are not covered by FSA conduct of business rules, but are subject to industry self regulation under the Banking Code. The Association considers that, consistent with the current regulatory approach, cash deposit CTFs should be regulated under the Banking Code, rather than under FSA rules.

Why Does it Matter if Building Societies are not able to Offer the Child Trust Fund?

10. Building societies have long been market leaders in the provision of deposit-based savings for children—both directly for children themselves, and also for parents, grandparents etc wishing to save on behalf of a child. Societies have a significant commitment to offering children's accounts, for which their regional and local branch networks are particularly suited and which also help support the Government's efforts to address financial exclusion.

11. The publication Money£acts lists 49 of the 65 building societies as offering savings accounts tailored specifically for children. In many cases these accounts pay interest rates as good as or better than those available on any other account offered by the society. The interest rate returns on such accounts are well above what might be expected in purely economic terms for relatively small savings.

12. As mutual institutions, building societies do not have equity shareholders and therefore do not pay dividends. This enables societies to pay better interest rates than their competitors. This is widely recognised. For example, the ratings agency, Moody's recently said:

> "Societies" average [mortgage] rates are consistently lower than that charged by banks thanks to mutual pricing. Further, it is important to remember that this is only one half of the mutual pricing equation—societies also typically give higher rates of interest on savings accounts than the banks."

(*UK Building Societies—Steady As She Goes Moody's*—August 2003)

The Independent on Sunday (4 May 2003) said:

> "Most high-street banks and building societies offer savings accounts for seven- to 11-year-olds. These can be opened with a minimum investment of £1 and are designed to teach children to manage their savings, allowing them to deposit and withdraw limited amounts of money using a passbook.
>
> Building societies offer the most competitive rates of interest, paying between 4 and 4.7% gross for a minimum investment of £1".

13. Most building societies are regional or local institutions and have close links with their local community. They enjoy higher levels of trust than do proprietary companies such as the banks. This was illustrated in a recent report by leading academics, *Trust Rewards: realising the mutual advantage* published by Mutuo in May 2003.

Costs of Regulation

14. Seventeen building societies do not have the necessary permissions under the FSMA to undertake designated investment business. The main reason is for this cost. Most building societies concentrate on relatively simple deposit taking and residential mortgage lending business. To employ additional specialist staff and resources to deal with investment business does not make financial sense for many.

15. For most building societies the small sums likely to be involved in many CTF accounts would mean that commission earnings from an equity-based CTF product would simply not cover the potential significant additional expense of employing additional (suitably qualified) staff; providing ongoing training and putting in place and maintaining new control systems. So, although, in theory, it will remain an option for these seventeen societies to seek the necessary regulatory permissions to enable them to offer the stakeholder CTF account, in practice, the high costs associated with doing so, are likely to remain prohibitive.

Conclusion

16. In order to ensure the Child Trust Fund is made as widely available as possible, and to give consumers a full choice of building society providers of the CTF account, the Association considers it essential that the Government drops its proposal that all CTF providers be obliged to offer the CTF stakeholder product.

7 November 2003

Memorandum submitted by the Tax Faculty of the Institute of Chartered Accountants in England and Wales

Introduction

1. On 28 October 2003 HM Treasury announced that a Sub-committee would undertake an inquiry into Child Trust Funds. This is the response of the Tax Faculty of the Institute of Chartered Accountants in England and Wales to this request for written evidence.

Who We Are

2. The Institute is the largest accountancy body in Europe, with more than 123,000 members. Three thousand new members qualify each year. The prestigious qualifications offered by the Institute are recognised around the world and allow members to call themselves Chartered Accountants and to use the designatory letters ACA or FCA.

3. The Institute operates under a Royal Charter, working in the public interest. It is regulated by the Department of Trade and Industry (DTI) through the Accountancy Foundation. Its primary objectives are to educate and train Chartered Accountants, to maintain high standards for professional conduct among members, to provide services to its members and students, and to advance the theory and practice of accountancy (which includes taxation).

4. The Tax Faculty is the focus for tax within the Institute. It is responsible for technical tax submissions on behalf of the Institute as a whole and it also provides various tax services including the monthly newsletter "TAXline" to more than 11,000 members of the Institute who pay an additional subscription.

General comments

5. The Tax Faculty welcomes these proposals which are intended to give children a more secure financial start to their adult lives. We welcome the opportunity to contribute to contribute to the consultation process.

6. Although the Child Trust Fund was first announced more than two years ago, the current consultation exercise is being conducted at an unrealistic pace. Past experience shows that this usually leads to bad law. It is important that adequate time is given for proper discussion to take place.

7. The Government has restated its commitment to a welfare strategy which is founded on the principles of:

— Security;

— Opportunity; and

— Responsibility

8. We question whether the amounts involved in the Child Trust Fund (CTF) will be sufficient in 18 years' time either to offer help towards financial security or to support many available opportunities. Although those fortunate to have had additional sums contributed will be in a more secure financial position, it is presumably those without such backing that need help most.

9. We believe that one of the laudable principles behind the CTF is to encourage saving. It is not enough merely to give money in the hope that the person will save: indeed the result may be exactly the opposite to this intention. As is recognised in the detailed proposals, it is important to couple this proposal with education on the value and importance of saving. Financial education must necessarily include education about the UK tax system. The current complexity of the system with its plethora of rates, allowances and credits will make this a gargantuan task. The proposed CTF looks highly complicated and that in itself will discourage take-up.

10. We note that 40 pages of notes have been required to explain the detail of the CTF and wonder at the complexity of the regulations that will be needed to implement them and ensure that they are properly targeted. We have already seen how complex the Tax Credit system has become with around 30 statutory instruments required to date. We would hope that given the timeframe for implementation, the main rules for the operation of CTF can be finalised without the need for excessive regulation. In 1999 The Tax Faculty produced a paper *"Towards a Better Tax System"* (set out in the Appendix[15]), in which we put forward Ten Tenets against which new legislation should be judged. We hope that the committee will consider whether these have been applied in this case.

Specific comments

Qualifying for a CTF account and New Tax Credits

Protective claims

11. The basic entitlement to a CTF account will be linked to entitlement to child benefit. The additional £250 will however only be available to children in families receiving Child Tax Credit (CTC) and with a household income below the CTC threshold.

12. In order to ensure that children will not potentially lose this entitlement it will be necessary for parents to consider making a protective tax credits claim. For example, Mr A runs his own business preparing accounts to 31 March 2004. Mrs A does not work but looks after their children. They have a baby on 1 January 2004. They have never previously claimed tax credits as their income averaged £80,000. In March 2004, the business suffers a disaster wiping out all profits for the year.

13. Not only will the family suffer a loss of many months tax credits, but it is possible that they may not manage to claim their tax credits within the necessary three months. The new baby will lose out in 18 years time as a result.

14. The Tax Faculty has raised the problem of the interaction of the three-month back-dating rule and the annualised award of tax credits repeatedly during discussions on tax credits. The CTF proposals plan to base a new system on the unsound, and as yet incomplete, New Tax Credit (NTC) system. We would suggest that it is important to think again on this point.

[15] Not printed.

Qualifying for a CTF account—Definition of household

15. One of the complicating factors of the NTC system is the need to use annual income where the make-up of the household changes during the year.

16. We presume that the NTC claim position on the date of the child's birth will be relevant when considering the additional £250 payment. This will often be difficult to establish in practice and is a further reason for not building the new CTF system onto the NTC rules.

NTC enquiries

17. A NTC enquiry could result in the withdrawal or the increase of the NTC award. Consideration must be given to the impact of this on the eligibility to the higher CTF payment.

New arrivals to the UK

18. We understand that on returning to live in the UK, Child Benefit is not payable until a minimum period of presence of 182 days in the previous 52 weeks has been established. How will this affect the CTF award, particularly where a child may have already passed its seventh birthday? It is not clear which will be the base NTC year to be used for establishing entitlement to the higher award. We would welcome clarification on this point.

Additional endowment (para 2.20)

19. The proposals suggest that for some taxpayers the NTC claim may not be finalised until 18 months after a child first becomes eligible for a CTF account. On the basis of information currently in the public domain, we do not understand this reference.

Other issues

Anti avoidance

20. It will be necessary to have specifically targeted anti avoidance legislation prohibiting unscrupulous lending to "the family" against the promise of future money on the child's eighteenth birthday.

CTF Maturity (para 1.20)

21. The proposals would allow for funds from a CTF account to be transferred into a tax-effective savings scheme on maturity. Assuming that the child and relatives have contributed the maximum sums, an amount in excess of £22,000 would be available on maturity. We should welcome clarification on the nature and extent of the anticipated "tax effective" savings scheme. Will there be a cap?

22. Although not relevant for 18 years, consideration should also be given to the nature of the individual identification evidence, which will be required on maturity. Many 18 year olds do not hold a passport nor a driving licence.

Managing the account (paras 1.21 and 1.22)

23. Interaction implies two way involvement. We wonder how the Government's link with the school curriculum will enable children to have a real impact on their investment. It is likely to be parents who will manage the account and who will therefore be most in need of education.

Information pack (para 1.23)

24. This will need to be both understandable and comprehensive. It will also be needed in many more languages than is usual because of the number of people affected.

Projections for fund growth (paras 3.3 and 3.12)

25. The proposals do not comment on who will pay the charges associated with moving funds between accounts. Furthermore Table 3.1 has ignored the effect of management charges. This, together with an optimistic assumption of fund growth of 7%, gives an over optimistic projected future value.

Lifestyling (para 3.15)

26. This term should be defined.

Comparison with ISAs (para 3.19)

27. Like the ISA, the CTF is to be used as a wrapper for a variety of investments. ISAs have not been taken up in the numbers that had been anticipated, possibly due to the complexity of the product. It will be essential to avoid unnecessary complexity within the CTF product if children are to have any hope of understanding their own investment. Explaining clearly and fully the "wrapper effect" may be impossible. Education for parents will also be needed and the costs included in the Regulatory Impact Assessment.

28. The guidance material should include numerous simple illustrations.

Children under 18 who are parents (para 3.30)

29. In these situations, the grandparents will be in a position to make decisions about their own children's CTF accounts, but not that of their grandchildren. Rather than the Inland Revenue having sole responsibility, would it be possible for a claim to be made to pass responsibility to the grandparents (where they are in agreement) until the "young parent" reaches 18?

30. We regret the added complexity imposed through having a different age of majority in Scotland, particularly as movement to and from Scotland is common.

Tax treatment of CTF accounts (para 4.7)

31. We welcome the exemption of these accounts from the parental settlement rules and hope that this will also be extended to funds in feeder accounts.

32. We would welcome clarification on how the inheritance tax exemptions would be applied to these accounts. For example, is the date of the gift when funds are placed into a feeder account or when they are place into the CTF. This is particularly relevant to the application of the inheritance tax exemption for normal expenditure out of income, IHTA 1984, s21.

33. There should be a statutory commitment that the £1,200 annual limit should be raised annually in line with inflation.

Annual statements (para 5.13)

34. Approximately 9 million taxpayers currently receive Statements of Account from the Inland Revenue. 6 million receive tax credit award notices. Neither of these has been developed with the needs of the customer in mind, but those of the issuer have taken priority. Annual Statements for CTF accounts must be more user friendly and relevant to their audience.

35. Parents and children will be able to opt to receive these electronically (para 5.17). This implies that both will receive a statement, otherwise "both" cannot request this option. Children frequently change email accounts and it will be easy to lose track of statements sent in this way to dead accounts.

Partial Regulatory Impact Assessment

36. The level of charges will be critical to the success of this initiative: too low and there will be too few providers, too high and there will be nothing left in the account.

37. Current IT problems affecting other parts of the tax system indicate that there will be significant costs associated with operating the administration of this system. Operational issues must be fully researched and costed before implementation.

38. The cost of public education should also be included.

7 November 2003

Supplementary memorandum submitted by HM Treasury providing further information in response to Question 45

REACTIONS TO THE CHILD TRUST FUND

"The Child Trust Fund is a new and imaginative way of helping children as well as their parents to get into the habit of saving." *Mary Francis, Director General of the Association of British Insurers, press release issued on 28 October 2003.*

"It's great to put every child in the land onto the first step of the savings ladder. We congratulate the Government for helping low-income parents who had never before considered putting money away for their children's future. Our new research into attitudes towards saving shows this will be a popular initiative." *National Consumer Council, 28 October 2003.*

"The need for a new financial initiative, coupled with steps to improve financial literacy, has never been more necessary. As the role of personal provision in long term saving becomes more significant, so the need for financial empowerment becomes more urgent. The Child Trust Fund will have an important role to play." *Richard Saunders, Chief Executive of the Investment Management Association, press release issued on 28 October 2003.*

"We are delighted that investment trusts will be an option for the Child Trust Fund. Many large investment trusts are ideal for saving for children over 18 year periods offering strong long-term performance and low charges." *Annabel Brodie-Smith, Communications Director at the Association of Investment Trust Companies, press release issued on 28 October 2003.*

"We are delighted the Chancellor has used this opportunity to progress with the launch of the Child Trust Fund. It is the major boost to savings that the industry and consumers have been looking for." *Tony Vine-Lott, Director General of PEP and ISA Managers Association, press release issued on 9 April 2003, ie after Budget 2003 announcement.*

Letter to Mr John McFall MP from the Director of Distribution Strategy, Norwich Union

NORWICH UNION AND SOCIAL RESPONSIBILITY

I thought it would be a good idea to write to you following my recent appearance at the Treasury Sub-committee Hearing on Child Trust Funds.

You will undoubtedly recall that you asked me about our position on ethical or social responsibility investments. Unfortunately within the constraints of the hearing I felt I was unable to give the clarity that you were seeking.

Before commenting on the issue of investment funds I would highlight our own commitment to the issue of corporate social responsibility. Enclosed with this letter is a summary of our Corporate Social Responsibility Report, which provides details of the framework within which we operate.[16]

Through our fund management arm, Morley Fund Management, we offer investors a range of socially responsible investment funds. Indeed Morley has a global reputation in this field and details of their approach are also enclosed.[17]

Norwich Union believes that the Child Trust Fund should form part of a wider initiative on the part of Government and the savings industry to increase the levels of responsibility taken by individuals to save for their future security. Offering a suitable range of investment choice that enables savers to select investment funds that balance all of their requirements, including where desired the ability to avoid investing in certain industries, is key to encouraging more people to save. However, we feel that this is an area where personal choice should prevail and would not wish to be prescriptive about the ability to invest in legally operating industries.

I trust that this information provides the clarity that you were seeking. I would be happy to clarify or add to any points if it would help further in your considerations.

9 December 2003

Supplementary memorandum submitted by the Homeowners' Friendly Society

PRICE CAPPING FOR THE CHILD TRUST FUND: KEY EVIDENCE

I would like to place on record for Committee members a comment following formal evidence given to your current Inquiry on the Child Trust Fund.

The issue of price capping and a Sandler style 1% cap on products has been under discussion by the Committee. In oral evidence presented to the Committee, I understand that a number of comments have been made to the effect that there will be no providers prepared to offer products at a 1% charge.

[16] Not printed.
[17] Not printed.

I would wish to draw the Committee's attention to our own submission where we state:

> "Homeowners is happy to meet the 1% price challenge".

We remain committed to this position.

I would also point out to the Committee that Homeowners launched a 1% childrens' savings product in April 2003—Better Start. Homeowners would be delighted to send Committee members more details.

However, we do accept that 1% would be impossible, or unacceptable for many providers and there is, therefore, a concern that a 1% cap would unnecessarily restrict the market. We agree that careful consideration needs to be given to the impact of any charge cap before implementation.

I hope these comments add further scope to the Committee's Inquiry.

24 November 2003

Supplementary memorandum submitted by HM Treasury providing further information in response to Question 350

TERMS OF REFERENCE FOR INDEPENDENT RESEARCH ON PRICE CAPS FOR THE CHILD TRUST FUND (CTF)

The stated objectives of the Government at the outset of this project were:

> "The research will consider the implications of a price cap on the CTF for consumers and providers, and the impact on distribution. More specifically, the following areas would be considered:
>
> — The impact on consumers of different price caps, in particular the difference between those making no additional contributions and those making the maximum permitted additional contributions;
>
> — The potential market size given assumptions and sensitivities regarding propensity to make additional contributions;
>
> — The impact on different types of providers and distributors under different price caps, specifically the return on capital, payback periods and willingness to participate in the market; and
>
> — The implications for market reach, specifically to low-income families"

(Note: Para 4.1 of the document *Detailed proposals for the Child Trust Fund* sets this out.)

List of Reports from the Treasury Committee since 2001

Session 2003–04

First Report	The Transparency of Credit Card Charges	HC (2003–04) 125
Second Report	Child Trust Funds	HC (2003–04) 86

Session 2002–03

First Report	National Statistics: The Classification of Network Rail *Response: Second Special Report*	HC (2002–03) 154 *HC (2002–03) 550*
Second Report	The 2002 Pre-Budget Report *Response: Third Special Report*	HC (2002–03) 159 *HC (2002–03) 528*
Third Report	Split Capital Investment Trusts *Response: Fourth Special Report*	HC (2002–03) 418 *HC (2002–03) 651*
Fourth Report	The Handling of the Joint Inland Revenue/Customs and Excise PFI Project *Response: Fifth Special Report*	HC (2002–03) 184 *HC (2002–03) 706*
Fifth Report	Annual Report for 2002	HC (2002–03) 491
Sixth Report	The UK and the Euro *Response: Sixth Special Report*	HC (2002–03) 187 *HC (2002–03) 1004*
Seventh Report	The 2003 Budget *Response: Seventh Special Report*	HC (2002–03) 652 *HC (2002–03) 1028*
Eighth Report	Appointment to the Monetary Policy Committee of the Bank of England of Mr Richard Lambert	HC (2002–03) 811
Ninth Report	Appointment of Ms Rachel Lomax as a Deputy Governor of the Bank of England and member of the Monetary Policy Committee	HC (2002–03) 1011
Tenth Report	Inland Revenue Matters *Response: Eighth Special Report*	HC (2002–03) 834 *HC(2002–03) 1181*

Session 2001–02

First Report	The 2001 Census in England and Wales *Response: Ninth Special Report*	HC (2001–02) 310 *HC (2001–02) 852*
Second Report	Budget 2002 *Response: Tenth Special Report*	HC (2001–02) 780 *HC (2001–02) 1075*
Third Report	The Office of Government Commerce *Response: Eleventh Special Report*	HC (2001–02) 851 *HC (2001–02) 1217*
Fourth Report	Appointment to the Monetary Policy Committee of the Bank of England of Mr Paul Tucker and Ms Marian Bell	HC (2001–02) 880
Fifth Report	Banking, the Consumer and Small Businesses *Response: Twelfth Special Report*	HC (2001–02) 818 *HC (2001–02) 1218*
Sixth Report	The Financial Regulation of Public Limited Companies *Response: Thirteenth Special Report*	HC (2001–02) 758 *HC (2001–02) 1219*

Seventh Report	Parliamentary Accountability of Departments *Response: First Special Report [Session 2002–03]*	HC (2001–02) 340 *HC (2002–03) 149*
Eighth Report	Inland Revenue: Self Assessment Systems *Response: Fourteenth Special Report*	HC (2001–02) 681 *HC (2001–02) 1220*
Ninth Report	Appointment of Sir Andrew Large as a Deputy Governor of the Bank of England and Member of the Monetary Policy Committee	HC (2001–02) 1189

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