The Child Trust Fund, tax-incentivised universal children’s savings accounts launched in 2002, was arguably the most innovative social policy implemented under the post-1997 Labour governments. The objectives of the Child Trust Fund range widely across savings policy, financial engagement and asset-based welfare, and are notable for seeking to change the behaviour of both children and their parents. However, the curtain now appears to be falling on the Child Trust Fund: it is not achieving its aims as well as was hoped and, in the context of wide-ranging public spending cuts, the Government has announced that the entire policy is to be scrapped.

This paper therefore explores how the effectiveness of the Child Trust Fund policy could be improved, while simultaneously cutting its cost substantially by over two-thirds, or £388m per year. The paper reviews the long-term aims of the Child Trust Fund and considers its future in the context of the wider children’s savings regime.

BETTER BUT CHEAPER?
Reforming the Child Trust Fund

Rajiv Prabhakar, James Lloyd and Ian Mulheirn
BETTER BUT CHEAPER?
Reforming the Child Trust Fund

by Rajiv Prabhakar, James Lloyd and Ian Mulheirn

Kindly supported by
CONTENTS

Acknowledgements........................................................................................................................................4

About the authors........................................................................................................................................5

Executive summary.....................................................................................................................................6

Chapter 1
Introduction..................................................................................................................................................9

Chapter 2
The policy objectives of the Child Trust Fund ....................................................................................11

Chapter 3
How are Child Trust Funds performing? ...............................................................................................15

Chapter 4
Participation and saving rates in Child Trust Funds: potential reforms .........................................24

Chapter 5
Cutting the cost of Child Trust Funds....................................................................................................29

Chapter 6
Conclusion..................................................................................................................................................34
ACKNOWLEDGEMENTS

The funding of this pamphlet comes from a ‘knowledge transfer’ grant awarded by the Economic and Social Research Council to Dr Rajiv Prabhakar for a project on ‘The Assets Agenda: transferring knowledge on assets, financial education and wealth inequality’ (RES–189–25-0002). He is very grateful for financial support received from the Economic and Social Research Council under this scheme.

The SMF is grateful to Sam Davies who contributed to the original quantitative analysis incorporated in this report while undertaking an internship with the organisation.
ABOUT THE AUTHORS

Dr Rajiv Prabakar is a lecturer in personal finance at The Open University and a research fellow at the London School of Economics. He is author of The Assets Agenda (2008); Rethinking Public Services (2006); and Stakeholding and New Labour (2003) (all published by Palgrave-Macmillan). He has conducted both theoretical and empirical work on asset-based welfare and the Child Trust Fund.

James Lloyd joined the SMF in June 2009. He was previously Head of Policy & Research at the ILC-UK, which included a secondment to the Prime Minister’s Strategy Unit to advise on social care and ageing issues. He read Philosophy at University College London and has Masters degrees in Comparative Politics, and in Public Policy. James has a particular interest in social care, assets and wealth, industrial policy and financial regulation. His previous publications have included A National Care Fund for Long-term Care (2008) and Asset Accumulation in Focus: The Challenges Ahead (2007).

Ian Mulheirn was appointed Director of the Social Market Foundation in October 2008. He joined the Social Market Foundation as the Chief Economist in February 2008, after three years as an economic advisor at HM Treasury. He has worked in a variety of policy areas including child poverty, savings & investment, welfare to work and higher education funding. He has also undertaken research into the drivers of worklessness in London and evaluation of the Working Tax Credit and the National Minimum Wage. He has a Masters degree in Economics from University College London and an undergraduate degree in Philosophy Politics and Economics from Oxford University.
EXECUTIVE SUMMARY

The Child Trust Fund (CTF), tax-incentivised universal children’s savings accounts launched in 2002, was arguably the most innovative social policy implemented under the post-1997 Labour governments. The objectives of the CTF range widely across savings policy, financial engagement and asset-based welfare, and are notable for seeking to change the behaviour of both children and their parents. However, the CTF today is at a crossroads: it is not achieving its aims as well as was hoped, and it is no longer affordable in its current state.

Administrative data that has emerged since its launch has revealed wide variations in savings rates for different children within the CTF, and in active account openings by parents – a key objective of the policy. Crucially, these variations appear correlated with socio-economic characteristics, suggesting that the core target groups for the CTF are not engaging with the policy. Savings rates and active engagement need to be significantly improved among lower-income households if the policy is to meet its objectives. But the deep-rooted savings and financial engagement problems that the CTF was introduced to address will remain unless policy addresses them and a reformed CTF remains the best vehicle to do so.

At the same time, the UK confronts an acute public spending squeeze starting this year to begin the long process of fiscal consolidation. Confronted with a dire fiscal situation, the Coalition Government elected in 2010 has announced its intention to pass legislation to end CTF payments, saving £320 million in 2010–11, rising to £520 million in 2011–12. From August 2010, contributions at birth will be reduced and contributions at age 7 will stop. From January 2011, all contributions at birth will stop.

This paper therefore outlines a package of reforms to boost the effectiveness of the CTF while also exploring how the cost of the programme could be cut by over two-thirds, or £420 million per year, while retaining many of its benefits.
MAKING THE CHILD TRUST FUND MORE EFFECTIVE
To improve saving rates and active engagement with CTFs among lower-income households, the government should:

- Simplify choices around opening a CTF account;
- Develop behavioural interventions, such as direct-debit schemes to make it easier for parents to save for their children;
- Impose restrictions on how the CTF can be used at the age of 18, to reassure parents that savings will be used wisely at 18;
- Make receipt of full voucher entitlements among low-income households conditional on visiting a financial adviser, in order to encourage engagement with basic financial advice through the Moneymadeclear programme;
- Address the key aim of encouraging engagement directly by implementing government matching of contributions from households on the first £50 of savings each year for the first five years of a child’s life, at a cost of £160 million per annum.

CUTTING THE COSTS BY TWO-THIRDS
To cut the annual cost of the Child Trust Fund policy, the government should:

- Abolish universal CTF payments for seven year olds, saving £220 million, since this payment is unaffordable and unlikely to encourage further engagement for parents;
- Reduce the value of universal payments at birth from £250 to £50, and the value of additional awards for lower-income households from £250 to £50, saving £150 million.

Currently all children’s savings – not just the CTF – are tax free. Children’s savings accounts therefore tend to be tax havens for wealthy parents who have exhausted their ISAs. But this is no longer affordable and must be examined alongside cuts to CTF expenditure. The government should therefore:

- Abolish tax-relief on all non-CTF children’s savings accounts for under-16s,
saving the Exchequer around £200 million and establishing the CTF as the only tax-free children’s savings vehicle. This money should be recycled to fund the cost of matched CTF contributions set out above.

The SMF estimates that the net effect of these proposals, which would increase the effectiveness of the CTF, would cut the annual cost of children’s saving policy by £420 million.

Policymakers should recognise the gravity of the underlying challenges of low levels of saving and financial disengagement that confront consumer finance in the UK. These will not go away without efforts to address financial engagement and savings behaviour. But it is possible to achieve these policy goals, using the CTF, at much lower cost.
CHAPTER 1: INTRODUCTION

Child Trust Funds, the universal tax-free savings accounts for children born after 2002, represent one of the most distinctive and eye-catching policies adopted by the post-1997 Labour governments. Policy makers from countries including the United States, France and New Zealand have shown interest in learning from the UK’s experience.

However, the Child Trust Fund (CTF) policy today stands facing the abyss. Confronted with a dire fiscal situation, the Coalition Government elected in 2010 has announced its intention to pass legislation to end Child Trust Fund payments, saving £320 million in 2010–11, rising to £520 million in 2011–12. From August 2010, contributions at birth will be reduced and contributions at age 7 will stop. From January 2011, all contributions at birth will stop.

The new government has argued that the CTF scheme is being funded by public borrowing, so the government is effectively building up debts which will have to be re-paid by young people. It is argued that the CTF does not make young people wealthier, since every pound paid into the scheme by the state represents an extra pound of debt, which young people will ultimately shoulder the burden of.

However, as is explored in subsequent chapters, this view of CTFs ignores the amounts that parents save into accounts, and only conceives of CTFs as a savings policy, rather than contributing to multiple other policy objectives.

Besides fiscal considerations, other factors have led to scrutiny of the CTF policy. Early data on take-up for CTFs suggest that they may not be meeting some of their key policy objectives for enhancing financial engagement and saving among key target groups. In particular, early data suggests that levels of active engagement, saving and contribution rates for CTFs are all lower in poorer areas of the country.

It is therefore an appropriate time to take stock of the CTF and explore where next for one of the most innovative social policies of the last decade. This report contributes to ongoing policy discussion on the future of CTFs by:
• Reviewing the objectives of the CTF policy;
• Examining early evidence on the performance of CTFs against these policy objectives, including administrative data on engagement among different groups and academic research with users;
• Proposing reforms to the CTF that would enable the policy to achieve its goals more closely;
• Recommending a package of far-reaching changes to substantially cut the cost of the policy without damaging its potential to achieve its objectives.

The CTF’s policy objectives remain vitally important for public policy. The problem is that it is not achieving them as well as was hoped, and the programme costs too much. This paper proposes solutions to both of these shortcomings.
CHAPTER 2: THE POLICY OBJECTIVES OF THE CHILD TRUST FUND

The objectives of the Child Trust Fund are relatively transparent and are notable for their focus on attempting to influence the behaviour of both children and their parents. The previous Labour government summarized the desired policy objectives as threefold:

- **Security**: in future all children will have the backing of a stock of financial assets at the start of their adult lives, helping to cushion the impact of unforeseen circumstances;
- **Opportunity**: funds can be used to take advantage of opportunities throughout adult life, enabling individuals to play a more confident and continuous role in their communities;
- **Responsibility**: development of the saving habit will promote independence and financial education will help individuals to make better financial choices throughout life.

What are Child Trust Funds?

Launched in 2002, Child Trust Funds are savings accounts opened in the name of children around the time of their birth and given 100% tax-relief on all interest and investment gains. Families may make contributions into funds up to the value of £1,200 each year. Savings into a fund are inaccessible until a child is aged 18, when the account matures. From the age of 16 the young person is granted control over how their CTF is managed, for example, choice of provider or type of account.

All babies in the UK born after September 2002 have received a voucher from the state, which can be used by their parents to start a CTF account. All families receive a £250 voucher, although children from lower income households qualify for an extra £250 once their family’s entitlement to Child Tax Credit has been determined. If a family does not use its voucher, after one year the government opens an account on a child’s behalf, investing the entitlement with one of a rotating list of approved private sector CTF account providers.

---

At the age of seven, the government makes an extra £250 or £500 payment into the CTF (the higher payment is for children from low income families). The first wave of these payments was made in September 2009. The 2009 Budget announced that children with disabilities would get an extra £100 a year into their CTF accounts, and those with severe disabilities would receive an extra £200 a year.

CTF accounts can be simple interest-bearing cash savings accounts, invested in shares, or ‘stakeholder’ accounts, which are invested in less-risky shares the closer a child gets to the age of 18. Stakeholder accounts also have a charge cap on running costs limited to no more than 1.5%.

Various financial companies offer CTF accounts as part of a market that is widely perceived to be competitive. Accounts are also available that are compatible with Shariah finance.

The CTF policy has also been integrated with a programme of financial education for school children that includes a lesson on the Child Trust Fund.

The CTF was introduced to tackle a range of perceived problems across several areas of public policy including savings policy and financial engagement. Their introduction also marked the adoption of an ‘asset-based welfare’ policy agenda, which seeks to secure a range of perceived benefits associated with asset-ownership among individuals. The specific outcomes sought by the CTF policy are as follows:

**SAVINGS POLICY**

As a simple, tax-incentivised universal savings device, the CTF is designed to foster higher rates of saving by engendering savings behaviour among young people and parents alike in the context of the perceived absence of a ‘savings culture’ in the UK. The CTF seeks to normalise both household saving and the possession of a stock of savings.

**FINANCIAL ENGAGEMENT**

As well as aiming to boost savings levels in aggregate, the CTF is designed to increase financial engagement among beneficiaries in the future. The policy is therefore coherent with, and contributes toward, a range of government
strategies relating to financial services and consumers. Among both children and parents, CTFs are designed to improve ‘financial engagement’ by encouraging young people and their parents to interact with the financial services industry and normalising the use of financial products. By encouraging active participation in choosing the type of fund used for their child and fund provider, it is intended that parents will improve their levels of financial education and financial capability. For example, parents are encouraged to think about the risk/reward trade-off of investment-based CTF accounts.

The CTF policy seeks to advance financial education among children by encouraging them to think about what interest rates mean and the riskiness of different investments, as well as engaging them in financial planning decisions about how much to save, and the workings of the financial services industry more broadly. In effect, by ensuring that all children possess a financial product, this means all children are able to ‘practice’ financial decision-making and thinking about financial choices.

ASSET-BASED WELFARE
A further key objective of the CTF policy – and one that represents a new element for public policy – is to achieve the behavioural benefits identified as being associated with asset ownership. Reflecting the ‘asset-based welfare’ agenda, the benefits of owning assets at the start of one’s adult life are said to include:

• The confidence and financial security to make potentially risky ‘investments’ in higher education, starting a business, pursuing further training or getting on the housing ladder.
• An expectation of owning assets among children as they enter adulthood thereby improving their perception of future financial status and life course asset accumulation.
• Young people possessing a stake in society, with associated benefits for their behaviour, participation in the community and view of public institutions.

In advancing these goals, proponents hope that the CTF will also prove to be an effective citizenship policy. It is argued that young people possessing a CTF will
grow up with a stronger sense that society has invested in them, encouraging greater levels of civic engagement, trust and social capital. While these claims are hard to verify in concrete terms, it seems clear that only a policy such as CTF can put them to the test.

This section has outlined the aims of the CTF, but what evidence is there on the policy’s performance to date? This is explored in the next chapter.
CHAPTER 3: HOW ARE CHILD TRUST FUNDS PERFORMING?

As described above, the various outcomes that comprise the objectives of the CTF are numerous, diverse, and cut across multiple different policy domains including savings policy, financial capability and citizenship. How is the CTF performing against these multiple policy objectives?

As an explicitly long-term policy measure, a full evaluation of the CTF will be impossible until the first recipients of accounts reach 18 years of age in 2020. However, it is important more generally to underline the fact that policymakers are likely to confront difficulties in measuring the efficacy of the CTF for public policy. Some of the outcomes sought by the CTF policy are likely to be hard to define and measure, in particular, the behavioural outcomes associated with possessing a CTF. It is unclear whether the government intends to assess forward planning and attitudes to risk among those children with CTFs, compared to preceding cohorts that did not possess CTF accounts. Similarly, the outcomes sought for CTFs reflecting the objectives of citizenship policy are relatively difficult to evaluate.\(^2\)

Finally, it is not clear whether policymakers have made assessments of the effect of the CTF on the financial capability of parents. This may reflect the fact that attempts by academics and researchers to define and measure financial capability, most recently with the publication by the Financial Services Authority (FSA) of the Baseline Survey of Financial Capability, are still in their relative infancy.

Nevertheless, in light of the early data and evidence available on the performance and outcomes generated by the CTF policy up to this point, it is possible to explore how well the CTF is performing against some of its objectives.

\(^2\) Policymakers may in future have recourse to data sources, such as the Citizenship Survey, which is commissioned by the Department for Communities and Local Government, to assess the impact of CTF for citizenship policy.
EVIDENCE FROM CHILD TRUST FUNDS ON SAVINGS AND FINANCIAL ENGAGEMENT

Regular new administrative data makes possible a limited early assessment of CTFs in relation to savings policy and financial engagement. Since their launch in 2002, emerging data has identified several issues particularly in relation to saving rates and the extent of active participation in opening a CTF account by parents. Such data provides an opportunity to assess some leading indicators of the success of the CTF policy against a few of its stated objectives.

ACTIVE PARTICIPATION

As described above, parents of new born children are given a choice regarding what kind of CTF to open for their child and with which provider, although accounts are opened automatically if parents fail to make a choice within 12 months. Encouraging parents to actively make this choice is an important aspect of the policy as it is a key mechanism by which CTFs are designed to increase financial engagement and capability.

Official figures show that from January 2005 to September 2008, on average 27% of parents did not open an account for their child, suggesting lower levels of engagement with the policy among this inactive group.\(^3\) In particular, around 33% of low-income households entitled to the extra £250 voucher did not open a CTF account, compared to 18% among wealthier households. This trend can also be seen by comparing data for wealthier parts of the country to poorer areas. Administrative data on active opening rates among families by parliamentary constituency reveal that the percentage of accounts opened by parents for children born on or before 5 April 2008 is higher in more affluent areas such as Guildford (83.6%), Harrogate and Knaresborough (82.6%) and Henley (84.8%).\(^4\) In contrast, the percentage of accounts actively opened by parents is lower in Glasgow East (52.5%), Liverpool Walton (59.3%) and Bradford West (57.1%).

---


Delving deeper into this phenomenon, the SMF has compared CTF active opening rates against administrative data on tax credit receipts that give an indication of the relative poverty levels by constituency. The chart below plots the proportion of tax credit recipient families in each constituency who receive more than the basic family element of the child tax credit against the proportion of CTF accounts that were actively opened by parents. Families entitled to more than the family element are (by definition) less well-off than those who are not, and approximately half of all families in the UK are entitled to more than the basic amount. Hence, the x-axis on the chart below represents a measure of family affluence in each parliamentary constituency.

**Chart 1: Proportion of families actively opening a Child Trust Fund by relative poverty**

The chart shows a strong correlation between the proportion of families in an area who are better off and CTF engagement by parents on this measure. It shows that

---

5 The graph plots the proportion of Child Trust Fund accounts actively opened by parents against the relative poverty of an area. The relative poverty statistic was created by dividing the number of families receiving the Child Tax Credit at or below the family element by the total number of families with children in any given area. This produced a statistic for the proportion of families who receive Child Tax Credit at or below the family element, with a score closer to zero being indicative of a higher level of poverty in an area. The data from Child Trust Fund accounts and Child Tax Credit is from HMRC.
for every one percentage point increase in families on the lower level of tax credits (higher income), the proportion of CTF accounts actively opened rises by around 0.55 percentage points.

The government has not issued targets for active opening of CTF accounts by eligible parents, hence it is unclear whether this performance is lower than anticipated. It is also difficult, given their unique characteristics, to benchmark rates of active participation in CTFs with other types of financial product. Indeed, participation levels in most savings products such as Individuals Savings Accounts (ISAs) and pension saving reflect under-saving across the population.6

As is explored in more detail below, the failure by parents to engage actively with opening a CTF account could reflect a rational decision among some parents to let the state open a CTF account for their child. However, a specific policy objective of the CTF policy is to increase engagement with financial products among parents by encouraging them to select a type of account and provider. Variations in active CTF account opening suggest the policy is not being uniformly effective. Given that the objectives of the CTF policy matter more for policymakers in relation to poorer, financially disengaged households, these statistics can be interpreted as revealing a key problem with the efficacy of the CTF policy.

SAVING RATES

In addition to apparent socio-economic variations in whether parents actively open an account for their children, there is evidence to suggest that savings rates also vary among different socio-economic groups.

Geographical variations are observable in the percentage of accounts receiving contributions in different parts of the country. The percentage of accounts receiving contributions varies by region, for example, the North East (22%), the South East (28%), and the West Midlands (22%).

6 A better comparison may be Pension Credit which, like Child Trust Funds, effectively represents ‘free money’ from the state. Take-up of Pension Credit is around 70% (See: http://www.dwp.gov.uk/docs/pc-pilot-discussion.pdf) However, this apparently low level of take-up is widely perceived to result from resentment at the active means-testing involved.
In addition, average contribution rates appear to vary by area. Official data, which is only available at the regional level, show that average contributions to CTF accounts in the year 2008–2009 was £235 in the North East, £368 in London and £240 in the North West. Such data is significant for two key reasons. First, at 22–28%, the percentage of CTF accounts receiving contributions appears to be relatively low.

Second, although the distribution of means-tested opening vouchers for CTF accounts makes the policy explicitly redistributive, higher rates of saving into accounts in wealthier areas suggests that the tax-relief bestowed on CTF accounts is primarily benefiting richer households. Administrative data on CTF accounts for 2008–9 show that among lower-income families, 87% did not save into their CTF account and among those that did, the average contribution was £172. By contrast, among wealthier families not entitled to Child Tax Credit, 30% of accounts received contributions and total average savings were £302. Such income-related variations in who is benefiting from tax-relief on savings in CTF accounts could be seen as reinforcing wealth inequalities among children. Indeed, data from the UK Wealth and Assets Survey shows that when CTF accounts are excluded, around 50% of children have no financial assets of their own but amongst those that do, the median amount is £800 and the mean is £2700. In short, it appears that the CTF may be accelerating rather than reducing wealth inequalities among children.

WHY DO VARIATIONS IN PARTICIPATION AND SAVING EXIST?
These variations in active CTF account opening and savings rates, apparently correlated with socio-economic characteristics, matter for the CTF policy given its stated objectives around achieving a savings culture, increasing engagement with financial products, and giving children a nest-egg at the age of 18.

---

8 Ibid.
10 A mean is average value, calculated by adding all the observations and dividing by the number of observations. A median is the middle value within a set of observations arranged in ascending/descending order.
A number of hypotheses can be put forward to explain apparently lower rates of active participation and contribution rates among different socio-economic groups. These relate to the way that households make budgeting and spending decisions, and choices around whether to put money into a CTF. Other possibilities include how households approach financial decisions and the potential complexity of the CTF for families. Variations in engagement and saving rates may also be the result of time constraints on parents, or attempts by parents to ensure fairness among children that do and do not receive CTF payments from the government. We explore each of these in turn.

Household budgeting
Lower levels of active engagement and saving into CTF accounts among lower-income households may reflect factors associated with household budgeting and decision-making. For example, surveys of financial behaviour have repeatedly shown households citing *affordability* as the principal barrier to saving. 11 Affordability will inevitably determine how much households save into CTF accounts, and saving rates are likely to be lower among those with lower incomes.

As well as affordability issues, households in lower socio-economic groups may be taking rational and informed budgeting decisions around *spending priorities*, concluding income is better allocated to expenditure on a child in the present, for example, toward books and a school uniform, rather than saving for the child’s future.

Complexity, choice and financial decision-making
Although the CTF is predicated on giving parents choice around the account used for their child, studies in behavioural economics have identified that complexity, excessive volumes of information and “too much choice” can all be barriers to individuals making choices, and in particular, financial decisions. 12

---

Indeed, the extent to which complexity and choice is a barrier to individuals making decisions may be associated with their socio-economic characteristics including levels of education and numeracy, financial literacy and previous experience of using financial products. Previous research commissioned by the FSA has identified a relationship between ‘financial capability’ and income. Take-up and contributions to CTFs may therefore reflect existing variations in financial capability across the population.

It can therefore be hypothesised that the failure of some parents to open CTF accounts results from how this choice is presented to parents, the nature of the choice and the information provided. This explanation is supported by original qualitative research on CTFs featuring focus groups of new parents. The focus groups identified problems with information received from financial providers as a key reason why CTF accounts were left unopened. Concerns were expressed about both the quality and quantity of information received from providers. Parents felt confused with the material made available by account providers and overwhelmed by the volume of mail-shots touting for their custom.

Those parents who had not opened a CTF reported that the main reason why they had not done this was because of confusion over the information received from financial providers. Those who opened accounts also reported dissatisfaction with the information received from providers about CTF accounts. For example, they complained about hidden charges that financial providers imposed on CTF accounts. Recent research also identifies that a key aspect of the information


15 The study involved 7 focus groups in England convened in January and February 2006. About 8 parents attended each group, with 58 participants in all. The study covered parents who receive the standard £250 voucher as well as those who qualify for the higher £500 payment. About a third of participants had the higher £500 payment. Most participants were female although there were also some male respondents. Individuals were each paid a £20 incentive payment for taking part in the discussion. The discussions lasted about one hour. The focus groups were all based at Sure Start centres, which are now known as Sure Start Children’s Centres. These centres offered a way of accessing parents who qualify for the £500 payment without too much intrusion.

overload experienced by some households is not the official information received, 
but secondary brand-specific promotional information, for example, available at 
super-market check-outs. It appears that for some households, it is not official 
information sources, but extraneous promotion of CTFs that may result in ‘too 
much choice’ and associated confusion.

Insights from behavioural economics also suggest inertia can be a barrier to both 
saving and engaging with financial products, and it may be the case that such an 
‘inertia effect’ influences saving in the CTF. Indeed, it is worth noting that with 
its application of automatic enrolment to personal pension accounts, UK pension 
reform assumes individuals display inertia in relation to financial decisions. 
In contrast, the CTF policy attempts to combat inertia through promotional 
information about CTFs. However, inertia may well be a barrier to active take-up 
and saving into the CTF by parents, and the extent to which inertia acts as a barrier 
to saving in a CTF may be correlated with socio-economic characteristics.

Household behaviour
It is likely that some parents may not open a CTF account because of time and other 
pressures associated with the first year of a child’s life. Qualitative research with 
parents exploring their experiences with CTFs found some cited the fact that the first 
year of their baby’s life was a busy time as a factor affecting their active participation 
in opening an account. The time and effort required to study information about 
CTFs is likely to be proportionately higher for parents who have not previously 
engaged with financial products before than for wealthier households who have.

The higher ‘time-costs’ of engagement for lower-income households must also be 
set against the fact that the fact the state will automatically open an account for a

---

child one year after its birth. This may lead some parents to make a judgement that actively choosing an account is not worth the effort required.

Household relations
It is reasonable to assume that many parents seek to treat their children equally. However, the introduction of CTFs for children born after September 2002 creates an obvious inequality in relation to those born before this time. Wealthier households may be able to equalise financial outcomes through extra transfers to other children in the household. However, poorer households may not, and as a result, disengage with CTFs in order to minimise inequalities among children within the family.

This hypothesis is supported by qualitative research into parental attitudes toward CTFs.\textsuperscript{20} It found that worries about creating inequality between siblings was a particular concern, and that parents with children who did and did not have CTF accounts took various steps to correct this perceived unfairness. Most reported that they would save for children within the household that do not possess a CTF account \textit{before} putting money into the CTF of younger children. This situation was more challenging, however, for lower-income parents with children who had received the £500 payment as they reported more difficulties in saving.

Transfers from parents to children via a CTF are also likely to depend on the expectations of parents regarding how their children will use the money. Some parents may be deterred from saving into a CTF account if they are unconfident that their child will spend the money wisely at the age of 18.

These reasons for the limited success of the CTF to date in expanding financial engagement and savings behaviour point the way to a range of reforms that could resolve the problems. These are the focus of the next section.

CHAPTER 4: PARTICIPATION AND SAVING RATES IN CHILD TRUST FUNDS: POTENTIAL REFORMS

The previous sections have reviewed the design of CTF accounts and the wide-ranging objectives of the CTF policy. However, evidence from administrative data suggests that there are problems around saving and contribution rates, as well as with active engagement by parents in opening accounts. For these reasons the policy appears to be less effective than might have been hoped. Various hypotheses have been explored to explain these variations in participation. In relation to active engagement with CTF accounts, recent original research with parents supports the argument that many parents are confused by the information and choices around CTF accounts. Confusion not only deters their participation in opening an account, but potentially engenders wider disengagement reflected in lower savings rates.

Given the wide variations that exist in active participation and contributions toward CTFs, which appear to be closely associated with the socio-economic characteristics of households, how can the government raise participation and contribution rates? A number of levers are available to the government. The choices for parents around opening accounts can be simplified further, and various behavioural interventions could be applied to make saving a habit. Parents could be given more confidence that Funds will be used wisely when their children turn 18. Voucher payments could be made partly conditional on parents using financial advice services so that engagement and education is improved. To encourage greater saving, pound-for-pound matching contributions from the Government could be implemented.

Simplify choices around opening a CTF account
Since their launch in 2002, government and providers have sought to make opening a CTF account easier and to improve the information on offer to parents. However, the persistence of confusion among parents, some of whom report the way that the choice of accounts is presented deters them from making a decision, suggests more needs to be done. Various levers are available to policymakers in
this regard such as tighter regulation of the volume of material parents receive, reviewing the form information takes, and investigating when in the first year is the optimal time for parents to be informed about the CTF. 21

Develop behavioural interventions
To increase contribution rates to CTFs among parents, the government should explore ‘behavioural’ measures to encourage parents with bank accounts to make direct debit payments into a fund, which ultimately become a regular part of household budgeting.

As noted, some households may be making a rational decision to let the state open an account for their child after one year. To encourage active participation in opening CTF accounts, the government should explore whether ending this automatic process, would result in higher levels of active participation, or would actually see many children left without CTF accounts altogether.

Impose restrictions on how Child Trust Funds can be used at the age of 18
Some parents may be deterred from saving into a CTF, since children have complete control over the use of the fund at the age of 18. If parents fear that the money will be spent on frivolous items, restricting what accounts can be used for might encourage parental participation. For example, restrictions could be imposed allowing maturing accounts to be put toward such things as paying higher education tuition fees, pension contributions, house purchase or funding a business start-up. A precedent for such an approach is New Zealand’s tax-incentivised ‘Kiwisaver’ accounts, in which withdrawals from tax-incentivised savings are conditional on savings being used for certain types of expenditure,

---

21 In October 2007, the Economic Secretary to the Treasury asked HM Revenue and Customs to consult on how the process of using vouchers to open Child Trust Fund accounts could be made easier. In the original policy parents had to send in their CTF voucher to a provider to open an account. In the consultation HM Revenue and Customs canvassed three options: to leave the system unchanged; to make it compulsory for providers to open an account without a voucher; or to have a voluntary system that would remove the legal requirement for providers to have the voucher but leave it up to the provider whether to open an account without a voucher. The majority of consultation respondents favoured the last option, mainly because it would allow providers to decide on whether to move to a voucherless system on their own cost-benefit analysis. In Budget 2008, the government announced that from April 2009, the government would implement this option of allowing providers to open an account without a CTF voucher if they wish (HMRC: 2008).
such as house-purchase. Such restrictions on CTFs may create administrative costs for the government, and some parents may resent restrictions being applied retrospectively to existing savings in CTFs. As such, an alternative approach would be to simply raise the age threshold at which funds can be accessed to 21, when parents may be more confident of their child taking responsible financial decisions.

**Make receipt of full voucher entitlements conditional on using financial advice**

Given the extent of parents failing to actively open a CTF account themselves, and the apparent confusion about savings products, it may be effective to link the activation of the savings voucher to take-up of financial advice. Such an approach would go a long way to furthering the core aims of the CTF in encouraging financial engagement and education.

On this approach, parents would no longer automatically receive vouchers for the full amount their child is entitled to. Instead parents would receive vouchers for a proportion of this amount, with receipt of the remainder conditional on parents attending a financial advice session to discuss different types of CTF account and financial planning for the child more broadly.

Financial advice sessions could be provided under by the government’s *Moneymadeclear* service, or under a range of other frameworks, such as SureStart.22 Decisions regarding what type of account to choose could be made during the advice session with an adviser, so that all those attending did engage and experience making a choice about a financial product.

In this way, the CTF policy could be far more effective in achieving its goals around financial advice and financial behaviour, rather than at present, when every child receives £250–£500, but for as many as 45% of families in some areas, the impact on financial engagement and financial capability is negligible. A significant proportion of the value of the voucher entitlement would be paid irrespective of whether parents attend a financial advice session, and accounts continue to be

---

opened automatically after one year. All new babies would therefore continue to receive a CTF account regardless of whether their parents took up the available financial advice session and hence the CTF policy would continue to be universal in nature.

**Strengthen the role of the CTF in citizenship policy**

One mechanism for improving saving and engagement with CTFs that has been suggested is to make CTFs more central to children’s lives as citizens. For example, the CTF could feature as a topic in school classrooms as part of citizenship education looking at the responsibilities of citizens and the roles people can take in the community. It has also been suggested that public authorities might reward young people for volunteering in the local community by making extra payments into their CTF accounts, so that CTFs become a vehicle for linking children to their environment and locality.

**Implement matching contributions for low-income households**

As described above, rates of saving into CTF accounts are variable. One mechanism to increase saving would be to bestow extra financial incentives. However, given saving rates into CTF accounts do appear to reflect socio-economic gradients, any extra financial incentives must be easy to understand among people unfamiliar with savings products and concepts such as the rate of return. In this respect the implications of the tax free nature of the accounts is meaningless to many parents, particularly those in the target group.

The principle of ‘matching contributions’ has been deployed as a mechanism to encourage saving in the current Savings Gateway scheme, is a feature of the Conservative proposal for Lifetime Savings Accounts, and also featured in the Labour Party 2010 general election manifesto in the form of a ‘Super-ISA’. The policy of matching contributions in government-sponsored savings vehicles recognises that pound-for-pound contributions may be more effective at encouraging saving than tax relief, which many savers may not understand and

---

does not provide the same tangible incremental incentives to save. Consequently tax relief tends to disproportionately benefit the better off.

In order to increase the financial incentives for low-income households to save into a CTF account, the government should implement matching-contributions in relation to payments into a CTF account for households entitled to Child Tax Credit. This change would encourage households to save. If matching contributions were available up to a child’s fifth birthday, they would encourage households to develop the habit of saving into a CTF account over an extended period. This, more than any other measure, would be likely to boost the effectiveness of the CTF in terms of its stated aims. To limit the cost of this change, matching contributions could be capped at £50 per year. Such a policy change would cost no more than £160 million per year if it was assumed all lower-income parents saved at least £50 into a CTF account.

However, while the above measures would improve the effectiveness of the CTF in pursuit of its intended goals, they won’t solve the second big problem facing the policy: that it costs far too much. How can the cost be cut, but with the benefits of the CTF retained?
CHAPTER 5: CUTTING THE COST OF CHILD TRUST FUNDS

The previous sections have described the objectives of the CTF, early evidence on its efficacy in light of administrative data and original research, and proposed some reform options for improving active participation and saving rates in CTFs.

However, while arguments about improving the effectiveness of CTFs are valuable, such discussion may prove immaterial given the announcement by the 2010 Coalition Government that it intends, in response to a dire fiscal situation, to abolish CTFs completely.

In 2008–9, the administrative cost to the government of running the CTF was £4.8 million, and the cost of vouchers for new-babies was £250 million. However, with the introduction of payments for children aged seven, and extra vouchers for disabled children, the cost of the CTF policy has increased, and was previously forecast to rise to £540m next year.

<table>
<thead>
<tr>
<th>Year</th>
<th>(Projected) Cost in £ millions</th>
</tr>
</thead>
<tbody>
<tr>
<td>2009/10</td>
<td>£380</td>
</tr>
<tr>
<td>2010/11</td>
<td>£520</td>
</tr>
<tr>
<td>2011/12</td>
<td>£540</td>
</tr>
<tr>
<td>2012/13</td>
<td>£550</td>
</tr>
</tbody>
</table>

Source: HMRC (2009)

The Government has said that it will pass legislation to end CTF payments, saving £320 million in 2010–11, rising to £520 million in 2011–12. From August 2010, contributions at birth will be reduced and contributions at age 7 will stop. From January 2011, all contributions at birth will stop.

25 Ibid.
The Government has justified this sweeping change by arguing that since the CTF is being funded by public borrowing, the government is effectively building up debts which will have to be re-paid by young people, i.e. the very beneficiaries of CTFs. In this way, it is argued that the CTF does not make young people wealthier, since every pound paid into the scheme by the state represents an extra pound of debt, which young people will ultimately shoulder the burden of.

In the context of the CTF and its objectives, this argument is noticeable for defining CTFs purely as a wealth-building policy, rather than in terms of the CTFs other strategic objectives for citizenship policy, asset-based welfare and financial engagement.

Rather than complete abolishment, are there other ways in which the cost of the policy could be slashed, while preserving as many as possible of its beneficial outcomes?

The principal costs associated with the CTF policy for government are the different voucher payments awarded to children and the tax-relief on CTF accounts. The government therefore has multiple options for reducing the overall cost of the CTF policy by lowering the value of vouchers children receive, or targeting the tax-relief available, for example, by limiting tax-relief on CTFs to low-income households. The SMF therefore recommends the following budgetary changes in relation to the CTF policy:

**Abolish voucher payments for children aged seven years**

The most simple and immediate way in which the government can and should reduce the cost of the CTF policy while preserving many of its benefits is to abolish voucher payments for children at seven years of age. It is far from clear that these payments do anything to further the aims of financial engagement or encouraging saving. As identified by the Government, abolishing these payments for children at seven would immediately reduce the projected annual cost of CTFs by around £220 million.26

**Saving: £220 million p.a.**

---

26 For the sake of budgeting, these figures uses data from HMRC on the number of vouchers and additional payments paid to babies born in the year 2007–8.
**Lower the value of vouchers for babies**

Lowering the value of vouchers awarded to children born each year could substantially cut the cost of the CTF policy. However, it would not be appropriate to abolish completely vouchers for higher-income households not entitled to child tax credit, which would fundamentally undermine the universal nature of the policy. However, the arbitrary nature of both the £250 and £500 payments at birth means that the same ends could be achieved with much smaller sums.

The Government recently announced that from August 1st 2010, the value of payments at birth would be lowered to a £50 universal payment, and a £50 extra contribution for low-income families.

These measures would immediately cut the annual cost of vouchers for babies from £220 million to £40 million each year. The SMF supports these changes, and proposes that they be left in place on a permanent basis.

**Saving: £180 million p.a.**

**Abolish tax-relief on non-CTF children’s savings**

As described above, when CTFs are excluded, patterns of wealth among children under-16 in the UK are extremely skewed. Half of children have no financial assets. Among the 50% that do, the median (£800) amount is significantly less than the median (£2700), suggesting it is the children of the very wealthiest households in the country that possess the largest share of financial assets.

Much of this financial wealth belonging to children is likely to be held in savings accounts, which do not pay tax on interest-earnings. In many instances, it is likely that children’s savings accounts are in fact used for tax-avoidance purposes by wealthier families.

Calculations by the SMF suggest that tax-relief on children’s savings account costs the Exchequer around £180 million p.a., if these savings were subject to the tax-
rates of the highest earner in the household. As such, the tax-relief on children’s savings is principally of benefit to the wealthiest families in society.

At this critical juncture in the development of the CTF, it is appropriate to take a broader look at the entire tax-incentivised savings regime for children, the role of the CTF and how tax-relief is apportioned to different savings vehicles.

Given its benefits across a range of policy areas, it is right to make the CTF the central pillar of the tax-incentivised children’s savings regime in the UK. For this reason, the government should scrap tax-relief on children’s savings accounts for under-16s, with the savings for the Exchequer recycled into the budget for CTFs. This is the right decision because:

- Unlike other types of children’s savings vehicles, CTFs are universal. By 2018, all children in the UK will have one;
- The annual cap on tax-relief for savings into CTFs ensures that that benefit of tax-relief among children is much more evenly distributed;
- Unlike other types of children’s savings product, CTFs contribute toward policy goals across citizenship policy and financial engagement for all, so it is right that tax-relief is directed towards a children’s savings vehicle that achieves these objectives. For example, financial education for children in schools will be undermined if only half of children have a savings product;
- Although abolishing tax-relief on children’s savings will create losers, those who lose out will be wealthier households, with the biggest losers concentrated among the wealthiest families in society.

27 These calculations assume a 4% rate of interest and apply a 30% tax-rate to interest earned on the stock children’s financial assets.
NEW BUDGET FOR CHILD TRUST FUNDS UNDER SMF PROPOSALS

Assembling together the SMF’s proposals for the future of the CTF, a revised budget for the CTF policy is as follows:

<table>
<thead>
<tr>
<th></th>
<th>Total projected cost in £ millions</th>
</tr>
</thead>
<tbody>
<tr>
<td>Current projected cost for 2011/12</td>
<td>540</td>
</tr>
<tr>
<td>Abolish seven year payments</td>
<td>-220</td>
</tr>
<tr>
<td>Reduced payments at birth</td>
<td>-180</td>
</tr>
<tr>
<td>Matching contributions over first five years</td>
<td>160</td>
</tr>
<tr>
<td>Abolish tax-relief on children’s savings</td>
<td>-180</td>
</tr>
<tr>
<td>Total savings</td>
<td>420</td>
</tr>
<tr>
<td>Revised cost of Child Trust Fund</td>
<td>120</td>
</tr>
</tbody>
</table>

If implemented in full, these proposals would save £420 million from the annual cost to the Exchequer of the Child Trust Fund. The new annual cost for the Government would be £120 million.
CHAPTER 6: CONCLUSION

Child Trusts Funds have been one of the most eye-catching and innovative social policies implemented in the UK under the post-1997 Labour government.

This paper has sought to contribute to the debate on their future by reviewing their objectives, their performance in light of early evidence, and potential refinements to the policy that might improve rates of saving and active participation. Given the fiscal landscape the UK confronts in 2010, the paper has also proposed a package of reforms to cut the cost by two-thirds, while retaining and enhancing the benefits of the policy at a time when the challenges of greater financial engagement and saving are as crucial as ever.

It is important to remember that the CTF policy is by its very nature a long-term strategy. When the first beneficiaries of CTFs reach the age of 18 in 2020, and thereby enable the first rounded evaluation of the policy, the current fiscal crisis afflicting public spending should have eased considerably. Policymakers should recognise the gravity of the underlying challenges that confront consumer finance. These will not go away without efforts to address financial engagement and savings behaviour. But it is possible to achieve these policy goals at much lower cost.

In this context, the package of measures proposed here – abolishing vouchers for seven year olds, limited matching contributions for low-income households, and making the full value of vouchers conditional on using financial advice – represent a realistic and viable future for the Child Trust Fund.
The Child Trust Fund, tax-incentivised universal children’s savings accounts launched in 2002, was arguably the most innovative social policy implemented under the post-1997 Labour governments. The objectives of the Child Trust Fund range widely across savings policy, financial engagement and asset-based welfare, and are notable for seeking to change the behaviour of both children and their parents. However, the curtain now appears to be falling on the Child Trust Fund: it is not achieving its aims as well as was hoped and, in the context of wide-ranging public spending cuts, the Government has announced that the entire policy is to be scrapped.

This paper therefore explores how the effectiveness of the Child Trust Fund policy could be improved, while simultaneously cutting its cost substantially by over two-thirds, or £388m per year. The paper reviews the long-term aims of the Child Trust Fund and considers its future in the context of the wider children’s savings regime.