Delivering Saving and Assets

The Modernisation of Britain's Tax and Benefit System

Number Nine

November 2001

HM TREASURY

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1 Introduction

1.1 In April 2001, the Prime Minister, Chancellor and senior ministers launched *Saving and Assets for All*, a consultation document outlining proposals for two radical new initiatives to extend the benefits of saving and asset-ownership more widely – the Child Trust Fund and the Saving Gateway.

- The **Child Trust Fund** was proposed as a universal account, opened for all children at birth, with an endowment contributed by the Government at birth and at ages five, eleven and sixteen. Every newborn child would receive an endowment, with those in families on lower incomes receiving a larger amount.
- The **Saving Gateway** was proposed as an account targeted at low-income households, delivering a strong incentive to save regularly through the Government matching money saved in the account. The operation of these accounts would be linked to financial education.

Summary of this document

1.2 The Government is pleased to be able to report that it has received a very positive response to the initial round of consultations on these new proposals. To maintain the momentum generated, the purpose of this consultation document is:

- to provide a report on the results of the initial round of consultation (Chapter 2);
- to outline the current position of the Government's thinking on the Child Trust Fund and to launch a further round of consultation on more detailed options for implementation (Chapter 3);
- to provide an update on the Government's proposals for the Saving Gateway and to announce the Government's intention to run pilot projects for the Saving Gateway (Chapter 4); and
- to assess further the need to integrate financial education into both initiatives in order to ensure that they best fulfil their policy objectives (Chapter 5).

STRATEGY FOR SAVING

1.3 These newly proposed initiatives are part of an overall strategy towards saving presented in *Helping People to Save* (November 2000). This strategy recognises the crucial importance of saving and asset-ownership in providing individuals with:

- financial security for a rainy day;
- greater comfort during retirement and old age; and
- access to greater independence and long-term opportunity throughout their lives.

1.4 The Government's strategy seeks to increase individuals' likelihood of saving by focusing on three central strands:

- creating the right environment for saving, including a stable macro-economy, employment opportunity for all, and a well regulated and efficient market in financial services;
- creating the right incentives for people to save, including a tax and benefit system which supports, rather than penalises, savers; and
- providing clear, impartial information and education towards greater financial literacy to support people in making the right saving choices for themselves.

What the Government is doing

1.5 The Government is implementing this strategy across all fronts. In particular:

- following the recommendations of the *Myners Review of Institutional Investment*, a review of the medium- and long-term retail savings market was launched in July 2001;
- ISAs and stakeholder pensions are extending tax-advantaged saving to more groups, while the Pension Credit will ensure that people who have saved for their retirement are not unfairly penalised;
- the extension from April 2001 of the 10 pence rate of income tax by £300 over and above indexation has benefited around one million savers;
- financial education has been introduced into the National Curriculum for schools in England[1]; and
- the Financial Services Authority (FSA), with statutory responsibility for financial education, is working to improve the financial capability of the public and help consumers get a fair deal, through the provision of information, including comparative tables on specific providors products.

Consultation on new proposals

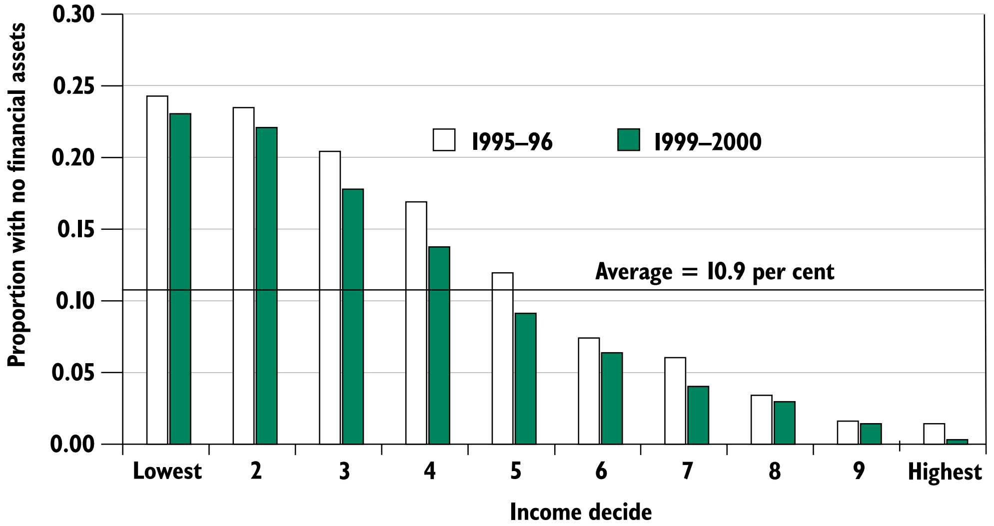
1.6 The Government recognises that some people, particularly those on lower incomes, need particular help with saving. Evidence published in *Saving and Assets for All* and *Helping People to Save* shows that too many people earning low incomes do not have enough money saved towards the key objectives identified above. Evidence published by the independent Institute for Fiscal Studies sheds new, but all too familiar, light on the problem – see Figure 1.1 below.

1.7 One of the issues is that tax incentives do not reach those on low incomes, many of whom pay no tax or only small amounts of tax. Another problem is that lack of financial information and skills, coupled with unfamiliarity with financial service providers, both of which factors disproportionately affect lower income groups, combine to make it even harder for people from these groups to begin saving toward their futures.

[1] The Scottish Consultative Council on the Curriculum established education for financial capability as an entitlement from ages five to eighteen in *Financial Education in Schools: A Statement of Position* (1999). The Qualifications, Curriculum and Assessment Authority for Wales and the Northern Ireland Council for the Curriculum, Examinations and Assessment are currently conducting curriculum reviews which will include consideration of financial education. The term "school curriculum" is used in this document to refer to financial education initiatives under the auspices of these bodies as well as the National Curriculum in England.

I.8 By directly targeting those on low incomes and offering them a real financial incentive to save, together with the information and education they need to help them make informed choices about saving behaviour, it is intended that the Saving Gateway would help those with the lowest levels of saving to make better informed decisions about saving and, according to their individual circumstances, to save more and to kick-start a saving habit.

Figure I.1: Proportion of families with no financial assets, by income and year



Note: Income is that of the family before housing costs and is adjusted for family size using a simple equivalence scale of 1 for the first adult, 0.7 for any second adult and 0.5 for each child.

Sources: Disney, Emmerson and Wakefield (2001) 'Pension reform and saving in Britain', Oxford Review of Economic Policy, Vol. 17, No. 7, using data from the Family Resources Survey updated using figures from 1999–2000; authors' calculations.

I.9 It is proposed that the Child Trust Fund, by providing all children with access to a financial asset around which their families and they themselves can start to save, tied in to financial education delivered through the school curriculum, would help develop the saving habit in future generations. It would also provide young adults with access to a financial asset at a time when they are starting their productive lives.

2 REPORT ON INITIAL CONSULTATION

GENERAL SUMMARY OF CONSULTATION RESPONSES

2.1 The Government published *Saving and Assets for All* on 26 April 2001, to consult on its proposals for the Child Trust Fund and the Saving Gateway.

Respondents

2.2 The Government received a large number of responses from a wide variety of sources. In addition to fifty formal written responses, the consultation included many informal meetings with a wide variety of organisations. The Government has also continued to consider academic and other research in this area.

2.3 The breakdown of formal respondents was as follows:

- twenty-four financial services providers, including banks, building societies, life offices, friendly societies, financial services arms of wider consumer services groups, investment companies and brokerages;
- nine trade bodies, mostly representing financial services providers;
- five charities, mostly concerned with the care of children;
- three consumer organisations;
- nine "others", including the Financial Services Authority, academics, affinity groups, development agencies, professional bodies, and individual members of the public.

2.4 Furthermore, a number of members of the public responded directly to issues raised in the consultation through the "Citizen Space" area of the UK Online website (**http://www.ukonline.gov.uk/online/citizenspace/default.asp**).

Overall messages

Proposals welcomed in principle

2.5 Respondents broadly supported the principles underlying the Government's consultation. In particular, there was recognition of the need to take measures to extend the benefits of saving and asset-ownership more widely. Beyond this welcome in principle, respondents expressed a wide range of opinions about the specific design and implementation of the proposals. Most of these comments were in response to questions raised in the consultation document.

Simplicity

2.6 One overriding theme to emerge was an almost universal recognition of the importance of keeping the policies simple, both from the perspective of delivering the Child Trust Fund and Saving Gateway (simplicity of provision), and from the need to ensure that consumers are able to understand the schemes and their relevance to themselves (simplicity of use). The Government recognises the importance of simplifying the delivery and design of these schemes, and has sought to apply this principle wherever possible without compromising its fundamental policy objectives.

RESULTS OF CONSULTATION – CHILD TRUST FUND

2.7 All of those who responded to the consultation provided opinions on the proposals for the Child Trust Fund, although most did not respond to every question. A question-by question analysis of the main responses is provided below. A more detailed breakdown is available in Appendix 1 to this document, published on the Treasury website (**www.hm-treasury.gov.uk/Consultations_and_Legislation/consult_liveindex.cfm**)

Endowment

2.8 In *Saving and Assets for All*, the Government proposed a progressive endowment paid at birth, with further progressive top-up payments made by the Government at ages five, eleven and sixteen. It asked:

- How best could a progressive element be introduced into the basic endowment?
- Should additional progressivity be introduced by paying additional endowments at key life-stage triggers, with the value of future payments dependent on family income at that time?
- What options, in addition to provision of regular statements, could be considered for keeping a Child Trust Fund account "live"?

Progressive element to endowment

2.9 Respondents divided roughly equally between those in favour and those against a progressive element. Respondents who argued against a progressive element in the endowment raised concerns over excessive administrative costs that could occur if this progressivity were linked to means-testing. Among those in favour of a progressive endowment, the most popular means of determining eligibility for the higher rate of endowment was via a link to an existing tax credit or benefit.

Additional top-up payments

2.10 Approximately three-quarters of respondents were in favour of additional top-ups (i.e. endowments at particular ages after birth). Additional top-ups were favoured as maximising the opportunity to keep the accounts active. Respondents opposed to top-ups pointed out the loss of investment growth if the endowment were staggered, rather than paid as a single sum at birth. Concerns were also raised that progressive top-up payments would require means-testing at four separate points, which might increase administrative costs and complexity.

Keeping the account live

2.11 All respondents agreed that regular financial statements would be an effective reminder of the account's existence. In addition, the two most popular suggestions for keeping the account live were:

- **for children:** integration of the Child Trust Fund into classroom teaching through the National Curriculum;
- **for both parents and children:** use of internet-based interactive applications and e-mail.

2.12 Other suggestions included birthday cards, the use of top-up payments and production of dedicated newsletters or magazines targeted at both children and parents

Contributions

2.13 In *Saving and Assets for All*, the Government proposed that additional contributions could be made into the Child Trust Fund, possibly with a limited tax incentive based on the ISA model. It asked:

- Should there be a tax incentive for additional contributions into the Child Trust Fund, and if so, up to what limit?

Incentives

2.14 The Government's proposal to allow additional contributions to the Child Trust Fund was widely welcomed. Over two-thirds of respondents argued in favour of tax incentives to encourage this. Most of the options put forward favoured tax relief based on the ISA model. A handful of respondents suggested more generous relief based on the grossing-up of post-tax contributions at the basic rate of tax, in the manner of stakeholder pensions. Those opposed to tax relief were most concerned that this incentive would not reach those families on the lowest incomes.

Investment options

2.15 The Government proposed that the Child Trust Fund might offer a variety of different investment strategies, each with its own risk and reward profile. It asked:

- Should the Child Trust Fund offer the option of different investment strategies, or should it offer only one, risk-averse, investment option?
- What role is there for private sector financial services providers and mutual societies in delivering the bundle of services (deposit capability, investment management, advice and information) that could make up a Child Trust Fund account?

Choice

2.16 The vast majority of respondents felt there should be an element of investment choice, with that choice including some exposure to equities. The long life of the account was viewed as lending itself to equity-based investments, which were expected to produce superior returns over cash, gilts or corporate bonds, more than outweighing any additional associated charges.

2.17 Specific suggestions on investment included index-tracking collective investment funds, actively managed funds, and time-related investment strategies, which would move assets from higher- to lower-risk investments with the approach of maturity. The small minority of respondents supporting a more conservative investment strategy involving cash or gilts were concerned about the potential for under-informed parents – particularly those with less experience of financial services – to be exposed to equity markets without sufficient understanding of the associated risk. Chapter 5 of this document discuses the importance of financial education and information to the success of the Child Trust Fund and Saving Gateway initiatives.

Private sector role

2.18 While no respondent argued against there being a potential role for the private sector, no consensus emerged on the exact form this involvement could take. Suggestions included:

- **open market competition:** with the Government designing a basic product specification as was the case with ISAs;
- **a single provider:** with links to different fund managers' funds; and
- **existing products:** provision based on modification of existing product specifications.

These issues are discussed in more detail in Chapter 3.

Access to funds

2.19 In *Saving and Assets for All*, the Government proposed that access to the Government endowment might be restricted until children reach age eighteen or twenty-one. The Government also questioned whether restrictions should be placed on the uses to which Child Trust Fund assets could be put, and whether parents should have access to their own contributions into the Child Trust Fund. It asked:

- At what age should young adults gain access to their Child Trust Fund assets?
- Should parents have access to any additional contributions they have made into their children's Child Trust Fund?
- Should the assets in a matured fund have restrictions placed upon their use?

Age of access

2.20 Three-quarters of respondents felt that eighteen was the right age for access. The most commonly cited argument in favour of age eighteen was that it is the legal age of majority. Those respondents in favour of access before eighteen argued that young adults not remaining in secondary education after age sixteen might otherwise feel discriminated against. Some argued for a later age, on the basis that young adults would be more likely to know what to do with their assets at age twenty-one or even twenty-five. Some other respondents also suggested that the precise age of access should depend on other factors, such as the use to which assets are to be put, or whether or not the recipient goes into tertiary education.

Parental access

2.21 Most respondents were against parental access to contributions. Two main arguments against parental access were raised. The first was based on considerations of cost, and the second on maximising the assets available to children at maturity. Any ability to withdraw Child Trust Fund assets would require more complicated systems for operating the accounts, increasing administrative costs. It might also require that systems keep track of who has paid in contributions, in order to differentiate between parents', grandparents', friends' and children's own contributions. Asset growth could be negatively affected by the need to maintain some contributions as cash deposits. There were also concerns raised by some respondents that assets could be "raided" by parents.

2.22 Arguments in favour of parental access centred on the concern that some parents might save money for their children that they might need to access in a later emergency.

Restrictions on use of assets

2.23 Responses were evenly balanced between those in favour and those against restrictions on the final use of assets. Those arguing in favour of restrictions pointed to the element of Government funding and suggested linking the spending of the endowment to socially desirable outcomes, e.g. education. A number of those in favour discussed the possibility of a hybrid system with greater restrictions on use at maturity, but with these being lifted as the account-holder gets older.

2.24 Those arguing against restrictions mostly raised issues concerning responsibility and simplicity of operating the Child Trust Fund. They suggested that restrictions on use – unless highly restrictive – would be costly to police and raise complex issues regarding what constituted a 'worthy' use of the endowment.

Financial education

2.25 In *Saving and Assets for All*, the Government identified that financial education would be an essential component in helping children and adults understand the benefits of saving.

The Government also recognised a potential to link the Child Trust Fund into broader social concerns such as civic responsibility. It asked:

- What would be the best way to build in financial education into a Child Trust Fund, especially bearing in mind the objective of using it to develop young people's saving habits?
- Could voluntary community service or other activities be rewarded through small bonuses paid into the fund?

2.26 By far the most popular suggestion for education was the use of classroom teaching through the school curriculum. Many respondents saw the Child Trust Fund as an ideal way to make financial education more directly relevant to all children. A number of other public sector initiatives were suggested as sources of financial education, including Sure Start, the Connexions service, and links with NHS services for parental education. The most frequent suggestion for involvement from financial services providers and other financial organisations was the provision of online, web-based tuition modules – fourteen respondents suggested this.

Voluntary service credits

2.27 Responses were approximately evenly split between those in favour of and those against voluntary service credits. Most respondents – even those in favour of the idea – were aware of the additional administrative costs that these would add. In addition, those against raised concerns over the risk of confusing saving objectives with voluntary service objectives (and vice versa).

RESULTS OF CONSULTATION – SAVING GATEWAY

2.28 There were fewer responses to the consultation on the Saving Gateway than for the Child Trust Fund. Of the fifty respondents, twelve made no reference to the Saving Gateway. Nevertheless, there were many high-quality responses referring to the Saving Gateway, and they are summarised below.

2.29 While the overall response to the proposals for the Saving Gateway was positive, a small number of respondents called into question the creation of a wholly new and distinct saving vehicle for lower-income earners. Concerns included the danger of adding complexity to what, to some potential savers (especially those on lower incomes), already appears a complicated decision, as well as the cost of building additional systems to administer the Saving Gateway. However, these comments were made in a spirit of constructive engagement with the principle of extending incentives to save more widely and – as discussed below – a very strong attraction to the idea of "matching" incentives.

2.30 A number of respondents pointed out that while they could provide "best-guess" answers to the consultation questions based on their experience, definitive answers to many questions could only be gained by testing the Saving Gateway concept through a set of pilot projects.

Targeting

2.31 In *Saving and Assets for All*, the Government proposed that the Saving Gateway would be targeted at low-income earners. It asked:

- What is the appropriate mechanism for targeting eligibility to the Saving Gateway in order to ensure that all those who would benefit from stronger incentives to save are reached?

Mechanism **2.32** The two main suggestions provided by respondents to this question were to link eligibility for entitlement to an existing tax credit or benefit, or to some form of measure of income. Arguments in favour of a tax-credit or benefit-based eligibility passport centred around their simplicity, in that they would obviate the need for a new means test. Some respondents suggested that an income test be built into the tax system so that all basic rate or starting rate taxpayers be eligible for the Saving Gateway.

Matching incentives

2.33 In *Saving and Assets for All*, the Government proposed that the Saving Gateway could offer a "matching" incentive, possibly based on a pound-for-pound match of individuals' contributions made to the account. It asked:

- Is matching the best way to deliver non-tax based incentives to save to lower-income households?
- At what level should a matching rate be set? Should the level be fixed or vary according to income?

Type of incentive **2.34** Respondents were almost unanimously supportive of matching as a saving incentive. They noted the main advantage of matching as being its simplicity – the fact that the incentive is directly related to the amount saved makes it easier to understand than tax-based incentives. That the incentive is not tax-based, also has the advantage of reaching more of the target group – lower income earners – many of whom pay only very low levels of tax. However, some respondents questioned whether matching would benefit the very poorest groups in society who, they argued, might not be able to contribute anything.

Matching rate **2.35** Arguments for a fixed versus a varied matching rate were evenly matched. Variations in matching, both in relation to participants' income level and their levels of saving appeared attractive to some respondents due to the increased progressivity and incentives that could be respectively introduced. But it was also noted that additions of this kind could add unnecessary complexity to the scheme and increase providers' administrative costs.

Developing a saving habit

2.36 In *Saving and Assets for All*, the Government identified a key objective of the Saving Gateway policy as being the encouragement of a regular and sustainable saving habit. It asked:

- What is the best way of structuring the incentives in the Saving Gateway to ensure that the saving habit is encouraged?
- At what level should limits on contributions which are matched be set? Should the limit be set on a monthly or annual basis?

Structure of incentives **2.37** Many respondents noted that the benefits of regular matching (i.e. on a monthly basis) would bring the rewards to saving closer to the action of saving. Others noted the need to incorporate an element of flexibility into the Saving Gateway match profile so as not to exclude those unable to commit to monthly saving.

Limits on contributions **2.38** Responses for the level of the contribution limit varied widely, from £10 pounds per month (£120 per annum) to £125 per month (£1,500 per annum).

Monthly vs annual limits **2.39** Although, there was a wide variation in respondents' views of the appropriate level of contribution, the majority favoured small monthly contributions, in order to keep saving targets realistic and manageable. Monthly targets were preferred because respondents felt that a month is the timeframe within which most financial planning occurs in lower income households. Those in favour of annual limits pointed out the flexibility that an annual limit would provide, allowing participants to skip a month's saving without being penalised in terms of lost matching.

Duration

2.40 In *Saving and Assets for All*, the Government suggested that each Saving Gateway account could last for a fixed period of time, to put an upper limit on the amount of matching available to any one saver, and to ensure that the account would act as a "gateway" into mainstream saving products. The Government asked:

- For what period of time should the Saving Gateway run?

2.41 In general, responses called for an account life of between three and five years, pointing to the issues of simplicity and minimising providers' administrative costs. The link was made between an extended account life and the need for continuous eligibility testing of participants. Repeated eligibility testing was in general seen as highly undesirable.

Access and flexibility

2.42 In *Saving and Assets for All*, the Government proposed that participants in the Saving Gateway would have access to funds in their accounts, so that they would be able to use these assets on a rainy day. It also suggested that Saving Gateway assets might be exempted, at maturity, from annual contribution limits on products such as ISAs and stakeholder pensions, in order to help the transfer of assets from the Saving Gateway to mainstream saving products. The Government asked:

- Before the account matures, should savers have instant access to all funds – including matching funds – in the Gateway, or just to their own contributions?
- How best could the Saving Gateway be integrated with existing saving vehicles such as ISAs and stakeholder pensions?

Access to funds

2.43 The most commonly suggested approach to the issue of access was that savers have access to their own savings, but not to Government matched contributions. Respondents suggested that the high priority given to rainy-day saving militated against restricting savers' access to their own contributions, but many also noted that access would likely reduce the amount of saved assets available to participants at maturity. Possible solutions were suggested by a number of respondents, including a disincentive to access savings in the form of withdrawal of matching contributions, or restricting access to certain defined purposes, to include rainy day emergencies.

Integration with existing vehicles

2.44 Approximately half of respondents addressing this question suggested that Saving Gateway assets at maturity be exempted from annual stakeholder pension or ISA limits. Most responses centred on the idea of providing a positive reward or further incentives being offered to those who choose to transfer their Saving Gateway assets into a recognised long-term saving vehicle. The suggested exemption of assets from annual limits was seen as the simplest solution. A minority of respondents also suggested a direct financial incentive, over and above matching contributions, for savers transferring their assets into an ISA or stakeholder pension.

Investment options

2.45 In *Saving and Assets for All*, the Government raised the possibility that the Saving Gateway, like the Child Trust Fund, could allow different investment strategies, although it recognised that the shorter duration of the Saving Gateway would make it less well-suited to this option than the Child Trust Fund. The Government asked:

- Should a Saving Gateway offer the possibility of different investment strategies?
- What role would there be for private sector financial services providers and mutual societies in delivering a Saving Gateway?

Investment strategy

2.46 The consensus view was that savings invested in the Saving Gateway should be held in cash rather than gilts, bonds or equities. It was felt that the relatively short lifetime of the account would make cash the less risky option while the need for liquidity for rainy-day access would make any investment other than cash bad value for money.

2.47 Almost all respondents saw at least some role for private sector financial services providers, although there were a number of different views on the types of providers most likely to be involved. Banks and building societies were cited most frequently as potential providers; other suggestions included partnerships between financial service providers and local community groups, and the possiblity of a single provider running the Saving Gateway nationwide

Financial education

2.48 In *Saving and Assets for All*, the Government recognised the central role that financial education would have to play in a successful Saving Gateway. It asked:

- What would be the best method of delivering financial education through the Saving Gateway?

Delivering and signposting

2.49 Most respondents came up with a number of suggestions for delivering or signposting financial education. Suggestions included: workplace initiatives; Government initiatives such as the New Deal and Connexions service; local public services, such as Citizens' Advice Bureaux and libraries; community groups and credit unions; the FSA, through its consumer helpline; and product providers through statements and internet-based applications.

2.50 It also became clear from the responses that financial education would need to be considered in the context of the three stages in the lifetime of a Saving Gateway account: up to the point of opening the account, on an ongoing basis throughout the lifetime of the account, and at maturity. A wide range of different issues would need to be addressed at each stage. The channels through which financial education could be delivered are discussed in detail in Chapter 5.

3 THE CHILD TRUST FUND

BACKGROUND

3.1 The Child Trust Fund proposal announced in *Saving and Assets for All* attracted a great deal of interest during the consultation period. As shown in Chapter 2, the Government received a wide-ranging set of responses to the consultation.

3.2 As set out at the launch of *Saving and Assets for All*, the Government's intention for the Child Trust Fund proposal has been to narrow down the number of possible options for its introduction, and to present more detailed proposals for further consultation. The following section sets out a more detailed possible specification for the Child Trust Fund, with a number of options for delivering the scheme.

Box 3.1: Child Trust Fund – summary of proposed features

- **Centrally managed set-up process, linked to Child Benefit systems.**
- **Progressive endowment at birth, with additional Government top-ups at ages five, eleven and sixteen.**
- **Additional contributions – up to an annual limit – payable by parents, other family and friends, and children, with growth exempt from tax.**
- **Investment of assets in a wide range of vehicles, including equities.**
- **No access to assets, including additional contributions, until account maturity.**
- **Maturity of account at age eighteen.**
- **No restrictions to be placed on use of assets at maturity.**
- **Financial education to be fully integrated into Child Trust Fund account through financial services providers, school curriculum and other providers.**
- **Further consultation on role of providers of financial services in delivery of Child Trust Fund accounts.**

3.3 The Government believes that a Child Trust Fund designed along these lines would help to meet its objectives, including: widening the opportunities available to all young adults, by ensuring that regardless of their family circumstances they are able to start their adult lives with immediate access to a stock of assets; providing an opportunity for parents, family and friends to save for the child's future – and potentially help to reinforce the habit of saving within the family; and providing a useful focus for financial education for children.

PROPOSED CHILD TRUST FUND FEATURES

Account set-up

3.4 It is proposed that setting-up an individual's Child Trust Fund account would be linked to the Child Benefit system. Child Benefit currently has take-up rates in excess of 98 per cent which would make it ideal for triggering creation of new Child Trust Fund accounts.

Endowments

3.5 The Government believes that there is a strong case for a progressive element to the endowment payment, with the associated eligibility test being carried out centrally. The Government would want to avoid setting up a new administrative system and one possible means of doing this would be to link eligibility to an existing tax credit or measure of income used in a tax credit.

Top-up payments **3.6** The Government also believes that there is a case for further top-up endowments to keep interest in the accounts active. It proposes that these would be generated centrally on the relevant dates – at ages five, eleven and sixteen.

Value of endowments **3.7** The value of endowments, including the progressive element for lower-income families and the value of top-ups, will not be addressed further at this stage of the consultation. It will be considered as part of the Government's ongoing review of spending priorities in Spending Review 2002.

Additional contributions

3.8 It is proposed that contributions to Child Trust Fund accounts from parents, other family and friends, as well as the children themselves once they are old enough to contribute, would be permitted. In order to facilitate smaller value and irregular contributions, for example "birthday money", it is proposed that the accounts would need to allow some sort of "over the counter" payment of cash sums. The Government believes that this would help maximise the value of assets for all young adults, by ensuring that contributions could be made as easily as possible. However, it recognises that a cap on such contributions would be required (see paragraph 3.11).

Keeping accounts live **3.9** A key issue in ensuring that additional contributions are made would be that the accounts are kept live – that they do not lie dormant and unused. Other ways of maintaining interest in the account among both parents and children, as suggested by the responses to the consultation, would include using regular statements, internet access to account management facilities, and regular communications from Child Trust Fund providers – including via e-mail – for example at children's birthdays. Another important opportunity would be to develop strong linkages between the Child Trust Fund and financial education in the school curriculum.

Investment options

Choice of investments **3.10** The Government recognises that choosing the right type of vehicle for investment of Child Trust Funds would be important. It believes that assets – both endowments and contributions – could be invested in a wide range of vehicles, including actively- and passively-managed equity-based collective investment vehicles. This feature would potentially allow maximum prospects for growth of Child Trust Fund assets. But it would also need to be supported through financial information and education for parents and children to ensure that they are aware of the risks associated with equity investment. Nevertheless, given the long lifetime of the Child Trust Fund account, the choice of some form of exposure to equities would be desirable in order to ensure potential maximisation of asset values.

Tax relief **3.11** It is proposed that growth of assets in the Child Trust Fund account would be exempted from tax. However, a maximum limit on the level of additional contributions would need to be applied to prevent the Child Trust Fund account being used as a tax shelter. This could be set at about £1,000 per account per year.

Access to assets

Contributions 3.12 The Government's current thinking is that, in order to simplify administration of the accounts and generate maximum returns from growth, additional contributions paid into Child Trust Fund accounts should be tied up until the account matures. This would mean that there would be no access to contributions once they have been made (although depending on the delivery method – see paragraphs 3.22 to 3.30 – it would be necessary to allow switching between funds or providers). Although this could create the risk that some families, particularly those on lower incomes, might save money in the Child Trust Fund that would best be held in a more liquid saving vehicle, the administrative complexity of allowing access militates against this option.

3.13 Unwelcome complexity if access were allowed would arise primarily from the fact that access rules would need to be different for different types of contribution. For example, the Government endowment would need to be restricted from any access before maturity. Parental contributions, on the other hand, would presumably be made available to parents. Contributions from other parties, such as grandparents, might well require a different set of rules, given that other contributors might not always want parents to have access to contributions they make to the Child Trust Fund. Such rules would require that assets from different sources be identifiable in the Child Trust Fund. They might also need to be held in different types of investment vehicle, given the separate liquidity requirements of the assets. All of this would add significantly to the administrative burden of running Child Trust Fund accounts, making them less attractive to providers and consumers alike. For this reason the Government proposes that there should be no access to any assets once they are saved in the Child Trust Fund until it matures.

3.14 Lack of access would make the wide availability of high quality, relevant information and education even more important if parents are to make the right financial choices concerning their children's Child Trust Fund accounts. In some ways, however, restricting access also simplifies the message on saving in the Child Trust Fund – that parents should be certain they will not need access to their contributions before making them.

Age of access 3.15 In line with the results of consultation, the Government proposes that maturity of the Child Trust Fund would be at age eighteen.

Restrictions on use of assets 3.16 All young adults would have access to their assets at this age, with no restriction to be placed on their use. One of the clearest messages to emerge from the consultation was that while there may in some cases be some benefit in terms of ensuring that Child Trust Fund assets are not "wasted" on undesirable spending, this benefit would come at too high a cost in terms of implementation. Restrictions on the use of assets would also run counter to some of the objectives of the Child Trust Fund, and could even create a disincentive for parents to save in the accounts.

3.17 The main practical barrier to restricting use of assets concerns the policing of restrictions. Child Trust Fund providers could not be expected to do so, and this was reflected in many responses received. The Financial Services Authority, in its response, made clear that it would have no regulatory power to police such restrictions and that to expect provider firms to do so would be to place a burden on them in terms of cost and likely disputes with their customers.

3.18 In the United States, Individual Development Accounts, which offer matched saving for low-income individuals with use restricted to purposes such as education, enterprise, pensions and housing, offer an example of how restrictions can be enforced. However, IDA programmes are, for the most part, small-scale and locally delivered by a network of local groups and small financial services providers. These organisations are able to police restrictions only by micro-management of each IDA account. For example, a participant wishing to use IDA assets to pay for further education would have to provide details of the course they wished to attend. If approved, the IDA administrator would then arrange for payment to be made to the relevant institution, deducting the same amount from the individual's IDA. This model, while potentially effective on a local scale, is far too cost-intensive to be scalable to a large programme such as the proposed Child Trust Fund.

3.19 While there is some risk that assets from some matured Child Trust Funds would be spent unwisely if restrictions are not placed on their use, it is also the case that one of the objectives of the Child Trust Fund proposal is to help make young adults more aware of the financial opportunities and responsibilities that they will face. This process would involve far more than simply transferring the assets in their Child Trust Fund account to young adults at age eighteen, and would include financial education through the school curriculum and direct contact with their Child Trust Fund provider through interactive channels such as the internet and digital television. To restrict use of assets at maturity would undermine the sense of being a responsible stakeholder that the Child Trust Fund and its associated financial education would be intended to provide to young adults.

Financial education

3.20 As will be clear from the preceding discussion, financial education would not just be an adjunct to the Child Trust Fund, but a fundamental part of delivering the policy objectives. There needs to be careful consideration given to the ways in which a wide range of organisations involved in education – from schools to financial services providers to Government-sponsored training initiatives and beyond – would best be involved in providing of appropriate education and information. This subject is tackled in greater detail in Chapter 5.

Voluntary service credits

3.21 The idea that voluntary or community service by children could be rewarded with credits into their Child Trust Fund accounts was put forward in *Saving and Assets for All*. The Government proposes that, for simplicity, to reduce the administrative burden, and to keep the policy objectives focused on saving and asset-accumulation, there should be no credits of this nature. The Government nevertheless remains committed to supporting the voluntary and community sectors. For example, Millenium Volunteers is an initiative funded by Government, to encourage young people between the ages of sixteen and twenty-four to get involved in local projects including sports coaching, environmental projects and youth leadership.

POSSIBLE DELIVERY MODELS – FURTHER CONSULTATION

3.22 The section above describes possible features of the Child Trust Fund. One significant issue – that of the delivery model – has yet to be addressed, and it is on this issue that the Government would like to focus the next round of consultation. Two main options for delivery of the Child Trust Fund are set out below for consultation.

Option 1: open market competition

3.23 Under this option, private financial services providers would be able to enter the market to offer Child Trust Fund accounts on satisfaction of a set of entry conditions, for example in the same way as entry into the ISA market is managed.

3.24 Parents would be notified of their child's Child Trust Fund entitlement once they had completed the Child Benefit application as described above, which could lead to the creation of a Child Trust Fund account identifier on a central system. Endowment payments could be made to parents from the central Child Trust Fund system in the form of paper or electronic credits. Parents would then be expected to choose a Child Trust Fund account from the market of available Child Trust Fund providers, using the endowment credit to open the account. At this point, the provider could, as part of the account opening procedure, contact the parent about investment choice for the endowment and additional contributions.

3.25 These endowment credits might have a limited lifespan – for example, if they were not used in twelve months to open a Child Trust Fund account, then they would expire. In this event, the Child Trust Fund central system would open an account in the child's name with a default provider, to ensure that every child receives a Child Trust Fund, regardless of whether their parents take a positive step to open an account.

3.26 Under this model, financial services providers in the Child Trust Fund market would compete among themselves, as they currently do for other forms of business, making use of direct and intermediary-based channels, as well as potential affinity marketing opportunities. In addition to investment performance and other criteria for financial products, providers could also seek to compete on Child Trust Fund-specific criteria, such as the quality of financial education offered to children.

Option 2: licensed provider approach

3.27 In this option, the number of providers would be limited; for example, there might be between five and ten Child Trust Fund "licenses" available, for which providers would have to tender on a competitive basis, for a fixed number of years.

3.28 The smaller number of providers might make it possible to develop more capability within the central Child Trust Fund system. Thus, once parents had completed their Child Benefit applications and an account identifier been created on the central Child Trust Fund system, notification of their child's entitlement would include information on the five to ten licensed providers. This information could include further contact details for each provider, as well as an automated process allowing each parent to select their chosen Child Trust Fund provider. Once they had made their selection, the central Child Trust Fund system could transfer details of each new account to the relevant provider, along with payment of the endowment. At this point, the provider could contact the new Child Trust Fund customer to discuss investment options and additional contributions.

3.29 Where parents do not make a choice of Child Trust Fund provider, default accounts could either be transferred to a specifically contracted default provider, or distributed among the panel of licensed providers.

3.30 While there would still be a strong element of competition between the licensed providers under this option, the choice faced by parents would be smaller.

CHILD TRUST FUND CONSULTATION – NEXT STEPS

3.31 The Government invites responses on these options for delivery of the Child Trust Fund, with particular focus on the following issues:

- the relative cost-effectiveness of options 1 and 2;
- the implications of options 1 and 2 for the service parents and children receive;
- the extent to which either option 1 or 2 could minimise the number of dormant default accounts;
- the extent to which either option 1 or 2 could integrate relevant and targeted financial education and information for both parents and children; and
- what the likely lead-times to set up and provide a Child Trust Fund would be under each of the options.

3.32 Responses to these questions, as well as other views on the delivery of the Child Trust Fund, should be received by 28 February 2002 and should be sent to:

Saving Incentives Team
HM Treasury
Parliament Street
London SW1P 3AG
Email: ***saving-assets@hm-treasury.gov.uk***

3.33 The Government will also engage in more detailed informal consultation with stakeholders on more technical issues, including investment options.

4 Saving gateway

BACKGROUND

4.1 The Government's consultation on proposals for the Saving Gateway received a well-argued and diverse set of responses. One significant difference to emerge from the consultation was in the attitude of financial services providers to proposals for the Saving Gateway and Child Trust Fund. Both were welcomed as being potentially important additions to the Government's policy towards encouraging the development of the saving habit. However, there was noticeably greater engagement by financial services providers with the Child Trust Fund at the level of practical implementation issues than with the Saving Gateway.

4.2 Written responses to the Saving Gateway were presented at a higher level of detail. Few responses suggested that there was no role for the private sector – as noted in Chapter 2, many suggested that banks or building societies would be the most likely candidates, but few responses directly addressed the issue of how providers might seek to bring the Saving Gateway to market.

4.3 Many providers were able to see the Child Trust Fund, with its universality and long account life, as a viable commercial proposition. The Saving Gateway, by contrast, was viewed as being much less likely to form the basis of a self-sustaining competitive business model. This perception was due to a number of factors, including the short duration of the account, the fact that it would be targeted at individuals with less experience of financial services providers, and the low balances likely to be carried in each account.

Single provider of the Saving Gateway

Single provider vs competition

4.4 For the reasons discussed above, the Government believes that the Saving Gateway would probably be better suited to provision through a single provider than through a competitive market. In this context, a single provider could also include a consortium of businesses and/or other organisations. A single provider would have the following advantages over competitive market provision:

- by consolidating a fragmented market, it would enable scale economies to be realised more efficiently;
- by concentrating supply, it would simplify the task of directing eligible individuals towards the service; and
- integrating financial education into the Saving Gateway service would also be simplified in the single-provider approach

4.5 The Government believes that the financial services industry would generally be supportive of this approach.

PROPOSED SAVING GATEWAY FEATURES

4.6 Based on consultation and analysis, the Government is able to propose answers to the questions concerning the Saving Gateway posed in *Saving and Assets for All*. The detailed features of the scheme, as now proposed, are provided below.

4.7 Given these features, and the need for a single-provider approach to delivery, the Government's next steps in the policy development process will be to institute a number of pilot projects for the Saving Gateway. The proposals for the pilots are discussed more fully from paragraph 4.25 below. They will allow aspects of the Saving Gateway design to be tested. The design of the Saving Gateway will be reviewed in the light of these pilots and other considerations, including international evidence.

Box 4.1: Proposed Saving Gateway – summary of features

- **Single provider of Saving Gateway account.**
- **Eligibility via tax-credit or working-age benefit "passport".**
- **Matching set at a fixed rate.**
- **Saving limited to £25 per month.**
- **Individuals' Saving Gateway accounts to last for five years, with a maximum available match of £1,000 per account.**
- **Savers to have access to their own savings, but not to matching funds.**
- **Assets to be held as cash deposits, with no equity investment.**
- **Assets to be exempted at maturity from annual limits for stakeholder pension or ISA contributions.**
- **Financial education to be focused on three stages – opening and pre-opening, during account lifetime, and maturity.**

Targeting

4.8 The Government proposes that the Saving Gateway would be targeted at individuals. In order to keep administration simple and to avoid the need to design a separate means test, it is proposed that eligibility for the Saving Gateway would be determined in the form of a "passport" or linkage to an existing working-age benefit, tax credit or measure of income used in a tax credit. In addition to being simple to administer, this method of determining eligibility also has the advantage of making it much easier to target eligible individuals with information about the Saving Gateway, as the systems for communicating with tax credit and working-age benefit recipients are already in place. The Government will also consider options for targeting the Saving Gateway at people moving into paid employment

Matching incentives

4.9 As the analysis of consultation results showed, there was overwhelming support for the concept of matching as a saving incentive. Matching would be both easy to understand and an effective and responsive financial incentive for saving. Subject to the results of piloting, the Government therefore reconfirms its intention to offer incentives in the form of matched payments.

4.10 In order to optimise both the factors identified above, the proposed Saving Gateway match would be set at a single, fixed level. The level of matching could be set at £1 matching for £1 saved, although the Government will continue to examine what precise level is appropriate. The Government is determined to make the matching incentive as transparent as possible, while also providing a generous incentive for lower earners to start the saving habit and take up financial education.

4.11 The Government has considered the option of having a flexible match rate, based on income level or the amount an individual has saved in their Saving Gateway account, but believes that any benefits in terms of additional progressivity would be more than offset by increased complexity for provider and participants alike.

Developing a saving habit

Structure of incentives

4.12 The Government proposes that the Saving Gateway be based on monthly contribution limits. Monthly limits would encourage potential savers to think about saving as a regular and sustainable part of their ongoing financial planning.

Limits on contributions

4.13 It is proposed that the Saving Gateway account would place a monthly limit of £25 on contributions. All contributions up to this point would be matched. The Government believes that this is a realistic figure that would provide sufficient incentive to save and participate in financial education, while recognising that low-income households may have relatively low levels of spare resources available to save.

4.14 Evidence from IDA programmes in the US[1] has shown the importance of using monthly match limits as a goal or target on which savers can focus their behaviour. It is important not to set this target at too high or too low a level, in order to ensure that the psychological benefits of match limits can be optimised. The limit of £25 a month would represent approximately 5-7$^1/_2$ per cent of monthly disposable income (income after rent and council tax) of a household with gross monthly earnings of £1,200 a month, depending on household composition.

Duration

4.15 There is a case for having a flexible link between the lifespan of the Saving Gateway account – that is, the time that any one account would remain active in the sense of paying matching contributions once it has been opened – and the maximum total saving limit. Not doing so could have the consequence of creating incentives for individuals to continue saving into their accounts, when they should be taking a "holiday" from saving or even using their saved assets for rainy-day purposes.

4.16 Consider the example of an individual who works on a part-time basis, and is paid for the hours worked each month. In a month when he or she has less work than normal, he or she may wish to contribute less than normal into the Saving Gateway. If the account was designed to last for three years, for example, this single month of reduced saving would represent a month of potential matching contributions lost. The lack of flexibility to take a break from saving would punish individuals whose income stream may be variable.

4.17 The proposed Saving Gateway would overcome this problem by combining the monthly contribution limit and lifetime of the account with an overall limit on matching contributions available. The model proposed could:

[1] Schreiner et al, "Savings and Asset Accumulation in Individual Development Accounts", Center for Social Development, Feb 2001.

- last for five years from the time of opening;
- allow matched monthly contributions up to a limit of £25 a month;
- with an overall cap on the total amount of available matching of £1,000.

4.18 Under this model, the individual in the example above could take a break from making contributions without affecting the total amount of matching for which they would be eligible.

Access and flexibility

Access to contributions

4.19 Because of the need of those with low levels of savings to focus on building up liquid savings for use in a rainy day, the proposed Saving Gateway would not penalise those wishing to access their own contributions. They would be able to withdraw any contributions made into the account without losing the matching contributions that had built up. However, individuals would not be able to access the Government's matching contributions until the account matures i.e. after five years, once the total matching limit of £1,000 has been reached, or if the account is closed for good, whichever is the earlier.

4.20 In the event of accessing their own contributions, individuals would have to "re-save" those contributions before they were eligible for any further matching. For example, an individual who has saved £100 plus £100 in matching contributions could withdraw his or her £100 saving, but would not receive any more matching until their own contribution balance again exceeds £100. This rule would prevent the possibility of individuals withdrawing and re-depositing their contributions ad infinitum to increase the amount of matching they receive.

Integration with existing saving vehilces

4.21 An option to facilitate the transfer of matured Saving Gateway assets into existing saving vehicles, and fulfil the "gateway" element of the Saving Gateway scheme, would be to allow assets transferred from a matured Saving Gateway into an ISA, Child Trust Fund or stakeholder pension to be exempted from the annual contribution limits of those saving vehicles. Thus an individual with £2,000 in total in a matured Saving Gateway account might be able to transfer that amount into a stakeholder pension, for example, and then also make additional regular contributions in that year up to the annual limit, which currently stands at £3,600. The Government will consider the technical and other implications of this approach.

Investment options

Liquidity

4.22 To allow easier access to savers' own contributions, the Government proposes that assets be held in liquid form. For this reason, Saving Gateway assets would be held in the form of cash deposits, with no potential to invest in equities or other investment types.

Financial education

4.23 As with the Child Trust Fund, there would be a wide range of different financial education and information needs at the core of the Saving Gateway scheme. To begin with, eligible individuals would need to be informed of the opportunity to open the account. At account opening, individuals may need assistance with basic financial planning in order to determine how much they could responsibly save. During the lifetime of the account, they may need information to help them take decisions over whether to continue saving or withdraw assets from the Saving Gateway. And, perhaps most significantly, at maturity, savers may need help with decisions on how to continue with their saving habit in mainstream saving vehicles, as well as what to do with their assets.

4.24 The challenge of fulfilling all these needs is discussed at greater length in Chapter 5.

SAVING GATEWAY PILOTS

4.25 The Government believes, in line with many respondents to the consultation, that a scheme such as the Saving Gateway should not be implemented on a wide scale without first having been tested in a controlled environment. For this reason, the Government will be setting up a number of pilot projects for the Saving Gateway.

4.26 The pilots will be designed primarily to test *practical* elements of delivering a Saving Gateway account to real participants. Issues for testing will include:

- the practicalities involved in using different methods for targeting eligibility to the Saving Gateway;
- how to reach eligible individuals with relevant information about the benefits of the Saving Gateway;
- how to design an application procedure that combines simplicity for the participant with regulatory compliance for the provider, and minimise the potential for fraud;
- how to structure incentives in order to minimise borrowing to save in the Saving Gateway;
- the best way to present account information – deposits, withdrawals and matching contributions – to encourage regular saving from participants; and
- how to administer the process by which Government pays matching contributions to individual Saving Gateway accounts.

Model for running pilots

4.27 These are just some of the types of question to be put to the test in pilot projects. The Government will look to run the pilots on the following lines:

- pilot projects will be run in around three or four locations, with a target of up to 500 participants per project;
- the Government intends to work in partnership with one or more financial services partners on the projects, providing account management systems and distribution outlets;
- the pilots will also involve financial learning initiatives, run by housing associations, credit unions or other local community groups;
- the pilot projects will involve technical evaluation of delivery and design issues, and incorporate qualitative evaluation of participant responses;
- the projects will operate for about eighteen months.

4.28 The pilots will be based heavily on the blueprint for the Saving Gateway account discussed above, albeit with some modifications, such as allowing the account to be open for a shorter duration.

Box 4.2: Community Finance and Learning Initiative

The Government will consider the option of piloting the Saving Gateway alongside the Community Finance and Learning Initiative (CFLI) run by the Department for Education and Skills.

The CFLI aims to support local community based organisations in disadvantaged areas to combat financial exclusion by improving access to learning, financial literacy education and support for people facing financial problems, such as difficulty accessing mainstream financial services and finance for micro-enterprise. Objectives of the initiative are to:

- **increase awareness of, and access to, free education and training and DfES financial incentives for learning by reaching out to those excluded from mainstream financial services and learning opportunities;**
- **build financial literacy skills through the provision of appropriate training, education and support;**
- **support access to financial services (basic bank account, savings, insurance) for those excluded from mainstream financial services by providing advice and a signposting service for other providers (e.g. high street banks, the Post Office, credit unions); and**
- **provide a vehicle to access sources of finance for micro-enterprise.**

4.29 These pilot projects are the next essential stage in the Saving Gateway policy-making process. The data gathered from the projects will be invaluable in providing insight into the practicalities of designing and delivering a special saving account targeted at lower-income individuals. The Government's aim is to have the pilots ready to start by mid 2002.

4.30 In addition to setting up and running these pilots, the Government will be looking to continue to involve interested parties in the development of these policies. Any comments on the proposals put forward in this chapter should be sent by 28 February 2002 to:

Saving Incentives Team
HM Treasury
Parliament Street
London SW1P 3AG

Email: *saving-assets@hm-treasury.gov.uk*

5 Financial information and education

5.1 This chapter discusses the crucial role that financial information and education will play in ensuring that the Saving Gateway and Child Trust Fund policies are successful. It covers:

- the role of financial information and education in saving, including the case for Government involvement;
- the need and opportunities for financial education and information as part of the Saving Gateway and Child Trust Fund; and
- existing sources of financial information and education.

The role of financial information and education in saving

The saving decision

Complexity

5.2 The decision to save is a complicated one, involving the need to consider a number of inter-related questions. These include:

- whether to save?
- how much to save?
- in what form to save? and
- with which financial service provider to save?

5.3 For any given individual, the answers to these questions will depend on a variety of factors such as: their income; their current employment and future employment prospects; their family structure; and their age, health and life expectancy. These factors, taken together, will determine the individual's preferences for spending and consuming in the present, as opposed to saving and then spending and consuming in the future. As earlier sections of this paper have argued, the value of future consumption opportunities will be related to specific needs which may arise in the future: for security on a rainy day; for comfort during retirement; and for the opportunity to take advantage of financial independence.

5.4 Depending on their ability to identify and understand these needs, individuals will look for saving products that best meet them. Here, another set of objective factors that come into play will be the types of saving product available and the competing merits of the providers offering them.

Decision-making process

5.5 Even this brief discussion of the saving decision reveals something of its complexity. In order to tackle the decision successfully, individuals need to be able to carry out two processes:

- **acquiring information:** as well as information on different types of saving products and providers, individuals will also need to have information – or at least, informed expectations – about issues such as future income, employment and spending needs.
- **processing information:** gathering information is clearly just the first stage in any decision-making process. Individuals have to be able to use the information if it is to help them make choices; the processes involved will include being able to generate and apply relevant decision-making criteria, based on the available information.

Costs and benefits

5.6 Both of these activities carry potentially significant costs. They can be time-consuming and complex. In order to minimise these costs, individuals need to have easy access to sources of financial information such as financial services providers and the financial media. They must also have the financial capability to be able to make sense of the information they receive and process it appropriately.

5.7 While the costs of making an informed decision to save may be great, a decision also has the potential to deliver significant benefits in terms of enhanced future consumption opportunities. This is why many individuals are willing to bear the costs of saving decisions. We can conceptualise the cost-benefit analysis as follows – individuals will be prepared to make a saving decision if:

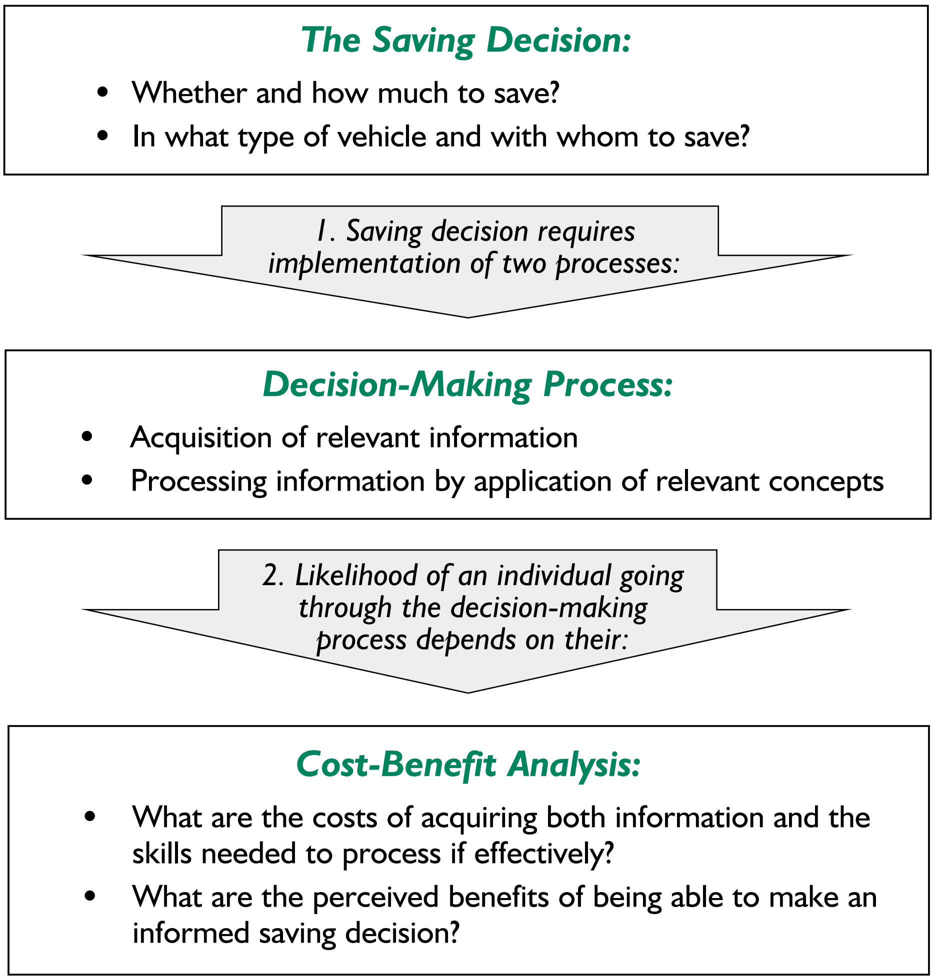
- they are aware of the likely benefit in terms of arriving at the right saving decision for themselves; and
- they believe that this benefit will outweigh the associated costs. [1]

5.8 However, the ability to conceptualise and value these benefits will depend, as was the case for the cost burden, on individuals' financial capability and their access to information about financial products and providers. Someone who is lacking in basic financial capability may be unaware of the power of compound interest in delivering asset-growth, or the role of tax relief in optimising that asset-growth. And even if an individual does have the financial skill to understand these concepts, they will not be able to realise the potential benefits available to themselves if they are unaware of the existence of ISAs, or the product providers who offer them.

5.9 The analysis presented in this chapter so far can be summarised by way of a diagram, presented below in Figure 5.1. If individuals are to take an informed decision about their saving options, their cost-benefit analysis must be positive: the costs of doing so must be lower than the benefits that they perceive in terms of saving outcomes.

[1] The fact that information acquisition is costly means that individuals behaving rationally are extremely unlikely to be fully informed – diminishing marginal utility makes it unlikely that the cost of acquiring and processing information beyond a given point are outweighed by the benefits. (Office of Fair Trading, *Consumer Detriment under Conditions of Imperfect Information*, London 1997)

Figure 5.1 The informed saving decision



The case for government intervention

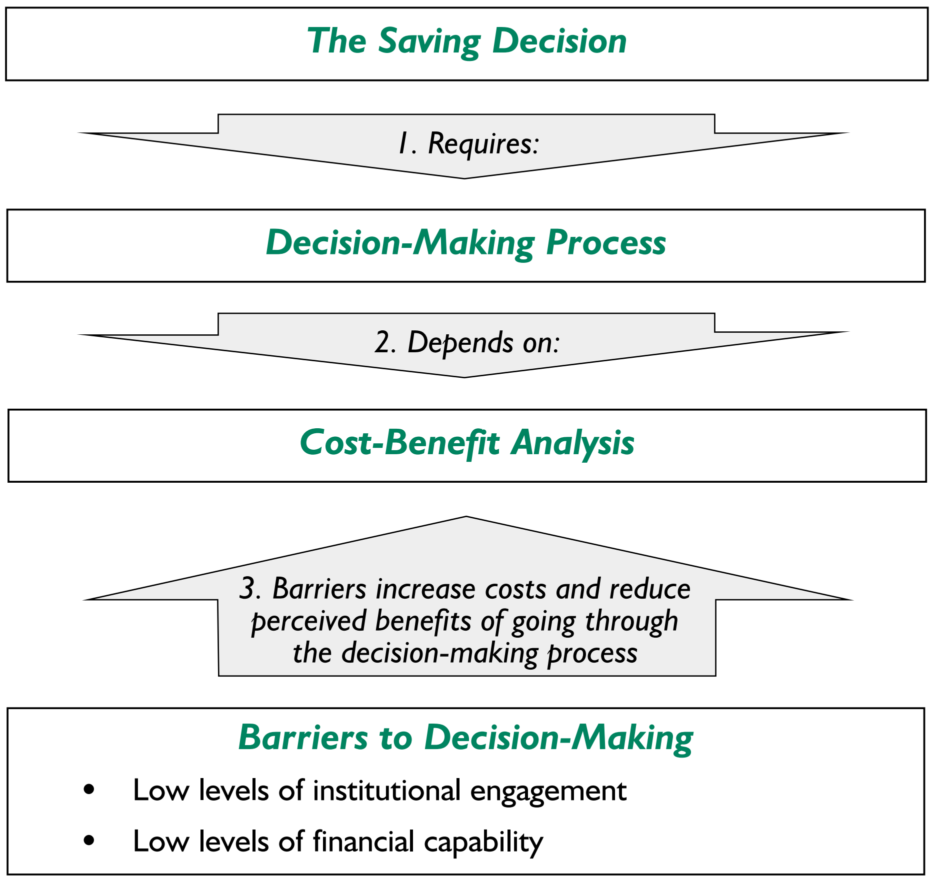
5.10 As we have seen, the costs and perceived benefits of participating in the saving decision-making process will not be the same for everybody. Two factors in particular will determine how much effort it takes an individual to acquire and process the relevant information:

- **Financial capability:** will determine the skills that the individual has to draw on in both stages of the decision-making process. Financial literacy makes it easier to know which information is relevant, and to apply the requisite concepts to get the most out of that information.

- **Financial inclusion and institutional integration:** a history of engagement with financial services providers reduces the cost of acquiring and processing information by providing individuals with a pool of knowledge they can already draw on, as well as breaking down institutional barriers to saving.

5.11 These factors influence not just the costs, but also the perceived benefits, of saving decision-making. Financially literate individuals with an existing engagement with financial services providers are much more likely to be able to understand the benefits of saving as being relevant to them than those with little or no understanding of the concepts involved. The impact of these barriers is reflected in Figure 5.2 below.

Figure 5.2 Barriers to the informed saving decision



5.12 Low levels of financial capability and institutional engagement undermine the ability and reduce the likelihood of individuals making a positive decision to save. The importance of these barriers highlights the importance of financial education and information in helping people to save. Understanding the way that these barriers act to influence individuals' saving decision-making points us in the direction of the best way to combat there effects. In order to overcome these barriers to saving decision-making, policy must focus on two areas: the first is to increase the perceived benefits of the saving decision, the second is to reduce the costs. The Saving Gateway and Child Trust Fund operate in both ways.

Increasing perceived benefits

5.13 By offering a financial incentive to save that is easily understood and explained, the Saving Gateway increases the perceived benefits of taking a saving decision by providing a generous financial incentive to save that is easy to understand and easy to take advantage of – for eligible individuals, the Saving Gateway will be the most effective way to save and accumulate assets. Evidence shows that this effect of the Saving Gateway will be targeted at those who most need it: as Box 5.1 shows, low levels of institutional engagement and financial literacy are a primary cause of those on low incomes not having saved enough financial assets.

5.14 Similarly, the Child Trust Fund endowment will also act as a kick-start to the process of saving for children. By providing an asset around which future saving can be planned, the endowment will increase the perceived benefit of saving even small amounts for children's future, making saving for their children a more realistic aim for all families.

Reducing the costs of taking a saving decision

5.15 These polices will also help reduce the costs of taking saving decisions in two ways. First, by introducing easily accessible and simple to understand accounts, the Saving Gateway and Child Trust Fund will support those savers with little or no experience of dealing with financial services, and thus make it far easier for them to take the first step in engaging with a financial institution.

5.16 Second, by providing a significant component of relevant financial education, the policies will ensure that individuals are properly equipped to take the right decisions for themselves in the future. In addition to providing a financial incentive and a simple choice, the Saving Gateway will provide education and training to ensure that savers can make best use of their savings and continue to save long after they have left the Saving Gateway. The Child Trust Fund, by connecting to the school curriculum, will ensure that children reach young adulthood not only with access to a financial asset, but having had the opportunity to learn at first hand of the significant benefits to be gained from taking a decision to save.

Box 5.1: Financial literacy, financial exclusion and saving

There is a growing quantity of recent research to suggest that financial literacy and lack of familiarity with financial institutions arising from financial exclusion contribute to preventing people on low incomes from saving. A recent study on financial exclusion in an inner-city neighbourhood in Bristol looks at a range of personal finance issues, including saving.[a] It shows that in addition to low incomes and unemployment, low levels of financial literacy combined with low levels of engagement with financial services in the community as a whole act as an important constraint on individuals' saving behaviour. These effects are exacerbated by the particular problems of living in areas of high deprivation – there are few financial services providers based locally, overall levels of basic educational skills such as literacy and numeracy are low and the concentration of financially excluded individuals means that there are few people in the community to whom others can turn for basic information about financial services.

Another study looks at patterns of ownership of interest bearing accounts from 1978 to 1996. While income is an important determinant, it is not the only significant factor. According to the study, the effect of post-sixteen compulsory education was to increase the probability of having an interest bearing account by 6% (all other things, including income, being equal)[b]. The Bristol study also recognises the importance of formal education in providing basic capability, and concludes that learning opportunities outside secondary education are crucial for those who are financially excluded.

Evidence from other countries is also illuminating. The latest study of Individual Development Accounts in the US provides evidence on the importance of education, literacy and institutional perception on saving.[c] Overall, it confirms the conclusions reported in *Saving and Assets for All*, that institutional factors, such as the lack of incentives, information, access and facilitation, are the strongest determinants of saving behaviour among low-income groups, stronger even than income and relative poverty. More specifically, the IDA experience is showing the importance of education and information within the complex of institutional factors: participants' saving levels increased with their attendance at financial education classes.

[a] Kempson and Whyley, 'Kept out or opted out?: Understanding and combating financial exclusion', The Policy Press/Joseph Rowntree Foundation, 1999.

[b] Banks and Tanner, 'Household Saving in the UK', IFS, 1999.

[c] Schreiner et al, 'Savings and Asset Accumulation in Individual Development Accounts', Centre for Social Development, 2001

5.17 In summary, it can be seen that providing financial information and education is an integral part of the success of both the Saving Gateway and the Child Trust Fund. The following section discusses in further detail the specific needs for financial information and education that will arise from each of the policies.

SPECIFIC REQUIREMENTS FOR FINANCIAL INFORMATION AND EDUCATION

Saving Gateway

5.18 In order to identify the specific requirements for financial information and education created by the Saving Gateway, it will be useful to break the account down into three distinct stages – account opening, account lifetime and account maturity. The types of information and skills required by participants in the Saving Gateway will be different at each of these stages.

Saving Gateway opening

5.19 This stage is defined as the period up to the point at which an individual has successfully opened a Saving Gateway account, and may include a significant period of time during which the individual is eligible for the Saving Gateway, but does not know that it exists. During this stage, the types of information and education needed would include:

- generic information on the existence of the account and the financial benefit offered, including a specification of the eligibility criteria;
- specific advice on an individual's eligibility status, with (if relevant) information on how and where to apply;
- information on the benefits of saving to help potential participants understand the relevance of saving to them; and
- introductory training in basic financial planning, in order to help each participant calculate an affordable monthly saving level.

Saving Gateway lifetime

5.20 This stage in the Saving Gateway lifecycle is defined as the period between the opening of the account and the point at which it matures. The information and education requirements during this stage would include:

- continued support in financial planning in order to enable savers make the right decisions about when to save more, when to take a break from saving, and when to withdraw assets from the Saving Gateway;
- more specific information on saving objectives to help focus savers on their longer-term saving goals; and
- provision of information on existing mainstream saving vehicles, as a further step towards familiarising savers with their saving options after maturity.

Saving Gateway maturity

5.21 Under the proposals put forward in Chapter 4, account maturity would arise either after five years, or once the saver had built up a balance excluding matching of £1,000, whichever was the sooner. At this point, the saver will have the following requirements:

- further information on mainstream saving options, including information on how to take these options forward; and
- an element of personalised support through the process of deciding where to continue saving, how much to save, how much of the Saving Gateway assets to transfer into a new saving product, and so on.

Child Trust Fund

5.22 The same breakdown into three account-stages can usefully applied to the Child Trust Fund, although different actors (parents, children, other family and friends) will be involved to a different extent in each stage.

Child Trust Fund opening

5.23 As proposed in Chapter 3, opening of the Child Trust Fund could take place automatically after the birth of a child. Nevertheless, there will still be significant choices that parents will need to make, and these choices will require that parents have access to various forms of information and guidance. These will include:

- notification of the existence of the Child Trust Fund, and of the benefits that are offered;
- information on the various providers of the account, and the next steps needed to open the account;
- help with calculating an affordable and sustainable level of parental contribution to the Child Trust Fund; and
- information on investment choices for the endowments and any additional contributions.

Child Trust Fund lifetime

5.24 This stage lasts eighteen years, from the time that the account is opened at birth, until its maturity. There will be two distinct groups involved in the account over this period, with consequently distinct sets of information and educational requirements. The first group are parents and other potential contributors to the account such as friends and other family members. Their requirements will include:

- for other contributors, information on how and where to make additional contributions into Child Trust Fund accounts;
- for parents, ongoing support with financial planning decisions, particularly as they have more children and need to allocate resources more carefully; and
- also for parents, information on when and how to make changes to investment strategy, including the possible option of transferring to another provider.

5.25 The second group that will need to be reached during the lifetime of the account are children, and they will have a different set of informational and education requirements, including:

- general personal financial education to be delivered through the school curriculum;
- an introduction to the basic concepts of saving, including compound interest, as illustrated by the Child Trust Fund;
- information on how to save in the Child Trust Fund; and
- guidance on possible uses of financial assets, including transfering into existing saving vehicles.

Child Trust Fund maturity

5.26 When the child reaches the age of eighteen, they will have access to the assets within their Child Trust Fund accounts. At this stage, they will need more targeted information and guidance on how best they can make use of these assets. If they wish to continue saving, they will need further help with financial planning to ensure that they save in the type of vehicle best suited to their particular needs. Parents, too, will benefit from information at this stage to help them through the process of advising their children on how best to make use of their assets.

5.27 What this section has revealed is the wide variety of requirements for information and education that will be created by the introduction of both the Saving Gateway and the Child Trust Fund. The next section catalogues existing roles and responsibilities for providing financial information and education, within both the public and private sectors.

EXISTING SOURCES OF FINANCIAL INFORMATION AND EDUCATION

5.28 There are a large number of sources of financial information and education already in existence, belonging to governmental, private sector and not-for-profit organisations. The challenge of providing participants in the Saving Gateway and Child Trust Fund with the information and skills that they need to make the right saving choices will be as much about linking them to these existing – but perhaps under-utilised – sources as it will be about providing new channels through which to disseminate knowledge. Some of the most important of these existing channels include:

- **Financial Services Authority:** is the UK's independent financial regulator; under the Financial Services and Markets Act (2000), one of the FSA's four statutory obligations is to promote public understanding of the financial system and to mediate information asymmetries, providing education for financial capability and consumer information and advice;

- **Department for Education and Skills:** the Department's core responsibilities include the provision of financial education through the National Curriculum, with an explicit goal to provide education on how the economy functions, including the role of business and financial services;

- **Department for Work and Pensions:** in addition to providing targeted financial information and education through the New Deal initiative, the Department also has responsibility for providing consumer information on pensions;

- **private sector:** includes banks, building societies and other financial services providers, as well as independent financial advisors and other financial intermediaries, providing a broad range of information from widespread product-based mass marketing campaigns to much more targeted and individual-specific advice on personal financial needs;

- **not-for-profit sector** – through trade unions, community groups, and locally-based services such as the Citizens Advice Bureaux, the sector is widely involved in the provision of financial information and advice, particularly to disadvantaged groups.

Box 5.2: Targeted schemes from the Department for Education and Skills:

In addition to its core responsibilities, the Department for Education and Skills, has developed a number of targeted financial information and education initiatives. These include:

- **Adult Financial Literacy Programme – Part of the National Strategy 'Skills for Life', its aim is to improve adult literacy and numeric skills; the scheme was launched on 1 March 2001. The Adult Financial Literacy campaign aims to reduce the overall number of adults who have difficulty with literacy and numeracy by 750,000 by 2004. It also aims to significantly increase the standards of provision for learners and improve the training and professional development of teachers of basic skills.**
- **Community Finance and Learning Initiative (CFLI) – The CFLI aims to tackle poor skills and exclusion by promoting financial and learning products in areas of high financial and social exclusion.**
- **Connexions Service – The aim of the Connexions service is to provide all teenagers with the skills they need to make the transition from work to adult life. The Service will bring together all the organisations that support young people and provide coherence in a way that has not happened before. Connexions will provide both a universal (all teenagers will have access to the service) and targeted (intensive support will be available to those who need it most) service and cater for the varying needs of all young people.**
- **Education Maintenance Allowance – the Education Maintenance Allowance Scheme currently being piloted, is also encouraging young people to develop financial management skills. Young people in receipt of an EMA gain some measure of financial independence and many save some of their weekly payments towards expensive items bearing in mind what weekly costs such as travel must be covered first.**
- **Information Advice and Guidance Partnerships – this service currently provides free information and advice services to adults, but from this autumn Government will be spending £5 million to pilot free in-depth guidance services to help the most disadvantaged in our communities.**

5.29 The Government will be continuing to work on the development of policy options toward the provision of financial information and education for the Child Trust Fund and the Saving Gateway. As part of this process, it will be looking to engage with interested parties to discuss ways that existing sources of financial information and education can be integrated into provision of the Child Trust Fund and Saving Gateway. The Government encourages respondents to submit their views, by 28 February 2002, to:

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