Saving and Assets for All

The Modernisation of Britain's Tax and Benefit System, Number Eight

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Abstract:

The Government believes that saving and asset ownership are an important complement to the three main pillars of its welfare strategy: work and skills, income, and public services. Regular saving provides individuals with a pool of financial assets for times of adversity, or for planning for retirement, or to enhance long-term independence and opportunity. The Government has done much to extend the benefits of saving and asset-ownership, through Individual Savings Accounts, Stakeholder Pensions, and the Pension Credit. But there is strong evidence to suggest households on lower incomes are not saving enough for themselves, or their children, to enjoy the benefits and opportunities of asset ownership. The Government also wants to ensure that all children grow up knowing that they have a financial stake in society. All young people should be able to embark on their adult lives with a financial asset to invest in their future. This paper presents options for policies designed to increase rates of saving and asset-ownership, both among the lower-income households of today, and in generations of families to come.

1 Introduction

1.1 The Government wants everyone to have a stake in society. To ensure that all adults and young people have the opportunity to participate in the economic and social life of the country, the Government has made important strides in three areas key in ensuring opportunity for all:

- work and skills;
- income; and
- public services.

1.2 The Government sees these areas of policy – improving job chances, raising incomes and enhancing the quality and reach of mainstream public services – as the three pillars of its welfare policy. But, while these three pillars form the foundation of the Government's strategy, there is a further factor influencing people's well-being that needs to form a fourth, complementary, strand of welfare policy – the role of financial assets.

1.3 The Government recognised the benefits of financial assets in *Helping People to Save*, a consultation paper published as part of the Pre-Budget Report in November 2000. It identified the importance of savings in providing people with:

- independence throughout their lives;
- security if things go wrong; and
- comfort in old age.

1.4 The Government wants more people to enjoy the benefits that assets can bring. For example, the financial buffer that comes from a nest-egg of savings provides a cushion for families if they are hit by unemployment or other unexpected adversity. Furthermore, savings represent an invaluable resource when the time comes for people to retire and savings also help to provide choice and opportunity – from holidays to training and parental leave.

1.5 The Government is also concerned about promoting inter-generational mobility – extending to the children of lower-income families the opportunities that might be taken for granted higher up the income ladder. The Government wants more people to be able to have the running start that owning financial assets brings. It wants more young people to reach age eighteen with a financial asset that will provide them with financial opportunities and security – for example, by helping them pay for lifelong learning, or by providing them with money in a savings account that they can call on when starting a family, buying a house, or in times of special need.[1]

1.6 *Helping People to Save* identified the need for incentives to save targeted at lower-income households, based on evidence that these families do not have sufficient levels of savings to draw upon, either in times of rainy-day adversity, for retirement, or to pursue the opportunities available to those who do have access to savings. This can have a direct effect on the opportunities available to less wealthy people. Research shows that young people without assets are more likely to have lower earnings, higher unemployment and poorer life-chances overall.[2] Conversely, those with assets have improved prospects in life – not just because savings provide both a financial buffer against rainy-day needs and a source of financial independence and opportunity, but perhaps also because the very act of saving encourages greater self-reliance, forward-planning and an increased willingness to make personal investments.

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[1] Kelly, G. and Lissauer, R. *Ownership for All*, Institute of Public Policy Research, 2000.

[2] Bynner, J. and Despotidou, S. *Effects of Assets on Life Chances* Centre for Longitudinal Studies, Institute of Education, 2000. This paper is available on the Department for Education and Employment website (www.dfee.gov.uk).

1.7 The focus of this paper is on how the benefits of building up financial assets can be extended to lower-income families, and whether the benefits of asset-holding, taken for granted by many higher-income families, can be spread to the rest of the population.

1.8 Supporting adults in building up a financial base for themselves and their families will help them to feel more able to ride out difficult times, plan for their future and retirement, and to seize new opportunities. Building a financial base will help today's adults on low and moderate incomes to make key investments in themselves, their homes, and their standard of living in retirement. It will help people realise their aspirations, to save and plan for their futures.

1.9 If the Government can help to ensure that all children grow up knowing that they have a financial stake in society, this will help tackle the structural barriers to opportunity that are passed from one generation to the next. This will begin to *prevent* disadvantage by ensuring that children from lower-income households access the opportunities that flow from asset-ownership. The Government wants to help all young people get the best start in life and have the means to continue their learning, get their first home, or take advantage of other opportunities. As many young people as possible – some of whom are growing up with low expectations and limited prospects – should be able to embark on their adult lives with a financial base that they can use to invest in their future.

1.10 The saving and assets strand of the Government's welfare strategy will build on the 'something for something' approach which underpins the other elements. If you save the government will reward you for your efforts. This will enhance people's capacity to be more independent and determine their own future. Financial assets should be the preserve of the many not the few.

1.11 This paper sets out the Government's early thinking. It aims to;

- provide an analysis of the problem;
- identify the goals of an asset-building strategy;
- establish the building blocks for new measures; and
- set out some possible policy options.

1.12 The options presented in this paper are for consultation, to be followed by the publication of further consultation documents in the autumn.

2 Building on what the Government has Done Already

2.1 The Government's welfare strategy has already increased opportunity and security for many people by focusing on the three pillars of welfare: work and skills, income and public services.

WORK AND SKILLS:

2.2 The New Deal for Young People has put employment at the heart of the Government's strategy to spread opportunity underpinned by policies to make work pay. So far, more than 280,000 young people have found jobs through the New Deal since it was launched nationally in April 1998.

2.3 Opportunities for employment provided by the New Deal for Young People are also being extended to other groups.

- The New Deal for over 50s was rolled out in April 2000 to address below average employment rates for the over 50 age group. In its first nine months of operation, over 29,000 people returned to work through the programme.
- Through the New Deal for Lone Parents, over 83,000 lone parents have moved into work.
- The New Deal for 25+ offers intensive support for older long-term unemployed people, 61,000 of whom have already found employment through the scheme, which will be extended and intensified on a national basis from April 2001.
- The New Deal for Partners offers an adviser service for partners of unemployed people, and is now being extended on a voluntary basis to all partners of sick and disability claimants.

2.4 Outside the New Deal, investment in skills through the Learning and Skills Council and the expansion of Modern Apprenticeships will help provide young people with the skills to equip them for the modern labour market.

2.5 Since its launch in 1998, the National Childcare strategy has created childcare places that have helped more than 540,000 children, which, taking into account turnover, represents a net increase in places for 343,000 children.

INCOME:

2.6 Families with children will be, by October 2001, £1,000 a year better off on average as a result of the personal tax and benefit reforms over the Parliament as a whole. The Government has also embarked on an ambitious strategy to tackle child poverty, with a commitment to abolish child poverty in a generation and halve it in 10 years. Personal tax and benefit reforms announced in this Parliament will lift over 1.2 million children out of poverty. Specific measures include:

- Record increases in universal Child Benefit, which have seen the rate for the first child rise by 26% in real terms since 1997.
- The Children's Tax Credit, worth up to £10 a week for around 5 million families, with £20 a week for families in the year of a child's birth to increase

the level of support at the time it is needed most.

- The Working Families' Tax Credit, which is benefiting nearly 1.2 million families, around 300,000 more than received Family Credit at its peak.
- An increase in the National Minimum Wage for adult workers over 22 to over £4.10 an hour from October 2001, and subject to economic conditions prevailing at the time, £4.20 from October 2002.
- In 2001-02, the Government will be spending around £4.5 billion a year extra in real terms on pensioners as a result of policies since 1997. Of this, £2 billion goes to the poorest third of pensioners.
- 2 million of the poorest pensioner households are now at least £15 a week, or £800 a year, better off in real terms as a result of Government measures since 1997. All pensioner households are on average £11 a week, or £580 a year, better off.

SERVICES:

2.7 The Government has committed itself to a major investment in public services. The 2000 Spending Review provided for an average annual growth in spending for the three years from 2000–01 of 5.2% for education, 5.6% for health, 20% for transport, 12% for housing and 4.2% for the criminal justice system.

2.8 As a result of prudent management of the public finances, Budget 2001 was able to add to these resources by allocating an additional £2 billion over the next three years. This money, provided on top of planned increases announced in the Spending Review, will go straight to the front line to deliver results and meet targets.

2.9 The 2000 Spending Review also announced further initiatives, such as a more than doubling of expenditure on Sure Start, and the creation of a Children's Fund.

- Sure Start aims to tackle the causes of poverty and social exclusion through local community-led programmes working in partnership with parents and parents to be. There are 142 programmes already running or approved, covering over 110,000 children under 4 in disadvantaged areas. A further 118 programmes will be operational by April 2002, with a total of 500 planned for 2003-04.
- The Children's Fund provides £450 million over three years to 2003-04, the majority of which will be targeted at providing preventative services for children (primarily aged 5-13) and their families, helping them before they hit crisis.

SAVING AND ASSETS

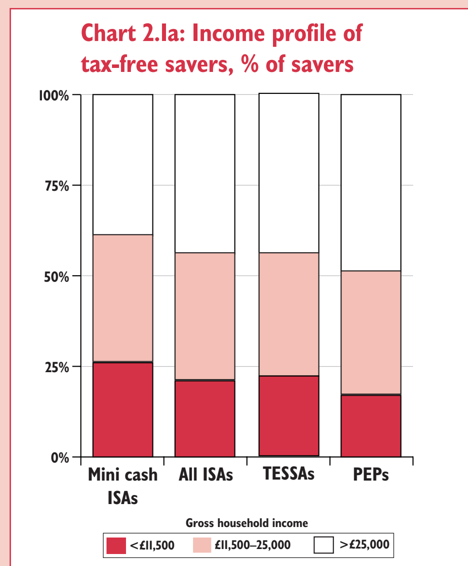
2.10 An active welfare strategy based on work, income and public services needs to be complemented by a strategy to extend the benefits of saving and asset-holding to all members of society. The Government has already taken a number of important steps in promoting saving and asset-building:

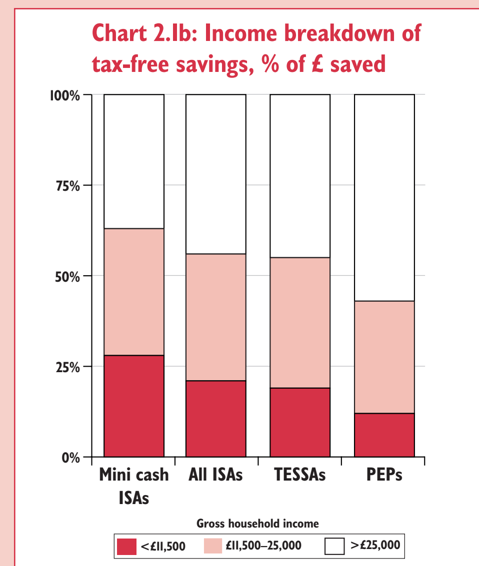
- ISAs were introduced in 1999 to encourage tax-free saving amongst lower and moderate income groups. Analysis of the first year of ISAs has shown that 9.3 million accounts were opened during 1999-2000 and that ISAs – particularly

Box 2.1: Individual Savings Accounts

ISAs were introduced in April 1999 in order to extend tax incentives to save, particularly to lower-income savers. ISAs have proven very popular – in their first year, 9.3 million ISA accounts were opened and over £28 billion invested in them. This was a third more than was invested in Tax Exempt Special Savings Accounts (TESSAs) and Personal Equity Plans (PEPs) in their final, and most successful, year. The success of ISAs continued last year, with £20 billion invested over the first three quarters of 2000-01, nearly £3 billion more than had been invested over the same period the year before.

ISAs have also proven successful in attracting relatively more low-income savers than TESSAs and PEPs. As shown in chart 2.1a below, more than a quarter of mini cash ISAs have been taken out by those with household incomes of less than £11,500 per year, compared to around one in five for TESSAs and one in six for PEPs. Chart 2.1b shows that more of the money saved in mini cash ISAs is held by people with household incomes below £11,500, confirming that more of the benefit of tax-free saving is going to low-income savers than was the case with TESSAs and PEPs.[a]





As well as spreading tax relief more widely, ISAs have also proven to be more generous than the old PEP and TESSA regime. In 2000–01, savers will have paid almost £100 million less in tax than would have been the case with PEPs and TESSAs. The difference next year will be almost £300 million. With the extension of the £7,000 contribution limit announced in the Pre-Budget Report, savers will be receiving £800 million a year more in tax relief than if PEPs and TESSAs had remained.

Many ISAs meet the Government's voluntary CAT standards, which are benchmarks for charges, access and terms. CAT standards help people identify straightforward products that should offer a reasonable deal. A study of the ISA market by McKinsey's has found that CAT standards have helped ISA savers achieve value for money. They have set an interest rate floor for cash ISAs, while the 1% limit on charges in CAT equity ISAs saves a typical saver investing £3,000 a year in a CAT equity ISA over £35 a year in charges over someone saving in a non-CAT ISA. CAT standards have also made ISAs more accessible by placing modest limits on minimum contributions, e.g. a ceiling of £10 on minimum equity contribution limits, making it possible for people wishing to save smaller amounts to benefit from the tax advantages of ISAs.

The challenge is now to build on the success of ISAs by developing incentives to save for those low-income households for whom tax relief is not the most effective way of encouraging saving.

[a] Inland Revenue analysis of the NOP Financial Research Survey for 1999-2000.

mini-cash ISAs - have attracted relatively higher numbers of low-income and younger savers. The Government has developed CAT standards – which set benchmarks for charges, access and terms of financial products – for ISAs so that people can easily identify products which offer them a reasonable deal (see box 2.1 on ISAs).

- The introduction of stakeholder pensions which are simple, flexible and have low charges will encourage moderate income groups to save for their retirement and to benefit from the tax-relief that is available for pension contributions (see box 2.2 on stakeholder pensions).
- The introduction of a Pension Credit from 2003 will reward pensioners for having built up savings during their working lives, or for carrying on working beyond retirement age.
- From October 2001, the £500 capital limit in the Sure Start Maternity Grant and Funeral Payments will be abolished so that families on low incomes with small amounts of savings receive support from the Government to cover the additional costs associated with the birth of a new baby or the death of a close relative. More generally, the development of a new integrated system of support for children and an employment tax credit to be introduced in 2003 offer the opportunity to review the treatment of capital in assessing a person's or family's entitlement to support.
- The Financial Services and Markets Act (2000) places the Financial Services Authority (FSA) under a statutory obligation to promote public understanding and awareness of the financial system so as to ensure a better understanding of their financial needs. The FSA will pursue this by programmes to improve general financial literacy, particularly among the vulnerable and inexperienced, and by improving the quality and clarity of the information available to consumers.

Box 2.2: Stakeholder Pensions

A key element of the Government's overall saving strategy is to help people provide for their comfort and security in old age. This means people need to build up decent second pensions, whether through their employer, the State or their own personal saving. To help people save, the Government gives generous tax relief to pensions, on the grounds that these provide a secure income throughout retirement.

However, until recently, personal pensions have often been poor value for all but the highest earners, as much of the benefit of tax relief went in high initial charges or penalties for those unable to make regular contributions. In addition, millions of people were mis-sold pensions in the 1980s and 1990s, thus not only bringing financial hardship to those affected, but also deterring many more from starting a pension.

The Government has sought to redress these problems and extend the benefits of pension saving to all:

- **We have ensured that people who were mis-sold a pension receive compensation, with 660,000 cases for compensation already settled since 1997.**
- **For low earners, or for those with broken work records, the Government is introducing the State Second Pension. This will significantly increase the pension to which millions of carers, part-time and disabled workers are entitled. In fact, for someone earning £120 a week, they will be £40 a week better off in retirement than they would have been under SERPS.**

- **And to provide those on moderate earnings with a better vehicle for saving, the Government has introduced Stakeholder Pensions. They have been available since 6 April 2001.**

The key features of stakeholder pensions are their low cost and their flexibility. Annual management charges are capped at no more than 1 per cent. of the fund value. Contributions can start from as little as £20 per month and can be increased, reduced or indeed stopped altogether without penalty. When an employee moves jobs, they can take their stakeholder pension with them. And, provided you earn less than £30,000, you can save in a Stakeholder without having to opt out of your existing occupational pension – a crucial rule which will help prevent mis-selling.

But as well as providing a better deal for those saving for a pension, stakeholders open up the possibility of saving for people who were denied it in the past:

- **Those without earnings will be able to have a stakeholder pension. So, for example, people caring for children or taking a career break will no longer immediately have to stop saving for a pension just because they are not in work: they will now be able to continue, or indeed start, a pension thereby benefiting from the tax relief it brings.**
- **This rule also means that, for example, parents can open a stakeholder pension for their children. With the benefit of compound growth over a very long period of time, the monthly contributions required to build up a pension fund can become relatively small.**
- **And from October 2001, all employers with five or more employees and that do not make pension arrangements for their staff will have to offer access to a stakeholder pension to eligible employees.**

There are currently 46 approved stakeholder pension schemes available from a variety of providers, including banks, insurance companies and affinity groups such as the Trades Union Congress.

2.11 Steps are also being taken to combat the problems of financial exclusion, which exacerbates the problem of low levels of saving by reducing access to the most basic of saving products:

- All the high street banks now offer basic bank accounts, which are free to open and run, and allow those people with no or poor credit histories to obtain a bank account. The Government is also working with the banks, building societies and the Post Office on the provision of universal banking services through post offices.
- In future, credit union members will be afforded similar protection to that already given to depositors with banks and building societies.

2.12 While significant progress has already been made in encouraging people to save, further steps need to be taken. Among lower-income households there are very low levels of savings. According to DSS survey data, in 1998–99, 46% of households earning less than £200 per week had no savings at all. The same was true of 70% of lone parents. 57% of families with children where there are two or more adults had less than £1,500 in savings. (see box 2.3 on low- and middle-income saving inequality). As a part of its ongoing strategy to create the right conditions and incentives for saving for all, *Helping People to Save* committed the Government to continue to look at ways to bring the benefits of saving to lower-income households.

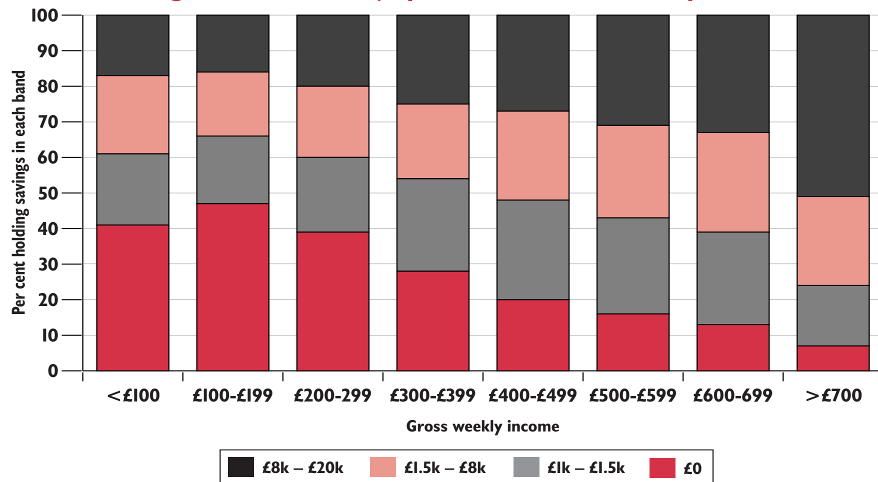
2.13 Furthermore, the Government is also concerned to build on its efforts to extend opportunities to the next generation. This document proposes policies which, in addition to addressing the low levels of savings among low and middle income households, also aims to ensure that young adults begin their working lives with the access to the benefits and security of owning financial assets.

Box 2.3: Saving patterns among lower income groups

Recent research has shown that the proportion of households with no saving is increasing over time. In 1997, one in ten households had no form of savings at all (including housing, pensions and life assurance and all liquid financial savings apart from current accounts). This figure had almost doubled since the beginning of the 1980's.[a]

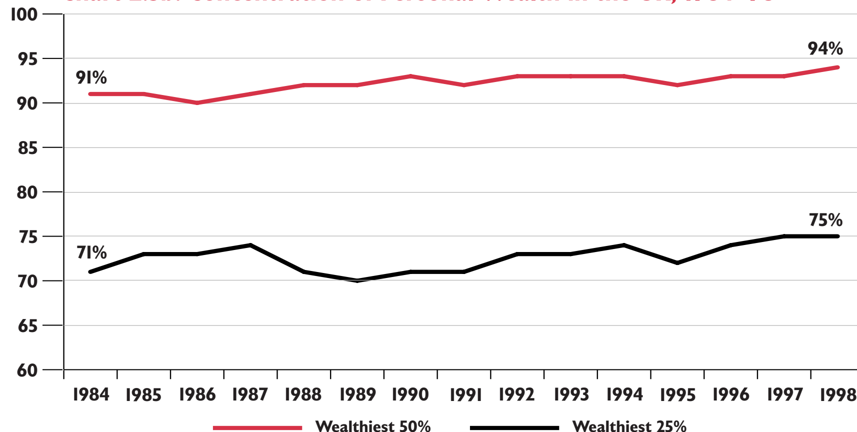
However, as Chart 2.3a below shows, the problem is particularly serious for those on low incomes. 46% of those on household incomes of less than £200 and 43% of those on less than £300 have no financial savings at all (excluding housing and pensions, but including current accounts).[b]

Chart 2.3a: Amount of Financial Savings (excluding pensions and housing, including current accounts) by Gross Household Weekly Income



According to Inland Revenue statistics published in 2000, 94% of total personal sector wealth, including housing and pensions, is owned by the wealthiest half of the adult population, and 75% is owned by the wealthiest quarter. As Chart 2.3b shows, this inequality has increased over time.

Chart 2.3b: Concentration of Personal Wealth in the UK, 1984–98



[a] Banks, J. and Tanner, S. (1999) *Household Wealth in the UK*, Institute for Fiscal Studies.
[b] Department of Social Security (2000) *Family Resources Survey*.

3 Policy Objectives and Priorities for Savings and Assets

3.1 Saving is the process leading to the creation of a stock of financial assets. As set out in *Helping People to Save*, holding such a stock of assets offers individuals the following benefits:

- security if things go wrong (assets used for rainy-day purposes e.g. to cover periods of temporary unemployment, sickness etc);
- comfort in old age (assets used to provide a secure income throughout retirement); and
- independence and opportunity throughout their lives (assets used for expenditure on short-term needs such as school uniforms or holidays and longer-term objectives, such as deposits for house purchases and lifelong learning).

3.2 Independent Financial Advisers (IFAs) usually advise those with no saved assets to prioritise these objectives as follows:

- first, saving towards a rainy-day fund;
- second, long-term saving towards a retirement fund; and
- third, saving towards other beneficial objectives reflecting individual needs and choices.

3.3 The Government agrees with this model, subject to individuals' circumstances. The model is also endorsed by independent analysis (see box 3.1 on lower-income savers). The focus of the Government's saving policy should be to encourage individuals to develop a regular saving habit. This is because there are clear benefits of being a regular saver. These arise most importantly because the more regular and durable the saving habit of the individual is, the more likely they are at any one time to have built up a substantial stock of assets, and the more likely they are therefore to be able to enjoy the benefits of ownership of these assets.

Box 3.1: Evidence on Lower-Income Savers

Independent research commissioned by Pearl Assurance provides some insight into the behaviour of lower-income savers.[a] Based on both quantitative and qualitative research, the study identifies a five-fold typology of saving behaviour among lower-income savers.

- **Non-savers: those who had never had any savings at all, as a result of a decision not to save;**
- **Passive savers: those with a stock of assets not resulting from saving – e.g., through a bequest, gift or tax rebate;**
- **Instrumental savers: those with savings specifically ear-marked for a particular short-term purpose;**
- **Long-term savers: those with savings towards some specific long-term aim, e.g., retirement or further education**
- **Rainy-day savers: those saving for a non-specific future change in circumstances**

Box 3.1: Evidence on Lower-Income Savers (continued)

The research showed that by far the most regular and durable saving behaviour was displayed by long-term and rainy day savers, who displayed a strong attitudinal preference for saving over spending. Faced with a temporary loss of income, these savers were less likely to stop saving, and were also extremely likely to start saving again when they did have to stop saving. This was in contrast to instrumental and passive savers, who were both more likely to stop saving in adverse conditions, and less likely in general to move into the more regular and durable types of saving. As a result of these patterns, long-term and rainy day savers were far more likely to have built a significant pot of assets, and less likely to be reliant on consumer credit. Another significant finding was that those who had developed a regular saving habit were far more likely to save in a variety of different ways – including in pension plans and investment vehicles such as ISAs.

As for the factors underlying these different patterns of behaviour, the study found evidence to suggest that long-term and rainy day savers developed the saving habit early in life, in some cases as early as childhood. Among those who developed the saving habit later in life, there was evidence that saving for their children had been an effective trigger in developing the habit.

The authors of the research draw some public policy implications from their findings:

- **"the ideal model of saving would lie somewhere between a long term and a rainy day saver. This would involve a strong commitment to saving for general rather than specific purposes, but with an acceptance that savings may need to be spent at some point in the future"**
- **There are great potential benefits to be gained by encouraging lower-income earners to develop the saving habit, in terms of their increased self-reliance in the short term (rainy days) and the long term (retirement)**
- **Given the strong association between regular saving in adulthood and development of the habit in childhood, there is a need for policy that encourages children to save for general, non-specific and longer-term purposes.**
- **Given the lack of leverage of tax relief in encouraging lower-income earners to save, different types of policy tool are required to influence the development of regular saving behaviour in the long-term.**

These conclusions are significant, and should inform the approaches taken by the Government in its efforts to spread the benefits of saving and assets to all member of society.

[a] Whyley, C & Kempson, E. (2000), *Understanding Small Savers I & II*, Pearl Welfare Study Programme.

3.4 In addition to the direct financial benefits of saving, there are indirect behavioural benefits to be gained through promoting saving. There is some evidence to suggest that the *process* of saving has a positive impact on individual's self-reliance, and attitude towards personal development. This behavioural benefit of saving offers one important rationale for the Government to become involved in encouraging saving. Many of the direct financial benefits of owning a stock of savings could be delivered through income transfers, grants or loans. The behavioural benefits, however, can only be realised if individuals are encouraged to develop a "saving habit". There is also an argument that behavioural benefits in individuals, such as greater focus on the future, have broader social benefits which the Government should seek to pursue.

3.5 Apart from the behavioural and social benefits achievable through encouraging people to develop the saving habit, there is a role for Government and the Financial Services Authority in developing individuals' saving habits where appropriate and where this development is hindered by barriers – such as apathy, inertia or lack of information – that can

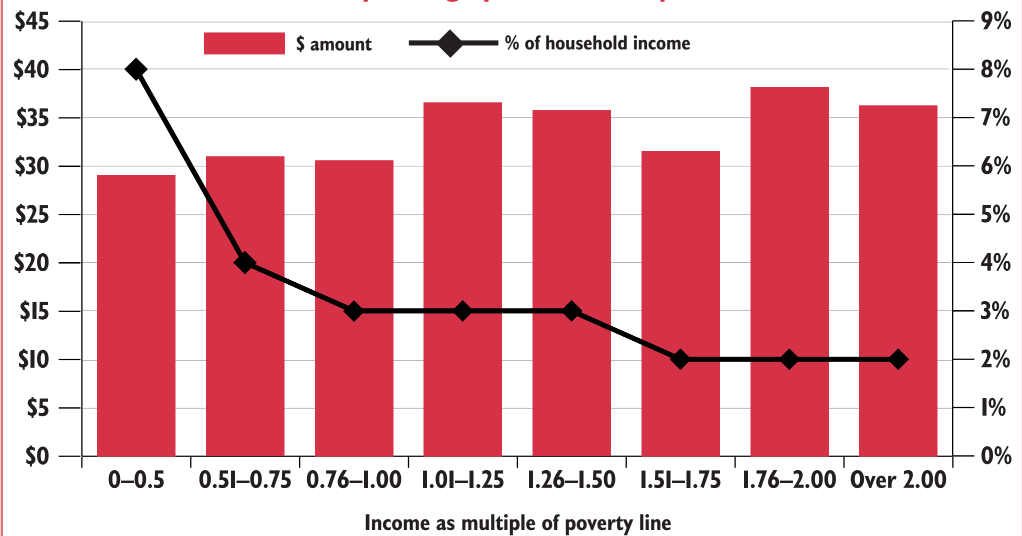
be mitigated through Government action. Evidence from research conducted in the United States on Individual Development Accounts, which found that institutional barriers have a significant impact on saving patterns among lower-income households, supports this conclusion (see box 3.2 on IDAs). Therefore, the primary focus of policy aimed at broadening the benefits of saving to all households should be encouraging individuals to develop the saving habit, with a view to maximising the benefits they enjoy from asset ownership.

Box 3.2: Individual Development Accounts

Individual Development Accounts have been piloted in the United States since 1997. People saving towards particular objectives – housing, business or education – have limited amounts of saving matched, typically at a rate of $2 for every $1 saved. As well as the generous incentives to save, the role of personal advisors and mentors has been a key factor in encouraging people to save. This approach, involving a focus on personal development, is possible because the schemes are small-scale and run locally by community groups and other non-governmental organisations, although matching funds originate from the Federal government.

Preliminary research into IDAs shows that participants' – whose incomes ranged from under half to over twice the poverty line – mean monthly savings averaged $33 per month.[a] While no rigorous analysis was done to look at the extent to which this was new saving, there are nevertheless some interesting results in the data. In particular, the study found that there is a small and statistically insignificant relationship between poverty and the amount saved each month; if anything, poorer households saved a *greater* proportion of their household income each month.

Chart 3.2: Mean Monthly Saving by Income Group in IDA Pilot

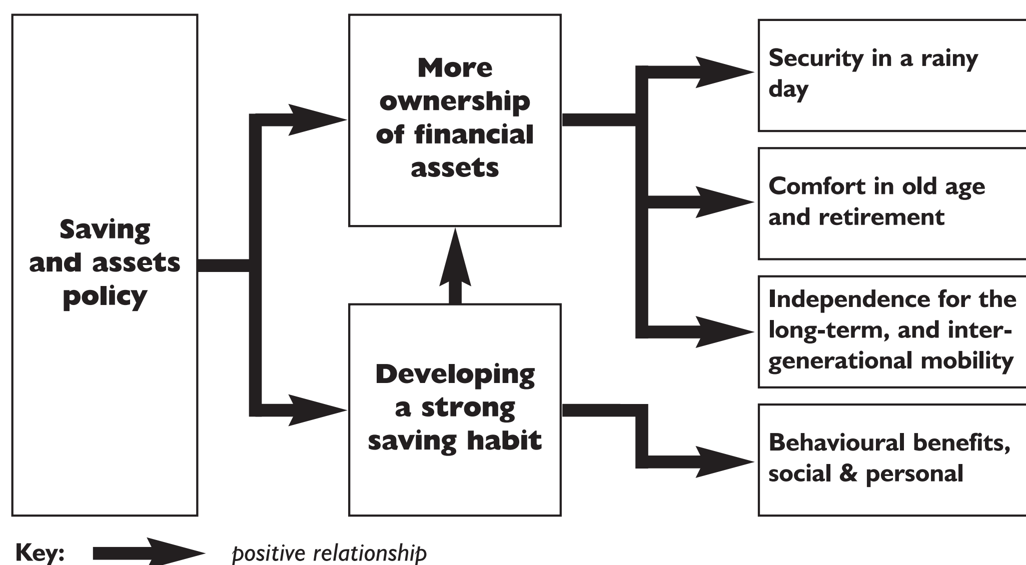


The authors of the research use this finding as evidence to support the contention that poverty *by itself* does not explain the saving behaviour of lower-income groups. In particular, they argue that the findings support an *institutional* theory of saving, whereby it is a combination of institutional factors such as incentives, information, access and facilitation that is the strongest determinant of saving, more influential than personal characteristics, even poverty. These findings are significant, for they suggest that government has a positive role to play in encouraging people to save by removing the barriers to saving – including a lack of information and education – faced by lower-income households.

[a] Sherraden, M et al (2000) *Saving Patterns in IDA Programs,* Center for Social Development.

3.6 The relationship between the policy objectives of the Government's saving and assets policy are represented in Figure 3.1.

Figure 3.1: How Government policy can help people benefit through saving and asset ownership



3.7 However, it is not enough just to focus on the process of saving. Other approaches to increasing asset-holdings among the poor are also needed, and for this reason the Government will also be looking at ways to improve the asset-ownership of young adults as they begin their working lives, particularly in the light of evidence to suggest that asset-ownership can have an impact on individuals' well-being (see box 3.3 on assets and well-being). However, pursuit of this objective needs to be undertaken in a manner that is consistent with other policies, in particular, without diminishing incentives to save or work, and without detracting from the saving priorities of rainy-day assets and provision for retirement.

Box 3.3: Evidence on Assets and Well-Being

There is new evidence to suggest that asset poverty has a strong independent effect on young peoples' chances in life. The most powerful way of capturing the *independent* effect of asset-holding (i.e. controlling for income and other socio-economic factors) is to use data which allows us to track the performance of individuals over their life-cycle. The National Child Development Study allows an analysis of the impact of parental and household attributes on the performance of individuals over time.[a] It contains information on savings and investments at the age of 23 and a range of social outcomes at 33.[b] It shows that the absence of a minimal level of financial assets in the form of savings or investments is strongly associated with poor outcomes for earnings, employment, well being, health, entrepreneurship and marital breakdown.

- **For both men and women there was a strong positive relationship between holding assets and time spent in full-time employment between 23 and 33, and a strong negative relationship with time spent in unemployment.**
- **For men, there was a highly significant relationship between asset holdings at 23 and earnings at 33. There was no relationship for women.**

Box 3.3: Evidence on Assets and Well-Being (continued)

- **Asset holding at 23 was a good predictor for general good health at 33. There was a strong negative relationship between asset holding and "malaise".**

As always with longitudinal research results need to be interpreted with some care. There may be some underlying causal factor which leads both to greater levels of asset holding at age 23 and the outcomes observed at age 33. To eliminate some of this uncertainty, the NCDS study controlled for a range of additional variables which could be taken as proxies for self-reliance and personality type. The researchers also controlled for earnings at 33 in order to discount the impact of higher earnings on better non-earnings social outcomes, even where higher earnings were, in part, a result of higher asset holding at 23. The positive relationships associated with asset holding outlined above remained to a significant degree.

Some questions remain, for example, the impact of asset holding is only tested for one age cohort over one period of time. Further study of longitudinal data would be needed before we can assert the conclusion with total confidence. Nevertheless, this powerful new evidence suggests that having access to at least limited financial assets can have a marked impact on people's economic and social well-being.

[a] Bynner, J. and Despotidou, S. "Effects of Assets on Life Chances" Centre for Longitudinal Studies, Institute of Education, 2000.

[b] The NCDS uses detailed information on 12,000 people born in 1958. All figures reported are in today's prices.

3.8 Taken together, these considerations strongly suggest that the Government's policy to support increased saving among low-income households should focus on:

- encouraging the development of a strong saving habit;
- with additional efforts to encourage the asset-ownership outcomes of children as they enter young adulthood and independence, building on the work of the Financial Services Authority in developing public awareness of financial issues, particularly among the vulnerable and financially inexperienced.

4 Policy Framework

4.1 As discussed in Chapter 2 of this paper, the Government is already doing much to extend the benefits of saving and asset-ownership to all. These policies are set out in Table 4.1. But the Government wants to go further. Table 4.1 also highlights some of the shortcomings of existing policy vehicles and financial services in providing incentives for lower income households to save more. From this framework, a list of essential features of policy can be developed.

4.2 It is essential that saving products are straightforward and that people understand the choices that they are making. Policy should therefore be based around

- **Transparency:** policy should be easy for people to understand.
- **Advice and information:** policy should ensure that savers have access to the information they need in order to make informed decisions about their saving choices.
- **Financial education:** policy should include an element of financial education, particularly for younger savers.

4.3 The design of saving products must be flexible enough to meet the needs of lower income savers. Any saving product should embody:

- **Access to funds:** policy should allow sufficient access to funds for rainy-day purposes.
- **Flexibility of contributions:** should offer the ability to vary contribution levels in line with changing financial circumstances.
- **Easy integration:** the policy should be easily integrated with existing saving vehicles such as stakeholder pensions, ISAs, etc.

4.4 Policy should build on people's existing desire to save for their own, and their children's, future. Policy should therefore be based around:

- **Developing saving habit:** policy should tap into and develop positive attitudes towards saving, with a particular focus on saving by and for children.
- **Targeting:** to extend the reach of Government saving policy, new measures should be targeted at those who currently have low levels of savings.
- **Incentives:** policy should deliver incentives for people to develop a regular and sustainable saving habit. The limited value of tax reliefs for lower-income households means that policy should consider a wider range of incentive mechanisms.

4.5 These features of the policy will need to be balanced against considerations of cost and value for money. The following cost criteria will be relevant:

- minimisation of fraud;
- minimisation of deadweight costs; and
- minimisation of administrative costs.

4.6 Coherence with other policy areas – pensions, benefits, and taxation – is a further constraint that needs to considered when developing the policy. *Helping People to Save* identified the need for savers not to be unfairly penalised through removal of benefits, and a number of reforms have already been made to some benefit capital limits. The Government will continue to ensure that any new policy initiatives are designed to be consistent with the overall welfare strategy as pursued through the tax and benefit system.

Table 4.1: Policy Framework for Saving

Policy Objective	Current System	Advantages	Barriers for lower income households	Policy Suggestions
Asset ownership for rainy day security	Basic Accounts • Current a/c • Saving a/c • Mini cash ISA	• Transparency • Access to funds • Flexibility of contributions • Tax benefits (mini cash ISA)	• Lack of awareness of need • Lack of regular saving habit • Limited value of tax benefits	• Advice and information on saving options • Financial incentives for regular, sustainable saving • Targeted at lower-income households not reached by existing tax relief on savings • Policy delivered through saving vehicle offering: – Ability to access funds for rainy day purposes – Flexibility to vary or stop contributions – Easy integration with existing saving vehicles such as stakeholder, mini cash ISA etc • Ensuring that young adults have access to financial assets
Asset ownership for comfort in retirement	Pensions • SERPS/S2P • Occupational • Personal • Stakeholder	• Tax benefits • Long term saving vehicles • Provides secure income throughout retirement	• No access to funds during accumulation period • Limited value of tax benefits	
Asset ownership for long-term independence & opportunity	Investments • Maxi ISA (stocks and share or life insurance) • AESOPs • Housing	• Tax benefits • Employer incentives (AESOP)	• Limited value of tax benefits • Limited access to AESOPs • Charging structure may limit access • Lack of flexibility	
Encouraging development of saving habit	• All of the above	• See above	• See above	• Continue to develop financial education on saving priorities and objectives • Developing positive attitudes toward saving • Particular focus on young adults and children

5 Policy Options

5.1 The Government is looking at a number of ideas to ensure that the benefits of saving are more widely available. These policies should have some of the key features and meet the criteria set out above. Two possible vehicles for delivering the Government's objectives are the Child Trust Fund and the Saving Gateway. These would build on existing Government policies, and address separate but complementary policy objectives.

CHILD TRUST FUND

5.2 A Child Trust Fund would be a universal account, opened for all children at birth, with an endowment paid in by the Government, based on the principle of progressive universalism – every baby would receive an endowment, but those in families on lower incomes would receive a larger lump sum. A Child Trust Fund would meet the Government's objectives for saving and widening opportunity by ensuring that all young adults, regardless of their families' circumstances, start their adult lives with immediate access to a stock of assets. This would provide them with the benefits of having savings – security, opportunity, long-term independence – with those children most in need receiving the most help from the Government (see Box 5.1 on illustrative examples of Child Trust Fund and Saving Gateway). A Child Trust Fund could also form the foundation of Government's efforts to encourage children to develop the saving habit for themselves.

Potential features of a Child Trust Fund

5.3 The following paragraphs describe some of the features that could be included in a Child Trust Fund. These features are presented not as finished proposals, but as ideas for discussion and consultation; a final Child Trust Fund may have many different features not listed here. Questions for consultation are given after discussion of each feature.

5.4 **Endowment:** The endowment could be made progressive by introducing a number of income bands at which different levels of endowment are paid by the Government. The simplest way of achieving this would be to have two levels of endowment, with the higher level payable to children with parents on incomes below a set threshold.

5.5 Another feature could be to have the endowment paid in instalments at key life-stage triggers – for example at birth and at ages five, eleven and sixteen – on an income-related basis. This would serve a number of purposes. First, it would add a further degree of progressivity by targeting additional endowment funds to those who most need them on a continual basis. Second, it would help to keep the Child Trust Fund account "live" by reminding parents and children that the funds – both endowment and contributions – are there and are growing. This objective could also be advanced by providing regular statements of account to parents and, when they are old enough, children.

5.6 **Questions for Consultation:**

- 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"?

5.7 Contributions: Additional contributions could be made into the Child Trust Fund by parents, relations, or friends, possibly with a limited tax incentive based on the ISA model. This would allow people to develop the saving habit by building on existing positive attitudes to saving for their children's future. It could also significantly increase the value of the assets children receive.

5.8 Question for Consultation:

- Should there be a tax incentive for additional contributions, and if so, up to what limit?

5.9 Investment options: A Child Trust Fund could be linked to a number of different investment "strategies": for example, low-risk investment in cash, medium-risk investment in corporate bonds or higher-risk investment in equities. This feature could increase the value of the assets available within Child Trust Fund accounts, but would need to be provided in conjunction with some form of advice and information on the risks inherent in investing in securities.

5.10 Questions for Consultation:

- 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?

5.11 Access to funds: Access to the endowment could be restricted until the child has reached a certain age – perhaps eighteen or twenty-one. This would provide more time for the Government endowment to appreciate in value, and for additional contributions to be made. It would also ensure that the assets become available to young adults at a crucial transition point when they are likely to most require access to financial assets. This could be supported by restricting the uses to which young adults can put the funds in their matured Child Trust Fund. For example, as is the case with IDAs in the US, funds could be restricted to investments in lifelong learning, enterprise or housing. The Government is willing to consider this proposal, but recognises that regulatory and implementation issues may prove difficult.

5.12 Whatever decision is taken on access to the endowment, a Child Trust Fund could be designed to give parents access to their own contributions. This could ensure that parents have sufficient access to rainy-day funds. However, this may add to the administrative cost of running the Child Trust Fund.

5.13 Questions for Consultation:

- 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 its use?

5.14 Financial Education, Information and Advice: A Child Trust Fund scheme could be tied into the financial education component of the National Curriculum, and used as a concrete method of illustrating the real benefits of saving to children and young adults, encouraging them to develop the habit of saving regular, sustainable amounts.

5.15 The Child Trust Fund could also be used to link into broader social concerns such as civic responsibility, community service, or educational achievement. An example of this could be for participating community groups to reward service from children by providing them with "credits" that have a cash value only when paid into the Child Trust Fund.

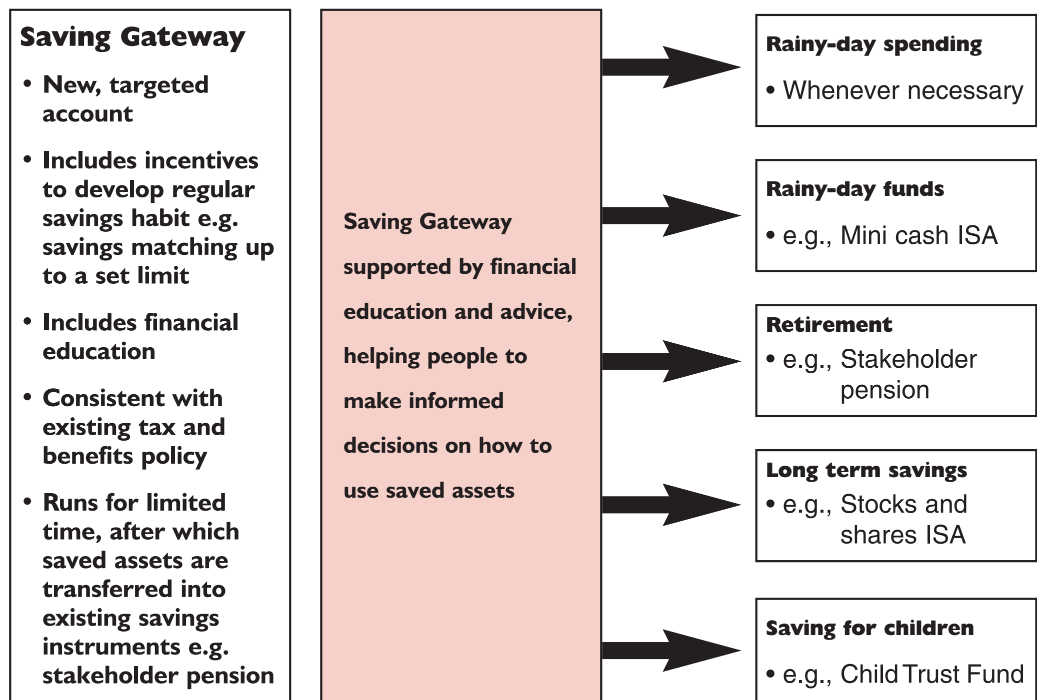
5.16 Questions for consultation:

- 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 community service or other activities be rewarded through small bonuses paid into the fund?

THE SAVING GATEWAY

5.17 While a Child Trust Fund would seek to ensure that future generations start their adult lives with access to the benefits of savings, the Government is also concerned with ensuring that current and future generations of adults are encouraged to save for themselves. The second proposal is therefore a Saving Gateway, which would build on the universality of both ISAs and a Child Trust Fund. It would add a further progressive element to ensure that the benefits of developing the saving habit and building a stock of assets are targeted at those who stand to gain most by them.

Figure 5.1: The Saving Gateway



5.18 The Saving Gateway is represented in Figure 5.1. The proposal would be to provide a single account, targeted specifically at lower-income households, through which incentives to save are delivered.

Potential features of the Saving Gateway

5.19 Once again, the following possible features are presented as ideas for discussion and consultation only. Questions for consultation are included below.

5.20 Targeting: Eligibility for the Saving Gateway would be targeted at lower-income households, who, as the evidence in Chapter 3 shows, tend to have low levels of savings.

5.21 Question for consultation:

- 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?

5.22 Matching incentives: These incentives to start and maintain regular saving among lower-income households could take the form of a Government "matching" incentive, whereby the Government makes a contribution for every pound saved, up to a fixed limit, in the Saving Gateway. For example, matching could be fixed at a 1:1 level. So £100 saved by an individual would, after matching, be worth £200, and so on (see box 5.1 on illustrative examples of Saving Gateway).

5.23 Questions for consultation:

- 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?

5.24 Developing a saving habit: In order to meet the Government's key objective of encouraging the development of a regular and sustainable saving habit, incentives could be structured in such a way as to ensure that those savers who save regularly are rewarded most. For example, instead of a single annual limit for savings eligible for matching, the Government could set smaller, monthly limits, thereby encouraging people to save regularly.

5.25 Questions for consultation:

- 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?

5.26 Duration: The Saving Gateway could run for a fixed period of time. This would serve a number of purposes. First, it would put a limit on the amount of matching incentives available to each saver. Second, it would make clear the Saving Gateway's role as a kick-start or bridge into existing saving vehicles such as ISAs or stakeholder pensions.

5.27 Question for consultation:

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

5.28 Access and Flexibility: After the end of the matching period, individuals would have the flexibility to transfer funds saved in the Gateway, plus any matching funds, into a variety of existing savings vehicles, including savings accounts, mini cash ISAs, stakeholder pensions, standard ISAs or the proposed Child Trust Fund. This process could be kick-started by exempting payments from the Saving Gateway from any existing contribution limits for these vehicles. Furthermore, during the lifetime of the Saving Gateway, users could have access to

funds – possibly matching payments as well as contributions – in order to ensure that funds are available on a rainy day. These features, taken collectively, would help to ensure compatibility of the Saving Gateway with the saving objectives and priorities identified above, but Government will ensure that the Saving Gateway is not open to fraudulent abuse.

5.29 Questions for consultation:

- 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 savings vehicles such as ISAs and stakeholder pensions?

5.30 Investment Options: As with a Child Trust Fund, a Saving Gateway could include the option for funds to be invested in a variety of investment vehicles with varying degrees of risk and return, although in the case of a Saving Gateway, the shorter duration of the account would probably make riskier investment strategies less desirable, Again, as with a Child Trust Fund, this could be delivered through the involvement of private financial services companies.

5.31 Questions for Consultation:

- 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?

5.32 Financial Education, Information and Advice: Access to financial education, information and advice is a crucial part of the scheme. An important element of the Saving Gateway would thus be to ensure that savers fully understand the rationale for, and the benefits of, saving and are able to make the right decisions for themselves when the time comes to move their assets into conventional saving vehicles, such as stakeholder pensions or ISAs. Financial education and advice could range from production and distribution of leaflets and decision-trees, to more interactive media such as information videos, CD-ROMs or internet applications. It might also include provision of a personalised financial "health-check" – possibly in conjunction with existing and planned New Deal programmes providing careers advice.

5.33 Question for consultation:

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

5.34 In order to answer these, and other questions, the Government proposes to start a consultation process with financial services providers and other interested parties.

5.35 For further information, please contact:

- by e-mail: saving-assets@hm-treasury.gov.uk
- by telephone: 020 7270 4558
- by post: HM Treasury
Saving Incentives Team
Room 23/G
Parliament Street
London SW1P 3AG

Box 5.1: Illustrative Examples of Saving Gateway and Child Trust Fund

The following examples show how the Saving Gateway and Child Trust Funds might work to deliver an asset base to all children, with additional incentives to save for families on lower incomes. The assumptions and figures used in these examples are for illustration purposes only, and do not represent the Government's thinking on how final Saving Gateway or Child Trust Fund schemes would operate. All the examples given below assume a 2.5% real rate of return on funds held in the Saving Gateway, and 5% in real terms in the Child Trust Fund, and that the return on funds is not subject to tax.

The Saving Gateway

The following illustrative assumptions for the Saving Gateway are used in calculating the example:

- **that the Saving Gateway scheme is open to families or individuals earning at or below a set threshold for eligibility;**
- **that the Saving Gateway scheme lasts three years from the time that an individual opens it; and**
- **that the Government matches every pound put into the account, on a 1:1 basis, up to a monthly maximum of £50, the equivalent of an annual maximum of £600 of matched funding.**

Example 1: Anne, who earns less than the threshold for eligibility, opens a Saving Gateway account and saves £25 a month for the full three years of the scheme. When the account matures, the value of Anne's Saving Gateway will be £1,870 in real terms, adjusting for future inflation. This total will be comprised of:

- **£900 of Anne's own regular contributions;**
- **£900 of matching funds contributed by the Government; and**
- **£70 interest (which, for the purposes of this illustration, has been calculated on a monthly basis).**

Child Trust Fund

The following illustrative assumptions for the Child Trust Fund are used in calculating the examples below:

- **that for parents below a threshold income level, the Child Trust Fund pays an endowment of £800;**
- **that the endowment will be staggered over time, with £500 paid at birth, and further tranches of £100 paid at ages five, eleven and sixteen;**
- **that for all other parents, the Child Trust Fund pays a total endowment of £400, similarly staggered into an initial payment of £250 at birth, followed by three payments of £50 at ages five, eleven and sixteen.**

Example 2: Daphne and Eric have a joint household income below the threshold. When their baby, Jane, was born, the Government paid £500 into a Child Trust Fund for Jane. Jane's grandparents also make regular monthly contributions of £5 a month into Jane's Child Trust Fund. By the time she reaches the age of eighteen, Jane will have received further payments of £100 from the Government on each of her fifth, eleventh and sixteenth birthdays. When her Child Trust Fund matures, Jane will have access to assets worth £3,376 in real terms, comprised of:

Box 5.1: Illustrative Examples of Saving Gateway and Child Trust Fund (continued)

- a £800 endowment from the Government;
- £1,080 of regular contributions from her grandparents; and
- £1,496 of interest, calculated monthly.

Example 3: In Example 2 above, when Jane is born, Daphne decides to start saving in a Saving Gateway. Like Anne from example 1, Daphne saves £25 a month, and receives matching support from the Government. At the end of the three-year lifetime of her Saving Gateway account, Daphne has accumulated £2,001 (including matching payments and interest). Daphne decides to put £1,000 of this amount immediately into her daughter Jane's Child Trust Fund. She invests the remainder in a mini cash ISA. When Jane's Child Trust Fund matures, it will have a total value of **£5,455** in real terms, comprised of:

- a £800 endowment from the Government;
- £1,080 of regular contributions from her grandparents;
- a £1,000 lump-sum contribution from Daphne's Saving Gateway; and
- £2,575 of interest, calculated monthly.

Example 4: Bill and Claire – who have an income above the threshold level – give birth to their first child, John, and receive an initial endowment of £250 into John's Child Trust Fund. Bill and Claire make regularly monthly contributions of £10 a month into John's fund, until he is eighteen. John also receives additional payments of £50 from the government on his fifth, eleventh and sixteenth birthdays. When John turns eighteen, the value of his Child Trust Fund will be **£4,288** in real terms, made up of:

- a £400 endowment from the Government
- £2,160 of regular contributions from his parents
- £1,728 of interest, calculated monthly.

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