The Blair government launched the Child Trust Fund (CTF) in 2003. The CTF provides the parents of each baby born in Great Britain from September 2002 with a voucher for £250 (~$450), which they must use to open a savings and investment account in a financial institution on their child’s behalf. Families below the poverty line will receive an additional £250 per child. Each child will receive an additional endowment at age 7 (also increased for low-income families), the amount of which will be determined in future budgets. Additional contributions are strongly encouraged—up to £1,200 (~$2,150) annually will be tax-advantaged. No withdrawals are allowed until the child turns 18, at which time he or she can either withdraw the funds to spend for any purpose or roll them over into a new account. The government expects to send the first vouchers to families in April 2005.¹

CTF accounts are intended not only to help young adults build a tangible stock of assets but also to change the behavior and attitudes of Britons of all ages with regard to saving and investing. The government has outlined four goals for the CTF legislation:²

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

¹ The mission of the Initiative on Financial Security (IFS) is to examine solutions to America’s asset crisis so that more Americans can own homes, finance college, start businesses and prepare for a secure retirement. In collaboration with business leaders, IFS is exploring and recommending financial products that create asset building opportunities for the tens of millions of working Americans who currently lack access to tax-advantaged or employer-subsidized savings vehicles. IFS is supported by the Ford and Charles Stewart Mott Foundations.
Assuming various contribution levels, the government has estimated that the potential value of CTF accounts at maturity will range from £421 to £24,786.³

<table>
<thead>
<tr>
<th>Endowment</th>
<th>£250</th>
<th>£500</th>
</tr>
</thead>
<tbody>
<tr>
<td>Annual Contributions (adjusted for inflation)</td>
<td></td>
<td></td>
</tr>
<tr>
<td>No additional savings</td>
<td>£421</td>
<td>£841</td>
</tr>
<tr>
<td>£60</td>
<td>£1,858</td>
<td>£2,279</td>
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<td>£120</td>
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</tr>
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<td>£480</td>
<td>£11,919</td>
<td>£12,340</td>
</tr>
<tr>
<td>£1200</td>
<td>£24,365</td>
<td>£24,786</td>
</tr>
</tbody>
</table>

Assumptions included in projections:
- Charges of 1.5%
- 2.5% inflation rate
- 4.5% real fund growth (equivalent to around 7% nominal fund growth)

The government plans to add financial education modules to the National Curriculum to reach children and to carry out broad information campaigns to educate the general public.

Upon receiving their vouchers, families must choose a provider and a type of investment account. Financial institutions are not required by law to offer CTF accounts. Those that wish to, including banks, brokers, investment managers and life insurers, must be approved as accepted providers by the Financial Services Authority (the independent industry regulator).

There are two categories of CTF accounts. **Stakeholder accounts** are predominantly equity-based and move progressively to bonds and cash as the account matures in order to decrease risk. Providers are required to offer stakeholder accounts, which will have sales charges capped at 1.5% per year. **Non-stakeholder accounts** are any other accounts and include cash, bonds, and alternative equity investments. The government has officially endorsed stakeholder accounts as preferable for most families because it views the higher market risk of investing in equities as justified by the potentially higher returns and long-term nature of the accounts.

Anyone may make additional contributions of up to £1,200 per year after tax. There is, however, no capital gains tax on income earned by investments over the 18 years and no personal tax is levied on the lump sum upon withdrawal. The government has set £10 as the minimum contribution level that all financial institutions offering CTF accounts must accept.

The government estimates the CTF will cost the Treasury approximately £230 million annually, assuming 700,000 births per year and excluding additional endowments as well as implementation costs.⁴

The British tax agency, Inland Revenue, will choose providers and open stakeholder accounts for families that fail to do so within one year of receiving their voucher, to ensure that all children will have CTF accounts, including those in state care. CTF account holders may transfer their accounts among providers at any time and as many times as desired at no charge.

**DISCUSSION**

Asset building research by American academics and the experience of Individual Development Account (IDA) programs in the U.S. were important sources of inspiration to the intellectual parents of the CTF, the Institute for Public Policy Research (IPPR). The CTF is part of the government’s broader strategy of creating a system that supports increased savings, which comprises improved macroeconomic stability, an efficient and well-regulated financial services market, a tax and benefit system that does not unfairly penalize savers, special assistance to those with lower incomes, and savings products suitable for each life cycle stage.⁵

In 2001, as part of its effort to make the financial services market more efficient and consumer-friendly, the government commissioned a review—known in the U.K. as the Sandler Review—of the medium- and long-term retail savings market. In response to the Sandler Review’s recommendations, investment products are currently being created that are more transparent and risk-controlled than their predecessors, and that have simplified sales processes. CTF stakeholder accounts are part of this family of Sandler products, which will include redesigned medium- and long-term savings accounts for adults.

**KEY CTF DEBATES**

Numerous debates surrounding the policy arose as the CTF bill made its way through Parliament to become law.

1. **There was a fundamental disagreement over whether or not the CTF is the best strategy to improve poor children’s opportunities.** The Liberal Democrats thought that public funds dedicated to asset building policy would have greater impact if spent on expanding the shorter-term child poverty programs the government has already introduced. Specific criticisms included the arguments that poor children cannot benefit from money that is locked away for 18 years and that the small amounts that low-income families are likely to save in CTF accounts will not significantly improve the lives of their children.

2. **Restricting use of the funds** at 18 was considered but rejected on practical and philosophical grounds. Practically, government and financial institutions feared that enforcing restrictions would be time consuming and expensive. Philosophically, it was felt that mandating use would contradict the goal of inculcating financial self-sufficiency and responsibility.
Financial institutions were active participants throughout the CTF legislative process. Key issues of concern were the amount of the cap for service charges, the complexity of the mandated sales process, the required minimum allowable contribution levels, the frequency and content of statements and, more generally, whether the government would decide these issues in time for financial institutions to set up their CTF infrastructure before the first vouchers are issued. A relative victory for the financial services industry was the February 2004 decision that the sales cap for stakeholder accounts will be 1.5%, instead of 1% as currently mandated for stakeholder pensions and potentially for other Sandler products.

In spite of the higher price cap, financial institutions remain concerned that many CTF accounts will be too small to be profitable within a time frame they consider reasonable and dissatisfaction remains with other regulations.

There exist, however, non-financial pressures on institutions to offer CTF accounts. They must consider how their reputation would be affected should they turn away customers walking in the front door with a voucher for their child. Politically, given their vulnerability to government regulation, financial institutions must also take into account their need to maintain a good relationship with the Financial Services Authority.

How many providers will choose to enter the market and whether or not the CTF is a policy that will enable young adults to improve their life chances and financial institutions to profit remains to be seen. What is clear is that the CTF binds the fates of the government and the financial services industry together: each will lose prestige and money if CTF accounts are not successful.

4. The government was asked to allow the creation of accounts for children born before the cut-off date that would enjoy the same tax advantages of the CTF, without the government endowments, in order to limit the extent to which the CTF forces parents to differentiate between children born before and after September 2002. The government has declined to do so for the time being, relying on financial institutions to bridge the gap and committing itself simply to monitoring whether or not evidence of an “unmet demand in the marketplace” arises.

5. Allowing early withdrawals for disabled children who need access to the money before age 18 for medical expenses was suggested. At present, however, the only sanctioned early withdrawals are in the case of a child’s death.

6. Several points were made related to the CTF’s use of means testing (determining eligibility for state benefits through asset and income levels). The Conservative Party objects to means testing in principle and argued that all government endowments should be the same amount. The Conservatives also pointed out that the existence of maximum asset limits for receipt of state benefits creates a disincentive for people to save amounts that would make them ineligible for assistance. The government’s response to this possible clash of policy goals was to raise the asset threshold for some benefits from £3,000 to £6,000 and pledge to keep the matter under review. Finally, poverty advocates feared that giving larger endowments to low-income families would automatically mark them as less desirable clients to financial institutions, which might then devote fewer resources to such families due to the difficulty of recouping the costs of small accounts.

3. CTF accounts were always intended to be held entirely in the private sector. What was considered, however, was authorizing a restricted pool of providers. Although it was thought this might simplify the process of choosing a provider, especially for families not used to dealing with financial institutions, restricting providers was deemed cumbersome and anti-competitive; the provider market will therefore remain open to all interested financial institutions.

“Imagine embarking on life at 18 without skills, with a poor education, with little confidence, no work experience and no financial backing from your family. Those are circumstances in which unfortunately thousands of children do start their lives.... Money put aside changes your horizons. It makes you plan, brings responsibility, offers protection and opportunity. And I want to ensure that those on lower incomes - and the next generation - can share those advantages.”

- Prime Minister Tony Blair

THE FINANCIAL SERVICES SECTOR

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A CHILD ACCOUNT POLICY FOR THE U.S.

Were a policy similar to the CTF to be implemented in the U.S., advocates, policy makers and financial leaders might consider the following issues.

MATCHING FUNDS AS INCENTIVE TO SAVE

The benefits of the CTF are considerably improved if additional contributions are made over their 18-year life and the accounts grow into meaningful nest eggs. A drawback to the CTF is that its incentives to save do not expand on existing tax-based incentives to the full extent possible. This is particularly true for families that do not have a sufficient tax liability to benefit from tax deductions. Studies of IDAs in the U.S. have shown that low-income families will save given appropriate structures and incentives. While the CTF represents a significant advancement in savings structures, government provided matching funds through direct payment or refundable tax credits would be an even more effective incentive to encourage families in lower income brackets to save.

RESTRICTED USE OF FUNDS

The CTF may well succeed in increasing overall individual savings; how well it fares as asset building policy is less clear given the free use of funds at age 18. An American policy should be explicitly designed to stimulate asset acquisition, limiting the use of funds to investment in higher education, a small business, a down payment on a house, or a retirement account. In addition to stimulating asset acquisition, such restrictions would also be consistent with existing U.S. asset building and long-term saving policies.

HYBRID MARKET

A hybrid system in which accounts are offered by a government sponsored entity and by private financial institutions would maximize consumer protection and the quality of product offerings. Access to a government sponsored account would give families the choice of a basic account with low costs and good service. Private sector participation in the market would be equally important. The financial institutions' product design expertise and marketing creativity would raise the account's visibility, thereby stimulating greater participation and higher account balances. An additional benefit of the hybrid system is that the existence of quality low-cost government accounts would stimulate competition among private sector providers.

Universal child accounts are a bold and imaginative idea to motivate more people to save and to give more children a real stake in their future. In addition to widening the scope of opportunity, the accounts' universality serves as a unifying force by appealing to values across the political spectrum.

SUPPLEMENTARY READING


The New America Foundation is at http://www.newamerica.net and has created AssetBuilding.org, a clearinghouse of information and resources related to asset building.


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