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THE U.K. CHILD TRUST FUND: EARLY RESULTS*

The Initiative on Financial Security (IFS) at the Aspen Institute
and
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In recent years, the personal savings rate in the United States has fallen sharply. Compared to the past experience in the U.S. and other industrialized countries, it is now at an historically-low level. This decline raises concerns about the ability of Americans to finance their long-term needs such as educating their children, buying a home, or enjoying a secure retirement, as well as the long-term economic prosperity of the United States.

One promising initiative for increasing personal savings is now underway in the United Kingdom. Since its beginning in 2005, the U.K. has given every child born on or after September 1, 2002, a Child Trust Fund (CTF). A mechanism for building the savings capacities of families, CTFs give all children a financial asset to fund their transition to adult life.

As well as encouraging saving, the perceived benefit of the policy in the UK goes beyond enabling people to accumulate resources to fund future consumption for particular purposes (e.g., higher education or income in retirement). By helping individuals to build assets, the CTF will empower and enable them to develop their capacities so that they can be more self-sufficient and participate fully as citizens in a society in which they have a stake.

IFS and other policy advocates have proposed a child savings account policy for the U.S., following the lead of the U.K. The IFS proposal replicates the U.K. model but with the additional feature of government matching contributions for children from low-income families. Matching contributions

are designed to encourage more private saving on behalf of children most in need of a financial asset at age 18.¹ Lessons from the U.K.'s experience with CTFs will help inform not only the U.K. policy but initiatives in the U.S. as well.

How Child Trust Funds Work

A CTF is an investment account with a small, initial endowment from the government of £250 (about \$500) with an additional £250 for low-income children.² The cost of CTFs is about £240 million (about \$500 million) for the U.K.'s 760,000 newborns each year, and there are now over 3 million CTFs in operation. The U.K. will provide an additional contribution at age 7 and convert CTFs to adult savings accounts when they mature in 18 years.³

Families open a CTF with the financial provider of their choice by depositing the initial endowment. Some 75% of families redeem their government vouchers, a take-up rate that compares favorably with savings rates in 401(k) plans in the United States and membership in occupational pension schemes in the U.K. The government assigns unredeemed vouchers to a private provider so that every child will have a CTF.⁴

Accounts are tax-free and grow through additional contributions by family and friends, which can be up to £1,200 (about \$2,500) every year. Account funds are locked-up until children reach age 18, at which point they may choose how to spend their accumulated savings. The U.K. has allocated £11.5 million (\$23 million) to fund an active financial education campaign to teach children how to use their CTFs

*This paper is an abbreviated version of a report (forthcoming) by ippr and IFS on the U.K. Child Trust Fund.

responsibly, including an inter-disciplinary “Money Week” in schools to coincide with the second government contribution when the child turns 7 years old.

Although CTFs are initially funded through a government-issued voucher, the accounts themselves are available only through financial services companies. Through private sector delivery, the U.K. hopes to use CTFs to leverage its personal savings rate by connecting all families to the financial system and exposing them to equity investing. With the right safeguards in place, a competitive private sector model of delivery is viewed as capable of providing consumer choice and driving continuous improvement and innovation, while at the same time avoiding the stigma that the policy is merely another form of welfare.

Saving through the Private Sector

Companies seeking to offer CTFs must first be approved by the government. In addition, government regulations define the type of approved investments available through a CTF. A CTF can be a cash savings account or an investment account. Investment accounts come in two forms -- the “stakeholder account” and “non-stakeholder account” -- both of which provide exposure to equity investing. Providers **must** offer the stakeholder account, which is invested in a lifecycle fund featuring equities over the first 13 years and gradually moving to lower-risk investments as the child approaches age 18. Stakeholder accounts also contain a 1.5% annual cap on fees. A non-stakeholder account may be invested as the parents choose and is not subject to a fee limit. Current statistics indicate that the stakeholder account is popular. Over 75% of all CTFs are stakeholder accounts, while 19% are cash savings accounts and 5% are in non-stakeholder accounts holding a mixture of cash and non-cash assets.⁵

In addition to investment management, providers of CTFs perform such services as marketing, record keeping, redeeming vouchers, facilitating private contributions, and providing annual statements. The financial services industry has created a variety of arrangements for offering and servicing CTFs.⁶ There are currently 46 approved providers, over two-thirds of which are building societies, friendly societies, credit unions, and other financial institutions.⁷

CTFs are widely available in the U.K. because, in addition to approved providers, there is a large network of other companies that market them to parents, giving families wide access and choice of providers. There are currently 76 approved distributors, the majority of which have a direct relationship with an approved provider. Some retail banks and other depository institutions offer a CTF product to serve any new parents who may walk into the bank with a voucher, but the accounts are actually managed by another company as a provider. This arrangement allows these companies to retain existing customers and build new cross-selling relationships at a very low cost. Parents can also obtain account applications through non-financial companies such as Boots, a pharmacy and beauty supply company.

Mutual financial institutions make up over a third of CTF distributors. Mutuals have traditionally been major providers of children’s savings products in the U.K., so it is not surprising that they have dominated the CTF market. They also tend to have longer-term profit horizons, which are more in line with the longer-term returns from CTFs. However, banks, given their extensive branch networks, also have an important role in the CTF market, particularly as distributors. Other organizations involved in the delivery of CTFs include brokerage firms, independent financial advisors, and supermarkets.

Early Results about Savings Behavior

The long-term success of CTFs depends on their ability to attract additional contributions from family and friends. While the oldest children with CTFs have now reached the age of five, it is important to note that because the policy was introduced in 2005, the experience to date only reflects the impact on savings behavior over a period of two and a half years.

Qualitative research conducted in 2006 suggests that parents recognize the importance of making additional contributions to ensure their children a substantial asset at age 18. For many parents, the initial government endowment provided an impetus to think about saving for their own futures. It also led some to ask family and friends to contribute to a child’s CTF rather than buy presents for christenings, birthdays and holidays. The

fact that account funds are not available until age 18 was particularly important, as some parents believed that friends and family would be more likely to make contributions if they knew that the parents could not access the funds.⁸

Newly-issued government data indicate that almost one-quarter of CTFs have received additional private contributions.⁹ In the aggregate, 32% of stakeholder CTFs (579,000) opened by parents, 23% of cash CTFs (103,000), and 48% of non-stakeholder CTFs (31,000) have received additional contributions. Of these accounts, about one-third received contributions of less than £100 (about \$200) while over 40% received contributions between £100 and £300 (about \$200-\$600).¹⁰

Over and above the amounts already contributed, it is important to note the high proportion of accounts receiving regular direct debit payments, which indicate a level of commitment to continuing contributions, potentially over an account’s lifetime. Industry statistics provide additional support for the government findings and also show that most saving is by regular monthly payments.¹¹ Data on over 62% of all CTF accounts indicate that, in June 2007, about 23% of accounts received monthly contributions by an active direct debit. The same figures also show that the average monthly contribution was £21.20 (about \$40). Over a year, saving at this average rate would result in an additional £254 (about \$500) being contributed to the CTF. Nearly 7% of accounts had received some other form of contribution, such as a lump sum, since being opened, and the average amount of lump sum deposits was £404 (over \$800).

As might be expected, more CTFs for children in higher-income families receive private contributions, but the contribution rate among lower-income families is encouraging.¹² Among lower-income children, 15% of CTFs overall received additional private contributions as compared to 28% of all other children.

These results are similar to those found in a May 2006 survey of five of the largest providers (with around 40 percent of the market).¹³ In this survey, 33% of CTFs held by children from higher-income families were

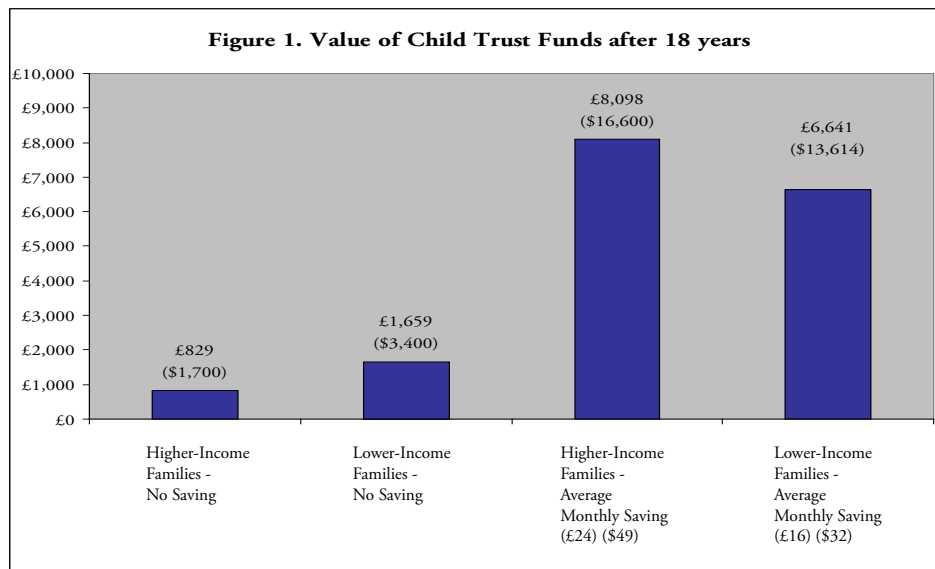
attracting regular monthly savings, compared to 19% of lower-income parents. The average monthly contribution made by higher-income families was £24 (equivalent to £288 or almost \$600 a year). Encouragingly, the average £16 contributed by lower-income families (£192 or about \$400 a year) was not far behind. Higher-income families did contribute more lump sum contributions. About 10% of higher-income families paid a lump sum into their child's CTF in the last year, at an average amount of £334 (about \$680) as compared to 6% of lower-income families, at an average amount of £286 (about \$590).

Although the amounts saved by lower-income families are likely to be smaller, a recent survey suggests that lower-income families are contributing a higher proportion of their incomes. Recent data from a major provider reveal that lower-income families are saving 1.1% of their net monthly salary in their child's CTF, while higher-income families are only saving 0.6%. The survey also found that both groups have increased the amount that they are saving into their children's CTFs since April 2005 by between 8% and 9%.¹⁴

Additional private contributions are critical to the growth in value of a CTF. Using data from the May 2006 survey, ippr projects what account balances might look like after 18 years, broken down by income levels and savings patterns. Figure 1 shows the value of a CTF at age 18 under four different scenarios: a higher-income account with no extra deposits; a lower-income account with no extra deposits; a higher-income account with an average monthly direct debit of £24 (about \$49); and a lower-income account with an average monthly direct debit of £16 (about \$32). If a higher-income family saved the maximum of £1,200 (about \$2,460) each year, a CTF would be worth £31,300 (about \$64,000) at current prices at age 18.¹⁵

Child Accounts in the U.S.

Although the U.K. was the first country to implement a universal child account policy, contemporary thinking about savings accounts for children originated in the U.S. in the late 1980s. More recently, U.S. policy discussions are focusing on historically low national and personal savings rates, as well as soaring college tuition rates, racial/ethnic



disparities in homeownership rates, and a generation of baby boomers that is, on the whole, unprepared for retirement. And while a number of short-term solutions have been proposed, none are as bold or as transformative in the long run as the Child Trust Fund.

The IFS child account proposal builds on the success of the U.K.'s strong precedent. It is grounded in the fundamental concept that we must invest today in the financial security of future generations -- and the best investment is one that facilitates engagement with the private sector and hands-on financial education. A universal policy paves the way for a fundamental shift in Americans' savings habits, and it gives *all* children *and* their families a chance to become part of the financial mainstream. In addition, a policy of government matching contributions gives an extra incentive to parents struggling to secure their children's financial futures -- an incentive that will ultimately help their children accumulate a meaningful amount of funds over 18 years.

With the U.K. as the first country to enact a universal child account policy, there are several lessons for the U.S. as it considers its own initiative:

Increasing Participation

The CTF policy to date has shown broad parental involvement and interest with some 75% taking the initiative to open CTFs on behalf of their children. This take-up rate for CTFs compares favorably with other savings

products. The government opens CTFs for those children whose parents do not open an account within one year of receiving a voucher. Savings rates in these accounts are much lower, with only 1% receiving additional contributions.¹⁶ This highlights the importance of encouraging even more parents to engage actively with the policy.¹⁷

Increasing awareness and involvement among all parents is a major challenge for any child savings accounts policy. Even though the U.K. CTF model is simple, there is some evidence that the variety of accounts and number of providers available may be undermining participation. In a recent focus group study, parents reported feeling overwhelmed by the choice of providers and the amount of time it takes to assess the different providers properly, particularly given the time constraints experienced by parents with a newborn.¹⁸ For many, the range of choices and the amount of information provided to them made it difficult to make a decision about which account to choose. Reaching these families may require providing a simpler account design and distribution channel.

Matching Contributions

Matching contributions have been shown to be an important incentive that increases private saving. Such contributions are a popular feature in employer retirement plans in the U.S., and IFS has proposed matching contributions for low-income children in its model of child accounts. Advocates in the U.K. have explored the potential for matching contributions by lower-income

families in CTFs. Their effect on stimulating private saving and changing savings behavior over the long-term could be powerful.

Financial Literacy

Finally, a continuing challenge is to educate children about how to spend their funds wisely. The U.K. has taken the lead on including financial literacy education as an integral component of the CTF program. Preparations for delivering financial education when children reach age 7 are well under way, and financial education will receive a more secure place on the educational agenda. In addition, CTF providers are already developing their own financial literacy materials. Ensuring that the potential financial literacy gains from the Child Trust Fund program are realized, not just by children but by their families as well, will require continued creativity and innovation by the government, community-based organizations, and financial institutions.

Because the IFS model of child accounts adopts the unrestricted nature of CTFs -- a highly controversial feature in the U.S -- the U.S. will be looking to the U.K. for lessons learned about effective methods for teaching financial literacy through the "hands on" experience gained with CTFs.

The Way Forward

Passing and implementing a universal child savings accounts policy in the U.S. will not be easy. It will require collaboration across sectors and a firm commitment from government to invest in the financial security of future generations. The U.K. has demonstrated the potential of child savings accounts, funded with a modest government contribution and delivered through the private sector, to change savings behavior and enable all children to build an asset to support their transition to adulthood. By importing a successful model from the U.K. and adapting it to American practice, Aspen IFS has laid the groundwork for a policy that will truly change the way Americans think about saving. Child savings accounts are not only an investment in our children; they promise a better economic future for the country as a whole.

Endnotes

1 More information about the IFS proposal can be found in its seminal publication, "Savings for Life," and descriptions of other proposals can be found in its recent brief, "The Case for

Child Accounts." Both publications are available through the "publications" link at: www.aspeninstitute.org/ifs.

2 The pound is currently worth about \$2.05. Except as otherwise stated, the statistics cited in this report are from Statistical Report 2007, issued by HM Revenue & Customs on October 24, 2007, and available at: www.hmrc.gov.uk/ctf/stats.htm. This report provides statistics on CTFs for children born on or before 4/5/2006 for whom an account was opened by 4/5/2007. About 29% of CTFs receive the additional payment for lower-income children. Lower-income is defined as families earning less than £14,000 or about \$29,000.

3 An additional government contribution at age 11 or 12 is under consideration.

4 Unredeemed vouchers are assigned in rotation to the 14 providers who have agreed to accept them.

5 CTFs opened by the government for children with unredeemed vouchers are invested in the stakeholder account. Newly-released data from a distributional analysis of CTFs indicate that accounts opened by the government comprise 29% of stakeholder CTFs. These data are available at: www.hmrc.gov.uk/stats/child_trust_funds/ctf-table-1.pdf.

6 Data on available providers and distributors of CTFs can be found at: http://www.childtrustfund.gov.uk/templates/Page_____1243.aspx.

7 Building societies principally offer savings accounts and mortgages while friendly societies offer savings, investments, pensions and annuities. Building and friendly societies as well as other mutual financial institutions are owned by their customers unlike, for example, banks and insurance companies, which are owned by shareholders.

8 Rajiv Prabhakar, "Attitudes towards the Child Trust Fund: What do parents think?," Working Paper 06-10, St. Louis: Center for Social Development, Washington University in St. Louis, 2006.

9 Data cover CTFs opened through April 5, 2007 for children born in or before June 2005.

10 Data can be found at www.hmrc.gov.uk/stats/child_trust_funds/ctf-table-2.pdf.

11 Data are provided by the Tax Incentivised Savings Association (TISA), the main trade body representing CTF providers and are available at: www.tisa.uk.com/docs/force.php?application=application/pdf&fileName=20070615C.pdf&cdl=open.

12 "Lower-income" families in these data mean families whose children received the additional government contribution to their CTFs. Data cited in this paragraph can be found at www.hmrc.gov.uk/stats/child_trust_funds/ctf-table-2.1.pdf and www.hmrc.gov.uk/stats/child_trust_funds/ctf-table-2.2.pdf.

13 Data come from S. Sodha, "Lessons from Across the Atlantic: Asset-Building in the U.K.," paper presented at the 2006 Assets Learning Conference, Assets for Arizona Institute (2006).

14 Data are provided by Engage Mutual Assurance in a press release titled "Wealth Divide Closing for Children's Saving," (2007), available at <http://www.engagemutual.com/MediaCentre/PressReleases/100907.asp>.

15 This assumes real growth of 3.5 per cent per year after inflation and management charges, and government deposits of £250 at birth and age 7.

16 www.hmrc.gov.uk/stats/child_trust_funds/ctf-table-2.pdf.

17 The U.K. actively promotes CTFs to parents and spent over \$10 million in 2005-2006 and \$6 million so far in 2006-2007 to advertise CTFs.

18 See Footnote 8 above.



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