Detailed proposals for the Child Trust Fund

HM TREASURY

Inland Revenue

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Introduction and Summary

INTRODUCTION

1.1 The Government is committed to an active welfare strategy that is founded on the principles of security, opportunity and responsibility. This framework underpins the proposals for the Child Trust Fund (CTF):

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

1.2 The Child Trust Fund has been developed during a long period of formal and informal consultation with potential providers, trade bodies, consumer organisations and other interested parties.

1.3 The Government first consulted on the CTF in *"Saving and Assets for All"*, published in April 2001 which sought agreement on the broad principles behind the CTF. Then in *"Delivering Saving and Assets"*, published in November 2001, the Government set out more specific proposals for delivering the CTF. That paper also discussed the importance of financial information and education to accompany the accounts. The Government has subsequently been working with interested parties to develop the details of the CTF.

1.4 This publication details how Child Trust Fund accounts will work including:

- the qualifying conditions;
- the particular features of CTF accounts;
- what parents and providers will need to do in operating accounts; and
- the role of financial information, education and consumer protection.

1.5 The CTF is a vital element in the Government savings strategy which aims to ensure that a range of savings products is available to suit people at all stages in their lives.

1.6 The Government believes that the Child Trust Fund will:

- help people understand the benefits of saving and investing;
- encourage parents and children to develop the savings habit and engage with financial institutions;
- ensure that in future 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.

SUMMARY

Qualifying for a CTF account

1.7 Entitlement to a CTF account will automatically be linked to entitlement to child benefit, which reaches virtually all children living in the UK. There will be no need to make a separate claim for the CTF – the notice of the child benefit award will automatically trigger the issue of the CTF voucher.

1.8 Although children born from 1 September 2002 are eligible for CTF accounts, the accounts themselves will not be available until April 2005. This means that for these children there will be less time for their CTF to grow in value before maturity. The CTF vouchers issued to children before the operational date in 2005 will have a higher value than the standard voucher to recognise this fact. The additional amounts will be set out in regulations.

1.9 The Government is putting in place special arrangements to ensure CTF accounts will be opened for children looked after by local authorities or under equivalent arrangements in Scotland, who do not qualify for child benefit.

1.10 All children in the UK will receive £250 from the CTF. But the CTF will be progressive and children in families receiving Child Tax Credit (CTC) and with a household income below the CTC threshold (currently £13,230) will receive an additional £250. This will be added to the CTF account once the CTC award for that year is confirmed. Around a third of children will receive this additional contribution.

1.11 The Government will make a further payment into the CTF account on the child's seventh birthday. As well as helping the accounts to grow, these age-related payments will be a useful reminder of the CTF account. The Government believes this will also trigger additional saving by family and friends. As with the initial endowments the payment will be progressive – a flat rate payment to all children and an additional payment to children in families on lower incomes. Amounts will be determined nearer the time. This structure provides the foundation on which the Government will build in future.

Choosing and opening a CTF account

1.12 CTF accounts will be available in 2005 from a wide range of providers, including banks, brokers, building societies, friendly societies, investment managers and life insurers. The Government wants to ensure the development of a competitive CTF market that provides simple, good value and accessible CTF accounts with adequate incentives to save.

1.13 The CTF will ensure that in future all children have a financial asset at age 18 to invest in their futures. For instance, an additional saving of £15 each month on top of the initial endowment of £250 could be worth over £5,000 (in real terms) by the time the child is 18.

1.14 All providers will be required to offer the stakeholder CTF account. This account will include investments in equities (shares in companies) given the generally higher returns on equities over the long term. The account will control the level of risk (but not completely eliminate it) particularly as the account reaches maturity.

1.15 Additional types of account can also be offered (such as cash deposit accounts, bonds, alternative equity investments) to ensure choice and to cater for different risk preferences and religious or ethical beliefs.

1.16 The Government will set out later this year the level of charge cap to be applied to CTF accounts. All income and gains from the account will be exempt from personal tax – as for ISAs.

Managing and closing an account

1.17 The Government will issue a comprehensive information pack to help parents to choose a provider and decide what type of investment would suit their circumstances best.

1.18 Some parents and guardians might not open a CTF account. To ensure these children are not disadvantaged, the Inland Revenue will open an account for them where:

- a CTF voucher has not been used to open an account within 12 months of issue; or
- a child has gone into care before a CTF voucher is issued; or
- there is no-one with parental responsibility for the child.

These accounts will always be stakeholder CTF accounts. Parents will be able to move the account to another provider, or other type of account at any point.

1.19 CTF accounts will be owned by the child and be in the child's name. Annual statements will be sent to the child throughout the 18 years the CTF account is open.

1.20 After the child's 18th birthday the account will cease to be a CTF account. The Government's intention is that when the CTF account matures, the funds can (if the account holder wishes) be rolled over into tax-effective savings schemes available at the time.

Strengthening the saving habit

1.21 Financial education helps children to understand the benefits of saving. Through linking with the school curriculum, the CTF will build on this foundation by allowing all children to interact with their own savings or investment vehicle, seeing at first hand how investments can grow over time.

1.22 The design of the CTF, including an additional Government contribution to the account at the age of seven, annual statements issued by providers to all children, teaching and learning resources for use in the classroom and a dedicated website, will help children engage with their account and make the best use of the assets at account maturity.

1.23 The Government wants parents to actively engage with the CTF but recognises that for many parents this may be their first investment product. The Government will provide resources to ensure parents are helped to make choices about their child's CTF, including an information pack to be issued alongside the CTF voucher, and will work with the Financial Services Authority (FSA) to ensure their consumer information activity includes the CTF.

1.24 Consumer protection will be delivered through the Inland Revenue complaints procedures, the FSA (regulator of financial services), the Financial Ombudsman Service (dealing with complaints about firms and investment advice by financial advisers) and the Financial Services Compensation Scheme (providing a safety net when FSA authorised firms go out of business).

1.25 The introduction of Child Trust Fund accounts will require primary and secondary legislation. The Government intends to introduce a Bill at the earliest opportunity subject to the availability of parliamentary time.

1.26 The consultations and ongoing discussions with interested groups have proved invaluable in developing the detailed plans which the Government hopes represent a simple and workable regime for all concerned. The Government will continue its engagement with these groups to ensure the successful delivery of the Child Trust Fund.

1.27 If you would like to comment on any of the proposals set out in this publication please contact Ann Marsh.

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Box 1.1: Key features of the CTF

- **Savings or investment account set up with initial Government endowment**
- **Available from April 2005 to children born from 1 September 2002**
- **Based on entitlement to child benefit – no separate claims process**
- **Endowment of £250 for all with additional £250 for children in families on Child Tax Credit (CTC) and income below the CTC threshold (currently £13,230)**
- **Further payments to be made by Government at age 7**
- **Parents, families, friends and the child themselves will be able to contribute up to £1,200 a year between them**
- **Funds not accessible until age 18**
- **Accounts to be offered by financial service providers approved by the Inland Revenue (ISA model)**
- **All providers must offer an equity-based stakeholder CTF account which will have controls on risk**
- **Additional types of account can be offered, such as cash accounts**
- **Where CTF account not opened within 12 months of issue of voucher the Inland Revenue will open a stakeholder CTF account for the child**
- **Accounts can be moved between providers at any time**
- **The Government will set out later this year the level of charge cap to be applied to CTF accounts**
- **Providers will report details of accounts opened to the Inland Revenue**
- **Providers will issue annual statements to children with CTF accounts**
- **All income and gains exempt from personal tax – as for ISAs**

2 Qualifying for a CTF Account

ENTITLEMENT THROUGH CHILD BENEFIT

2.1 The simplest way to make sure every child in the UK has the chance to have a CTF account is to link the account to the award of child benefit.

2.2 Linking entitlement to the child benefit award has a number of advantages:

- new parents are familiar with child benefit;
- child benefit reaches virtually all children in the UK; and
- there will not need to be a separate claim for a CTF account.

2.3 Where a person is entitled to child benefit for a child, and that child was born on or after 1 September 2002 and lives in the UK then the child will be eligible for a CTF account. There will be no need to make a special separate claim for the CTF – the notice of the child benefit award will automatically trigger the issue of the CTF voucher.

2.4 The parent or guardian can only use the voucher to open an account with one of a range of providers. Information and guidance will be available to help them make the right investment choice (see Chapter 3). The Government will pay an initial endowment of £250 into every child's CTF account soon after it is opened.

Children looked after by local authorities

2.5 There are some cases where child benefit cannot be claimed for children although they would otherwise be eligible, such as children who are looked after by Local Authorities or under equivalent arrangements in Scotland (commonly known as children in care). The Green Paper *Every Child Matters* shows the Government's commitment to providing children in care with the same start in life any parent would give their child – giving them the best possible chance of a brighter future. Children in care are one of the most vulnerable groups in society, with some of them spending a long time being cared for outside of their families. They often miss the opportunities parents strive to give their children and the Government has a responsibility to help these children as a good parent would. The Government proposes to make special arrangements for the CTF to ensure that these children are not disadvantaged.

2.6 If a child benefit award is made for a child before they go into care then they will be eligible for a CTF account in the usual way. But where a child goes into care either soon after birth or soon after arriving in the UK, and would otherwise be the subject of a child benefit claim, the CTF legislation will allow the Inland Revenue to open a stakeholder CTF account (explained in chapter 3) on their behalf.

2.7 The Inland Revenue is working with the Department for Education and Skills and the devolved bodies to set up appropriate arrangements for ensuring looked after children have a CTF account.

Adopted and foster children

2.8 Adoptive parents are entitled to claim child benefit and will therefore receive the CTF voucher to open an account on behalf of the child.

2.9 Where a child is looked after in a fostering, residential or other placement where it is not possible to claim child benefit the arrangements for children in care will apply. Under informal foster arrangements the person with whom the child is living is entitled to claim child benefit and the child will thus be eligible for a CTF account.

Children of Crown Servants

2.10 Children of Crown Servants posted overseas, such as members of the armed forces and civil servants, are eligible for child benefit by virtue of the child benefit legislation. This means that these children will be eligible for CTF accounts.

Children living in the UK with parents working elsewhere

2.11 Some people who are entitled to child benefit under UK law do not receive their child benefit payments from the UK because of EU regulations. For example, if a family lives in Northern Ireland but one parent works in the Irish Republic, child benefit will be paid by the Irish Republic.

2.12 Children in these families will be entitled to CTF accounts. When their parents make a claim for child benefit a CTF voucher will be issued even though child benefit itself will be paid by another country.

New arrivals to the UK

2.13 While the vast majority of awards of child benefit are made close to the child's birth some first awards of child benefit will be made much later. One instance of this will be when families return to the UK or move here from overseas. In these circumstances the child will only become eligible for a CTF account once an award of child benefit is made. The rate of endowment paid will be the rate for the year in which child benefit is awarded following the move to the UK.

Children not living in the UK

2.14 In some circumstances child benefit may be payable for children who are not living in the UK, for instance children of EU nationals working in the UK whose child still lives in the country of origin. These children will not be eligible for a CTF account as long as they remain outside the UK. If these children move to live in the UK, they will then become eligible in the usual way.

No claim to child benefit

2.15 In the exceptional cases where a parent or guardian chooses not to claim child benefit the child will not be eligible for a CTF account. This will be made clear in the publicity leading up to the introduction of the CTF.

Children leaving the UK

2.16 Where a child leaves the UK at some point after a CTF account has been opened for them, no action will be taken to close the account. No further Government payments will be made into the CTF account if the child is not living in the UK at the relevant time such as the seventh birthday. However, any income or gains on investments made in the account before the child left the UK will continue to be exempt from UK tax in the usual way. If children return to live in the UK any subsequent Government endowments will be paid into the account if a child benefit award is in place for that child.

ADDITIONAL ENDOWMENT

2.17 The Government recognises that it can be particularly difficult for people on lower incomes to save given other financial commitments. That is why there will be an additional endowment for children in low income families to help give their CTF accounts a good start. In addition to the £250 received by all children eligible for a CTF account, a second endowment of £250 will be paid to these children. This ensures that the CTF is both a universal and progressive policy – helping to extend opportunity to all while targeting support at those most in need.

2.18 Children will be eligible for this additional endowment if they are part of a household receiving Child Tax Credit (CTC), with a household income below the CTC threshold (currently £13,230), when they are first eligible for a CTF account. It is important that families take up their CTC entitlement as it is the automatic passport for eligibility to the higher rate endowment.

2.19 As with the initial endowment families will not be required to claim the additional endowment. The Inland Revenue will pay additional endowments automatically into the accounts of eligible children. The Inland Revenue will write to the child benefit claimant telling them about this payment.

2.20 A CTC award can only be finalised after the end of the relevant tax year when the parent(s) can provide evidence of their income in that year. The additional endowment will be paid once the CTC award has been finalised. For most households the position will be finalised in the months immediately following the end of the tax year but for some this could be up to 18 months after the child first becomes eligible for a CTF account; for example because the parents are self employed and it takes longer for them to confirm their income in a particular tax year.

2.21 We expect that around a third of children will receive this additional endowment.

Children looked after by local authorities

2.22 Children who enter the care system soon after birth before child benefit has been awarded and the CTF voucher has been issued will not be able to qualify in the usual way for the additional endowment. The Government will ensure that children who are in care are not disadvantaged in this respect.

AGE-RELATED PAYMENTS

2.23 As well as the initial and additional endowments, the Government will make a further payment into children's CTF accounts for their seventh birthday. As with the initial endowments the payments will be progressive – a flat rate payment to all children and an additional payment to children in families on lower incomes.

2.24 The first payments will be due in 2009; amounts will be determined nearer the time.

2.25 As well as helping the accounts to grow, these age-related payments will remind children, and their parents, of the CTF account and encourage additional saving by family and friends. This structure provides the foundation on which the Government will build in future.

2.26 Eligibility for age-related payments will be similar to that for the initial endowment and will be based on the child living in the UK and being the subject of a child benefit award at that birthday.

2.27 Any child who meets these conditions will receive an age-related payment. There will be no need for a child's parent or guardian to make a claim as the relevant details about the child will be in the records maintained by the Child Benefit Office. A second payment will be made into the accounts of children in families on lower incomes in the same way as the initial additional endowments are paid.

Children looked after by local authorities

2.28 The Inland Revenue will make special arrangements with local authorities to ensure that looked after children do not miss out on age-related payments.

CHILDREN BORN BETWEEN SEPTEMBER 2002 AND THE LAUNCH

2.29 Although accounts will not be available until 2005, children born from 1 September 2002 will be eligible for CTF accounts in line with the announcement in Budget 2003.

2.30 As with all other children, there is no need for families in this group to make a special claim for a CTF account – vouchers will be issued automatically to eligible children.

2.31 However, Child Tax Credit was not available before 6 April 2003 so it cannot be used to identify entitlement to the additional endowment (which will be based on households having finalised awards of CTC when the child first falls within the ordinary eligibility rules for CTF) for children born in the period from 1 September 2002 to 5 April 2003.

2.32 The Government will make sure these children do not miss out in two ways. Firstly a child born between 1 September 2002 and 6 April 2003 living in a household with a finalised award to CTC and below the £13,230 income threshold in 2003-2004 will be entitled to the additional endowment. Secondly the Government will use information held about other benefits in payment at the time the child first falls within the CTF eligibility rules (Working Families Tax Credit, Disabled Person's Tax Credit, Income Support and Job Seekers Allowance) to establish the family's eligibility.

2.33 Although children born from 1 September 2002 are eligible for CTF accounts, the accounts themselves will not be available until April 2005. This means that for these children there will be less time for their CTF account to grow in value before maturity. The CTF vouchers issued to children born before the operational date in 2005 will have a higher value than the standard voucher to recognise this fact. The additional amounts will be set out in regulations.

2.34 Nearer the time the Inland Revenue will be contacting parents of children born between September 2002 and April 2005 to remind them of the CTF and to let them know when to expect further information. This will be followed up with vouchers and information packs between January and March 2005.

3 Choosing and opening a CTF Account

3.1 On opening a CTF account, families will be required to make two decisions:

- which provider to invest with; and
- which product to invest in.

This chapter sets out details of the choice of providers and the type of products that will be available.

PROVISION OF CTF ACCOUNTS

3.2 The CTF market will operate in a similar way to the market for Individual Savings Accounts (ISAs). Any firm with the relevant FSA authorisation will be able to enter the market by application to the Board of the Inland Revenue, subject to meeting the requirements of the CTF regulations. CTF providers will be audited by the Inland Revenue on a regular basis to ensure that they have maintained their FSA authorisation, and that they are correctly operating CTF procedures. The Government expects a wide range of providers – including banks, brokers, building societies, friendly societies, investment managers and life insurers – to offer CTF accounts. The CTF is also likely to be offered via a range of distribution channels, such as providers' local branches, direct marketing, the internet and sales by 'retailers' of different descriptions. The CTF information pack will include a list of firms offering the CTF.

Transfers between providers

3.3 It will be possible to transfer a CTF account to another CTF provider at any time and there will be no restriction on the number of transfers that can be made. People can transfer if they feel the returns that they have been receiving over time are poor and believe that other providers may offer better returns.

OPENING A CTF ACCOUNT

3.4 The Government wants to make opening a CTF account as simple as possible, which is why the claim for child benefit will be the trigger for the issue of a CTF voucher. Almost all eligible parents claim child benefit very shortly after having a baby and CTF will be able to build on the quick take-up of this system.

3.5 Before the CTF is launched in 2005 we will ensure that everyone eligible to open a CTF account is aware that there is no need to make a separate claim to open one, but that it will be essential to claim child benefit for children to have a CTF account.

The process

3.6 The CTF voucher will be issued to the child benefit claimant automatically by the Inland Revenue around the same time as the notice confirming the award of child benefit. There will be a covering letter with the voucher explaining that:

- the voucher can only be used to open a CTF account for the child named on the voucher;
- the child will not be able to access the money until 18;
- the sooner an account is opened, the sooner the child's fund can start growing;

- the account must be opened by a person who has "parental responsibility" for the child (usually any parent or guardian but explained in more detail in paragraphs 3.23 to 3.28). This will allow for cases where one parent is the child benefit claimant, but the parents want the other parent to open and manage the account;
- parents should choose an account and provider themselves;
- if this is not done within 12 months of the issue of the voucher the Inland Revenue will open a stakeholder CTF account;
- people can transfer accounts between providers at any time; and
- additional information and guidance will be issued in a comprehensive information pack.

3.7 The parent or guardian will have to give the voucher to the provider they have chosen. They will also need to choose whether to open a stakeholder CTF account or one of the other types of account available. Once the account has been opened, the Inland Revenue will ensure that the initial endowment of £250 is paid in to the account. Further Government payments will be paid into the account automatically and a letter issued to the child benefit claimant for the child to inform them of the payment.

Information for parents

3.8 The Government wants parents and guardians to make an active and informed choice regarding their child's CTF account and to open an account as soon as possible in order to maximise the period of investment and potential growth. They will need to make decisions about their preferred provider, which CTF account is best for their child and consider what savings they can afford to add to the account.

3.9 Parents need access to clear information and guidance to make these decisions and chapter 5 gives further details about financial information and education.

3.10 Detailed information about the CTF will be issued in a pack sent to parents alongside their CTF voucher. The Government will work closely with interested parties, including the FSA and groups with expertise in communicating with parents, as the pack is developed but expects that it will include:

- a full explanation of the CTF rules;
- details of all CTF providers;
- a clear and objective explanation of the stakeholder CTF account which all providers must offer;
- an explanation of other CTF saving and investment options;
- a step-by-step guide to opening an account; and
- signposting to sources of further information and guidance.

3.11 The pack will also include illustrations showing parents the impact of a range of investment choices and contribution levels on account growth and the risks associated with these choices. The Government will be discussing this with the FSA with the aim of ensuring a common standard.

3.12 The following table illustrates what the money contributed to the CTF might be worth after 18 years in real terms (today's prices), assuming a nominal fund growth rate of 7%[1] and inflation rate of 2.5% (contributions are assumed to increase in line with inflation). No account is taken of account charges.

Table 3.1 Illustrative projections for fund growth

Nominal rate of return 7%; Inflation 2.5%		
Endowment	**£250**	**£500**
Value of fund at year 18 in real terms		
No additional savings	456	911
£5 per month	2,198	2,654
£10 per month	3,941	4,397
£15 per month	5,684	6,140
£20 per month	7,427	7,883
£40 per month	14,399	14,854

TYPES OF ACCOUNT

3.13 Providers can offer a range of CTF accounts to suit different needs. The CTF will be a "wrapper" in a similar way to the ISA i.e. the CTF can be wrapped around a variety of products such as cash, unit trust or life insurance products. The CTF information pack will highlight sources of information, education and advice to help families in the decision making process.

Stakeholder CTF account

3.14 The Government will require all providers to offer a stakeholder CTF account which will follow the principles of Sandler stakeholder investment products – simple, low cost, accessible and risk-controlled. As the initial contribution in a CTF account stays invested for 18 years and there is no access to the money until the child reaches 18, this account should be considered as a long-term investment. The Government wants all families to benefit from the potential higher returns that might be achieved through equity investments (shares in companies) although appreciating that with any investment in equities there is a risk of a loss in value. However, this risk will be reduced (although not completely eliminated) by the investment being long term and measures to control the degree of risk.

Risk controls on the stakeholder CTF account

3.15 Funds in CTF accounts will, like pensions, be invested for a long period. In view of this, it is appropriate for the stakeholder CTF account to follow a similar approach to the proposed risk controls for the Sandler Stakeholder Pension, rather than the Sandler medium term product (which caps equity and property exposure at 60%). Risk will be controlled in the stakeholder CTF account by a requirement to diversify the investment and by a principles-based approach to 'lifestyling'.

3.16 The stakeholder CTF account should be designed to spread assets between stocks and asset classes to balance risk and return with regard to the expected maturity of the investment. A lifestyling approach should be taken, where the proportion of less risky investments should increase as the stakeholder CTF account reaches maturity. The form of lifestyling will not be prescribed but providers will be expected to follow a principles-based approach, as envisaged for the Sandler Stakeholder Pension.

1 The 7% rate is an illustration and actual returns will depend on the movements in the stock market. Fund growth of 7% is consistent with the FSA's conduct of business handbook. For simplicity the illustration assumes no movement to lower risk assets towards maturity.

3.17 Providers will be required to manage the investment appropriately for the needs of the account holder. Unless otherwise notified by the investor, the presumption should be that the account holder will want to close the account at 18 or move the funds to a cash account; the account should therefore gradually be shifted from equities to investments such as gilts or cash as age 18 approaches. If the account holder indicates that he or she wants to continue investing the CTF funds in another equities-based product at age 18 there will be no need to move the funds out of equities.

3.18 As a long term investment, the stakeholder CTF account should be suitable for the vast majority of families, enabling them to benefit from the higher returns on equities over the long term while controlling the risks of stock market investments.

Other CTF account choices

3.19 The Government recognises the diversity of preferences among the population. Different attitudes towards risk and return, and different religious, social or ethical beliefs may mean that the stakeholder CTF account is not suitable for everyone. For instance, some consumers prefer to invest in ethical funds or investments compatible with their religious beliefs and the Government would welcome CTF providers including such products in their range. To cater for this, providers will be able to offer a range of investment choices (including cash, bonds and alternative equity investments) in addition to the stakeholder account. The guidelines for the types of investments eligible for CTF accounts will be based on ISA regulations. Like the ISA, the CTF will technically be a wrapper for a variety of investments. However, unlike the ISA an investor will not be allowed to have more than one CTF account.

REVENUE-ALLOCATED ACCOUNTS

3.20 Some parents and guardians will not open a CTF account and the Inland Revenue will open an account for them so that their children are not disadvantaged.

3.21 The Inland Revenue will do this where:

- a CTF voucher has not been used to open an account within 12 months of the issue of the voucher;
- a child has gone into care before a CTF voucher is issued; or
- there is no one with parental responsibility.

These accounts will always be the stakeholder CTF accounts. There will be a list of providers offering these accounts (it will not be compulsory to take on Revenue-allocated accounts) and the Inland Revenue will ask those providers in turn to open an account for the child.

3.22 The Inland Revenue will not manage these accounts but will write to the child benefit claimant to inform them that an account has been opened, that it is a stakeholder CTF account, and that someone with parental responsibility can take on the management of the account at any point. The account can be moved to another provider, or other type of account, free of charge (although there may be some costs in effecting the transfer, as in the case where shares are sold).

OWNERSHIP OF CTF ACCOUNTS

3.23 CTF accounts will be owned by the child and be in the child's name; one of the key policy aims of the CTF is to encourage an understanding of the benefits of saving and the Government wants children to identify with their CTF accounts and the assets building up in them.

3.24 However, although the account will belong to the child, it will not be possible for children to give instructions as to how they want the account to be managed, although we hope that as they grow up they will be encouraged to discuss the performance of the fund and the options available.

3.25 This is because the accounts can be invested in equities, and the law does not allow children to enter into enforceable contracts to acquire equities. For this reason the CTF account will have to be managed until the child's 18th birthday (or in Scotland 16th birthday) by a person who has "parental responsibility" for the child. That automatically includes the power to administer the child's property.

3.26 Under general law parents who are married to each other will each have parental responsibility. Where parents are not married the mother will automatically have parental responsibility, as will the father if he is registered on the birth certificate, if the parents agree by means of a parental responsibility agreement, or a court so orders. Other individuals who will have parental responsibility include adoptive parents, a step-parent under a parental responsibility agreement, testamentary or special guardians and a person with whom a child is living under a residence order.

3.27 In most cases the child benefit claimant will either have parental responsibility or be able to pass on the voucher to a person who has it. Where there is no one with parental responsibility or who is willing to exercise it, the Revenue will open a stakeholder CTF account for the child.

3.28 In Scotland the position is different in that children are entitled to administer their own property from the age of 16. This means that 16 year olds in Scotland will be able to manage their own CTF accounts. It will still not be possible for them to withdraw any of the money until they are 18.

Children under 18 who are parents

3.29 In England, Wales and Northern Ireland, where a person under 18 has a child who is eligible for a CTF account, it will not be possible for that parent to manage the account for their child.

3.30 This is because although parents under 18 have parental responsibility for their children under the Children Act 1989 they do not have the legal capacity to enter into binding contracts to acquire equities. This excludes them from making decisions about CTF accounts. In these circumstances the Inland Revenue will open a stakeholder CTF account on behalf of the child and once the parent reaches 18, responsibility for managing their child's account will pass to them.

3.31 The law is different in Scotland where 16 year olds are entitled to make their own decisions about their property, including CTF accounts. This means that a parent aged between 16 and 18 in Scotland will be able to manage their child's CTF account.

4 CHARGES, CONTRIBUTIONS, TAX TREATMENT AND CLOSURE OF ACCOUNTS

GENERAL RULES FOR CTF ACCOUNTS

Charge cap and sales regime

4.1 The Government wants to ensure that charges are set at levels that are good value for savers while also allowing efficient providers to make adequate returns. The Government has stated that there is a high threshold of persuasion for any move from a 1% charge cap for stakeholder products. The Government appointed Deloitte and Touche to conduct independent research on price caps for the CTF. This is in addition to the research on charge caps for other Sandler stakeholder products. This research covers the following issues:

- the impact on consumers of different price caps, in particular the difference between those making no additional contributions and those making the maximum permitted additional contributions;
- the potential market size given assumptions and sensitivities regarding the probability of additional contributions;
- the impact on different types of providers and distributors under different price caps, specifically the return on capital, payback periods and willingness to participate in the market; and
- the implications for market reach, specifically to low income families.

4.2 The economics of the price structure may also depend on the cost and nature of the sales regime being designed by the FSA. In July 2003 the Government's response to the consultation on the product specifications for Sandler stakeholder products noted that the Government is committed to making the CTF available within the stakeholder product suite. The FSA is currently researching the sales process for all the products within the stakeholder product suite. The Government will issue a report detailing the charge cap for the CTF (including specifying whether a charge cap will apply to non-stakeholder CTF accounts) and other products in the Sandler suite later this year.

Minimum contribution

4.3 Depending on the type of financial product, providers often have rules about the minimum contribution they are prepared to accept. This is especially true for equity-based investments where the cost of handling transactions is greater than for cash accounts.

4.4 Many providers accept low value contributions on condition that the saver commits to regular contributions. The Government wants to ensure that the CTF is accessible to all savers including those who cannot commit to regular contributions. Stakeholder Pensions currently require all providers to accept any contributions of £20 or more without any regular commitment. Providers are of course free to accept lower contributions. The Government will be reviewing the minimum contribution level for the Stakeholder Pension and other products. A decision on the minimum contribution for the CTF will be made later this year.

Tokens for voluntary contribution

4.5 One option for encouraging saving is for providers to offer CTF tokens which could be bought in the same way as book or phone tokens. The Government would not be involved in the issue of the tokens or require the acceptance of tokens from providers. Instead, this will be for the market to decide. Tokens might be available from providers (high street outlets or by post), newsagents, post offices etc. Family and friends could be more attracted to giving such a token to a child than cash as it could only be used to add to the child's CTF account. Organisations might also use this as a mechanism for rewarding young people for voluntary activities. The Government will work with industry to facilitate the development of contribution tokens.

Tax treatment of CTF accounts

4.6 CTF accounts will benefit from the same tax treatment as ISAs. This means that income and gains arising on the funds will be exempt from both income tax and capital gains tax so the child will not have to pay any tax on them. There will be no personal tax relief for additional contributions to the CTF. There will not be any tax charges when the CTF account matures at the child's 18th birthday. The Government's intention is that when the CTF account matures, the funds can (if the account holder wishes) be rolled over into tax-effective savings schemes available at the time.

4.7 Families will benefit from the Government's decision not to apply the income tax settlements legislation to CTF accounts. This legislation prevents parents getting a tax advantage by placing money in their children's accounts. Where gifts from a parent give rise to income of more than £100 in a year, the parent is taxed on all that income at his or her own income tax rate. However, contributions to a CTF account will not count towards this limit.

4.8 Contributions by parents, family and friends also involve the question of inheritance tax (IHT). Existing IHT rules will apply to CTF accounts but there is a generous and wide range of existing IHT exemptions for lifetime giving which would cover most people's contributions to the CTF.

SAVING BY FAMILY AND FRIENDS

4.9 A key aim of the CTF is to help all children build up a financial asset and Government endowments contribute to this aim. But the Government is also keen that family (and children themselves as they grow older) should play an active part in building the accounts where they can.

4.10 There will be no restrictions on who can put money into CTF accounts with family, friends, and the child themselves able to contribute. There is a limit of £1,200 on the amount that can be saved each year.

4.11 It will not be possible to carry forward unused limits from one year to the next. The annual limit applies to the total savings from all contributors in the year to the child's birthday. Providers will monitor this limit – if a contribution is made that takes the total over the limit a provider will either return that money or, in agreement with the contributor, place it in a separate savings account.

4.12 Feeder accounts may be set up by some CTF providers to accept additional contributions where the £1,200 limit has been exceeded. If the annual limit had already been reached and a grandparent wanted to pay £40 to the child's CTF account, this could be placed in a feeder account until the start of the next contribution year.

4.13 The feeder account would be an ordinary savings account subject to the normal tax rules for children's savings accounts. Children (like adults) are entitled to a personal allowance (£4,615 for the current tax year). This means that they do not have to pay tax if their total taxable income is less than £4,615 and any income exceeding their personal allowance is taxed at the appropriate rate bands.

4.14 Feeder accounts would avoid the problem of providers having to return money to families when the annual limit is exceeded. However, not all CTF providers will want to provide these accounts. It will not be a requirement and the Government is content to leave this to the market.

4.15 Some parents may also want to open savings accounts for children who do not qualify for CTF accounts. There is a wide range of accounts on the market for children and in most cases the income will be free of tax as outlined above.

4.16 The year for the purpose of the annual limit on contributions will run from one birthday to the next. This has been chosen instead of the tax year (not familiar to all potential CTF contributors) or the anniversary of the CTF opening date (not familiar to relatives and friends) because money is often given to children on their birthdays, and the date will be easy for family and relatives to remember.

CLOSING A CTF ACCOUNT

4.17 An important objective of the CTF is that the funds should be held in the account until children reach 18, helping to increase the value of the fund. This will provide young adults with a stock of assets at 18 – a key life stage. The only money that will come out of the account will be the money to meet providers' administration charges.

4.18 The funds will be free of all personal tax when the account matures and there will be no restrictions on how the funds can be used when they are accessed at age 18.

4.19 After the child's 18th birthday the account will cease to be a CTF account. When a child's CTF account matures, the CTF funds can be rolled over into other tax-effective savings schemes more appropriate to their life stage.

Death of child holding a CTF account

4.20 As a general rule the money in CTF accounts cannot be accessed until the child is 18. Sadly, however, there will be cases where the child dies before reaching 18 as well as other situations in which closure of the account may seem appropriate.

4.21 In England, Wales and Northern Ireland, a child aged under 18 cannot normally make a will, so on the death of a child the usual intestacy rules will apply to the child's estate. Under these rules the estate would pass to the child's parents, although if the child has a spouse or child they would have prior entitlement. In Scotland, a child aged 12 or over can make a will that would govern the destination of his or her estate, including the funds in the CTF account. Otherwise, under the intestacy rules in Scotland, the estate would pass to the child's parents, and any brothers or sisters; again the spouse or child of a married child would have prior entitlement.

4.22 All funds held in the CTF account, including Government endowments and all non-Government contributions, will remain the child's property, and will become part of the child's estate. The Government will not recover funds from a deceased child's account or estate.

Children who die before an account is opened

4.23 There will also be children who are entitled to a CTF account but who die before the account is opened. Similarly, there will be children who would have qualified for an additional endowment but die before the CTC award has been finalised.

4.24 In these circumstances a letter and payment for the amount to which the child was entitled will be sent to the parents.

CTF accounts after the death of parents

4.25 There will be circumstances in which the child's parents or their only carer die before the child and, apart from state provision, there are no funds available for the child other than the CTF. It could be argued that the child and the person responsible for them should have access to the CTF account immediately. However, the objectives of the CTF are long term and the Government does not propose to make the funds available in these circumstances. These children should not be disadvantaged in comparison with other 18 year olds who will have CTF accounts.

Terminal Illnesss

4.26 Where a child develops a terminal illness, parents may want access to CTF funds to pay for medical treatment or a special holiday. Although entirely understandable, particularly where parents have made contributions to the fund, the Government is concerned that this would be very difficult to administer fairly and with sensitivity.

4.27 It is also possible that some people would make fraudulent claims to access the money in the CTF account.

4.28 In view of the difficulties and risks involved the Government does not intend to allow access to CTF accounts in these circumstances.

5 STRENGTHENING THE SAVING HABIT

5.1 The consultation paper "Delivering Saving and Assets"[1] set out the role of financial information and education in helping people to save, including the case for Government involvement. The Child Trust Fund will ensure that children reach adulthood not only with access to a financial asset but having experienced at first hand the significant benefits to be gained from saving. Appropriate financial information and education linked to the CTF will help children engage with their account and make decisions about the use of assets at account maturity. Interaction with a real life saving or investment vehicle will support wider financial education in the classroom.

5.2 Financial information and education will also help parents make initial choices about their child's CTF account.

INFORMATION AND EDUCATION

Communicating with parents

5.3 The Government wants parents to engage actively with the CTF but recognises that for many parents this will be their first investment decision. To ensure we can provide appropriate support for parents, the Government will commission research into the best way to communicate complicated financial and investment decisions to parents. The results of this research are expected early in 2004. This research will inform a Government-led campaign, to begin in 2005, to create a high level of awareness of the CTF so that parents are prepared to receive more specific information and instructions. The Government expects that this initial phase will be maintained by lower level, ongoing work after 2006.

5.4 Some parents may seek information from other sources including advice organisations and the voluntary and community sector. Before the launch date the Inland Revenue expects to run a series of awareness-raising road shows for interested parties who have contact with parents.

5.5 Chapter 3 outlined the information resources the Government will provide to ensure parents are helped to make choices about their child's CTF, including an information pack to be issued alongside the CTF voucher. In addition the FSA will play a key role in providing information and guidance about the CTF.

Financial Services Authority

5.6 The Financial Services Authority (FSA) is the independent watchdog set up by the Government to regulate financial services and protect consumer rights. The Financial Services and Markets Act (2000) also places the FSA under a statutory obligation to promote public understanding of the financial system including the provision of appropriate information and advice. The FSA provides people with authoritative, independent information and generic advice.

5.7 The Government will work with the FSA to include the CTF in their consumer information activity. This will include incorporating the CTF into the FSA consumer website and may also include the development of a guidance leaflet. The Inland Revenue will also work with the FSA to assess whether decision trees and comparative tables are appropriate and useful for consumers in this context. Decision trees can help families to consider their ability to contribute to CTF accounts and their risk and return preferences; comparative tables can help them to choose a provider.

1 HM Treasury, November 2001

5.8 The FSA is exploring how a new interactive financial planning tool might be used as a stand alone service by community or voluntary organisations as well as by individuals to help consumers assess their financial position. Generic financial health checks could help families decide the balance between investing in the CTF and other financial priorities. The Government will work with the FSA as this product is developed to look at ways in which new developments such as CTF accounts could be included.

The CTF and education in schools

5.9 From 2007 onwards children with a CTF account will be starting school. Opportunities for teaching and learning about topics related to the CTF (such as saving and investing, risk and return, financial decision-making, the role of the financial services industry and how the economy functions) occur in school curricula across the UK.

Box 5.1 Financial Education

In England, financial capability education is delivered through the framework for Personal, Social and Health Education. Guidance setting out its place in the whole school curriculum was issued to all schools in July 2000. Citizenship, which includes a specific objective to provide education on how the economy functions, including the role of business and financial services was made compulsory in secondary schools in 2002. The Personal Finance Education Group is working with secondary schools across England to promote financial capability in the classroom.

Financial Education in Scottish Schools set out the learning outcomes in terms of financial understanding, competence, responsibility and enterprise. Learning and Teaching Scotland supports the development of financial capability through the Scottish Centre for Financial Education. The Centre provides advice, resources and plans for continuing professional development for teachers, highlighting the links between financial education and other curricular areas such as education for work and enterprise, core skills and citizenship.

In Wales, Personal and Social Education forms part of the Basic Curriculum for all 5-16 year olds. In Northern Ireland the curriculum is under review and financial education is on the agenda.

The FSA and others have produced a range of teaching and learning materials to support the delivery of personal finance education across the UK. A new emphasis on education for enterprise and work across the UK is also raising the profile and importance of financial capability.

5.10 The CTF, through linking with the school curriculum, will build on this foundation. It will reinforce and support the delivery of financial education in schools by ensuring that every young person has access to a financial asset, increasing the relevance of financial education for all and helping young people understand the advantages of saving. In particular, the additional Government payment at age seven will provide a useful starting point for involving children with their CTF accounts both in and outside the classroom.

5.11 To support learning through the CTF and related topics in the classroom, the Government will commission the development of a range of CTF teaching and learning resources. The resources will help children improve their financial capability and will be clearly linked to different parts of the curriculum including Personal, Social and Health education, Citizenship and Numeracy / Mathematics. The Government will ensure the development of teaching and learning resources to fit with curricula across the UK. These resources will be designed to meet the child's needs at different ages beginning with an introduction to the basic concepts of saving and moving towards guidance on possible uses of financial assets, including continuing to save, as the young person's CTF nears maturity. The Government will promote and make available these resources to all schools.

5.12 Over the next few years the Inland Revenue also intends to work closely with the Department for Education and Skills, the devolved administrations, and organisations such as the FSA and PFEG (Personal Finance Education Group) to assess what additional support will help children engage with their CTF and ensure CTF objectives are met. This could include joint work to consider the professional development needs of teachers teaching personal finance topics and issuing updated guidance on teaching personal finance incorporating the CTF.

Annual statements

5.13 Providers will also be involved in helping children engage with and learn from their CTF accounts through clear and targeted financial information. Providers will be required to produce an annual statement for each child's account. This will help remind children and parents of the account and ensure they get clear information about their CTF account.

5.14 These statements will follow a common format and subject to feasibility include the following information:

- the value of the CTF at the start of the year;
- the value at the end of the year;
- the value of the Government endowment and / or age related payments;
- non-Government savings in the account;
- investment income;
- the effect of investment gains or losses;
- the value of incentives (tax relief on fund growth);
- transfers from an existing CTF account if the parent has switched providers;
- providers' management charges; and
- a glossary of terms.

5.15 The Government will be working with interested parties to develop the detailed requirements for the statements.

5.16 Although the year for the annual contribution limit will run between the child's birthdays, providers will be able to issue the annual statement at a time that best suits their business processes.

5.17 Parents and children can opt to have this sent electronically if they would prefer. Providers may wish to develop additional information and education resources for their CTF customers building on their current resources for children but the Government intends to leave this for providers to decide.

5.18 In addition the Government will provide illustrations of the impact of a range of investment choices and contribution levels, helping children understand how the funds in a CTF account might grow in value over the years and the risks associated with these choices.

CTF Website

5.19 The Inland Revenue also plans to commission the development of a dedicated CTF website to provide a one-stop shop for information on the CTF. It will support the information provided directly to the parents of children born before the launch date and the information pack issued with CTF vouchers. In time it will be expanded to include resources for a variety of audiences including parents, family members, children and teachers.

CONSUMER PROTECTION

5.20 The Government recognises that, while financial information and education for individuals can help people make sensible choices regarding their finances, information and education in themselves should not be relied upon to provide consumer protection. The FSA has a statutory objective to secure the appropriate degree of protection for consumers. The CTF product specifications (detailed in chapter 3) and the FSA's work to establish the CTF sales regime (as mentioned in 4.2) will help minimise the risk that consumers make inappropriate choices for CTF accounts.

5.21 Consumer protection will also be delivered through the FSA's role as regulator of firms, the Financial Ombudsman, the Inland Revenue and the Financial Service Compensation Scheme.

Financial Services Authority (FSA)

5.22 By law, all financial services firms with the relevant FSA authorisation will be permitted to provide CTF accounts. The FSA ensures all authorised firms are run in a prudent and financially sound way, and regulates their business practices. The FSA publishes a document with details on how to resolve disputes between a consumer and a financial services provider "FSA guide to making a complaint", July 2002 or available online at http://www.fsa.gov.uk/consumer/pdfs/complaint.pdf.

The Financial Ombudsman Service

5.23 Complaints about provider firms are dealt with by the Financial Ombudsman Service. This service covers all the financial firms, such as banks, building societies, insurance companies, investment companies (such as unit trust and investment trust managers) and friendly societies, who will be able to be CTF account providers. The Ombudsman also covers investment advice given by financial advisers. Using the Ombudsman service is free to consumers and a solicitor is not required.

5.24 Firms are required by law to abide by the decisions of the Ombudsman. Information about the Financial Ombudsman Service is available at www.financial-ombudsman.org.uk.

The Inland Revenue

5.25 The normal Inland Revenue complaints procedure will apply to complaints by individuals and CTF providers.

5.26 In the first instance, complaints will normally be dealt with by the customer relations manager or complaints manager in the relevant office. Most complaints are resolved at this stage, but if not they can be reviewed by the director with overall responsibility for the office concerned. There is a simple complaints procedure which is set out in the Inland Revenue 's Code of Practice 1 "Putting things right". This leaflet is available in Inland Revenue Enquiry Centres and on the Inland Revenue website www.inlandrevenue.gov.uk and explains how and to whom to complain.

5.27 If the complainant is not happy with the director's response they can ask the Adjudicator to look into the complaint. The Adjudicator is a fair and unbiased referee whose recommendations are independent of the Inland Revenue. The Adjudicator's leaflet AO1 (also obtainable from Inland Revenue offices) gives information about complaining to the Adjudicator and there is a website at www.open.gov.uk/adjoff.

5.28 Finally, a complainant can ask their MP to refer their case to the independent Parliamentary Commissioner for Administration (usually known as the Ombudsman).

Financial Services Compensation Scheme (FSCS)

5.29 The FSCS is a safety net for customers of financial services firms. It pays compensation if FSA authorised firms are unable to pay claims against them, usually because they have gone out of business. The Scheme is funded by the industry and covers deposits, insurance and investments. Further details about the FSCS are available at: www.fscs.org.uk.

6 OPERATIONAL DETAILS, REPORTING AND COMPLIANCE ISSUES

6.1 This chapter sets out the technical details surrounding CTF account operating procedures, provider reporting requirements and compliance issues.

OPENING AND CLOSING CTF ACCOUNTS

Setting up CTF accounts

6.2 The CTF voucher can only be used to open a CTF account. It will include the following information:

- the name of the child;
- the child's date of birth;
- a unique reference number – possibly using the same format as the National Insurance Number;
- the amount of the voucher – either £250 or a higher amount for those eligible before 2005; and
- the expiry date of the voucher (12 months after the date of issue).

6.3 A person with parental responsibility can then give the voucher to a provider they have chosen from the list provided by the Inland Revenue.

6.4 The provider will keep the voucher and open a CTF account for that child, crediting it with £250, or other appropriate amount.

6.5 For new or transferred accounts providers will be required to make a fortnightly return to the Inland Revenue including the name of the child, the unique reference number and the amount to be credited to the account.

Claiming money

6.6 The Inland Revenue will make a payment to the provider based on the information in that return and the provider will credit the relevant amount to each CTF account. Where tax has been deducted from income arising on CTF investments, providers will be able to claim the tax back in the same way as in the ISA scheme.

Phasing in launch

6.7 The Government is considering phasing in the issue of CTF vouchers to children born between September 2002 and the launch date. Vouchers would be issued between, say, January 2005 and March 2005 and could be taken to the preferred provider.

6.8 The provider would then be able to set up the CTF account and claim the initial endowment from the Inland Revenue. This would mean that providers would be ready to put the money into accounts on or shortly after the official start date.

6.9 There would be advantages to phasing in the vouchers in this way. It would allow the Inland Revenue and providers to test their systems before the launch date and avoid a bulk issue of vouchers at the time of the launch.

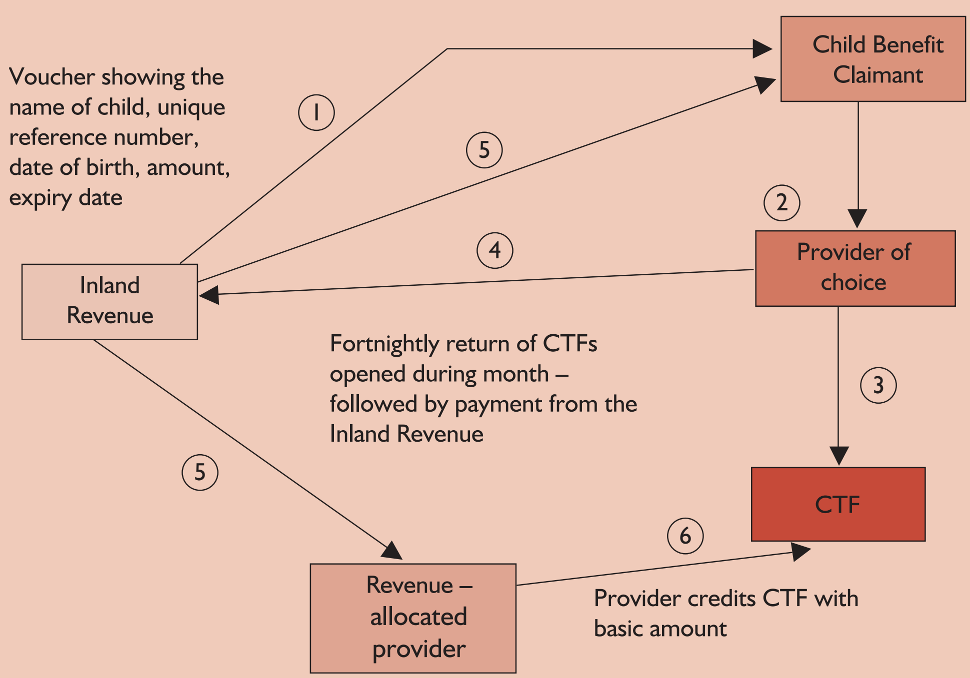
Revenue-allocated accounts

6.10 Where a CTF voucher has not been used to open a CTF account by the date of expiry of the voucher, the Inland Revenue will open a stakeholder CTF account for the child. It will be evident from the Inland Revenue records and the providers' returns that the voucher has not been used.

6.11 The Inland Revenue will send providers a fortnightly schedule with the details of accounts to be opened. Providers will be asked if they wish to provide this service and accounts will be allocated on rotation, i.e. the provider will simply be the next on the list of providers offering Revenue-allocated accounts. The provider will open the account, which will always be the stakeholder CTF account, and after receiving the money from the Inland Revenue, credit it with £250.

6.12 When the account has been opened a letter will be sent to the child benefit claimant informing them that the Inland Revenue has arranged for a CTF account to be opened for the child. The letter will remind claimants that people with parental responsibility can take on the administration of this account and change the type of account, or provider, at any point.

Box 6.1: Opening a CTF account



1. The first time that a child is eligible for CTF, the Inland Revenue issues a voucher to the child benefit claimant containing the name and date of birth of the child, its unique reference number, the amount of the award (£250), and expiry date of the voucher (12 months after date of issue of the voucher)
2. The child benefit claimant takes the voucher to a provider of their choice.
3. On receipt (and retention) of the voucher the provider opens a CTF account.
4. The provider must make a fortnightly return to the Inland Revenue containing the name of child, unique reference number, and amount to be credited to any CTF account opened. The Inland Revenue notes that the child has opened a CTF account with that provider and a payment is made to the provider which is then paid into the CTF account.
5. Fortnightly schedules of CTFs not opened by the expiry date are sent by the Revenue to the Revenue allocated CTF provider. At the same time a letter is sent to the child benefit claimant informing them that arrangements have been made to open a CTF account for their child with the provider.
6. The provider opens the stakeholder CTF account and pays £250 into the account following payment by the Inland Revenue.

Closing account at 18 **6.13** When children turn 18 they can withdraw the funds or give instructions for the money to be put in another kind of savings account. As such savings schemes cannot be anticipated (the first group of children will not be 18 until September 2020) details will be provided nearer the date.

6.14 The 18 year old will have to give the provider proof of their identity before being allowed to withdraw or move the funds in the account. There will be no restrictions on how the money in the account is used. If an account matures and the account holder does not give any instructions to the provider, the account will simply revert to being a taxable account.

Death of child **6.15** When a child holding a CTF account dies, the parent of the child will notify the provider and provide the same proof of death as required for other accounts.

6.16 If the CTF account has been open for 3 months or more, the provider can close the account and release the funds to the child's estate in the normal manner. If the CTF account has been open for less than 3 months the provider will be required to phone the Inland Revenue CTF helpline to obtain permission to release the funds.

6.17 Once this permission has been given the provider will close the CTF account and pay the balance in the account to the child's estate.

Money laundering **6.18** The following rules for CTF accounts should mean that it is not necessary to undertake additional checks for the purposes of the money laundering requirements:

- the account belongs beneficially to the child;
- the account must be held in the name of the child;
- no withdrawals can be made from the account while the child is under 18 (and alive); and
- the account is to be administered (i.e. investment instructions etc. given to the provider) until the child's 18th birthday (or 16th in Scotland) by a person who has "parental responsibility" for the child under the Children Act 1989 (or Children (Scotland) Act 1995). That automatically includes power to administer the child's property.

ADDING TO ACCOUNTS

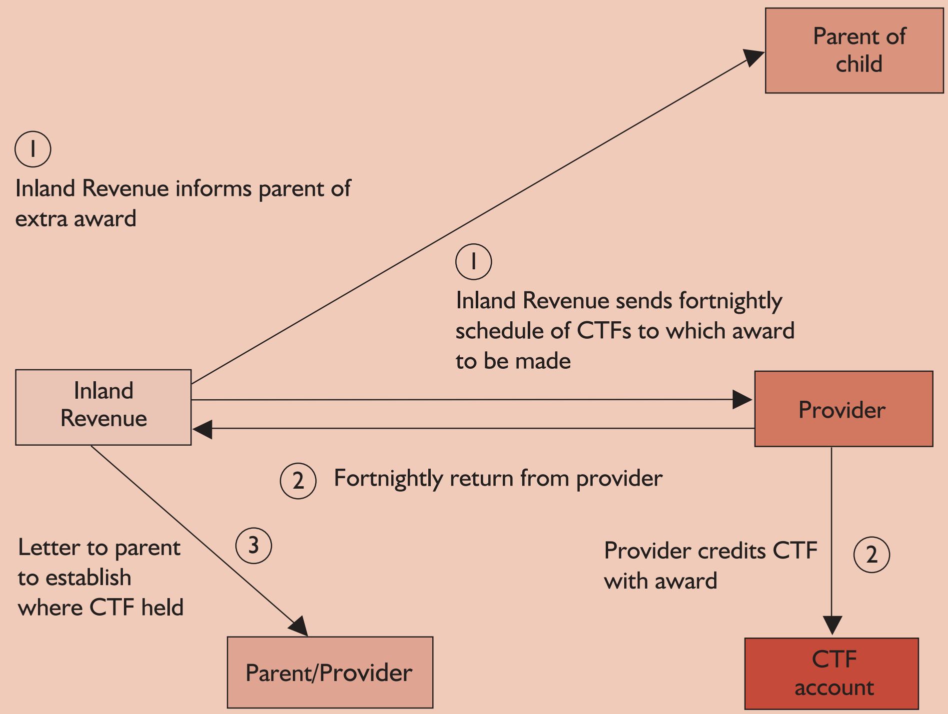
Additional endowment **6.19** Children who are part of a claim to Child Tax Credit (CTC) where the household income is below the CTC threshold (currently £13,230) at the time the child is first eligible for a CTF account will be entitled to the additional endowment.

6.20 It will not be necessary for parents or providers to claim this award. The information will be held on the CTC system and the Inland Revenue will send the provider a schedule with the name of child, the unique reference number and the amount to be credited to the account. At the same time a letter will be issued to the child benefit claimant informing them of the payment.

6.21 The provider will then confirm that they hold the CTF in their next fortnightly return following which the Inland Revenue will pay the provider who then credits the amount to the CTF account. Where the provider discovers that they do not have a CTF account listed on the schedule, an exception report will be included in their next return.

6.22 If a CTF account is reported as an exception in the account, information from the CTF database and the provider will be used to trace the CTF. If this fails, a letter will be sent to the parent to establish where the CTF account is currently held. The Inland Revenue's records will then be updated and the correct provider notified of the award.

Box 6.2: Additional Endowments



1. For children entitled to the additional endowment a schedule is sent to the relevant provider with name of child, the unique reference number and the amount to be credited. The parent is also informed at the same time.
2. The provider reports back on the fortnightly return that they either hold the account, in which case payment is made to the provider who then credits the CTF, or that they do not hold the account.
3. Information from the provider and from the CTF database is used to find where the CTF account is held. If this fails a letter is sent to the parent to find where the CTF account is now held.

Age-related payments

6.23 The Government will make payments into CTF accounts for the seventh birthdays of children holding CTF accounts. This payment will be in two parts, a sum which is paid to all children and a second amount paid to children in families claiming CTC and below the CTC income threshold (currently £13,230) at the child's seventh birthday. The amount of these payments will be announced nearer the time. It will not be necessary for parents to claim these payments.

6.24 Details of children's birthdays will be held by the Inland Revenue who will issue a letter before the children turn seven to check that the child is still living in the UK. The Inland Revenue will send the provider a schedule with the name of child, the unique reference number and the amount to be credited to the account. At the same time a letter will be issued to the child benefit claimant informing them of the payment.

6.25 The provider reports back on the fortnightly return that they either hold the account, in which case payment is made to the provider who then credits the CTF, or that they do not hold the account.

6.26 If a CTF account is reported as an exception in the return, information from the CTF database and the provider will be used to trace the CTF. If this fails, a letter will be sent to the parent to establish where the CTF account is currently held. The Inland Revenue's records will then be updated and the correct provider notified of the award.

REPORTING REQUIREMENTS

6.27 CTF providers will be required to make two sorts of returns to the Inland Revenue. These will be used to monitor and evaluate CTF accounts.

6.28 The Inland Revenue will require fortnightly returns of CTF accounts:

- opened;
- closed; and
- transferred.

We envisage these returns will be made via secure internet channels and the information will be used to maintain an accurate and up-to-date record of CTF accounts and where they are held. It will also be used to identify where Revenue allocated accounts need to be set up and where duplicate accounts have been opened.

6.29 Providers will be required to make an annual return of information to 5th April each year of all the accounts held including:

- provider name;
- provider reference number;
- name of child;
- address;
- date of birth;
- unique reference number;
- subscription (to the birthday ending in the tax year covered by return);
- value at year end of each of stakeholder CTF accounts, cash and other investments; and
- whether the account details include an adult contact.

This return will be required within 60 days of the reporting date

COMPLIANCE

6.30 Each CTF voucher will have a unique reference number and the Inland Revenue will use fortnightly returns by CTF providers to:

- check that the reference number of each CTF account opened is valid;
- check that only one CTF account has been opened for each eligible child; and
- keep track of where CTF accounts are held.

6.31 In the event that a CTF account is found to be invalid – for example where a duplicate account has been opened – Government endowments and the income and growth associated with them will be recovered. Funds subscribed to the CTF account by the child and persons other than the Government (and the income and growth on those funds) will remain the property of the child. Income and gains arising on the account will not be tax-exempt.

6.32 The Inland Revenue will carry out regular inspections to ensure that CTF providers have met their obligations.

6.33 Their auditors will:

- review providers' procedures;
- check the calculation of claims;
- carry out sample checks on individual CTFs; and
- check providers' returns of information.

6.34 The Inland Revenue has published a Code Of Practice (Code of Practice 4) entitled 'Inspection of Schemes Operated by Financial Intermediaries'. The leaflet explains how the Inland Revenue carries out inspections. Most are routine and the timing and frequency generally depends on the size of claims involved.

6.35 The Inland Revenue will also be offering advisory visits to institutions planning to offer CTF accounts.

A PARTIAL REGULATORY IMPACT ASSESSMENT

PURPOSE AND INTENDED EFFECT OF MEASURE

A1 The Government believes that 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 ownership to all. Savings and assets provide people with security in times of adversity, long-term independence and opportunity and comfort in retirement. The Child Trust Fund (CTF) is designed to strengthen the saving habit of future generations and ensure that all young adults, regardless of family background, have a stock of financial assets when they start their adult life.

A2 For children born from 1 September 2002, the CTF will provide a Government-funded endowment of £250 at birth with an additional £250 for children from lower income families. A payment will be made at age seven. Eligibility will be based on an award of child benefit for a child living in the UK.

A3 The endowments will be invested with a financial services provider of the parent's choice until the child reaches the age of 18. Where parents do not exercise this choice the Inland Revenue will instruct a provider to set up an account for the child. Providers will be asked if they wish to provide this service and accounts will be allocated on rotation.

A4 The Revenue–allocated CTF account will be the stakeholder CTF account – an equity-based account where providers will be required to control the extent of risk that the account is exposed to over its life-time.

A5 Parents, family and friends will be able to contribute up to £1,200 a year to the account. There will be no tax on income and capital gains generated by the account. Once the child reaches age 18 they may access the fund and they are free to use the assets as they wish. The intention is to accompany the Child Trust Fund with financial education that will encourage young adults to consider carefully the choices they make at this stage.

A6 The Financial Services Authority will determine the appropriate sales regime for the CTF.

IMPACT OF LEGISLATION

A7 The CTF legislation will have most impact on financial services providers. However, they are free to decide whether or not they want to offer the CTF in their product range.

A8 Other business, charities and the voluntary and community sector are unlikely to be affected by the introduction of the CTF. They may wish to be fully informed however, perhaps with a view to passing this information on to their clients, and information and guidance will be available on the Inland Revenue website and in leaflets. Some charities may wish to contribute to accounts held by certain children and regulations will be drafted with the aim of allowing them to do that – there will be the opportunity to comment on those draft regulations.

PREVIOUS CONSULTATIONS AND POLICY OPTIONS

A9 The key features of the CTF outlined in the detailed paper have been developed during a long period of formal and informal consultation with likely providers of the CTF, trade bodies, the FSA, consumer organisations and other stakeholders.

A10 *Saving and Assets for All*, published in April 2001 sought agreement on the broad principles behind the Child Trust Fund. In *Delivering Saving and Assets*, November 2001 the Government consulted on two proposals for delivering the CTF:

- open market competition, under which providers would be able to enter the market on satisfaction of a set of entry conditions similar to the way the market for ISAs is managed; and
- a licensed provider approach, under which provision would be limited to a panel of licensed providers, with licenses issued through competitive tender for a fixed number of years.

A11 The Government decided, on balance, in favour of open market provision and announced this in Pre-Budget Report 2002. Existing open market provision with product regulation has succeeded in delivering high quality and efficiently priced products, as evidenced by ISAs and Stakeholder Pensions. The open market approach will also maximise the scope for a variety of providers and distributors to enter the CTF market – and allow families to build on their existing relationships with national and local firms. The specification of product rules and provision of information and education would further limit the risk that parents are forced into making inappropriate choices.

A12 Following a recommendation of the Sandler Review in February 2003 the Government published its proposals for a suite of simple, low cost, risk-controlled 'stakeholder' investment products, to be sold through a simplified sales process. As part of this consultation, the Government sought views on whether explicitly linking the CTF to the other stakeholder products would be helpful. Most respondents agreed that there should be some links, with some calling for stakeholder and non-stakeholder versions of the Child Trust Fund. The Government's response to the consultation in July 2003 noted that the Government is committed to making the CTF available within the stakeholder product suite.

BENEFITS AND COSTS

Consumers

A13 Approximately 700,000 children each year from September 2002 onwards will benefit from a CTF account. The CTF will support the development of financial capability for these children through interaction with a savings vehicle and receipt of financial information and education throughout their childhood. Alongside the Government contributions, additional voluntary contributions from family and friends will help to strengthen the savings habit and ensure that children start their adult lives with a stock of assets, promoting independence and opportunity. The CTF will encourage engagement with financial institutions for parents and children, supporting the Government's efforts to address financial exclusion.

A14 The lock-in period of the Child Trust Fund is considered sufficiently long term to smooth out any short-term fluctuations in more volatile asset classes. The stakeholder CTF account to be offered by all providers is designed to offer a risk-controlled equity-based investment. This allows Child Trust Fund owners to benefit from the prospective, though more speculative and risky, long-term performance of equity relative to interest bearing instruments. However parents are not obliged to select a stakeholder CTF account if they wish to save or invest the money in a different way. We anticipate that the market will provide deposit accounts for those who are risk averse and accounts to meet the needs of those with savings strategies driven by religious considerations.

A15 The charge cap will benefit the consumer by ensuring that the reduction in yield to the consumer from the charges imposed by the firm is at a reasonable level, consistent with allowing efficient firms to make a reasonable return on their capital. Consumers will also benefit from any efficiency gains that are made on a wider industry basis that are driven through the consumer expectation and understanding of charges.

A16 There will be no application to claim the CTF. The award of Child Benefit will trigger the award of CTF for all eligible children. The Child Benefit claimant will receive a voucher which parents or guardians can use to open a CTF account with a provider of their choice within a year. Subsequent Government contributions will be made directly into an eligible child's account. The child's family and friends will be able to contribute up to £1,200 a year to the account.

A17 Parents and children will also benefit from the Revenue's intention to raise awareness of the CTF through marketing and work with stakeholders to provide tailored information and education resources, including an annual statement issued by firms.

Industry

A18 There are potential benefits to the savings and investment industry from the introduction of the CTF. It is anticipated that product providers will compete rigorously for the benefits that the CTF might yield. These include cross-selling opportunities to parents and relatives or guardians of the child and the opportunity to gain and retain lifelong customers.

A19 The Sandler philosophy of tight product regulation leading to reduced regulation of the sales process could lead to lower up-front marketing and distribution costs. Government will also be launching the CTF with an advertising campaign. This will give firms a head start on the marketing required to inform the public of the availability and nature of the product.

A20 A key aim of the design of CTF accounts and the systems needed to support them is to build as much as possible on the systems providers already have in place for ISAs with a view to minimising costs. The Government recognises however that there could be additional compliance costs due to the nature of the CTF as it will allow multiple savers and involves a voucher system.

A21 To offer the CTF firms will need to meet a number of requirements as detailed in the CTF paper. Firms will need to meet the product specification for the stakeholder CTF account and adopt the charge cap. HMT has commissioned independent research into an appropriate charge cap and the modelling will estimate the following:

- distribution costs;
- account set-up costs;
- on-going administration costs and cost inflation;
- fund management costs;
- persistency;
- lapses;
- investment growth;

- risk-adjusted discount values; and
- corporate overheads and distribution overheads.

A22 Further details of the costs for firms arising from the charge cap research will be detailed in the Final Regulatory Impact Assessment.

A23 The Government will require CTF firms to make fortnightly returns of CTFs opened, transferred and closed for operational and compliance purposes. They will also be required to make an annual return for statistical purposes. Firms will also be required to provide information on CTF accounts to customers in an annual statement.

A24 We would be grateful for submissions of compliance costs from firms, particularly smaller ones.

Government **A25** The cost of the Child Trust Fund to the Exchequer is estimated as follows:

Cost of initial Government endowments (Annually Managed Expenditure)

The following fiscal projections were published in Budget 2003[1].

2003/4	2004/5	2005/6
£350m	£230m	£235m

The value of the additional endowments at age 7 has not been announced (an issue to be determined in future Budgets).

Implementation costs – capital and running costs

The Inland Revenue is carrying out a feasibility study and we will have estimates of implementation costs later this year. These will be published in the final Regulatory Impact Assessment.

EQUITY AND FAIRNESS

A26 The CTF will be both universal and progressive. All eligible children born from the implementation date will benefit from the Government endowment, with those from the poorest families receiving the largest amounts.

A27 All financial services providers with relevant authorisation from the FSA can choose to enter the market – on satisfaction of a set of entry conditions.

1 Fiscal projections are updated and published twice a year – in the Budget (Spring) and Pre-Budget Report (Autumn)

CONSULTATION WITH SMALL BUSINESS: THE SMALL FIRMS' IMPACT TEST

A29 Some financial services firms would fit the definition of a small firm. However there are no automatic costs associated with the CTF – firms are free to decide whether or not to offer the product.

A30 As part of our consultations we have discussed the CTF product specification and operating procedures with financial services trade bodies. We are aware that some smaller firms may be unable to achieve economies of scale or access capital markets as readily as their larger competitors, but these have not been raised as issues of particular concern. Any further feedback from prospective product providers would be welcome. Some smaller building societies may not currently have permission to carry on designated investment business and so would be unable to offer the stakeholder CTF account themselves.

A31 We intend that all returns and claims from firms will be required in electronic form, possibly by internet. We understand from consultation that this will not present any particular difficulty to smaller providers.

COMPETITION ASSESSMENT

A32 We believe that the CTF will not have significant competition effects. The regulation will create a new market for saving through the Child Trust Fund and may encourage wider saving for children who do not benefit directly from it.

A33 The introduction of the CTF may also impact on the general market for children's savings, and the wider UK savings and investment market. The extent of its wider impact depends very much on the size and breadth of the existing market for children's savings. It is difficult to assess how the market share for general children's savings is defined at present as much saving for children may not be explicit. On the evidence available we believe that no firm has more than a 20% share of the explicit children's savings market.

A34 There are no automatic costs following regulation as firms are free to decide whether or nor to offer the CTF. It is not anticipated that the costs of providing the CTF would be higher for some firms then others. However, there is the possibility that smaller providers may be disadvantaged as they may not, initially at least, be able to benefit from economies of scale or as readily access capital markets in the same way as their larger competitors.

1 Fiscal projections are updated and published twice a year – in the Budget (Spring) and Pre-Budget Report (Autumn)

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