

REGULATORY IMPACT ASSESSMENT (RIA)

Child Trust Fund Full Regulatory Impact Assessment

Purpose and intended effect of the measure

The policy objectives

1. 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.

Background and introduction

2. 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 standard and higher rate payment will also be made at age seven. Eligibility will be based on an award of child benefit for a child living in the UK.
3. 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. This means that the Revenue will have a list of providers for these accounts and accounts will be sent to providers by rotating through the list – no other means of selection will be involved.
4. 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.
5. 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. The account is owned by the child and opened in their name. 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.

6. The Financial Services Authority (FSA) will determine the appropriate sales regime for the CTF.

The risk(s) being addressed

7. The CTF will 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. It will help people to understand the benefits of saving and investing and encourage parents and children to develop the savings habit and engage with financial institutions.

Options

8. The key features of the CTF outlined in the paper 'Detailed Proposals for the Child Trust Fund' published on 28 October 2003 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.
9. Saving and Assets for All, published in April 2001 sought agreement on 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.
10. 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.
11. 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.

Business sectors affected

12. 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.
13. 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.

Issues of equity and fairness

14. 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.
15. The CTF has been designed to be as inclusive as possible. The legislation aims to extend eligibility to all children living in the UK subject to a Child Benefit claim being in place in respect of them. Special arrangements are being made to fully include children looked after by local authorities.
16. The legislation allows for a range of CTF accounts to be available to made available to provide choice and the development of products that will meet the needs of those savers and investors with particular religious or ethical requirements or of other minority groups.
17. All financial services providers with relevant authorisation from the FSA can choose to enter the market – on satisfaction of a set of entry conditions.

Benefits

18. 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.
19. The lock in period of the CTF 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 CTF 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 cash-based accounts for those who are risk averse and accounts to meet the needs of those with savings strategies driven by religious considerations.
20. 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.
21. 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 into the account.
22. 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.
23. 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.

24. 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.

Costs

Policy costs

25. The cost of the policy is the cost to the Exchequer of the Government endowments. This is set out in paragraph 40 below.

Implementation (compliance) costs

26. 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.

27. 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.

28. To offer the CTF firms will need to meet a number of requirements as detailed in the October 2003 publication 'Detailed Proposals for the CTF'. Providers will be required to meet the costs of setting up and administering CTF products, marketing and selling products, required contributions to overheads, and the cost of capital to support the business written, from the revenue derived from the product charges. It is expected that costs will vary significantly company to company according to their current business model, their current level of systems and process efficiency and their chosen route to market.

29. The Government has commissioned independent research into the impact of different charge cap structures and levels. The results of the research indicate that for the market as a whole, the costs of setting up and marketing CTF plans in the first year of operation will be between £130 million and £200 million. The total capital requirement for the industry is expected to be higher due to the losses expected in the early years of many plans. Lower volumes of new business in subsequent years will result in significantly lower annual costs of setting up and selling new CTF plans. Firms will be able to recoup costs through charges. The level of revenues will depend on the charge cap. The

Government will ensure that the decision on the charge cap will be evidence-based – set at a level that is good value for savers while also allowing efficient providers to make adequate returns.

Exchequer effect/distributional impacts

30. The cost of the CTF to the Exchequer are estimated as follows:

Cost of initial Government endowments

The following fiscal projections were published in Budget 2003.

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).

Small Business impacts

31. 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.

32. Informal discussion on the draft Partial Regulatory Impact Assessment, including discussion of the CTF product specification and operating procedures took place with 24 financial service providers and representative bodies on 30 July. 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. Comments from this informal consultation have been taken into account in subsequent versions of the RIA.

33. We intend that most 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.

Other costs and benefits (public & private sector)

34. Current estimates of the costs for the Revenue of introducing the CTF are as follows:

2003/4	2004/5	2005/6	Ongoing (per annum)
£9m	£44m	£29m	£9m

Special arrangements are needed to include those looked after children who do not have access to the CTF because a Child Benefit claim has not been made in relation to them before. The arrangements will place an information requirement on local authorities and their equivalents in Northern Ireland, Scotland and Wales. The impact is estimated to be negligible.

Unintended consequences

35. No significant unintended consequences of this policy have been identified.

Other impacts

Devolution

36. The Bill extends to England, Wales, Scotland and Northern Ireland. All the measures in the Bill are reserved matters.

Human Rights

37. Lawyers have advised that the provisions of this policy comply with the European Convention on Human Rights.

E-policy

38. Information on CTF is published on the Inland Revenue website and a dedicated website will be developed. It is envisaged that returns to the Inland Revenue by CTF providers will be made via secure internet channels.

Environmental impacts

39. There are no environmental impacts of this policy.

Rural proofing

40. This policy will not have a particular impact on rural communities.

Competition assessment

41. 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.
42. 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.
43. There are no automatic costs following regulation as firms are free to decide whether or not to offer the CTF. It is not anticipated that the costs of providing the CTF would be higher for some firms than 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.

Securing compliance

44. CTF business processes have been designed to minimise compliance risks. The use of a voucher creates some risk of investor fraud and this will be countered by the use of a unique reference number for all children in respect of whom a child benefit claim is made and a CTF voucher awarded. We will be able to identify duplicate and fake vouchers. The business processes also minimise the need for rework on the part of providers, as no Government payment will be made into a CTF account until the number has been verified.
45. Auditors will monitor provider compliance. Help visits will be available for providers for a period prior to operation of the CTF. Compliance will be encouraged through help and education. Penalties will be charged if necessary to enforce compliance. The legislation provides for a proportionate penalty regime.

Consultation

46. As detailed in sections 8 – 11 and 42, consultation on CTF has informed and shaped the development of the key features of the CTF.
47. The Partial Regulatory Impact Assessment was published on 28 October 2003.

Monitoring and evaluation

48. A plan will be drawn up to systematically evaluate the CTF against its policy objectives, including a plan for the collection of baseline data needed to carry this out. Annual returns from providers will be used to collect the data needed from them for monitoring and evaluation purposes.

Contact point

Tom Wright
Room 135
New Wing
Somerset House
London WC1A 2LR

020 7438 7535
Tom.Wright@ir.gsi.gov.uk

REGULATORY IMPACT ASSESSMENT

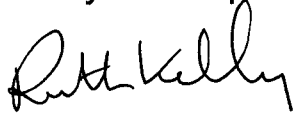
Child Trust Fund

Full Regulatory Impact Assessment

Statement of Ministerial Approval

I have read the regulatory impact assessment and I am satisfied that the benefits justify the costs.

Signed by the responsible Minister:



Ruth Kelly

Financial Secretary

Date 25.11.03