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The Child Trust Fund in the UK

Policy Challenges and Potential Responses

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The Child Trust Fund in the UK: Policy Challenges and Potential Responses

The United Kingdom introduced the Child Trust Fund (CTF) policy, a children's savings policy, in 2002. A focus group study conducted on parental attitudes to the CTF (Prabhakar, 2006, 2007) identified main reasons why CTF accounts were left unopened. This paper explores different ways that non-opening of accounts might be reduced. One strategy draws upon recent developments in behavioral economics and points to different ways that the CTF may be designed. An alternative strategy emphasises the role of financial education of parents as a way of addressing their concerns and increasing the opening rates of these accounts. The paper also considers another issue raised during the focus groups, namely parental unhappiness with the treatment of older siblings denied a CTF. This is part of a broader concern about the additional help that may be needed for children from particular backgrounds.

Key words: *Child Trust Fund; Child Development Fund; children's savings; financial education; behavioral economics; focus group study; social policy*

Introduction

The Labour government in the UK has recently introduced the Child Trust Fund (CTF) policy. All babies born from September 2002 receive either a £250 or £500 endowment from government, with children from low-income families qualifying for the higher endowment. These endowments are placed by parents into special accounts and are locked for 18 years. Three main types of account are available, namely interest-bearing, share and stakeholder (which combines share with interest bearing). Accounts are provided through open competition between banks and building societies. Only if parents do not open an account within a year of receiving their CTF does government step in and open an account on the child's behalf (from a rotating list of providers). During the lifetime of the account, up to £1,200 can be saved each year into the CTF. Once the account matures, the young person is free to spend their CTF as they please (HM Treasury, 2003). In 2006, the then Chancellor Gordon Brown announced that an additional £250 or £500 top-up payment would be paid by government when the child turns 7 (HM Treasury, 2006).

Parents are central to this policy. They are supposed to open an account and choose the type of account to open for their child. They will also make key decisions about saving as well as provide guidance to their child as he or she grows up. However, early signs suggest important issues confront parents over this policy. Official figures reveal that from January 2005 to September 2007, on average 26% of parents did not open an account for their child (HM Revenue and Customs 2009). A breakdown of the opening of accounts by Westminster parliamentary constituencies raises further issues. In particular, opening rates appear to be higher in richer constituencies than poorer inner city areas. For example, official statistics reveal that the percentage of accounts opened by parents for children born on or before 5 April 2007 in affluent areas such as Henley, Guildford and Harrogate and Knaresborough are 85%, 83% and 82.4%. In contrast, the percentage of opened accounts by parents in poorer areas such as Glasgow North East, Liverpool Walton and Bradford are 55%, 58.5% and 58.7% (HM Revenue and Customs 2008a). This suggests that particular issues face parents in poorer areas.

A focus group study that I conducted on parental attitudes to the CTF identified problems with information received from financial providers as one of the main reasons why CTF accounts were left unopened (Prabhakar 2006; 2007). Concerns were expressed about both the quality and quantity of information received from providers. In this paper I build on this finding by exploring different ways that non-opening of accounts might be reduced. One strategy draws upon recent developments in behavioral economics and points to different ways that the CTF may be designed. An alternative strategy emphasises the role of financial education of parents as a way of addressing their concerns and increasing the opening rates of these accounts. I also consider another issue raised during my focus groups, namely parental unhappiness with the treatment of older siblings denied a CTF. This is part of a broader concern about the additional help that may be needed for children from particular backgrounds.

This paper is organised as follows. First, I sketch brief details of my focus group study, highlighting details about the methods used as well as the key findings for further research. Second, I investigate in greater depth the issues raised during this focus group study. I look at the issue of those parents who fail to open an account as well as possible steps to provide extra help for particular individuals or groups. A conclusion summarises the ground covered in this paper.

Description of Focus Group Study

My study was based on 7 focus groups in England convened in January and February 2006. About 8 parents attended each group, with 58 participants in all. The study covered parents who receive the standard £250 voucher as well as those who qualify for the higher £500 payment. About a third of participants had the higher £500 payment. Most participants were female although there were also some male respondents. Individuals were each paid a £20 incentive payment for taking part in the discussion. The discussions lasted about one hour. The focus groups were all based at Sure Start centres, which are similar to the Head Start programme in the United States. Sure Start centres are based in deprived neighbourhoods and provide support for local families. Sure Start offered a way of accessing parents who qualify for the £500 payment without too much intrusion.

I found that while parents broadly welcomed this policy, they nevertheless highlighted two key problems with current policy (Prabhakar 2006; 2007). First, difficulties faced in opening CTF accounts. Those parents who had not opened a CTF reported that the main reason why they had not done this was because of confusion over the information received from financial providers. They said that the first year of their baby's life was a busy time and they felt overwhelmed by the information received from competing providers. Those who opened accounts also reported dissatisfaction with the information received from providers about CTF accounts.

Second, there was unhappiness about the treatment of older siblings who did not qualify for a CTF. There was a strong desire among parents to treat all their children equally, and there was unhappiness about older siblings who did not qualify for a CTF. People knew that policy had to start somewhere, and recognised that as time progresses this problem would erode (as all siblings would eventually qualify for a CTF). Nevertheless, the CTF contributed to a perceived unjustness without some measure to help older siblings without a CTF. In fact, this is part of a wider concern about the additional help that might be needed by certain individuals or groups.

I now address possible responses to the issues raised by my focus group study. I look at responses to the non-opening of CTF accounts as well as additional help that might be provided to specific groups. I also highlight the steps the Labour government is currently taking on these points. This paper charts the way that the CTF might evolve as well as the changes to policy that are already occurring.

Investigation of Issues

Non-opening of CTF accounts

The non-opening of CTF accounts by parents is often seen to be a policy problem (BBC News 2006; Ellson 2007). However, perhaps the first question to ask is why this is the case. One view may be that non-opening might simply be a rational calculation of the costs and benefits of opening an account. In particular, the first year of a baby's life is often a time-consuming period of a parent's life. A parent might reason that the time spent searching for opening a CTF account may be better spent on other activities given that the government will open a CTF after a year. The current default for the CTF allows those parents who calculate that it is better for them to open an account themselves to do so, while allowing others to defer this decision to the government. On this view, non-opening of accounts is not in itself a problem but rather indicates the spread of the different parental responses towards the merits of personal versus government intervention.

The above assumes that the decision whether or not to open an account is the outcome of a rational choice made by parents. If we depart from this assumption, then non-opening might be considered a problem. Evidence gathered during my focus group study suggested that parents do not open an account because they feel overwhelmed by the complexity of financial information that they face. Parents here face barriers in their capacity to make informed choices. Higher rates of non-opening in poorer Westminster constituencies suggest that additional barriers are faced by parents in those areas and that non-opening is not simply the outcome of rational decision-making.

Behavioral economics

Behavioral economics provides one way of analysing the non-opening of CTF accounts. Behavioral economics has attracted growing attention in policy circles in recent times (Prendergrast *et al* 2008; Beverly *et al* 2008). Behavioral economics departs from the assumptions of standard economic theory and implies a distinct approach to the design of policy and institutions. As the CTF has not been designed on behavioral lines this approach points to a fresh perspective for the design of policy. Behavioral economics is also relevant for the CTF as it has been applied to decisions about saving. Thaler and Sunstein (2008) provide an influential recent version of this approach. At the heart of this work is an argument about 'liberal paternalism'. This flows from a distinction they make between 'econs' and 'humans'. Econs are the rational choosers of standard economic theory. They are self-interested and seek to maximise their utility. Thaler and Sunstein argue that in reality people do not act as econs but humans. Individuals do not engage simply in a rational calculation of the costs and benefits of different actions but are also influenced by social norms and psychological predispositions. They say that although freedom of choice is important for individual freedom, government has a role in guiding or 'nudging' people towards particular decisions or actions. Government can do this by shaping the background framework or context within which people make decisions. This stance combines a liberal emphasis on freedom of choice with paternalist recognition that government has a role in guiding individual decisions.

The liberal paternalist framework has been applied to decisions about saving. Thaler and Benartzi (2004) argue that standard economic theory predicts that people will pick a saving plan that will maximise their utility over their lifetime. They argue that most people in fact find it difficult to form such a plan given uncertainty over future rates of return, income flows, future health needs and so on. They continue that people respond to this uncertainty by adopting 'rules of thumb' or displaying certain patterns of behaviour. They suggest that people display inertia in their choices, having a bias towards maintaining the status quo. Furthermore, people display are averse to making losses and find it easier psychologically to exert self-control if this can be put off to a future date (e.g. start a diet next week).

Automatic enrolment

Thaler and Benartzi (2004) argue that to improve participation rates in saving, it is better to harness inertia in a pro-saving direction. They propose various 'commitment devices' to support saving. To increase participation, they suggest enrolling people automatically within saving schemes. They acknowledge that although automatic enrolment tends to boost participation rates, individuals will tend to stick with the default contribution rate, which is often set at a low level. To support increased contribution, Thaler and Benartzi devised a Save More Tomorrow (SMarT) programme that builds on people's psychological dispositions. They propose tying increases in contribution rates to increases in salary (with contribution rates rising to a pre-set maximum level). This means that people do not perceive a loss in their wage-packet when making an increased contribution and also makes the decision to exert self-control easier by linking this to wage rises in the future.

The weight behavioral economics places on inertia in decision-making suggest that it is unsurprising that a significant proportion of accounts are unopened. Indeed, this theory predicts that this non-opening is likely to persist. One possible way of addressing this is by applying the SMarT principles noted above. The default for the CTF could be altered by the government automatically opening an account once a child is born rather than waiting a year before stepping in. Efforts might also be made to introduce various commitment devices to encourage parents to save, such as having direct debits from parents into CTF accounts.

Assessment

Automatic enrolment has various costs as well as benefits. Prendergrast, Foley Menne and Karalis Isaac (2008) argue that government would have to specify the default into which people are automatically enrolled. However, the population has diverse preferences and it is difficult for government to specify a default that satisfies all of these preferences (Prendergrast *et al* 2008). For the CTF, government would have to choose the type of account to open for the population as well as which provider or providers to select. It could adopt the current policy of opening a stakeholder account, but there is greater potential for mismatched preferences if government opened accounts for the entire population of parents rather than those who do not open accounts.

Automatic opening might also encourage passivity on the part of parents, notwithstanding efforts to combine enrolment with other measures such as direct debits. A different strategy is to take a more optimistic view of the potential for parental engagement. On current statistics, around three-quarters of parents still manage to take an active decision and open a CTF. This level of participation compares favourably with other types of saving scheme. Thaler and Benartzi (2007) report that in the UK some defined benefit pension schemes only require employees to contract in and not actually make any contributions as these are provided by the employers. They note that data on 25 such schemes reveals only around 51% of employees actually contract into the plan.

Financial education

Rather than alter the current default to allow for automatic enrolment, more effort might be made to encourage greater parental participation through other routes. One option is to rely on financial education programmes for parents. Behavioral economics is sceptical of the impact of these programmes. The assumption made about individual inertia suggests that it is difficult to change a person's behaviour. This perspective predicts that financial education programmes are likely to have a small effect on preferences and behaviour. Evidence exists that supports this view. A review of financial capability programmes for the Financial Services Authority in the UK found that the available evidence suggests that information and education has a positive, but only modest, impact on behaviour (de Meza et al 2008). Although behavioral economics is critical towards formal education, it highlights a promising role that might be played by personal counselling. De Meza *et al* (2008) suggest that differences in psychology rather than differences in information explain much of the variation in financial capability among the population in the UK. However, they continue that a review of the literature suggests that one of the most promising ways of supporting financial capability appear to be the use of active counselling sessions and personalised advice. Although the behavioral approach questions the contribution of general financial education as a way of changing behaviour, it acknowledges that personal advice sessions may perform a useful role in addressing psychological issues.

Such advice sessions can be seen as a type of financial education, namely an approach that prioritises the practical and 'learning by doing' aspects of education. Thus, behavioral economics can be viewed as stressing a particular branch of education rather than a rejection of all types of education. Counselling or personal advice sessions could be offered to parents to guide them on issues surrounding the CTF. Such sessions could tap into existing support services for parents or parental networks. For example, Sure Start centres might offer a personal finance session that could include advice about CTFs. Networks such as National Childbirth Trust (NCT) groups might be used as a forum for parents to share and exchange information and advice. This has similarities with a system of 'targeted mentoring' advocated recently for young people. Paxton and White (2006) say that guidance and advice could be provided to all young people on how to spend their CTFs, with additional mentoring being targeted at those groups with particular needs. Paxton and White say that schools and voluntary agencies could be involved in the provision of such advice.

Changes in government policy

The Labour government has taken various steps to ease the process of opening a CTF. In October 2007, Economic Secretary Kitty Usher asked HM Revenue and Customs to consult on how the process of using vouchers to open CTF accounts might be made easier. In the original policy parents had to send in their CTF voucher to a provider to open an account. In the consultation HM Revenue and Customs canvassed three options: to leave the system unchanged; to make it compulsory for providers to open an account without a voucher; or to have a voluntary system that would remove the legal requirement for providers to have the voucher but leave it up to the provider whether to open an account without a voucher. The majority of consultation responses favoured the last option, mainly because it would allow providers to decide on whether to move to a voucherless system on their own cost-benefit analysis. In Budget 2008, the government announced that from April 2009, the government would implement this option of allowing providers to open an account without a CTF voucher if they wish (HM Revenue and Customs 2008b).

On 24 October 2007, Kitty Ussher also noted that a pilot of face-to-face training for parents provided by the voluntary and community sector took place in Basildon and East London for 5 months. Ussher reports that this pilot was successful and that trainers from the voluntary and community sector will be used for intermediaries in places such as Manchester, Liverpool and Glasgow. This training will last from October 2007 to March 2008 (HM Treasury 2007). In line with the targeted mentoring approach, extra help might be aimed at parents in those areas with higher rates of non-opening. Thus targeted assistance might be used in places such as Glasgow, Liverpool and Bradford to address specific issues faced by parents in those areas.

Additional Help for Particular Groups

Older siblings

A second issue highlighted during my focus groups concerned unhappiness with older siblings denied a CTF. This is part of a broader issue of whether extra help should be provided to particular groups or individuals. Additional help is already part of the CTF. The 'progressive universalist' structure means that children from low-income families qualify for an extra £250 endowment and £250 top-up at age 7 from government. The question is whether such help should be extended. Parents highlighted the issue of older siblings who are not part of the CTF scheme. One can also consider those children who do get a CTF, but might need further help.

For older siblings, parents in my focus groups suggested that one option would be to allow them to split their CTF. Allowing parents to divide up endowments is likely to prove too complex to administer effectively. Parents suggested an alternative of providing an endowment for all older siblings. However, this will inflate costs and is unlikely to be attractive for politicians. Furthermore, this will raise other questions. For example, there is a question of how old older siblings would be allowed to be to qualify for an endowment. Some parents might already have a teenager before having another baby. One might say that 18 is a natural cut-off age for an older sibling as this is the year that a CTF matures. However, should a 16 or 17 year old be able to get an endowment? Some parents in the focus groups argued against providing a CTF beyond school leaving age (which is 16 in the UK). However, this was not a unanimous option and this highlights that not all controversies would disappear if older siblings are provided with an endowment. Perhaps the best policy response is for government and providers to raise awareness of savings accounts that already exist for children. When government is providing information to new parents about the CTF, it might also flag the existing savings accounts that could be used for older siblings. Government might also consider offering tax breaks to some of these accounts to address the unhappiness about older siblings not getting a CTF.

Help for 'looked after' children

The second category concerns those children who get a CTF, but may not be able to get access to the same sort of support from family and friends available to their peers. One group that has attracted policy attention concerns those children who are placed in local authority care. Looked after children are likely to face difficulties in attracting saving from family networks, thus placing them at a relative disadvantage to their peers. Additional help for looked after children will involve steps to tackle this savings gap. One way of addressing this is for other agencies, from the public and private sectors, placing extra deposits into their CTF accounts. Maxwell (2004) proposes that local authorities might make additional deposits of around £50 a year for looked after children. Maxwell, Sodha and Stanley (2006) suggest establishing a separate asset account to run alongside the CTF. This asset would be aimed at improving educational outcomes for those in care, by improving the child's sense of security and ability to plan as well as providing support at key transitions (such as post-compulsory education and training). They propose that government could provide such children with a £200 endowment and make £20 monthly deposits. Such accounts would be made available to all young people immediately as they enter care. Accounts would be frozen if a person leaves care before 18, and the funds transferred to their CTF if the person does not re-enter care. A related way of providing help is for public authorities or private organizations to match savings made by particular groups. David White, Chief Executive of the Children's Mutual (the largest single distributor of CTFs in the UK), proposes that government could match savings of up to £10 per month into the CTF for those on low-incomes (Institute for Public Policy Research 2007).

Additional help for some children has been taken in one of the devolved administrations in the UK. In 2005, the Welsh Assembly in Cardiff implemented a proposal that provided extra help for children in care. From 2006, the Welsh Assembly provides an annual £50 top up for children in care for those local authorities fulfilling their responsibilities.

Conclusion

The CTF has recently been implemented in the UK. A focus group study I conducted on parental attitudes to the CTF highlighted a positive response towards this policy. However, parents also raised various issues of concern. This paper has sought to build on this study by addressing the issues highlighted by the parents. Part of this focuses on how the opening rates of CTF accounts might be increased. One strategy is to rely on a process of automatic opening of CTF accounts by government. I have suggested that one danger with this is that it understates the potential for parental engagement with this policy. I have suggested that a more fruitful approach might be to examine the role of personal advice or counselling sessions. Such sessions might be combined with special help for those parents who appear to face greater barriers in opening accounts. I also looked at the additional help that might be needed for particular groups. Although I caution against providing CTF accounts for older siblings, preferring to rely instead on raising the profile of existing savings accounts, I have suggested that public or private agencies might make additional deposits for those young people who face a savings gap because of lack of access to family networks available to their peers.

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