Levelling up children's investments: Lessons from Child Trust Funds

The Coronavirus pandemic has underscored the importance of personal financial resilience and demonstrated the necessity of having a savings pot to call on to ride out any short-term financial shocks or unexpected expenditures.

But we know that even before the pandemic, the nation's personal finances were in a precarious position, with estimates from the Money Advice Service suggesting that over 16 million people in the UK have savings of less than £100[1].

Young people, in particular, are in a perilous state of financial wellbeing. Figures from the ONS published in 2020[2] reveal that one-in-four young people are struggling with money.

And the pandemic will compound young people's money problems, with the Resolution Foundation[3] finding that young people are much more likely to work in sectors disrupted by lockdowns and are much more likely to be furloughed or experience reduced income.

Having an adequate savings pot is a vital defence against an unexpected bill or expense, and can help prevent someone from relying on friends and family for money, or falling into problem debt. But a strong savings pot can also provide young people with the best possible financial start to adult life, allowing them to invest in their education, a first home or simply save for a rainy day.

The government has a vital role to play in supporting young people to build financial prosperity, and a central pillar of government policy must be to provide the incentives and support for young people to build a solid savings pot to help with their long-term financial resilience.

It is through the Junior ISA (JISA) regime that the government currently provides tax incentives to children's parents and relatives to save for their future.

However, the UK's personal financial resilience is hampered by two fundamental problems:

First, the UK has a cash problem as most people prefer to hold their savings in current or easy access savings accounts despite the low rates on offer, to the extent that the FCA considers excess cash savings as being harmful to the nation's finances. The vast majority of Junior ISAs (JISAs) are held as cash and while these JISA cash accounts typically fare slightly better, often paying above the rate of inflation, they are often better suited to investments given the 18-year time horizon.

Second, participation in long-term savings products is poor and many people in the UK do not have an adequate savings pot to call on. Again, this is particularly true of young people, many of whom will start adult life without a pot of money to invest for their future.

[1] *Money Advice Service, Millions at risk with savings of £100 or less, September 2016*
[2] *ONS, Young people's well-being in the UK, October 2020*
[3] *Resolution Foundation, Young workers in the coronavirus crisis, May 2020*

Lessons from child trust funds

Launched by the Blair Government in 2005, Child Trust Funds (CTFs) were tax-free savings accounts, opened with a government funded voucher, for every new-born child which aimed to provide the next generation with "the backing of a real financial asset to invest in learning, buying a home or setting up a business".[4]

The government provided a £250 voucher for every child born after 1 September 2002. The money could be held in a cash account or invested until the account holder's 18th birthday, when the account becomes that of the child and can be transferred to an adult ISA.

The government provided a further payment of £250 for children at age seven and children in lower income households were given an additional contribution of £250.

Parents were encouraged to make additional contributions, initially up to a maximum annual limit of £1,200 until the scheme was discontinued in 2011 in favour of Junior ISAs (JISAs), which do not have an initial government-funded contribution.

Around six million accounts were opened before the scheme was discontinued in 2011, with the first accounts maturing in September 2020. Over £1bn worth of accounts will mature this financial year.

The jury is still out on whether CTF's were ultimately successful as a tool to promote long-term savings engagement, and the scheme has rightly received criticism for denying some children access to the accounts under the Mental Capacity Act 2005. But the scheme shouldn't be written off and confined to the history books, as there are important lessons to be learnt for the current JISA regime to help level-up children's investments.

As developed in this report, we are calling on the government to take inspiration from CTFs to improve the JISA landscape in two main ways:

- **Conduct a ten-year review of the JISA regime** to explore opportunities to nudge parents towards stocks and shares accounts
- **Establish a new 'Help for Tomorrow' scheme** aimed at levelling up JISA participation by providing an incentive for parents who might otherwise not be able to afford to put money aside in an account.

[4] *Labour Party, 2001 Election Manifesto*

Section 1: Can lessons from CTFs help increase investment participation?

Cash is king for UK savers. While possessing cash savings is no bad thing, the FCA has found that too many people in the UK are holding too much of their savings in current or easy access savings accounts.

Of those with £10,000 or more of investable assets in the UK, 37% do not have any investments at all and are holding all their assets entirely in cash[5]. A further 18% were holding more than three-quarters of their investible assets in cash.

Unsurprisingly, this means that cash ISAs far exceed stocks and shares ISAs in popularity, with around 71% of all ISA accounts being cash only products[6]. The rest are split roughly equally between stocks and shares ISAs and combined cash & stocks and shares ISAs, with slightly over three million of each. In a typical year only around 22% of all ISA subscriptions are directed towards stocks and shares ISAs.

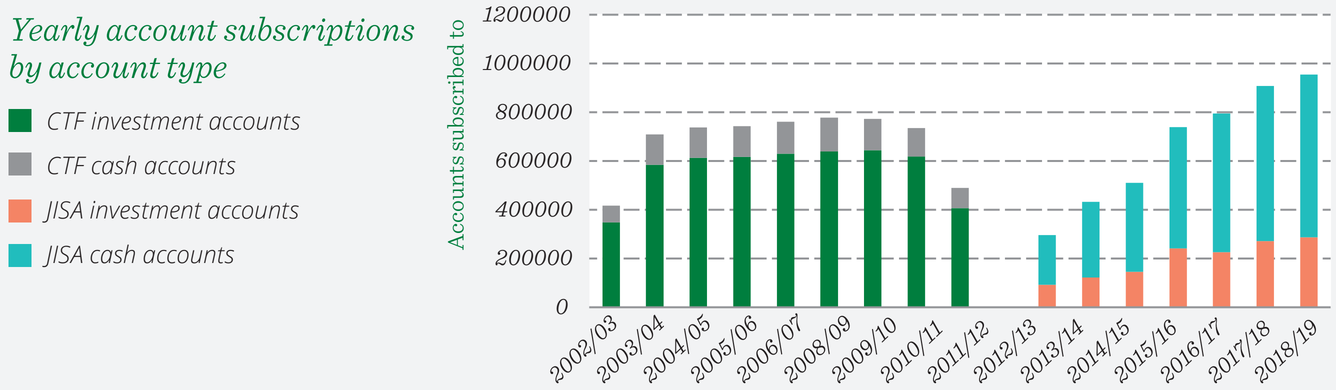
Of course many will choose to invest through other vehicles beyond just ISAs, but as a proxy for gauging our national saving habits, the UKs 15.5 million cash ISA holders show us that cash is the asset class of choice, and relatively few of us are likely to choose to invest our money in the stock market.

This is despite the fact that many cash accounts offer minimal interest, and in many cases offer less than the rate of inflation, meaning the money deposited is losing value in real terms.

And the cash problem starts early. The vast majority of JISAs are also invested in cash, despite the fact that cash accounts are unlikely to be the most suitable option given the money will be inaccessible for potentially 18 years, and will benefit from years of compound growth.

However, the graphic below shows that CTFs were not cash-heavy, and in fact in any given year around four-fifths of CTF accounts were invested, compared with just under a third of JISAs currently allocated to stocks and shares accounts:

Yearly account subscriptions by account type



Source: HMRC [7]

Why were so many CTFs invested as opposed to held in cash?

At every opportunity, parents were nudged towards selecting an investment account, and if parents did not make an active selection, the account was automatically defaulted into an investment account.

There were three main types of CTFs: savings accounts for those that favoured cash over stocks and shares; stakeholder accounts which were invested accounts with design features intended to manage investment risks; and investment/shares accounts which were invested accounts, with investments selected by parents.

Parents were able to choose any of these three accounts from a list of eligible providers, but if they did not make an active decision to select an account from one of the providers, the government would invest the voucher on behalf of the child in a stakeholder account. These were known as Revenue Allocation Accounts (RAA).

Where parents did make a conscious decision to select an account, they were steered towards investments over cash through guidance provided by the government, which emphasised the favourable return profile of investments compared to cash given the long-term nature of the accounts:

> *"When putting money away for a long time, accounts that invest in shares almost always produce a better return than savings accounts. In fact, this has been the case for every 18-year period in the last 40 years. This doesn't mean that there were not some years when shares didn't perform well. But when shares don't do well in one year, this is usually made up for by better performances in other years"[8]*

[5] *FCA, Evaluation of the impact of the RDR and FAMR, December 2020*

[6] *HMRC, ISA statistics, Number of individuals subscribing by income, June 2020*

[7] *HMRC, ISA Statistics, Amounts subscribed to each component, and average subscription, June 2020 and HMRC, Child Trust Funds: detailed distributional analysis, February 2013*

[8] *UK Government, CTF booklet for parents*

Furthermore, the journey map in the literature nudged parents towards opening an investment account:

Which type of Child Trust Fund account for my child?

The Child Trust Fund (CTF) is a longterm investment. Choosing an account that invests in shares could mean your child's money grows to a larger sum. But you could get back less than you put in. How do you feel about this?

I am happy to invest in shares and take a higher risk if it means my child might get more at 18.

Shares account (non-stakeholder)
- Invests in companies' shares
- It grows if those shares do well
- **Shares accounts almost always do better than savings accounts**
- **This has been the case for every 18-year period in the last 40 years**
- Shares can fall as well as rise so you could get back less than the amount put in
- There are no rules to reduce the risk when investing for the longer term
- There is no limit on the charges your CTF provider can make for running the account

I understand that investing in shares and taking some risk might mean my child gets more at 18, but I'm a little unsure about shares.

Stakeholder account
- Invests in companies' shares
- It grows if those shares do well
- **Shares accounts almost always do better than savings accounts**
- **This has been the case for every 18-year period in the last 40 years**
- Shares can fall as well as rise so you could get back less than the amount put in
- Has to follow Government rules to help reduce the risk
- Money has to be spread over a range of investments
- When your child is 13, money is gradually moved to more secure investments
- The total charge your CTF provider can make for running the account is no more than 1.5 per cent a year - no more than£1.50 for every £100 in the account
- The CTF provider has to allow you to pay in amounts from as little as £10

I don't want to take the risk of investing in shares and realise my child might get less at 18.

Savings account (non-stakeholder)
- Does not invest in shares: this is the cash option
- At 18 your child will get back whatever has been put in, plus some interest
- **Your child might not get back as much as they could with an account that invests in shares**
- There are no rules to reduce the risk when saving and investing for the longer term
- There is no limit on the charges your CTF provider can make for running the account
- You will not see a charge on your child's statement. Your CTF provider will take their costs into consideration before setting the interest rate

Source: CTF booklet for parents, National Archives

And when indicative future values were given for the stakeholder account, they were based on accounts invested in stocks and shares:

This table shows how your child's CTF account could grow over 18 years

Value of voucher	*Contribution*	*Final amount*
£250	£10 per month	**£4,500**
£250	£25 per month	**£9,500**
£250	£50 per month	**£18,000**

Please note the following *This table can only give you an idea of the final value. There is no guarantee that your child's CTF account will reach the value shown. The final value may be higher or lower. Values are rounded to the nearest £500. Includes further Government payments at age 7. It assumes that your child's CTF account is a stakeholder account, with a management fee of 1.5% and a growth rate of 7% a year and assumes that shares are moved progressively to more secure investments from age 13 to 18.*

Source: CTF booklet for parents, National Archives

CTF providers were also required to offer at least a Stakeholder account and were not permitted to offer only a cash account. Evidence suggests the majority of parents selected an account from a financial services provider with whom they are already familiar[9], often their high street bank, so the fact that all providers were required to offer an investment account prevented cash accounts from being favoured at familiar providers.

What lessons can be learnt from CTFs?

The nudges towards stocks and shares, defaulting of accounts to investments and the requirement for all providers to offer investment accounts appears to have had a powerful effect on investment participation, with around 83% of all CTF accounts opened investing in stock markets, predominantly in Stakeholder accounts selected by parents or as allocated by HMRC[10].

However, as we have already seen, the ratio of stocks and shares to cash accounts fell dramatically following the end of the CTF scheme and the transition to JISAs. JISAs are much less likely to be held in investments, despite the fact that equity exposure is almost certain to be more appropriate for children than cash. Fewer than a third of annual subscriptions to JISAs go into a stocks and shares account, a significant drop from the proportion of CTFs that were invested.

What can the government do?

Recommendation 1: The government should initiate a 10-year review of JISAs in order to understand the reasons why so few parents and grandparents select investment accounts, and to develop a green paper of policy recommendations to encourage more JISA accounts to be held as stocks and shares. As part of this review, the government could consider parents and grandparents decision making process when they open a JISA for their child or grandchild and the nudge framework around JISAs. This can be compared with the CTF framework to determine whether lessons can be learnt from the CTF literature to increase investment participation, and to ensure that the risks of cash accounts are properly considered.

Recommendation 2: The government should make financial education a mandatory element of the national curriculum, and ensure that the risks of inflation and the opportunity cost of cash savings are included as part of this financial education. That way, once the child is able to control their JISA at the age of 16, or CTF at the age of 18 they are equipped with the knowledge they need to make a more informed decision on their future savings or investments.

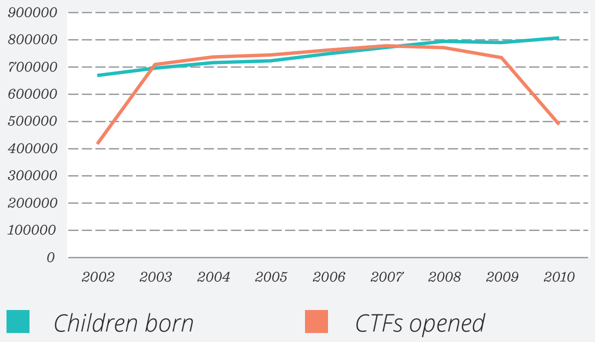
[9] University of Bristol, CTF wave 2 evaluation, January 2011
[10] HMRC, CTF distributional analysis, February 2013

Section 2: How to create a new generation of savers

The universal element of CTFs meant that all children, regardless of location or socio-economic background could participate in long-term savings and receive a capital sum that could be used to invest in their future. Children from lower income households (defined as those with household income below £15,575 in 2008/09) also received an additional payment of £250.

During during the life of the scheme (September 2002 – September 2011) 6,141,000 CTFs were opened, compared with 7,523,313 births in the UK between 2002 and 2011[11]. The number of accounts opened is slightly lower than the number of births, reflecting the low uptake at the beginning and end of the scheme, as can be seen when plotting the number of births against the number of accounts opened.

CTFs opened v children born



Source: The ONS[12] and HMRC[13]

As a consequence and by design, virtually every single child born during the life of the scheme had access to a long-term savings product to kick-start their financial future. Sadly, the government do not provide data on the number of JISAs opened each year by child age, so we can't directly compare the number of children with tax efficient savings products at various ages.

However, to put the numbers into context, roughly 42% of the adult population have an ISA, and around 82% of eligible children had a CTF[14].

What lessons can be learnt from CTFs for JISAs?

JISAs bear similarities to CTFs insofar as they permit both cash and stocks & shares investments and are tax-advantaged, shielding the savings and investments from tax while they are held within the accounts.

But the key difference is that a JISA provides no starting subscription incentive, contribution matching or other direct contribution from government. All contributions into a JISA must be made by parents, grandparents, friends or relatives or the account holder themselves.

And young people of today are arguably in much greater need of a helping hand in saving given the high costs associated with buying a home or funding further education. For example, to save enough to afford the average-first time buyer deposit[15] in 18 years time (assuming 2% deposit size growth from today) a new-born would need to save £3,129 annually into a JISA for the full 18 years.

This is more than triple the current average annual JISA subscription, which stands at around £1,020. The amount needed for a first-time buyer deposit in various regions is shown in the table below.

Region	*Average first-time buyer deposit in 2039*	*Yearly subscription needed (5% growth with 1% charges)*
UK	**£83,443**	**£3,129**
Scotland	**£52,074**	**£1,952**
Wales	**£47,584**	**£1,784**
Northern Ire-land	**£43,009**	**£1,613**
Yorkshire and Humberside	**£48,531**	**£1,820**
North West	**£50,037**	**£1,876**
East Midlands	**£56,891**	**£2,133**
West Midlands	**£61,276**	**£2,297**
East Anglia	**£74,481**	**£2,793**
South West	**£74,876**	**£2,807**
South East	**£94,562**	**£3,545**
Greater London	**£189,906**	**£7,120**

In contrast with JISAs, CTS were provided with an initial subscription to encourage further savings. As a result, the uptake of CTFs is much greater, although this did come at a cost of between £250m and £300m for the government each year.

Year	*Govt contribution*
2002 - 2003	**£300m**
2003 - 2004	**£300m**
2004 - 2005	**£250m**
2005 - 2006	**£250m**
2006 - 2007	**£250m**
2007 - 2008	**£250m**
2008 - 2009	**£250m**
2009 - 2010	**£250m**
2010 - 2011	**£150m**
Total	**£2.25bn**

Source: HMRC response to Quilter Freedom of Information Request. Rounded to the nearest £50m

However, the trade-off in providing savings accounts to all is that ongoing engagement was poor. Quilter's research found that over half (57%) of parents surveyed did not know which provider the CTF account was held with and two-fifths (39%) said they didn't know if the CTF was held in cash or stocks and shares.

Parents in low income households were much less likely to know which type of account their child had, with 50% of parents in the lowest income bracket (up to £15,000 a year) saying they were unsure where it was held, compared to 25% in the highest income bracket (£90,000+).

And we know that when parents did not make an active decision on what type of account they wished to open for their child, ongoing contributions were limited. The average market value of an RAA account (which was the default option if parents did not make an active decision) stood at just £489 in 2012 compared with £908 for parent-opened stakeholder accounts.[16]

[11] ONS, Vital statistics in the UK: births, deaths and marriages, January 2021
[12] ONS, Vital statistics in the UK: births, deaths and marriages, January 2021
[13] HMRC, CTF distributional analysis, February 2013
[14] HMRC, ISA statistics, Market value of ISA funds by country and region, June 2020
[15] Halifax, Average first-time buyer deposit, 2020
[16] HMRC, ISA Statistics, June 2020

What can the government do?

Recommendation 3: The government should collect, analyse and publish much richer data on JISAs, including regional data on where the children with accounts are located in the UK, and distributional data on the parents of JISA holders. HMRC currently provide this data for other adult ISAs, and it should now also do this with JISAs to allow the government to assess the public policy implications of the savings product.

In order to develop our understanding of children's long-term savings products more generally, as well as the effectiveness or otherwise of CTFs, the government should collect information on how CTF holders use their CTF at maturity, withdrawal rates, switches to other products including adult ISAs and suspected dormant accounts.

CTF account holders should be surveyed on their future financial plans, and the extent to which CTFs and associated financial education encouraged them to develop savings and investment behaviours for the long-term.

Collecting this data will ensure that the government and other interested parties can make a more detailed assessment of the merits of various long-term savings products and provide a richer picture on the policy changes that should be made to promote long-term savings among young people.

Recommendation 4: The government should consider implementing a 'Help for Tomorrow' scheme, which should be designed to offer parents who might not otherwise be able to afford to open a JISA for their child a voucher to open an account, and an incentive to make ongoing contributions.

The specifics of such a scheme, including eligibility, would require more detailed analysis of distributional data on households opening and contributing to JISAs currently. However, as an example, the government could allocate £50m to provide 200,000 JISA opening vouchers worth £250 to new-born children in households who claim either Child Tax Credit or Universal Credit[17].

The vouchers will not be mandatory, and instead parents will have to apply for a voucher from the government. This means they will have to make an active decision to start saving for their child's future and, combined with an ongoing contribution incentive, should help promote ongoing engagement.

To incentivise ongoing contributions, the government could provide a top-up of 15% of all contributions paid into a JISA from parents who receive Universal Credit or Child Tax Credit. The top-up should be discontinued when the child reaches 15 in order to prevent the recycling of the contribution.

In the 2018/19 tax year, just under £1bn of capital was placed into JISAs. In the absence of detailed distributional data on the income range of those contributing into a Junior ISA it is difficult to say how much of this capital was contributed by parents on in receipt of Child Tax Credit or Universal Credit.

However, we know that around 13% of all additional contributions into CTFs were made into accounts that received an additional government contribution (as the parents were eligible for Child Tax Credits)[18]. Using this figure as a proxy for the proportion of JISA contributions made by parents on low incomes, the 15% government funded JISA top-up would cost around £19.5m each year.

Taken together, such a scheme would cost the government around £70m per year, broadly in line with the Help to Save scheme, which costs around £70m each year and under a third of the yearly cost of the CTF scheme.

[17] There were 712,000 births in the UK in 2019, so 200,000 vouchers will be sufficient as long as under 28% of new-borns are to parents on Universal Credit or Child Tax Credit.

[18] HMRC, CTF distributional analysis, February 2013. 18% of the working age population are in receipt of Universal Credit.

Lessons from child trust funds

Despite being far from a success, CTFs were an important experiment in promoting long-term savings and there are certainly lessons that can be learnt from the scheme to give every child they best possible financial start to adult life.

As has been established, the ratio of stocks and shares accounts to cash accounts fell considerably following the transition from CTFs to JISAs with now only around a third of all JISAs being held in investment accounts, despite the fact that the money will be locked away for many years. Savings behaviours are developed early, and the excess JISA cash savings will only exacerbate the wider cash problem among adult savers.

To promote participation in investments, the government should undertake a ten-year JISA review to understand the reasons why so few parents select investment accounts, and consider implementing various 'nudges' to steer parents away from cash accounts, which are unlikely to be the most suitable option for their child. It would also be valuable for financial education to be a mandatory part of the curriculum, and for this education to emphasise the risks and rewards of various asset classes.

Furthermore, CTFs were the closest the UK has come to a system of universal basic savings, and were successful in expanding young people's participation in investment and savings products given that accounts were offered to every new-born child, compared to the situation today where JISAs are no longer universal and have no such incentives. The government should publish regional and distributional data on JISAs to accurately determine the socio-economic position of JISA subscribers, which will assist in designing an incentive programme to boost JISA participation.

Such an incentive programme, which we have called the 'Help for Tomorrow' scheme, could provide parents of new-born children who receive Universal Credit or Child Tax Credit with a £250 voucher to open an account (up to 200,000 should be available). The government should consider providing an additional top up of 15% of all contributions paid into a JISA by these parents. This would cost the government around £70m a year, broadly in line with other savings incentive schemes and well-below the cost of the CTF scheme.

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