


The Actuarial Profession
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Child Trust Fund – A Trojan Horse or a White Elephant?

Graeme McAusland and David Gulland

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Agenda

- Background to CTF
- The case for a White Elephant
- The case for a Trojan Horse
- Audience participation

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Background to the CTF

- Government objectives
- Overview of HMRC process and cash flows
- Other aspects of product design and charges
- Current players

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Government objectives – CTF Bill

- Help people understand the benefits of saving and investing
- Encourage parents and children to develop the saving habit and engage with financial institutions
- Ensure that in future all children have a financial asset at the start of adult life
- Build on financial education to help people make better financial choices throughout their lives

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Overview of HMRC process and cash flows



- Signing up for Child Benefit is catalyst for voucher
- Voucher sent to parent includes URN for child
- Booklet produced by HMRC
- £250 paid to all children rising to £500 for those on full Child Tax Credit (household income <£14k) ~ approx 35% of children!
- Parent chooses provider (or not) if not HMRC allocated
- Additional amounts at later ages – 7 and perhaps 12

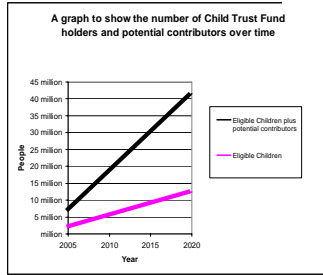
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Market Will Grow Quickly

- The Child Trust Fund market will grow to a point where all children will have one and millions of parents will be making contributions.
- By 2009, the likely date of the next election, there will be 5 million CTF holders and up to 11 million unique CTF additional payers.

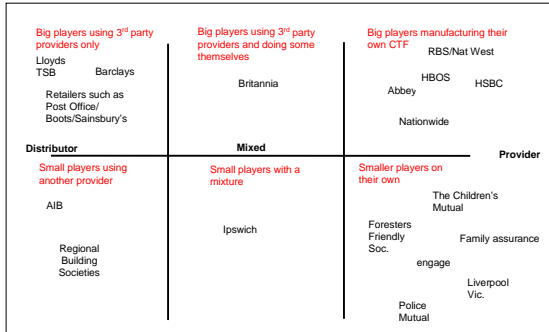


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Understanding the changing nature of the market: CTF market competitor landscape



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Product design and charges

- CTF is a wrapper
- Stakeholder / Non-stakeholder
 - Stakeholder:
 - 1.5% pa price cap
 - Equity based in early years
 - Investment restrictions
 - No transfer penalties
 - Non-Stakeholder:
 - Cash
 - Equity / Other
 - Have to make stakeholder available
- Maximum current contribution £1200 pa
- Most stakeholder OEIC based

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Making additional contributions to a CTF

PARENTS

- Most have desire to contribute
- However:
 - affordability is an issue for some
 - planning to begin when child is older/ finances settle down
 - others have established accounts in place
 - question likelihood of transfer?

PARENTS TO BE

- Waiting to assess financial situation
 - may not be in a position to contribute for some time after baby's arrival

But over time, reliance on CTF as primary savings may increase

- already set up therefore easy to use as repository?

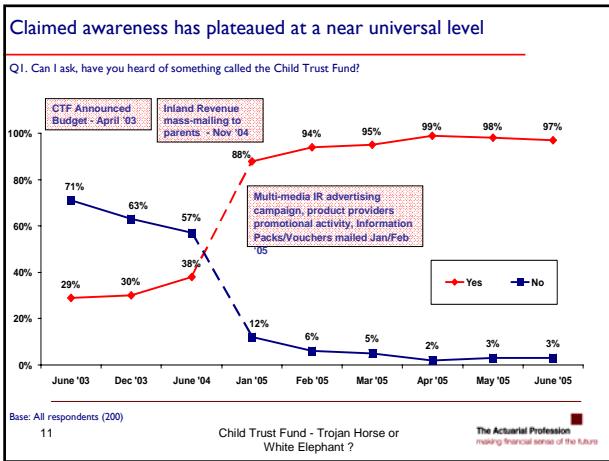
GRANDPARENTS

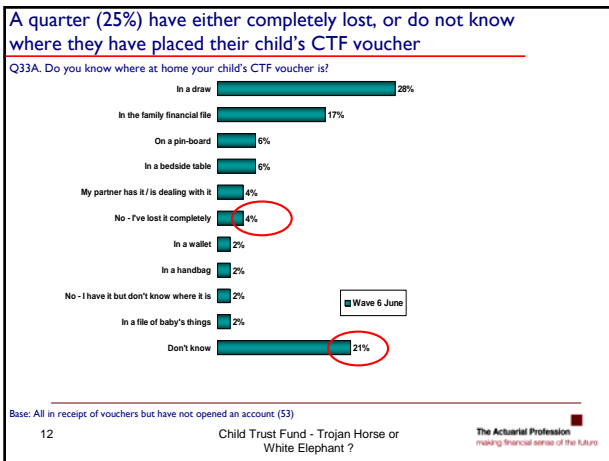
- Unlikely to make regular contributions
- However will deposit 'birthday'/ Christmas money....
 - one parent had distributed account details card to grandparents
 - embarrassing, but useful
- Some also considering occasional/ ad-hoc lump sums
- For one, CTF had raised issue of financial contributions

"This CTF was a catalyst for me and my daughter to talk about contributions."

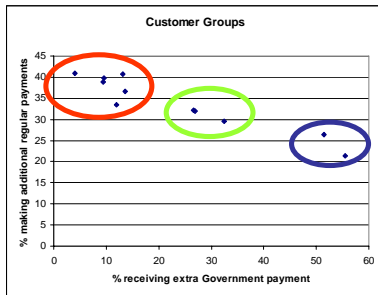
"At our stage of life, the worst thing you can do is to get involved in anything where you stipulate a certain amount on a regular basis. At our stage of life you don't know what is going to happen and we haven't got as much or as many resources to back us up in our later years."

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Who is responding?



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What do parents think?

- CTF in general
 - "I've received so much information to read that I feel overwhelmed. To be honest if I get 5 minutes peace and quiet I'm not going to spend it reading a financial brochure"
 - "Now I've set it up this will become my child's main account"
 - "The deadline prompted me into doing something"
 - "My Mum had seen the adverts and was keen for me to get it set up so that she could pay some money in"
 - "It's not often you get money back from the Government- I hope they continue the trend"
- Placing the voucher
 - "I tried to place but the queue was so long in the branch that I gave up"
 - "I didn't know you could do it on the web"
 - "I like to be organised, so I had everything sorted within a week of my baby being born."
- Revenue allocation
 - "I forgot to place it in time and now I am something to do with an island or was it Nationwide?"

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- The case for a Trojan Horse
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The case for a White Elephant

- Financial reasons
- Political risks
- Consumer risks

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Financial Reasons (1)

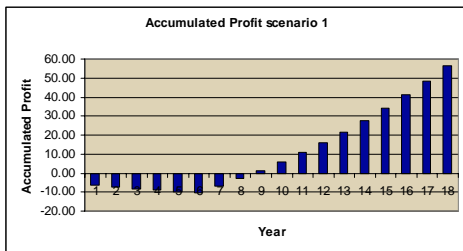
- The CTF could be a classic case of pricing using wishful thinking, and is uneconomic on traditional approaches:
- Consider a simple traditional profit test of a single policy:
- Even with efficient processes if we just receive the voucher and additional amount after 7 years then...

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What happens with just the voucher?

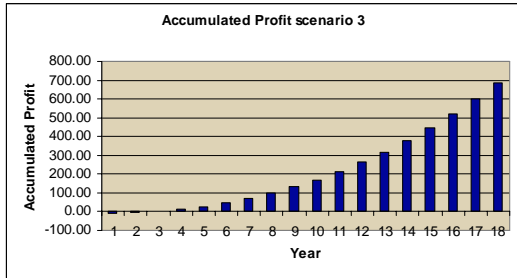


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It only works if you get additional contributions... (figures show impact of £20pm)

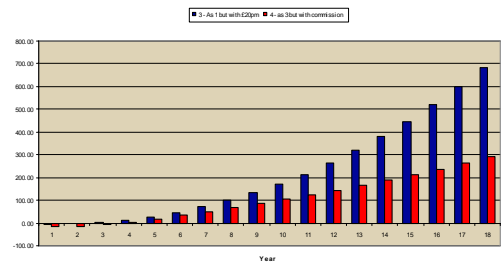


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But if you do get additional funds you'd need to reward the distributor...

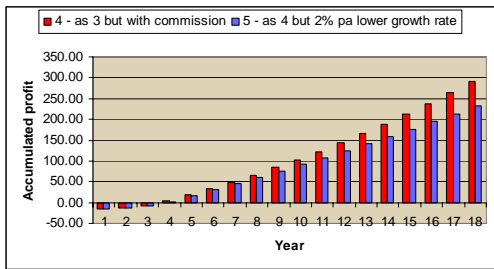


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Fund performance does not have much impact, does this encourage an alignment of interests?



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Results of profit tests

- The policy is just too small
- The charges are too small
- The payback period is too long
- Any reasonable profit depends on significant additional contributions
- And the power is with the distributor

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Financial Reasons (2)

- The dilemma of a specialist: to do CTF efficiently needs specialism, but specialism is likely to increase ICA requirements
- Reliance on distributors, especially supermarkets and specialist retailers – not traditionally loyal partners to product providers?
- Large number of small transactions and reporting to HMRC – cost implications

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Political risks

- Requires long-term commitment from government
- Requires the maintenance of the top-up amounts at ages 7 and later
- Political parties' views are mixed (but is it too late to change?)

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Consumer risks

- Its new ! Consumers distrust new.
- Its from the government ! Consumers distrust politicians.
- It's a CTF not a provider's brand. Or rather, it is chosen by the attractiveness of the cuddly toy (get pictures of the various ones in market) so no cross-selling possibilities

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The case for a Trojan Horse

- Financial – need to look at “project pricing” not traditional single policy approach
- Cultural – Callum McCarthy says existing financial services model is broken, is CTF forebearer of the new model?

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Financial – the power of scale

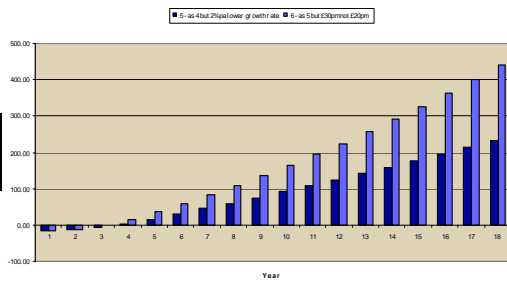
- 100% market coverage provides the opportunity for scale
- Automation of systems coupled with relatively simple product design controls costs
- On-line processing helps manage costs
- Consumer engagement benefits lead to more realistic commission discussions
- Parents and families behaviours change
- Additional contributions can be encouraged – families are emotionally positive about saving for children (unlike pensions)

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Financial – the power of upscaling



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The contents of the Trojan Horse (1):

- Administration capabilities for high volume of small policies
- Administration capabilities for links to government bodies
- A chair at policy/government discussions
-Anyone for NPSS?

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The contents of the Trojan Horse (2)

- Customers are inert
- Specialist players don't have the baggage/reputation that many others have over Personal Pensions, Mortgage Endowments etc
- Other markets show how a new brand can enter an existing market (Lexus, Innocent, Café Nero)
- ...high opportunity for other products (trust and emotion are key)

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The contents of the Trojan Horse (3)

- Does CTF open the door to the wider family?
- FSA's "next big thing" is likely to be financial capability – how will trusted CTF providers be viewed then?

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