

Financial Services Consumer
Panel response to: HMT's
discussion document –
Savings and Assets for all

July 2001

Savings and assets for all

Financial Services Consumer Panel response to:

HM Treasury's discussion document – *savings and assets for all*

Contents

Summary.....	2
Policy objectives.....	4
Policy framework.....	5
Policy options – Child trust fund.....	5
Keeping accounts live.....	5
Additional contributions.....	6
Access to funds.....	8
Financial education and the savings habit.....	9
Policy options – Saving gateway.....	10
Eligibility and type of savings vehicle.....	10
Matching.....	11
Savings habit.....	11
Access.....	11
Risk and private sector involvement.....	12
Financial education and advice.....	13
About the Financial Services Consumer Panel.....	15
Who is on the Panel?.....	15
How to contact the Panel.....	17

Summary

- a) The Government needs to be clear which of an individual's financial planning needs each of the proposals is aimed at meeting. They also need to be clear about who each of the proposals would be suitable for. Page 5
- b) The Government needs to be clear about who owns the Child Trust Fund, the child or parent? This will help answer some of the questions posed about the proposals. Page 6
- c) Government should be aware of the unintended consequences of tax incentives which can over complicate products. Page 7

- d) The Child Trust Fund must be simple and suitable for the mass of the population. In order to meet this, the Government needs to be specific about the objectives or financial needs of the consumers that the Fund is intended to meet. This will help determine the correct investment strategy for the Fund. Page 8
- e) The proposals should minimise the likely development of a secondary market, such as the secondary market that currently exists of borrowing against a benefits book. Page 9
- f) The proposals need to set out whether they are aimed at developing the savings habit or giving every young adult an endowment. The aims may be at odds with each other. Page 10
- g) Alternatives to matching, such as an enhanced interest rate, may help avoid some of the pitfalls of the current proposals by deterring the development of a secondary market. Page 12
- h) The overriding need to keep the Savings Gateway simple suggests that it should be restricted to cash only. Page 12
- i) Whilst important, financial education is not the solution to all consumer protection issues and is limited in what it can achieve. Page 14
- j) These proposals must be backed up by a strategy to increase access to general financial advice on basic financial planning or significant consumer protection issues will occur. Page 14

Policy objectives

1. The Panel broadly welcomes the proposals and notes that this approach to encouraging savings balances the tax breaks given to the well off in other initiatives.
2. However, the lack of specific policy objectives throughout the document makes it difficult to respond to the consultation. In para. 1.6 and 3.2, the Government outlines the three aims of saving generally: for a rainy day (such as temporary unemployment), retirement or to widen opportunity. Whilst these may be the general aims of saving, it is not clear which of these objectives the Government expects its proposals to achieve and for whom. In the light of this, our response makes some general points and gives some initial reactions only. We look forward to seeing further details of the proposals so that we can give a more considered response.
3. In para. 3.2 the aims are described as an independent financial adviser's (IFA's) typical advice to those with no saved assets as the order of priority for their savings. But individuals may have financial planning needs ahead of saving. For example, before saving, individuals may consider other needs such as paying off debts or their protection needs. Similarly, an IFA's advice may differ for those on incomes that interact with means tested benefits.
4. Deciding what specific objectives the proposals are aiming to achieve will be crucial in answering the questions such as when to allow the money to be drawn down (in the case of the Child's Trust fund). Similarly, the Pearl research referred to in the paper shows that there are various patterns of individual saving, e.g. saving for a particular purpose then spending it all. What drives people to spend their savings may be as important as the process of saving itself. Addressing the process of saving and spending

as a whole will also help answer some of the questions around the interaction with debt.

The Government needs to be clear which of an individual's financial planning needs each of the proposals is aimed at meeting. They also need to be clear about who each of the proposals would be suitable for.

Policy framework

5. The desirability of targeting incentives to specific groups needs to be balanced against the risk of complicating the scheme and depressing take-up. The policy framework should include as an objective maximising take up amongst target groups. Experience of means-testing shows that some people fail to take up benefits to which they are entitled, even where they are aware of them, because of a fear of social stigma, or because they find the whole process too complex.
6. We agree with the assertion in paragraph 4.6 that it is important to have coherence with other policy areas and draw the Government's attention to the disincentives to save in the social security system. For example, the social security system makes saving in life assurance advantageous compared to other forms of saving and the rate at which tariff income is calculated on savings (for the purposes of benefit assessment) is now considerably higher than the rates of interest obtainable in the market place.
7. Government should look at similar schemes in the past and assess their successes and failures.

Policy options – Child trust fund

Keeping accounts live

8. Paragraph 5.6 – *'What options, in addition to provision of regular statements, could be considered for keeping a Child Trust Fund account "live"?'*

9. Keeping the Child Trust Fund “live” may be one way of engaging the child with the fund. The Government needs to be clear about whether it is trying to target parents or children and who owns the money. If it is the children, the rules on when children can open and operate an account in their own names, and the role of the parents, may need an overhaul. Currently they are confusing and practice differs between organisations and between Scotland and the rest of the United Kingdom, as does the definition of a child.

The Government needs to be clear about who owns the Child Trust Fund, the child or parent? This will help answer some of the questions posed about the proposals.

Additional contributions

10. The ownership of any additional contributions needs to be clear (and see our comments at paragraph 17, below). If the additional contributions cannot be withdrawn from the fund by the donor, then the donor needs to be clear that they are making an irrevocable gift. If they can be withdrawn, it will be important that donors are doing what is suitable for them in the context of all of their financial needs. The provision of generic advice to help individuals consider other needs such as paying off debts or protection insurance will be important to reduce the risk of consumer detriment. Individuals on means tested benefits may be particularly at risk from a lack of information about the interaction of various forms of savings and benefits.
11. Paragraph 5.8 – *‘Should there be a tax incentive for additional contributions, and if so, up to what limit?’*
12. The acid test throughout the design of the Child Trust Fund should be simplicity. A more complex product may introduce consumer protection issues which are a high price to pay for incentives that favour the better off. As stated above, contributions should be made by a donor having considered all their financial needs and tax incentives on donations do

introduce the prospect of industry using, or mis-using, the concept of tax incentives in the marketing of these products/contributions.

13. Another consequence of tax incentives on additional contributions is the possibility of individuals finding themselves outside the law by having illegally benefited from tax advantageous contributions. Government should learn the lessons from the over-complication of ISAs which had the unintentional consequence of individuals violating Inland Revenue rules without realising. Confusion may be further exacerbated by the fact that a household's income will change overtime potentially qualifying them for differing tax breaks.
14. Any scheme should certainly be designed to avoid practical difficulties such as the need to complete a self-assessment tax return. Another tax implication might be that if a parent gives a child assets which produce income of more than £100 a year, the income is taxable as the parent's. At current interest rates, this is unlikely to affect lower-income families, but depending on the eventual form of the scheme its implications for parents who give regularly over a number of years should be reviewed.

Government should be aware of the unintended consequences of tax incentives which can over complicate products.

Investment strategies and private sector involvement

15. Paragraph 5.10 – *‘Should the Child Trust Fund offer the option of different investment strategies, or should it offer only one, risk-averse, investment option?’*
16. It will be vital to keep the Child Trust Fund simple. The experience of consumer confusion about different types of ISAs¹ demonstrates the importance of simplicity. Therefore, the type of ‘strategy’ offered must be dependent on what is suitable for the mass of the population in order to meet the objective, as yet not specified, of this initiative.

¹ FSA ISA Benchmarking Research, May 2000

17. The Child Trust Fund is a product so different in its nature from the Savings Gateway that, unlike the argument we make later, in paragraph 28, on the savings gateway, we make the following point. It must not be assumed that a 'risk-averse investment option' for the Child Trust Fund would be a cash only one. Cash only savings over the long term pose a risk of effective erosion of capital through a relatively low growth rate.
18. The objectives of the product must be clear. If it is intended to be a 'safe harbour' product, this is different from a product with consumer education advantages.

The Child Trust Fund must be simple and suitable for the mass of the population. In order to meet this, the Government needs to be specific about the objectives or financial needs of the consumers that the Fund is intended to meet. This will help determine the correct investment strategy for the Fund.

19. Paragraph 5.10 – *'What role is there for private sector financial services providers and mutual societies in delivering the bundle of services (deposit capability, investment management, advice and information) that could make up a Child Trust Fund?'*
20. Recent changes in the financial services industry, such as the decline of the direct sales force, suggest that advice may not be readily accessible for low-income consumers, unless the scheme incorporates a range of products which the industry is keen to sell. However, the sales motive may mean that advice is not always disinterested. In designing the scheme, the Government must ensure that any incentives for the industry to participate do not encourage mis-selling.

Access to funds

21. Paragraph 5.13 – *'Should parents have access to any additional contributions they have made into their Child's Trust Fund?'*

22. The key factor here is who owns the money. Allowing parents access to what they put in complicates matters and would seem odd if the trust fund belongs to the child.

23. Paragraph 5.13 – *‘At what age should young adults gain access to their Child Trust Fund assets? Should the assets in a matured fund have restrictions placed upon its use?’*

24. We draw the Government’s attention to the danger that secondary markets, which would undermine the objectives of the proposals, could grow up around these funds with teenagers borrowing from loan sharks on their ‘expectations’. Similar problems currently exist in the practice of individuals borrowing against their benefits books in advance of payment of their benefits. In considering the age at which young adults gain access to their funds and whether the use of matured funds should be unrestricted, Government may want to consider the likelihood of consumer protection problems resulting from the development of secondary markets.

25. The paper refers to the US model, which has yet to mature, with funds restricted to investments in lifelong learning, enterprise or housing. However, it is a rare 20-year old who can start a successful enterprise; low-income students should get their tertiary education free anyway, and a car to get to the local college in a rural area might be an absolute necessity. The Government must go back to its objectives in deciding whether the use of funds should be restricted.

The proposals should minimise the likely development of a secondary market, such as the secondary market that currently exists of borrowing against a benefits book.

Financial education and the savings habit

26. Paragraph 5.16 – *‘What would be the best way to build in financial education into a Child Trust Fund, especially bearing in mind the objective of using it to develop young people’s savings habits?’*

27. The aims of the Child Trust Fund proposals may be at odds. Consumer education objectives do not necessarily work along side the Government's aim to give each young adult an endowment. If all a child knows is that the money is going to be there at age 18, this will not help the child learn about the savings habit.

The proposals need to set out whether they are aimed at developing the savings habit or giving every young adult an endowment. The aims may be at odds with each other.

Policy options – Saving gateway

Eligibility and type of savings vehicle

28. Paragraph 5.21 – *‘What is the appropriate mechanism for targeting eligibility to the Saving Gateway in order to ensure that all those would benefit from stronger incentives to save are reached?’*

29. The Government should look to see whether research shows a preference for savings in different vehicles (such as this one) by the target group. Those who would benefit from stronger incentives to save are those with some money to save and are unlikely to be, for example, those reliant solely on benefits. For these people, we note other proposals such as the one put forward by the Child Poverty Action Group who suggest that those in receipt of benefits could receive an extra week's payment every year or every six month.

30. The ‘working poor’ could be helpfully targeted through a scheme such as the old *Save As You Earn* (SAYE) schemes in which regular tax-free savings were deducted from wages. SAYE schemes are currently available only in connection with employee share option schemes, but the principle of deduction from wages into a designated scheme could be extended to a range of schemes. Whereas major employers may already offer this facility into a standard savings account, smaller employers could be encouraged to do so too (particularly since the mechanisms are already in place for stakeholder pensions).

Matching

31. Paragraph 5.23 – *‘Is matching the best way to deliver non-tax based incentives to lower income households?’ At what level should a matching rate be set? Should the level be fixed or vary according to the income?*
32. The schemes need to be careful about putting off people who don't want to admit that they are eligible for a 'means-tested' initiative.
33. We also note that there are alternative ways of subsidising both schemes, such as through an enhanced interest rate rather than matched funding and this might avoid some of the issues the consultation paper raises in paragraph 5.29.

Savings habit

34. Paragraph 5.25 – *‘What is the best way of structuring the incentives in the Saving Gateway to ensure that the saving habit is encouraged? At what level should limits on contributions which are matched be set? Should the limit be set on a monthly or annual basis?’*
35. This is difficult to answer without really being clear what sort of saving habit the Government want to build up. Short-term? Long-term? Each type of saving may be important, but would require different incentives.

Access

36. Paragraph 5.29 – *‘Before the account matures, should savers have instant access to all funds in the Gateway, or just to their own contributions? How best could the Saving Gateway be integrated with existing savings vehicles such as ISAs and stakeholder pensions?’*
37. If account-holders have access to matching funds before maturity, this is effectively state-funded borrowing. The way in which people interact with debt is important - for example, the Pearl research 'Understanding small savers' points out that some people with savings prefer to take on short-term debt as a rational way of avoiding dipping into savings which have

been difficult to amass. The credit union model might be very useful here, where you cannot borrow until you have built up a certain amount of savings.

38. Similar to our comments on the Child Trust Fund, the Government must be aware of the dangers of a secondary market growing up around the scheme which could lead to consumer detriment for participants in the scheme. Also, people may be encouraged to borrow in order to reach the limit for matching funds. Individual's access to additional Government funds may be an important factor in whether this secondary market develops.

Alternatives to matching, such as an enhanced interest rate, may help avoid some of the pitfalls of the current proposals by deterring the development of a secondary market.

Risk and private sector involvement

39. Paragraph 5.31 – *‘Should a Saving Gateway offer the possibility of different investment strategies?’*

40. We note that there is a risk of consumer detriment in terms of suitability if individuals have to decide what type of savings gateway they want. Therefore, we suggest that the saving gateway is restricted to cash only. Costs are likely to be significant because there will be a multiplicity of small sums. To give people money in order to incur higher risks on an equity linked investment seems perverse. If people want to try equities, they should be doing it with money that they can afford to risk, i.e. – money on top of what they can save within these proposals.

The overriding need to keep the Savings Gateway simple suggests that it should be restricted to cash only.

41. Paragraph 5.31 – *‘What role would there be for private sector financial services providers and mutual societies in delivering a Saving Gateway?’*

42. Some National Savings products may be adaptable and would help to cover costs. The Government would need to exempt some National Savings products from having to make a commercial return on their products if necessary. National Savings would need a complete overhaul to be a good deal for consumers.
43. The link into conventional accounts will be important if one aim of the exercise is to encourage consumers who are currently on the fringes to engage with financial service products. It would also seem appropriate to link the Savings Gateway scheme to the Universal Bank.
44. Links with other financial services, depending on the types of saving scheme permitted, will require regulators will need to be very active to avoid mis-selling.

Financial education and advice

45. Paragraph 5.33 – *‘What would be the best method of delivering financial education through the Saving Gateway?’*
46. It will be important to link up with current initiatives such as the FSA’s consumer education work. In particular, perhaps, this would include the FSA’s campaign to promote awareness of basic financial planning using the channels of Post Offices.
47. However, whilst financial education is important the Government must be realistic about the extent to which it can solve potential consumer problems. It is not realistic that all participants in the scheme will “fully understand the rationale for, and the benefits of, saving and are able to make the right decisions for themselves when the time comes to move their assets into conventional saving vehicles, such as stakeholder pensions or ISAs”, paragraph 5.32. The Government should make use of existing research to ensure that they have a realistic view of what can be achieved through financial education.

Whilst important, financial education is not the solution to all consumer protection issues and is limited in what it can achieve.

48. There is considerable risk of consumers buying unsuitable or poor value products if participants in the scheme have not considered all their financial needs such as paying off debts and their protection needs, and for some participants, considered the interaction of the scheme with means tested benefits. It is clear, therefore, that financial education must be backed up by advice. We are supportive of the idea of a personalised financial 'health-check', providing this can be provided in a way that meets consumer demands. In its consultation document 'standards for retail financial products'², the Treasury proposed a CAT standard for healthcheck financial advice. In our response³ we recognised the need for generic advice and how vital it is for the Government to have a strategy for making advice more widely available, properly supported and funded. If accrediting generic advice helped increase provision the Panel would be supportive. There is a growing gap between heavily regulated 'advice' & completely unregulated info-providers. In our response to the 'standards for retail products' consultation, we suggest ways in which the gap could be bridged through accreditation including introducing training and competence standards and working with the Community Legal Service. There may be other models emerging as debates on this develop, such as the debate on polarisation and the study from the Institute of Actuaries into access to financial advice although these latter proposals have yet to be evaluated.

These proposals must be backed up by a strategy to increase access to general financial advice on basic financial planning or significant consumer protection issues will occur.

² 'Standards for retail financial products', HM Treasury. February 2001.

³ Financial Services Consumer Panel response to: HM Treasury consultation '*standards for retail financial products*', May 2001. Available on our website <http://www.fs-cp.org.uk> or through our secretariat on 020 7676 9346.

About the Financial Services Consumer Panel

The Financial Services Consumer Panel was established by the Financial Services Authority (FSA) in December 1998 to ensure that consumers' interests are represented in the development of the regulation of financial services. The Panel is independent of the FSA so that it can: advise the FSA on policy as it evolves, monitor the FSA's effectiveness in meeting its statutory objectives towards consumers, review developments in financial services where they impact on consumers, and publicly report its findings and recommendations. It can raise its own concerns and has resources to carry out its own research.

Who is on the Panel?

Colin Brown (Chairman)

Colin is an independent consultant specialising in consumer affairs. Previously Deputy Director of Research at Consumers' Association and Senior Fellow at the Policy Studies Institute, he has over 20 years' experience of social and consumer research.

Ann Foster (Vice-Chairman)

Ann is a former Director of the Scottish Consumer Council and has over twenty years' experience in the consumer movement. She is also a member of the Consumer Council for Postal Services. She was formerly Director of Government Affairs with Monsanto.

Jean Gaffin

Jean chaired OFTEL's Advisory Committee on Telecommunications for Disabled and Elderly People until 31 December 1999 and is currently a Non-Executive Director of Harrow & Hillingdon Healthcare NHS Trust. She has extensive experience of working on behalf of vulnerable consumers. Previous posts include: the Executive Director of the National Council for Hospice and Palliative Care Services and Chief Executive of Arthritis Care.

Yvonne Gallacher

Yvonne is Chief Executive of Money Advice Scotland, set up in 1989 by Scottish Consumer Council. She has over thirteen years' experience of consumer credit/money advice issues and of working with vulnerable consumers in a variety of roles, including debt counsellor, trainer and manager. She has also lectured and co-authored a Guide to Money Advice in Scotland. Yvonne is presently a member of the FSA Consumer Education Forum and Credit Union Consultation Panel. Yvonne is a member of the Scottish Consumer Council.

Harriet Hall

Harriet is a solicitor with considerable experience of consumer policy and retail financial services. She is a former legal officer with the National Consumer Council, where she worked on the needs of low income consumers, banking, credit, mortgages, regulation of equity release and long-term care insurance, the Financial Services and Markets Bill and the proposed EU directive on distance selling of financial services.

Dianne Hayter

Dianne is the Chief Executive of a new cancer charity, the Pelican Centre. She is the former Director of Corporate Affairs for the Wellcome Trust and was previously the Chief Executive of the European Parliamentary Labour Party and, prior to that, Director of Alcohol Concern. She has substantial voluntary sector and trade union experience.

John Howard

John is a solicitor with extensive experience of consumer issues as a former presenter of the daily consumer programme on Radio 4 'You and Yours'. He is currently a freelance broadcaster and his work includes presenting personal finance television programmes. He is a member of the Mortgage Code Compliance Board.

Vinod Kumar

Vinod is a social scientist with market research skills and extensive voluntary and public sector experience of policy analysis and research. Now retired, Vinod has previously worked for the Commission for Racial Equality and was Head of Policy and Research at the Royal National Institute for Deaf People. He is currently Non-Executive Director of Barnet Health Authority, board member of the South Barnet Primary Care Group and member of the Consumer Liaison Group of the Medical Research Council.

Nick Pearson

Nick is the National Money Advice Co-ordinator for the Federation of Information and Advice Centres. A career spent in advice organisations including the National Association of Citizens Advice Bureaux where he was manager of the Money Advice Support Unit, he has particular experience of credit, debt and personal finance issues and of working with vulnerable consumers.

Paul Salvidge

Paul is a former senior civil servant with experience of regulatory work, employment law, competition, consumer protection, telecommunications, financial services and company law. He was previously Competition Policy and Consumer Affairs Director at the Department of Trade and Industry.

Richard Smethurst

Richard is Provost of Worcester College, Oxford University; previously a non-executive Director of IMRO, he chaired their Training Standards Panel. He has served as an economic adviser in Whitehall, and on the Monopolies and Mergers Commission, where he was Deputy Chairman. Richard lectures widely on financial and economic topics to businessmen and adult education groups. He is President of the National Institute of Adult Continuing Education.

Jane Vass

Jane is an independent consumer researcher specialising in financial services. She was previously Head of the Financial and Economic Research Group at Consumers' Association and is still author and editor of a number of Consumers' Association publications. Other research has included work for the National Consumer Council. Her current committee memberships include: Council of the Ombudsman for Estate Agents, the Inland Revenue Tax Law Rewrite Project Consultative Committee and the FSA Training Advisory Panel.

Dave Watts

Dave is a partner in a media business which is involved in publishing, editing and journalism - personal finance plays a large part in this. He is a former editor of Which? and Money Which? and former Assistant Director of Consumers' Association. He was also a policyholder representative on the Insurance Brokers Registration Council for nine years.

How to contact the Panel

Financial Services Consumer Panel
25 The North Colonnade
Canary Wharf
London
E14 5HS

Tel: +44 (0) 207 676 9346
Fax: +44 (0) 207 676 9712
Email: enquiries@fs-cp.org.uk
Website www.fs-cp.org.uk