Helen Williams
Lifestyling Consultation,
HM Revenue and Customs,
Room G63,
100 Parliament Street,
London, SW1A 2BQ

9 December 2015

Dear Helen,

AFM Response to Consultation on Lifestyling of Child Trust Funds

1. I am writing in response to this consultation paper, on behalf of the Association of Financial Mutuals. The objectives we seek from our response are to:

   - Comment on the proposals in the consultation; and in particular highlight the lack of interest from consumers and our members in the introduction of lifestyling.

2. The Association of Financial Mutuals (AFM) represents 47 member companies, and in most of our member companies, customers present and future are the owners of the business. Between them, mutual insurers manage the savings, pensions, protection and healthcare needs of over 30 million people in the UK and Ireland, collect annual premium income of £16.4 billion, and employ nearly 30,000 staff[1].

3. The nature of their ownership and the consequently lower prices, higher returns or better service that typically results, make mutuals accessible and attractive to consumers, and have been recognised by Parliament as worthy of continued support and promotion. In particular, FCA and PRA are required to analyse whether new rules impose any significantly different consequences for mutual businesses[2].

[1] ICMIF, http://www.icmif.org/global-mutual-market-share-2013
[2] Financial Services Act 2012, section 138 K: http://www.legislation.gov.uk/ukpga/2012/21/section/24/enacted

4. AFM members were particular active in the Child Trust Fund, and continue to manage over 50% of all CTFs, and the great majority of Stakeholder Accounts. The sector has always been enthusiastic about the product, because of its focus on the needs of the family, and where parts of its function- on facilitating long-term financial planning- resonates well with our business model. The low profitability of the product made it less attractive to many competitors, but our members have found innovative ways to manage the product cost effectively.

5. The ability to lifestyle the CTF was an important component of the product at its conception, because much like long-term retirement planning, this ensured the policyholder was shielded from any dramatic swings in investment performance close to the product's fixed maturity date, when the child reached age 18.

6. Since that time, the CTF rules have changed dramatically, to remove the fixed maturity date, and to enable the funds to be transferred to an adult ISA. As originally envisaged, lifestyling would have occurred at age 13, giving a longer and smoother shift in composition. So the rationale for lifestyling has been eroded, and of course this is not a feature of CTF's replacement, the Junior ISA.

7. Our customer research suggests lifestyling is not understood or particularly valued by customers, hence its removal would be relatively painless. Very few funds are earmarked for time-boxed use and therefore the benefit of smoothing to a specific date are largely irrelevant for a customer. For those accountholders that wish to 'protect' their gains prior to age 18, cash funds remain available: personal management like this is preferable to fixed/ crude lifestyling that does not react to market conditions, such as the historically low returns available on cash investments at present.

8. Providers have seen a significant change in the economics of the CTF since it was first launched. The reduction and then ceasing of voucher payments has meant that profitability is even more eroded. The cost for providers will be high to design and implement a solution that seems to have little customer value is high. In view of this, **we see no desire amongst our members to retain lifestlying**.

9. Answers to specific questions are provided below. We would be pleased to discuss further any of the issues raised by our response.

Yours sincerely,

Chief Executive
Association of Financial Mutuals

AFM answers to Consultation Questions

1. *What are the costs, benefits and other impacts of lifestyling for CTF account holders and providers? Views on the assessment of impacts set out in Chapter 3 of this document would be welcome.*

For a consumer the cost of lifestyling can be significant, if measured by the impact of transferring from an investment to a cash based product. For example, the best cash Junior ISA rate available at present offers 3.25%[3]. This is considerably less than the type of return that a stakeholder has seen over the last five years, with typical returns in the range of 35% to 50%. So whilst future returns are uncertain, an accountholder is likely to see a lower return by utilising lifestyling: and if their CTF is then transferred to an adult ISA, this might be an unnecessary blip in the long-term nature of the product.

A possible benefit arises for a consumer if they had a targeted purchase in mind for their CTF, and they have accumulated the target value and wish to remove any future risk. In likelihood there will be very few such occasions where this applies. Research from OneFamily confirms most funds in Junior ISAs are retained after age 18 is attained, and we expect the same for CTF accounts.

For providers, the cost of lifestyling will depend on the nature of the process, and the volume of accounts that are lifestyled. Costs incurred will include the cost of selling units, system changes and additional customer communication, and will be duplicated each time the investment/ cash mix is amended. These costs are likely to exceed the maximum annual management charge levied, and will therefore be uneconomical to providers.

In addition, if a stakeholder CTF provider is not a cash deposit-taker, any cash funds will need to be invested on a fund-based format, with attendant management charges, and nominal returns at best.

The cumulative effect of the extra costs to providers is that the marginal profitability they obtain from stakeholder CTFs will be entirely undermined. So we see no benefits to providers.

2. *Should the current legislative requirement that stakeholder CTFs should be subject to lifestyling, unless the registered contact for the account instructs otherwise, be retained? Please explain your answer.*

When the CTF was first developer, our members were very enthusiastic about the features of the stakeholder version of the product, including lifestyling. However, as the nature of the product has changed the value of lifestyling has dissipated, and we consider that the legislative requirement, which has not to date been detailed, should be removed.

[3] http://moneyfacts.co.uk/isa/junior-isa/

3. *What would be the impact for CTF holders and providers if this legislative requirement were removed?*

As above, this will reduce costs for accountholders and providers. It will also provide certainty, and encourage greater focus on saving for the long-term, rather than a presumption that the funds should be withdrawn when the child reaches age 18.

As CTF books offer only marginal profitability at best, the removal of the requirement will avoid providers passing on extra costs to consumers, as well as the risk for some providers that they are unable to manage their CTF book in future. This would result in loss of competition and a consequent reduction in choice for consumers.

4. *Would some account providers continue to offer lifestyling or similar features as part of their CTF terms and conditions, in the absence of a legislative requirement to do so?*

We are not aware of any providers that would do so.