

CHILD TRUST FUNDS

INTRODUCTION

The FSA has published [CP04/10**](#) containing its proposed rules and guidance for the sales regime for Child Trust Funds (referred to as "CTFs"). The regulatory proposals for stakeholder CTFs (equity-based products with statutory minimum standards) take into account the regime applicable to stakeholder products in general. Non-stakeholder CTFs are due to be governed for the most part by existing regulation.

Consultation ends on 3 September 2004 and the FSA expects to publish its final rules in October 2004, which are due to come into force in December 2004. This is a relatively tight timeframe but reflects the Government's proposals for implementation.

OVERVIEW

In light of the Inland Revenue's responsibility for ensuring compliance with the CTF Regulations, the FSA has adopted a 'light touch' approach to its own regulatory regime for the sale of CTFs.

The FSA's proposals are designed to address two main concerns, arising from the fact that the CTF is a "uniquely universal financial services product":

- Consumer misunderstanding and lack of information about the nature and purpose of CTFs. The FSA proposes to combat this problem largely through financial education, provided by the government. Additionally, a key theme of CP04/10** is the FSA's desire to ensure that any financial promotion contains appropriate risk warnings. In particular, CTF providers must make it clear to consumers that, once a subscription has been made, it will not be returned to the subscriber under any circumstances.
- The scale of the initiative, particularly initially - the FSA believes that the CTF initiative will place a serious strain on firms' existing business, financial resources and systems and controls. Thus, the FSA has introduced notification and supervision requirements for prospective CTF providers to ensure that it can review the potential impact of CTF business on each firm and discuss any regulatory concerns that it may have before business plans are finalised. The FSA has also attempted, where possible, to simplify the regime. For example, as CTF providers will be required to issue annual statements, the FSA intends to disapply any additional requirements to provide periodic statements or contract notes for every transaction.

KEY PROPOSALS

Permissions and notification

A firm must be authorised by the FSA and have the relevant permissions in place to be approved as a CTF provider by the Inland Revenue. For example, a firm may need to be able to hold client money. However, an authorised firm will not need a specific FSA permission to be a CTF provider under the Financial Services and Market Act 2000.

A firm will be required to notify the FSA if it intends to become a CTF provider and if it intends to provide its own stakeholder CTF. Additional notification will be required where firms have agreed to accept 'Revenue allocated accounts' or intend to use a third part administrator.

Supervision

After the initial impact assessment, CTFs will be included in the FSA's normal supervision of the firm.

Business standards

- (a) **'Customer':** The FSA intends to treat only the **'registered contact'** as the 'customer' once the account has been opened, so as to exclude subscribers.
- (b) **Disclosure:** Firms will be required to provide a Key Features Document (for packaged products) or 'key information' (for savings accounts) to the person opening the CTF. There are likely to be changes to the Banking Code to incorporate these requirements. The disclosure requirements for CTFs are similar to those for PEPs and ISAs, although there will be no CAT Standard for CTFs.
- (c) **Point-of-sale material:**
 - Point-of-sale material for all CTFs will be required to include a risk warning so that subscribers are aware that, once their money has been paid into the CTF, it is **locked-in** until the child reaches 18 and then can only be taken out by the child.
 - In addition, point-of-sale material for non-stakeholder CTFs must contain a statement that a stakeholder alternative is available, a description of the main features of a stakeholder CTF and how the customer can obtain more information about it. Thus, if a CTF provider chooses not to offer a stakeholder CTF, it must still 'make available' the stakeholder option to its customers.
 - Point-of-sale material for stakeholder CTFs will need to state that the fact it is a stakeholder CTF does not mean that it is automatically a suitable investment.
- (d) **Projections and charges:** Firms will not be required to give projections and any firm intending to do so must ensure that its projections will not mislead the consumer in any way. Where a firm imposes a single annual charge, it will be permitted to provide a simplified illustration of the effect of these charges. However, this will need to be accompanied by an explanatory statement prescribed by the FSA.
- (e) **Depolarisation:** The FSA appreciates that most CTFs are likely to be sold without advice and so would fall outside the scope of the polarisation rules. However, the FSA proposes to introduce a transitional arrangement for the CTF rules so that firms can benefit from opportunities offered by depolarisation, while the polarisation restrictions are still in force. The FSA recognises that many of the investments held within a CTF may be packaged products. It therefore intends to change its existing rules so that firms offering advice on packaged products will not be obliged to advise on packaged products held within a CTF.
- (f) **Advice:** Where advice is provided, the existing know your customer and suitability rules will apply.
- (g) **Oversubscription:** The maximum limit for subscriptions to an account in any subscription year is £1,200. The FSA does not propose to introduce any new rules to address the issue of oversubscription but suggests a number of ways in which a firm may wish deal with the issue.

- (h) **Cancellation:** The FSA will disapply its cancellation rules in relation to stakeholder CTFs to ensure that once money has been paid into the CTF it cannot be taken out. Cancellation rights will only be available where they are obligatory under Community legislation (the Distance Marketing Directive and the Consolidated Life Directive) and should be capable of applying to the 'initial service agreement' only. However, the FSA intends to apply its existing cancellation rules to non-stakeholder CTFs.

Consumer information and education

The FSA is discussing with the Inland Revenue what it may be able to usefully contribute to the Government's multi-media information and promotion campaign, which will be launched later in the year. The FSA will also update its own consumer materials to include appropriate references to CTFs.

The FSA will consider CTFs in developing and implementing the national financial capability strategy and in developing a financial strategy for financial education in schools. Financial education is very much a government-led initiative and no obligations have been imposed on firms to educate their customers.

STILL TO COME

Still to come are:

- A separate FSA consultation on proposals for a simplified advisory sales process for stakeholder products.
- A decision from the FSA and the Joint Money Laundering Steering Group (JMLSG) on whether specific anti-money laundering controls need to be applied to CTFs. This should be reflected in future JMLSG industry guidance. At present, CTFs will fall within the scope of the UK anti-money laundering regime but the FSA considers the risk of CTFs being used for money laundering to be minimal.

FURTHER INFORMATION

If you require further information or assistance please contact [Paul Anning](#), [Nicholas Holman](#) or the member of the Lovells Financial Service Group with whom you usually deal.

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