



HM Treasury



HM Revenue  
& Customs

## Tax-Free Childcare:

the government's response to  
the consultation on childcare  
account provision

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# 1

## Introduction

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**1.1** Finding reliable, high quality, affordable childcare is a major concern for working families.<sup>1</sup> For many parents it is difficult to find good childcare, and the high cost of childcare can be one of the largest parts of most working families' household budgets.

**1.2** The government believes that there is a powerful case for improving access to childcare: to ensure that parents are supported to work, if they choose to, and have fulfilling careers with potential for progression; and that children have the best possible start to life through high quality early education.

**1.3** At Budget 2013, the government announced its intention to introduce Tax-Free Childcare. This new scheme will offer working families 20% support towards their childcare costs up to a maximum of £2,000 of government support per child per year. That is the equivalent of basic-rate tax relief on childcare costs of £10,000.

**1.4** As Tax-Free Childcare will offer support to more parents than the current Employer-Supported Childcare system, which is only available to some employees, the government also announced at Budget 2013 that it will phase out Employer-Supported Childcare. Existing members of Employer-Supported Childcare will be able to choose whether to remain on their Employer-Supported Childcare scheme or move to the new Tax-Free Childcare scheme (if they are eligible). The tax exemption for workplace nurseries will remain.

**1.5** Tax-Free Childcare will be delivered through childcare accounts. Parents will open a childcare account, then pay money towards childcare costs into the account, with the government paying a top-up to their contribution. Parents will be able to use the total funds with the qualifying childcare provider (or providers) of their choice.

**1.6** Box 1.A and Chart 1.A set out how childcare accounts will work under Tax-Free Childcare.

### **Box 1.A: Operation of Tax-Free Childcare**

To receive Tax-Free Childcare, a working family will register to open childcare accounts for each of their children. HMRC will check they are eligible for the scheme and, if they are, the account provider will open their account(s).

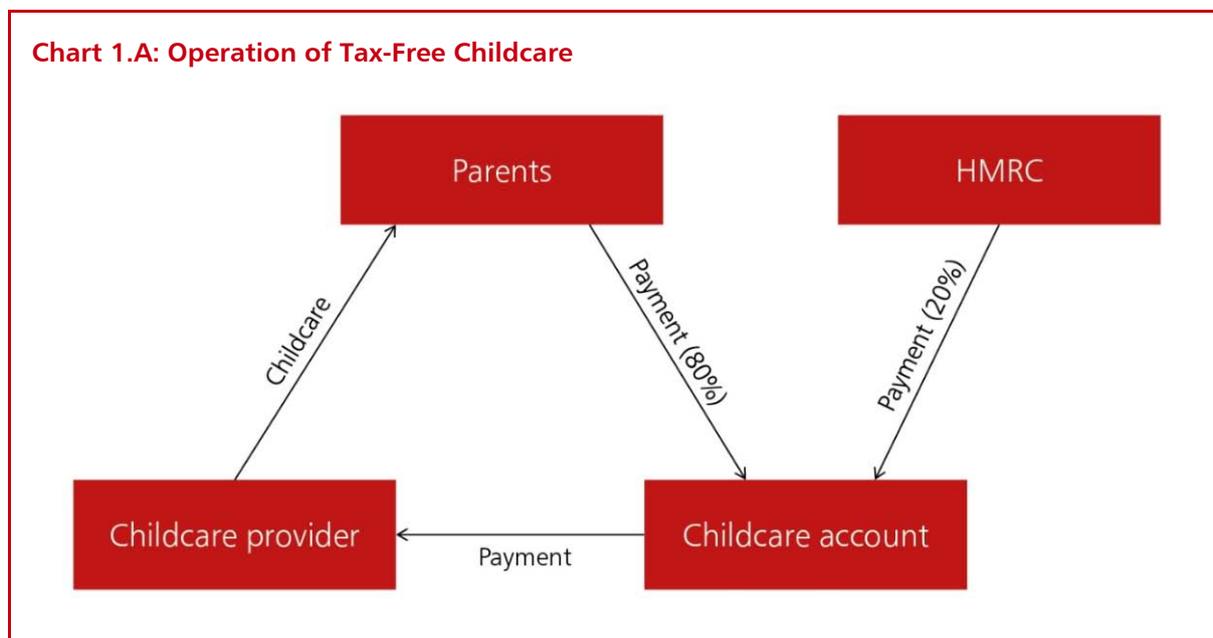
The family will then pay money into their Tax-Free Childcare account(s), similar to a regular bank transfer. The government will top up the family's payment, at a rate of 20p for every 80p the family pays in. The amount that the government will contribute is subject to a limit of £2,000 per child, per year.

The family will then be able to use this money to pay one or more qualifying childcare providers for childcare.

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<sup>1</sup> Childcare and early years survey of parents, 2012-13

**Chart 1.A: Operation of Tax-Free Childcare**



## The consultation

**1.7** In August 2013 the government launched a consultation on the implementation of Tax-Free Childcare. The consultation invited interested parties to comment on the detailed design and operation of the scheme. It set out the eligibility criteria, the role of the market, and the key information and validation processes. It discussed the considerations that have to be made in designing different aspects of the scheme, and asked questions in areas where stakeholders were likely to have knowledge or insight.

**1.8** The government engaged extensively with a wide range of stakeholders including families and their representative groups, childcare providers, employers and voucher providers in the Employer-Supported Childcare scheme. In March 2014 the results of that process were set out in *Delivering Tax-Free Childcare: the government's response to the consultation on design and operation*. This document set out detail on how Tax-Free Childcare will work for working families, including eligibility, customer experience and information and validation. In particular, it set out that Tax-Free Childcare will be rolled out to all eligible families with children under 12 within the first year of the scheme's operation, and confirmed that parents will not pay fees for childcare accounts.

**1.9** In May 2014 the government published a further consultation on options to deliver Tax-Free Childcare accounts. This built on the earlier consultation which had set out different market structures for private sector provision of accounts, by also covering public sector delivery options, namely through National Savings and Investments (NS&I), or within HM Revenue and Customs (HMRC).

**1.10** The government actively engaged with a range of stakeholders during the consultation. This included holding five workshops – one each for parents' groups, childcare providers and employers and software providers, and two for voucher providers in the Employer-Supported Childcare scheme – and received 35 written responses from a wide range of organisations and individuals. This is in addition to more than 20 workshops held during the first consultation; 87 responses to that consultation; and over 35,000 responses to the online questionnaires. The government is grateful to all stakeholders who participated in the consultation process.

**1.11** In addition to engaging with stakeholders, the government conducted and commissioned a range of further work to develop its understanding of each of the options in the consultation.

For example, the government analysed how HMRC might deliver the childcare accounts in-house; the timelines and processes required to run a procurement exercise; and the likely system build times for the various models. The government also considered the work required to progress each of the three main elements of Tax-Free Childcare – registration, eligibility and the operation of childcare accounts – and the interaction between those three elements.

**1.12** As part of this work, the government ran a pre-market engagement exercise to develop its understanding of the private sector models for delivering childcare accounts. This has provided helpful evidence on the level of interest and capability in the market. Further information on this is set out in Annex A.

**1.13** The government also commissioned *Economic Insight* to consider the options for government delivering childcare accounts against the private sector options on which it had reported as part of the first consultation. *Economic Insight*'s report has been published alongside this response document at <https://www.gov.uk/government/consultations/tax-free-childcare-consultation-on-childcare-account-provision>. They concluded that all of the models have the potential to represent a sensible and legitimate way to deliver childcare accounts from an economics perspective. A summary of the report can be found in Annex A.

**1.14** The government commissioned *Ipsos Mori* to conduct qualitative research amongst parents on the different approaches to delivering childcare accounts, building on similar qualitative research conducted by *Opinion Leader* as part of the first consultation. The report has been published in full at <https://www.gov.uk/government/consultations/tax-free-childcare-consultation-on-childcare-account-provision>. A summary of the findings can be found in Annex A.

**1.15** The government is aware of three stakeholders who conducted short online multiple-choice questionnaires of their own to inform their responses to the consultation. The Childcare Voucher Providers Association conducted questionnaires for parents and childcare providers in the Employer-Supported Childcare scheme, and the Chartered Institute of Personnel and Development and the Chartered Institute of Payroll Professionals conducted a joint, relatively small-scale questionnaire targeted at employers who are members of one or both of their organisations.

**1.16** An assessment of the different models for the provision of childcare accounts is set out in the next chapter, along with the government's decision. A detailed breakdown of the responses to the consultation by stakeholder groups is provided at Annex A, and a list of all respondents at Annex B.



# 2

## The provision of childcare accounts

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**2.1** Childcare accounts will be central to the delivery of the Tax-Free Childcare scheme. They will act as an intermediary between parents and childcare providers. Eligible parents will be able to open a childcare account online; pay money towards their childcare costs into that account; and have the payments topped up automatically by the government at a rate of 20%, up to an annual cap of £2,000 of government support per child. They will then allocate this money to the qualifying childcare provider(s) of their choice, with the account provider making the payment direct to the childcare provider(s).

**2.2** The consultation document sought views on new public sector options for the delivery of childcare accounts, against the private sector models previously consulted on. The full range of options was:

- Government provider – childcare accounts would be provided by government, either through NS&I using its existing banking infrastructure and service capabilities through its current delivery partner Atos; or in-house within HMRC
- Single provider – the government would tender for a single, private sector provider of childcare accounts. That contract would be re-tendered periodically
- Small, fixed number of contracts – the government would tender a small, fixed number of contracts (for instance 2-5) for entities to become account providers. Those contracts would be re-tendered periodically
- Open market – account providers would enter into arrangements with HMRC through a framework procurement, so that account fees are paid by government and not parents. There would be no limits on the number of providers that could enter the marketplace, so it remained the most open of the options

**2.3** In assessing options for childcare account provision in the private sector, the government set out the following criteria in its consultation last year:

- simple – easy for parents to understand and join so that Tax-Free Childcare is widely taken up
- efficient – low costs to childcare account providers, the government, parents and childcare providers of establishing, maintaining and participating in the scheme
- competitive – competition in the market for account provision (or competition for the market) which ensures that parents benefit as much as possible from government support
- secure – parents are protected if childcare account providers fail or make errors, fraud is mitigated and personal information is handled securely
- responsive – minimising the time between parents paying into their account, the government top-up being received, and payments made to childcare providers, and ensuring that changes of circumstances are quickly and effectively accounted for

**2.4** In the further consultation document, the government said the options to deliver childcare accounts in the public sector would be assessed against the same criteria. In their responses to the first consultation, stakeholders set out the importance of delivering support to parents through Tax-Free Childcare as soon as possible. The government therefore said it would also consider the speed at which each option could be delivered, informed by responses to this consultation, when taking final decisions on account provision. As part of this, the government said it would consider the ease with which systems and services could be built and integrated into a single scheme and how this impacts on costs and speed of implementation.

## **Consideration of criteria**

**2.5** The following section discusses the merits of the various models against the criteria outlined above, informed by the government's analysis, the consultation responses and workshops held with stakeholder groups, pre-market engagement with potential suppliers of childcare accounts in the private sector, and the two independent research papers.

### **Simple – easy to understand and join so that Tax-Free Childcare is widely taken up**

**2.6** The government wants as many working families as possible to access Tax-Free Childcare and benefit from support towards the costs of childcare.

**2.7** One of the most consistent messages across responses to both consultations was the need for Tax-Free Childcare to be as simple as possible for parents to engage with. Several respondents commented on the importance of a simple system to encourage take up of the scheme.

**2.8** One concern, raised by parent groups, childcare providers, and parents themselves in the qualitative research, was that if there were multiple account providers offering the same or similar service, this may detract from the simplicity of the scheme. There is a risk that multiple account providers will increase the administrative complexity of the scheme for all parties, and several respondents suggested that parents (as the key 'user') would find such a model burdensome. It could also be potentially confusing to select between providers, given the more important choice parents face is who to use as a childcare provider. Complexity was thought to be a particularly significant issue with the open market model as parents are likely to be presented with a wider range of options (that could change over time) making comparisons difficult.

**2.9** Other consultation respondents identified the potential benefits of having multiple providers competing in a marketplace, for instance competition driving up service standards and mitigating the risk of parents being left without a service if there were provider failure. This view also featured amongst parents who currently receive support via Employer-Supported Childcare and who responded to a survey conducted by the Childcare Voucher Providers Association, the representative group for voucher provider companies in Employer-Supported Childcare.

**2.10** The majority of respondents to the consultation preferred the use of either a sole account provider – either provided by the government or a single private sector provider – or a limited number of providers. It was seen that this would provide simplicity for working families, making it as easy as possible for parents to access the scheme and open a childcare account without having to choose between numerous different providers' offerings.

**2.11** The government's assessment is that all of the single provider models, whether in the public or private sector, could offer a simple scheme for parents to understand and join. The option of a small, fixed number of providers would not be far behind in that the choice faced by parents would be clearly defined and limited to a small number of options for which it would be relatively easy to disseminate information to help parents make an informed decision. The open

market model, given the unlimited number of providers that could join and the potential fluidity of providers entering and exiting the market over time, would be more complicated for parents to navigate and more difficult to provide clear information on the set of options parents can choose between.

## **Efficient – low costs to childcare account providers, the government, parents, and childcare providers**

**2.12** The government aims to deliver a scheme that operates at low cost for childcare account providers, the government, parents, and childcare providers.

**2.13** The government has said that **parents** will not pay fees for accounts. Therefore, costs to parents are measured only in terms of the ease of and time taken to join the scheme and manage their accounts. The time taken to join the scheme will depend on whether parents are presented with a choice between providers and how readily they are able to access information to inform their decision making.

**2.14** For **childcare providers**, administrative costs are likely to be lower for options with smaller numbers of account providers. Some stakeholders in the childcare industry noted, in their responses to both consultations, that having to deal with one or a limited small number of providers would be simpler, less administratively burdensome, and therefore lower cost than having to deal with a large number of providers.

**2.15** A number of voucher providers in the Employer-Supported Childcare scheme noted that many childcare providers already engage with numerous voucher providers under the Employer-Supported Childcare scheme, and would continue to do so when Tax-Free Childcare is introduced due to the transition period under which Employer-Supported Childcare continues. The Childcare Voucher Providers Association conducted a survey of childcare providers who already accept vouchers under Employer-Supported Childcare. That survey suggested that for those particular childcare providers having to deal with a number of different providers under Tax-Free Childcare would be less of a concern and less likely to push up costs.

**2.16** Costs to **account providers** comprise investment costs and operating costs. Ultimately these costs are met by **government**, who would either bear them directly by acting as account provider itself or pay fees to one or more private sector providers. Costs could be lower where there is competition and where providers are able to leverage existing infrastructure and service capabilities. Single provider models (or a small, fixed number of providers) are more likely to realise economies of scale. Models that can only be established via a further public procurement process would entail some transaction costs for government and suppliers in addition to costs for regulating the market and contract/performance management.

**2.17** The government held a supplier engagement day to test the potential market for the provision of childcare accounts. That process indicated that there are a range of suppliers that may bid for the work, including business process outsource specialists, voucher providers under Employer-Supported Childcare, and other organisations with experience delivering accounts. Potential suppliers were most interested in the single or fixed number of provider models. There was less interest for an open market. Some potential suppliers accepted government's invitation to follow up bilaterally and provided initial cost estimates.

**2.18** There was no single option that was clearly most efficient and lowest cost to all of parents, childcare providers, account providers, and government.

- In terms of costs to parents and the childcare industry, the government's assessment is that single provider models, whether in the public or private sector, would be most efficient. A small, fixed number of providers would not be too far behind this, but an

open market with an unlimited number of providers could increase costs significantly for parents and the childcare industry

- In terms of account provision in the public sector the government believes that the option for NS&I to deliver accounts would be efficient. This is because NS&I would be leveraging its existing infrastructure and service capabilities; and because the competition already held for its outsourced services (including existing and future services to government departments) ensures value for money for the taxpayer. HMRC, by comparison, would have to build account functions from scratch requiring greater investment costs
- The government believes that account provision in the private sector would also be efficient based on its supplier engagement and consultation responses, although there would be some additional transaction costs as noted above. In their responses to the consultation, voucher providers under Employer-Supported Childcare noted they would also be able to leverage existing infrastructure and service capabilities, although they would have to build capacity to handle the greater volume of parents under Tax-Free Childcare

**2.19** Cost to government is only one factor among a number considered by government to be important in the present context. Nevertheless, the government wants to choose an option which it believes is cost efficient. The government believes NS&I would be value for money due to leveraging its existing infrastructure and the competition already held for its outsourced services. Cost estimates for the NS&I option were within the initial cost range put forward by potential suppliers in the private sector. It is possible that other options might produce a cheaper way of account provision. However, as already noted, cost is but one factor; it can confidently be concluded that NS&I represents a cost efficient option; and the engagement with potential suppliers in the private sector supported that view.

**2.20** Moreover, comparison on cost grounds is far from straightforward. As part of their report *Economic Insight* considered whether cost-benefit analysis could be undertaken to compare the options empirically from an economics perspective. They concluded that, since a Tax-Free Childcare account provider market does not yet exist, it would be far from straightforward to size the advantages and disadvantages in a way that could be meaningfully compared. The granularity of evidence that would be needed to reach strong conclusions in response to nuanced issues simply does not exist, and only a pilot and/or ex-post evaluation of the chosen model would seem capable of delivering such evidence.

### **Competitive – competition in the market (or competition for the market) which ensures that parents benefit as much as possible from government support**

**2.21** In theory, parents can benefit from competition in two ways: it can lower any fees they could have to pay for accounts; and it can drive up service standards and lead to innovation in the marketplace. The government has said that parents will not have to pay fees for childcare accounts, so the potential benefits of competition for parents are limited to service standards and innovation. As such, this criterion becomes less important than it would have been had parents been charged fees for accounts.

**2.22** An open market or small, fixed number of providers are the only options that capture the benefits to parents of ongoing competition to provide accounts, which could potentially drive up service standards and lead to innovation. Of these, the more players there are in the market the more competitive it is likely to be, so the open market option may be the most competitive. *Economic Insight*, in their report to government, concluded that an open market model would still have the greatest potential to deliver dynamic benefits, even though the decision that parents would not pay fees had eliminated the price dimension of competition.

**2.23** Competition for the market can drive down costs for government, as detailed in the assessment under the efficient criterion, but only intra-firm competition in a multiple provider model could drive further benefits for parents in terms of ongoing competitive pressure to drive up service standards. The government acknowledges the point, as noted in the consultation document and reiterated by some stakeholders in this consultation, that government provision (or a single private sector provider) would therefore be less dynamically responsive than a market model that enables intra-firm competition. However, public sector provision (unlike a single private sector provider) can be expected to be speedily responsive to parents' needs, as the government retains control and could adjust and improve service levels over time in response to feedback from parents and the childcare industry.

**2.24** The government's assessment is that the open market model would have the most potential to drive up service standards for parents, followed by a model involving a small, fixed number of providers. However, the options for NS&I or HMRC to deliver accounts are close in that respect given the capacity for government to respond speedily to parents' needs and improve service standards over time through the control it exercises by providing accounts itself.

### **Secure – parents are protected if childcare account providers fail or make errors, fraud is mitigated, and personal information is handled securely**

**2.25** The government believes that security is integral to the successful take up and operation of Tax-Free Childcare. Indeed a recurring theme of responses was the need for parents to have absolute confidence that the money they pay into childcare accounts, as well as personal data, is secure. Respondents noted that parents would be paying large sums of money into childcare accounts, and it would be unacceptable if they were to lose that through no fault of their own.

**2.26** The options to provide childcare accounts in the public sector would eliminate the risk of a provider failing, as funds held by either HMRC or NS&I would be backed by government. NS&I is an Executive Agency of HM Treasury that already securely manages billions of pounds of public funds in national savings.

**2.27** For the private sector options, the likelihood of an account provider failing increases as the number of providers in the marketplace increases. This is because with greater competition in the market there is a higher chance of a firm becoming insolvent while holding parents' funds. Conversely, the impact of a provider failing is less where there are multiple providers, as parents would be able to move to one of the other providers and still receive support in Tax-Free Childcare. Whilst failure mechanisms can be put in place to mitigate these risks, they cannot eliminate them altogether, and there would be a cost associated with those mechanisms. Voucher providers in the Employer-Supported Childcare scheme suggested a number of ways in which consumers could be protected in the instance of private sector account provider insolvency – these included regulation by the Financial Conduct Authority, extending the Financial Services Compensation Scheme or using the Childcare Voucher Providers Association to regulate the market.

**2.28** The government recognises that there is a good track record for the security of funds in Employer-Supported Childcare, which is generally run through private sector voucher providers. A number of those voucher providers raised this in their consultation responses, pointing towards the Childcare Voucher Providers Association code of practice which ensures that each member has a fund protection policy to ensure security of funds.

**2.29** One theme from responses to the consultation was that NS&I is a recognised and trusted brand with a strong track record in holding customers' money securely, giving parents confidence to pay in money and potentially build up funds in their childcare account over time.

**2.30** In terms of data security, NS&I and HMRC have rigorous systems in place to assess and manage systems and data risks and parents will know that their personal information is transmitted over and held in secure government systems, and will be used only to perform necessary checks to verify identity and ensure eligibility. Under the private sector options, data security standards could be set as part of the procurement criteria.

**2.31** The scheme will also need to minimise risks of fraud and error that could cost the taxpayer. The government is confident that the design of Tax-Free Childcare will ensure that it is not open to wide-scale fraud and error. However, any scheme that involves government subsidy could be at risk of fraud and abuse, including the risk of organised criminal attacks. Although the government believes that the risks of fraud are small in Tax-Free Childcare, they can increase with the number of different entities involved and the number of different links in the chain, as it opens up more areas for potential attack. With the government providing accounts it is likely there would be fewer opportunities for a criminal attack on the system compared to an open market option where there are a large number of providers, for example by setting up fraudulent accounts (or even a fraudulent account provider) that siphons off the government contribution against the costs of childcare services that are never provided to parents.

**2.32** In a private sector model, there would need to be a new system of regulation to ensure that account provider(s) were minimising the risk of fraud and error.

**2.33** Some voucher providers in the Employer-Supported Childcare scheme have made the point that that scheme is relatively free from error and fraud, and that they do not believe that private sector companies are at any more risk than an in-house provider.

**2.34** Ultimately the government expects the level of error and fraud in Tax-Free Childcare would be relatively low under any of the delivery options, with small differences between the different options, but clearly greater potential in the open market option.

**2.35** Taking into account protection of parents' funds and the likelihood and impact of potential provider failure, the relatively modest prospects for significant fraud and error, and the secure handling of parents' information, the government's assessment is that the in-house options would be most secure given they uniquely ensure parents' money is backed by government without adding the costs of a further regulatory regime.

### **Responsive – minimising the time between parents paying into their account, the government top-up being received, and payments made to childcare providers, and ensuring that changes of circumstances are quickly and effectively accounted for**

**2.36** The government wants parents and childcare providers to benefit from a scheme that is responsive with payments being executed quickly.

**2.37** Of the two public sector options, NS&I is likely to be more responsive than HMRC, at least in the short-term. This is because HMRC would have to build an accounts function from scratch, which means there is a risk that accounts are less responsive to parents' needs in the short-term while HMRC builds experience and capability. In steady-state, once account functions are established, HMRC could be more responsive as the top-up could be applied automatically and instantly. NS&I's existing capabilities enable customers to manage accounts online 24/7, making payments in and instructing payments out to third parties.

**2.38** The speed of payments in the private sector options could be set in the requirements that potential suppliers would have to meet. They could therefore be equivalent to the NS&I option.

**2.39** Delivering childcare accounts through NS&I would ensure the scheme is responsive to parents' needs. There would be a one-stop journey for accessing the scheme: parents' interaction will be through a single portal where they can apply to join and open an account, make payments into their account, receive the government top-up, and set up payments to the childcare provider of their choice. Parents will be able to access this platform online through GOV.UK, which is regarded as one of the leading government websites in the world, and was the overall winner for the Design Museum's Design of the Year 2013 for its well thought out design, making the user experience simpler, clearer and faster. A telephone service will be available to assist those who are unable to manage their accounts online.

**2.40** A single private sector provider could also offer a one-stop journey through the GOV.UK portal, equivalent to the NS&I option. In their responses to the consultation, some voucher providers in the Employer-Supported Childcare scheme argued that parents could also have a 'one-stop journey' if there were multiple private sector providers. The government agrees that this could be possible – for example by directing parents from GOV.UK (which would host the registration) to the websites of account providers to set up their account.

**2.41** The government's assessment is that all of the models have the potential to be responsive in terms of payment execution and changes of circumstances. In the short-term, the HMRC option may be less responsive given the current lack of accounts capability and experience. The options that involve multiple providers may offer better service standards over time than single provider models as competition between providers has the potential to drive up standards, although the in-house options could also be improved over time in response to parents' and childcare providers' feedback from experience of the scheme given the control government retains.

## **Speed of delivery**

**2.42** Parents have told the government that they are keen for Tax-Free Childcare to be introduced as soon as possible, and the government is committed to introducing the scheme in autumn 2015.

**2.43** Speed of delivery of the public sector options would depend only on how quickly systems can be designed, built, tested and then launched. As HMRC does not currently have an accounts function, this option would take longer to deliver than the NS&I option where existing infrastructure and systems can be utilised. The government's assessment is that it would take HMRC around two years to design, build and test an accounts function, while using NS&I as account provider utilising existing infrastructure would enable the scheme to be launched in autumn 2015.

**2.44** The private sector options involve two stages to deliver: a procurement exercise to determine the account provider or providers; and then a design, build and test phase before accounts launch. Conceptually, this implies a longer delivery path, creating a greater risk to the government's desired timetable.

**2.45** Having considered other government procurement for similar services and projects of similar size and complexity, and taken advice from procurement experts within government, the government estimates that it would take around nine months to complete the procurement process before the design, build and test phase could begin.

**2.46** The government sought views in its market engagement exercise on how long it would take to build Tax-Free Childcare once the procurement phase is completed. Suppliers in one sector thought it would take three-to-six months to build account functions from contract signature; suppliers in another sector thought six-to-twelve months; and one existing customer account provider thought it highly unlikely that a solution could be in place by autumn 2015. The government's view, based on these estimates and its own experience from similar schemes, is that it would likely take around nine months for a supplier or suppliers to launch accounts,

even if leveraging existing assets and infrastructure, given the need to complete necessary development work, end-to-end integration with HMRC systems and testing of both the IT and supporting business processes.

**2.47** Combined with a procurement stage of around nine months, this would make it unlikely that the private sector options could deliver for autumn 2015. The government considered whether the speed of delivery could be improved if HMRC were responsible for registration and account providers solely responsible for accounts. In this scenario, the delivery timeline would be slightly de-risked and simplified for providers, but the government would still require around nine months to procure.

**2.48** The government's assessment is that the NS&I option would likely be speediest to deliver, given it would not require further procurement and as the design, build, and test phase would begin from existing infrastructure and service capabilities.

## **Ease with which systems and services could be built and integrated into a single scheme**

**2.49** Single provider models would likely be easier to integrate into a single scheme, given there would be fewer total systems that would have to be integrated with HMRC systems for eligibility checking. Although administering the scheme entirely within HMRC is, in principle, the easiest to integrate, the need to build a new account system means it would be less easy to build systems and services than the NS&I option or procurement of a single provider that is also able to leverage existing account infrastructure and service capabilities.

**2.50** Of the multi-provider options, a small, fixed number of providers would be easier to integrate into a single scheme than the open market option given there would be a defined and relatively small number of interactions between HMRC systems and account providers' systems.

## **Conclusion**

**2.51** All interested parties have now had an opportunity to comment on all of the options for account provision across public and private sectors. The results of this consultation – alongside those of the first consultation – provide a solid evidence base for the government's decision on the provision of childcare accounts in Tax-Free Childcare.

**2.52** The further consultation has provided new evidence such as detailed responses from a wide range of stakeholders to the consultation and the work the government has conducted and commissioned during the consultation period. It has also reaffirmed many of the findings of the first consultation, such as the importance of simplicity and security for parents and the fact that they want support to be available as soon as possible.

**2.53** The government has carefully considered the responses to both consultations and the evidence on all of the options. **The government's decision is that NS&I will be the scheme's account provider.** The decision was a relatively finely balanced one, involving weighing each of the elements dealt with above. The government considered that the NS&I option had real and particular advantages in terms of simplicity for parents and childcare providers, offering security for parents through a trusted brand with all funds guaranteed by the government, and speed of delivery. However, it was recognised that in relation to each of the factors there were a number of arguments both for and against the various options under consideration, and in some areas there was little to choose between some of the options. As an overall judgement, Ministers considered that the other factors dealt with above, some of which might arguably be said to tend in favour of other options, did not outweigh the advantages of the NS&I option. Accordingly, the conclusion is that the NS&I option is the right option to take forward.

# A

## Summary of responses

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**A.1** The first consultation on the design and operation of Tax-Free Childcare was run between 5 August and 14 October 2013. There were five questions which related to the provision of childcare accounts. From this consultation the main views related to account provision were:

- Parents wanted Tax-Free Childcare to be as simple as possible to access and use and valued simplicity more than choice. They also wanted certainty that their money was safe.
- Voucher providers in the Employer-Supported Childcare scheme largely favoured an open market with accredited suppliers, were keen to have employers involved (including in a mandatory role), and would need to change their current systems to accommodate the design of Tax-Free Childcare which would require investment. There were questions about how fees would be paid, and there were differing views about how best parents' money could be protected.
- The childcare industry were concerned about prompt and accurate payments and the administrative burden associated with having multiple providers.
- Employers were keen that any role in Tax-Free Childcare was voluntary with some larger employers interested in how they could best enable their employees to enter the scheme.

**A.2** A full summary of the responses to the first consultation can be found at: [https://www.gov.uk/government/uploads/system/uploads/attachment\\_data/file/318953/PU1607\\_Tax\\_free\\_Childcare\\_response.pdf](https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/318953/PU1607_Tax_free_Childcare_response.pdf)

**A.3** The further consultation published on 23 May 2014 can be found at: <https://www.gov.uk/government/consultations/tax-free-childcare-consultation-on-childcare-account-provision>. The government asked one question:

**The government would welcome views of the options to deliver Tax-Free Childcare accounts in the light of the issues and assessment set out in this document.**

**A.4** This section provides a summary of the views of each sector to this question, which were provided in the workshops and in written responses.

### Views of groups representing parents

**A.5** The majority of responses from groups representing parents in the consultation process favoured a sole provider. Of those that expressed such a preference, the majority favoured NS&I over other sole provider options.

**A.6** The criterion that carried most weight behind the preference for a single provider was simplicity. Respondents' desire was that accounts – and the scheme in general – should be as simple and easy to access and use as possible. A number of stakeholders believed that parents were unlikely to have the time and resources to make informed decisions between account providers – having choice of childcare provision was seen as being far more important. One

group representing parents said having a sole provider would mean there will be one source of information available to parents ensuring that they get consistent information. They added that they had seen examples in Employer-Supported Childcare of different providers providing different information, making it hard for parents to know where to turn for advice. On occasion they believed this information had been misleading or inaccurate. Some thought that making the system as simple as possible was particularly important for those on lower incomes, especially those whose income levels might mean over a year that there are interactions between Tax-Free Childcare and Universal Credit or tax credits. Efficiency was generally seen as inter-linked with simplicity – one respondent believed that a sole provider option could help avoid duplicated administrative costs.

**A.7** There was some acknowledgement of the benefits of competition – one respondent noted that it could improve the level of service and mitigate any risk of a sole provider being appointed and not delivering the service in time. A survey conducted by the Childcare Voucher Providers' Association, the representative group for voucher provider companies in Employer-Supported Childcare, suggested only 36% of parents would prefer Tax-Free Childcare to be delivered through a single government provider. With a sole provider the government would need to find a mechanism to ensure the provider continued to improve standards. However, a number of other groups suggested that the competition impact may be limited as parents may not discern much differentiation between services, and that inertia – as frequently seen with changing bank accounts and energy suppliers – could stop them moving provider even if they received poor service.

**A.8** One representation suggested that an account was simply a transactional device to facilitate payment to a childcare provider – a mechanism broadly similar to a direct debit – and that this was something that parents would not need a choice on. A number considered whether a range of account providers offering other incentives or products alongside the accounts to differentiate themselves would be beneficial to parents – some thought that it could be whereas others thought that it could make the system more complex or be a distraction, and one had concerns that it could be a back door way of introducing fees for account provision.

**A.9** Security of funds was considered very important, not least given the potential sums involved and the importance of childcare to parents. To emphasise this point: a number simply took it as given that there would be safeguards to ensure that parents could not lose their money in the event of account provider insolvency as Tax-Free Childcare was a government policy. They also thought that parents would automatically assume that any money invested in Tax-Free Childcare whatever the option would be completely safe. Data security was also referenced, but less so than protecting parents' funds. One respondent mentioned that the more extensive the data flows between organisations involved in account provision, the more risk there was that parents' data could be compromised.

**A.10** In focus group discussions, parents explained that trust played an important part in their preference for the government to be the single provider. One response to the consultation from a parent was explicit in highlighting that NS&I is a trusted brand. This point was echoed in some other responses to the consultation.

**A.11** There were a number of other points raised more generally on Tax-Free Childcare. The importance of guidance was a common theme and there was a suggestion that a 'better off calculator' would be useful for parents to understand under which scheme – Tax-Free Childcare, Universal Credit, tax credits or Employer-Supported Childcare – they would receive the most support. There were concerns expressed about what the 'digital by default' agenda could mean for parents who would have difficulty accessing this support online; it was recommended that the government look at keeping open as many alternative channels for parents to access Tax-

Free Childcare as possible, and that the number of contact points needed to resolve a query were kept to a minimum.

## Views of childcare providers

**A.12** Childcare providers acknowledged that the current Employer-Supported Childcare system generally works well. Having said that, the majority of responses received from the childcare industry favoured a sole provider in the new scheme. The main reason was that this option was viewed as a significant simplification – reducing the administrative issues and costs compared to the current Employer-Supported Childcare scheme. In responses, this was mentioned as easing the issues childcare providers associate with facing multiple registration and sources of income, as well as addressing inconsistencies in the timing of payments that they receive from different voucher providers in Employer-Supported Childcare. More broadly childcare providers thought that the simplification benefits of a sole provider would be replicated for parents by reducing any complexity associated with the scheme. As acknowledged by other stakeholder groups, one respondent argued that choice of childcare provider was far more important for parents than having a choice of account provider.

**A.13** There was not complete agreement on the preference for a single provider – a couple of respondents thought that having a small number of providers (but more than one) would be preferable, as this was viewed as a way of getting the benefit of competition without introducing undue complexity.

**A.14** Of those that expressed a preference for a sole provider model, NS&I was generally favoured over HMRC based on views of who would be able to deliver the better service. Some did not specifically identify who they thought would best perform the role of a sole provider.

**A.15** As well as simplicity, the criteria of efficiency and responsiveness were referenced by childcare providers. One stated that the responsiveness of the online system should be the same as other comparable products such as bank accounts that parents use. There was also reference to the importance of a high level of service standards, with prompt payments and top quality customer services being key components of this. In this context, a couple of responses noted what they believed to be the poor track record of government in delivering services of this kind. In addition, the potential loss of competition under a sole provider option was seen as being a negative factor by some, although others viewed having increased competition as potentially leading to a longer delivery timeline and increased costs for government.

**A.16** Finally the security of parents' money and data was also mentioned as being important, although few seemed to use this to distinguish between the options. A couple of respondents suggested that a single government provider could offer the best protection, although another noted that there had been no noticeable levels of fraud in the Employer-Supported Childcare scheme.

## Views of employers and payroll practitioners

**A.17** The majority of responses received from employers and those involved in HR and payroll administration expressed a strong preference for a single government account provider on the grounds of simplification, security and efficiency, although one employer favoured a small number of providers to provide an element of competition and parental choice.

**A.18** Of those who favoured a sole government provider, the majority view was that NS&I, utilising their existing account infrastructure, would be the best way of providing a system that was simple and secure for all parties. However, one respondent referenced concerns about current efficiency levels when making contact with government departments such as HMRC.

**A.19** It was generally felt that dealing with multiple account providers rather than a single provider would increase administrative complexity unnecessarily and be more burdensome and costly for employers. Responses from a relatively small-scale survey conducted by two leading representative groups indicated that some employers will be likely to want to assist their staff by arranging payments directly into childcare accounts from net salary deductions. Ease of transferring funds will be an important consideration. Consistency was identified as a specific requirement because variations in multiple account providers' procedures and data requirements would make this process more complex and potentially time consuming, increasing the administrative burden on employers. It was thought that consistency could best be achieved through a single account provider but some respondents also suggested that if a multiple provider model was chosen, consideration should be given to standardising requirements across providers to address this concern. It was acknowledged that a single provider would eliminate scope for parents to switch between account providers which would also contribute to simplification and efficiencies.

**A.20** One respondent felt that the simplification of having a sole account provider would also benefit parents, and it was suggested that this would make it easier for employers to communicate the changes to employees than if they had to explain numerous options for account provision.

**A.21** On the issue of competition, one felt that parents' priority was to have choice in the provision of childcare rather than the mechanism by which they operate their childcare account. The employer which favoured a small number of fixed contracts thought that this approach would deliver the benefits of competition and parental choice whilst remaining manageable for parents, though they also identified potential concerns in relation to security, funding, and the lack of an incentive to invest in infrastructure. It would also have to be easy for parents to switch provider if service levels were not good.

**A.22** Virtually all responses mentioned security as an important consideration in the provision of childcare accounts. Some noted that the government-backed nature of the in house options meant this was most likely to ensure that parents' funds were safeguarded. One respondent thought that this would also minimise the risk of fraud to a greater extent than a multiple provider model.

**A.23** One respondent identified ease of delivery and practicality as an important factor in favour of NS&I, having regard to its existing banking infrastructure and the expected fit between its current customer facing business and the requirements of childcare accounts. They also thought that NS&I's status as an Executive Agency of HM Treasury and access to the GOV.UK portal ought to enhance credibility and lead to lower costs.

### **Views of voucher providers in the Employer-Supported Childcare scheme**

**A.24** Some voucher providers in the Employer-Supported Childcare scheme recorded their view that the government should have made a number of simple alterations to that scheme rather than introduce a new scheme. Nevertheless, they also supported the principles and objectives of Tax-Free Childcare. In considering the question of account provision in the new scheme, one response suggested that in addition to the five criteria the government had set out, a further criterion should be added: namely, which option would increase participation levels amongst parents.

**A.25** All of the responses received from voucher providers and their representatives in the Employer-Supported Childcare scheme preferred the open market option, or at least a market where there were multiple providers of accounts.

**A.26** In considering the criteria some respondents said that this option could deliver a straightforward and simple end-to-end journey for parents and childcare providers. In particular, an open market could also provide the 'one-stop' customer journey into Tax-Free Childcare for parents, either by parents going to voucher providers' websites to start the process, or smooth and direct links between the government and voucher provider websites. In addition, if the open market consisted of providers who had experience of ESC, customers would also benefit from this experience, e.g. in terms of tailored websites and customer service focused on the needs of parents purchasing childcare.

**A.27** It was also argued that the employer could play a key role in making the journey simple for parents, and that an open market consisting of providers who have also offered ESC could facilitate that. In addition, participation by employers could deliver economies of scale in the overall system.

**A.28** The Childcare Voucher Providers Association issued questionnaires to garner views from parents and childcare providers in the Employer-Supported Childcare scheme. From these surveys, 37% of parents viewed removing the employer from the administration of financial support for childcare costs as a negative development, and only 8% as a positive development.

**A.29** As childcare providers already have systems in place to deal with multiple voucher providers, and would continue to deal with these providers during the transition when the ESC scheme is being phased out, there was a belief that an open market option would not impose significant additional burdens on childcare providers. The results of a respondent's survey of childcare providers suggested that 48% of childcare providers would like an open market and that only 6% thought that this would increase costs.

**A.30** More generally on efficiency, the extensive infrastructure and knowledge that already existed among voucher providers in the existing scheme were thought to ensure that an open market would be low cost for all, including taxpayers. In contrast, a couple of respondents pointed out the lack of experience held by NS&I or HMRC in working with childcare providers.

**A.31** Voucher providers thought that there were clear advantages for the open market option when looking at the competition criterion. They believed that competition would drive up the quality of the service for parents and reduce the costs overall for taxpayers. They cited the first Economic Insight report. More generally a number of voucher providers made the point that having multiple providers would provide competition in being first to market, raising awareness of Tax-Free Childcare and attracting as many customers as possible. They thought that this would mean that the scheme would be delivered to time with take up maximised.

**A.32** Similar points were made in relation to the responsiveness of the scheme – innovation would arise from competition which would ensure that the customer service would suit the needs of both parents and childcare providers, and unlike a sole provider option it would remain responsive over time to these groups' needs. One respondent contrasted that to HMRC's customer service standards as highlighted by the Public Accounts Committee in March 2013.

**A.33** On security a number of providers mentioned that there was little or no evidence of error and fraud in the current system. It was acknowledged that there would need to be some form of regulation or accreditation to safeguard parents' funds and data in the new scheme. There were a variety of suggestions including regulation by the Financial Conduct Authority (FCA), the government extending the Financial Services Compensation Scheme to include Tax-Free Childcare, and/or a role for the Childcare Voucher Providers Association. Another respondent thought that there would be limited risk of account provider insolvency from competitive pressures as long as pricing was set in a sensible way.

## Other respondents

**A.34** Along with responses from the main stakeholder groups, comments were also received from a range of other organisations including accountancy bodies, the software industry and local and devolved government bodies.

**A.35** These responses varied in their focus and there were differing views on the best option for account provision. All but one of the responses favoured a single government-backed account provider on the grounds of simplicity, security and efficiency, and amongst these there was an overall preference for NS&I, though this was not unanimous.

**A.36** The majority of respondents in this category felt that a single, government-backed provider would make childcare accounts simple for parents to use and some thought this would also simplify processes for childcare providers, who would only have to register with and accept payments from a single source. Some respondents again observed that competition was not an important consideration in the context of childcare accounts and felt that parents would be more concerned about having a secure, easy-to-access system than being able to shop around between different account providers. One acknowledged that a small number of licensed providers could be an option to allow more choice, though noted that this would be at the expense of time consuming and costly tendering processes.

**A.37** Security and efficiency were identified as important criteria and a single government provider was seen by some as the best way of ensuring that parents' funds were protected and the systems protected from the risk of fraud. Some of those who preferred NS&I as a sole account provider noted that it was a well-established and trusted provider with a reputation for good service, which would inspire confidence in the scheme. They also agreed that efficiencies could be achieved by using NS&I's existing banking infrastructure, together with the GOV.UK portal, thereby saving the cost of having to create new systems within HMRC or one or more private providers and potentially reducing the length of time required to roll out the scheme.

**A.38** One respondent who preferred HMRC as the sole provider noted that Tax-Free Childcare would sit alongside other systems for childcare support such as Universal Credit, and that some parents were likely to transfer between schemes as their circumstances changed. They thought that HMRC, with real-time access to information across these schemes, would be best placed to manage the complexities that could arise from movements between different schemes for support with childcare costs. Another respondent thought that using NS&I, with HMRC's involvement, would be a more transparent and efficient route than HMRC administering the entire scheme itself. Mention was also made of HMRC's role in tax administration – one respondent thought that parents could potentially be discouraged from claiming Tax-Free Childcare if HMRC were the account provider because of previous poor experiences of HMRC, or a perception that money from childcare accounts could be seized to recover tax debts.

## Supplier engagement

**A.39** The government ran a pre-market engagement exercise to develop its understanding of the private sector models for delivering childcare accounts, and provide further evidence on the level of interest and capability in the market.

**A.40** This engagement included running a 'supplier day' following issue of a Prior Information Notice to the Official Journal of the European Union (OJEU). The event was attended by business process outsource specialists, voucher providers in the Employer-Supported Childcare scheme, and another organisation with experience delivering accounts to a wide population base.

**A.41** As well as constituting a non-binding pre-cursor to potential tendering, paving the way for government to enter quickly into a procurement exercise if Ministers were to choose that option,

the government also gathered evidence and views via a questionnaire and structured one-to-one conversations with potential suppliers who wanted to discuss the issues in more detail, including initial views on costs.

**A.42** The process indicated that there are a range of suppliers that may bid for the work, including business process outsource specialists, voucher providers under Employer-Supported Childcare, and other organisations with experience delivering accounts. Potential suppliers were most interested in the single or fixed number of provider models. There was less interest in an open market.

**A.43** The government also sought views on how long it would take to deliver Tax-Free Childcare in the market. Suppliers in one sector thought it would take three-to-six months to build account functions from contract signature; suppliers in another sector thought six-to-twelve months; and one existing customer account provider thought it highly unlikely that a solution could be in place by autumn 2015.

## Qualitative research

**A.44** The government commissioned *Ipsos Mori*, an independent market research company, to conduct qualitative research amongst parents on the different approaches to delivering childcare accounts.

**A.45** This research sampled parents who said they had income within the qualifying thresholds for Tax-Free Childcare, had at least one child under the age of 11,<sup>1</sup> were in full or part-time work and used formal childcare. This meant that all of the participants would potentially be eligible for Tax-Free Childcare. The participants had a range of income levels; some did and others did not receive Employer-Supported Childcare.

**A.46** The research consisted of two focus groups and eight in-depth interviews. By its very nature, this type of research is not intended to survey a large audience or quantify the views of parents, but looks to explore in depth the reasons why parents favour certain choices.

**A.47** The key results were:

- Security was primarily understood in the sense of the security of individual contributions from online fraud. This was felt to be a critical element, which parents expected would be incorporated into the accounts given their experiences of online banking security requirements.
- Simplicity and efficiency were vitally important to parents. This was because they felt short of time and wanted a service which fitted into their lives. They wanted a website which was quick to access and navigate, had a clear and intuitive interface, and would reassure parents by using transaction and data entry confirmation messages.
- Responsiveness was important to parents with regard to ensuring support and advice was easily available, particularly in the early days of the scheme and for those who may find online access more problematic. Parents preferred to be able to access such support and advice online, or alternatively by telephone through speaking to a trained staff member.
- Views were polarised on the issue of competitiveness. Parents typically were averse to choice, feeling that it would be confusing and time-consuming to have to decide

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<sup>1</sup> Parents will be able to receive support through Tax-Free Childcare for children until the September after their 11<sup>th</sup> birthday, or in the case of disabled children, the September after their 16<sup>th</sup> birthday.

between providers. Those who advocated choice did so in order to select the most convenient provider for them, which was typically their bank.

- Parents tended to prefer the single government provider accounts option – albeit one in which investment was made to ensure that the system met their demands in relation to the level of security, efficiency, simplicity and responsiveness. Trust played an important part in preferences for a government provider.

**A.48** The report has been published alongside this response document at <https://www.gov.uk/government/consultations/tax-free-childcare-consultation-on-childcare-account-provision>.

## Economic analysis

**A.49** The government commissioned *Economic Insight* to consider options for the government to deliver childcare accounts itself against the private sector on which it had reported as part of the first consultation. Its conclusion was that:

- from an economics perspective, all of the models have the potential to represent a sensible and legitimate way to deliver childcare accounts;
- the main advantages of the public sector models over the private sector models are that: (a) transaction costs associated with childcare accounts are potentially reduced; and (b) they help mitigate the risks and consequences of performance failure;
- the main disadvantages of the public sector model are the potential loss of consumer choice and dynamic benefits, which could be delivered by a market with more than one supplier. However, the decision that parents should not pay for childcare accounts reduces the benefits associated with the purely open market model assessed in their first report (although it does not eliminate them). The decision could also raise costs and risks in an open market model that would be avoided in a closed market model;
- within the public sector models, the NS&I model has somewhat greater potential for delivering dynamic efficiencies than the HMRC model. This is because there are competitive pressures arising from the appointment of NS&I's Business Process Outsourcer and also the potential for spill-overs from other NS&I activities; and
- overall, from an economics perspective, it is not possible to arrive at a definitive quantitative view as to which model is 'best'. The granularity of evidence that would be needed to reach strong conclusions in response to nuanced issues simply does not exist, and only a pilot and/or ex-post evaluation of the chosen model would seem capable of delivering such evidence.

**A.50** The report has been published alongside this response document at <https://www.gov.uk/government/consultations/tax-free-childcare-consultation-on-childcare-account-provision>.

# B

## List of respondents

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A list of organisations who submitted written responses to the consultation can be found below.

Allsave Limited

Association of Taxation Technicians

Blois Meadow Day Nursery Ltd

Bright Horizons Family Solutions

British Association of Paid Nannies

Chartered Institute of Personnel and Development

Chartered Institute of Payroll Professionals

Childcare Voucher Providers Association

Children in Wales

Clybiau Plant Cymru Kids' Clubs

Colchester Borough Council

Conwy County Borough Council

Crown Prosecution Service

4Children

Grass Roots Group UK Ltd

Family and Childcare Trust

Independent Association of Prep Schools

Institute of Chartered Accountants in England and Wales

Low Income Tax Reform Group

Motivcom Plc

National Day Nurseries Association

P&MM Ltd

Playboard NI

Pre-School Learning Alliance

Pricewaterhouse Coopers

Professional Association for Childcare and early years (PACEY)

Redfish Systems Ltd

Scottish Childminding Association

Wales Pre-school Providers Association

Welsh Government

Wider Plan Plc

In addition, we received responses from 2 private individuals.





## **HM Treasury contacts**

This document can be downloaded from  
[www.gov.uk](http://www.gov.uk)

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