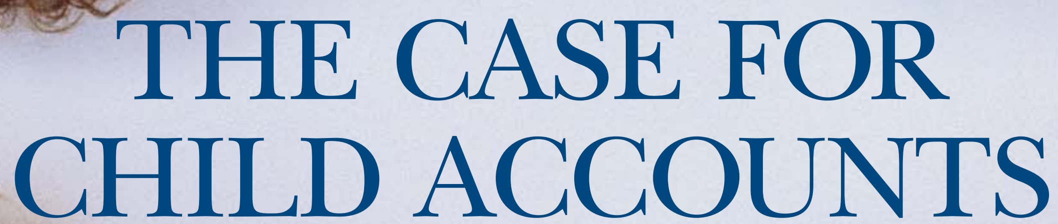

THE CASE FOR CHILD ACCOUNTS

THE ASPEN INSTITUTE

INITIATIVE ON FINANCIAL SECURITY

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Executive Summary

Among America's founding principles is the ideal that each citizen's ability to succeed—to achieve financial security, to do better than the generation that came before—should be as limitless as individual potential. A sound national savings policy is essential to achieving the American Dream. And higher rates of saving can also strengthen the national economy.

Unfortunately, the savings picture in the United States today is bleak. The U.S. personal savings rate has been declining for decades, and our net national savings rate is now the lowest among the G-20 countries.

The time to change course is now. The U.S. needs a sensible savings policy that allows all Americans to save at every stage of life.

Saving, like every other good habit, is best learned at the beginning of life. We believe the best tool for teaching that essential skill is through Child Accounts, a savings vehicle to put all children on the path to financial security from the very beginning of life.

From birth, every child will have an investment account initially funded through a modest government contribution. Contributions from family and friends and matching contributions for low-income children, along with investment earnings, will help the account grow. Child Accounts will also provide a hands-on opportunity for teaching financial literacy.

These accounts will be universal—each child, regardless of income, will receive a jump start in life. Child Accounts will also be simple, with limited, basic investment choices and no withdrawals for 18 years. They will be delivered through the private sector and administered by financial services companies. The account would be worth about $16,000 (assuming $50/month contributions, or $25/month with a government match) after 18 years of growth. That means that at age 18, every child will have a head start for entering adulthood—to invest in education, to buy a car or pay for work-related expenses, to start a business, or to help rent or buy a first apartment or home.

There are around 4 million new births in the U.S. each year. If enacted at the federal level, a Child Accounts program will require a $2.1 billion public investment for the first year, and $26.6 billion over 10 years ($20.7 billion endowment; $5.9 billion match). After the first three years, private contributions and investment income would exceed the government's initial contribution.

Based on modest family contributions and investment growth, account accumulations are projected to reach $100 billion over ten years. Although a federal program is the ultimate goal, piloting such a program at the state level is also feasible. A savings program for children is already under consideration in several states. The cost of launching the Initiative on Financial Security model of Child Accounts at the state level varies, based on both the size of the state and its distribution of income.

Child Accounts won't solve poverty today. Instead, they are a long-term investment in children and their financial futures. The Initiative on Financial Security model for Child Accounts represents a new way forward, offering families—regardless of income—an opportunity fund to launch their children into adulthood successfully.

These accounts represent an extraordinary opportunity to change our national savings behavior for the better and enable more Americans to save, invest, and own.

Introduction

The foundation of the American Dream has always been the unlimited potential for each citizen to rise as high as their talents would take them. Today, that foundation is showing serious cracks. The ability to achieve financial stability, to get an education, and to do better than our parents did is facing extraordinary challenges.

The savings picture today in the U.S. is bleak. For the first time since the Great Depression, the U.S. has a negative savings rate. The inability of families to save more is compromising their ability to build assets, to move up the social ladder, and to retire; at the same time it exacerbates the gap between those who have and those who have not.

Americans save too little—partly because they start saving too late. Saving, like every other good habit, is best learned at the beginning of life. An earlier start on saving means more money through the magic of compounding. And it instills a saving mindset that can persist throughout life.

Child Accounts: A Bold New Policy

The Initiative on Financial Security (IFS) of the Aspen Institute proposes a bold new policy called Child Accounts. Child Accounts are investment accounts, funded initially by a modest government contribution, given to each child at birth. Child Accounts will

- build a financial asset for every child to fund the transition to adulthood
- create a new generation of savers and financially savvy consumers
- connect more families, especially those in the low- and moderate-income brackets, to the U.S. savings system while increasing savings overall.

With Child Accounts, every child will have an investment account funded from birth. Contributions from family and friends and federal matching contributions for low- to moderate-income children, along with investment earnings, will help the account grow. Children at age 18 will have a head start as they enter adulthood—to invest in education, to buy a car or pay for work-related expenses, to start a business, or

Saving, like every other good habit, is best learned at the beginning of life.

Child Accounts can empower all of tomorrow's young adults toward a more secure future.

to help rent or buy a first apartment or home. Child Accounts will also provide a hands-on opportunity for teaching financial literacy to both children and their families.

Child Accounts have an extraordinary potential to improve the savings picture in the U.S. and inspire all Americans, regardless of income level, to save, invest, and own.

The best evidence of the program's possibilities is the successful system of child saving accounts already in place in the United Kingdom (briefly described in Appendix A).[1] Since the program's inception in 2005, every child in the U.K. receives a Child Trust Fund account delivered through the private sector. Early results indicate the program is markedly improving the savings habits of families across the country. More than a third of U.K. families have committed to making regular contributions to these accounts. It is clear that Child Trust Funds will have a substantial impact on the U.K. economy over time as well.

Child Accounts, modeled on the U.K. system but adapted to the American market, can achieve the same successful results in the U.S. Child Accounts can empower all of tomorrow's young adults toward a more secure future by helping them build a financial asset and experience the rewards of saving, investing, and owning.

How Child Accounts Work

Child Accounts build savings from the beginning of life. Every child born in the U.S. will have an account with a modest beginning endowment provided by the federal government.

Unfortunately, our saving system today doesn't include a vehicle like Child Accounts—a universal, tax-favored, private-sector investment account personally owned by children themselves. The federal government currently doesn't invest in children through savings accounts with start-up or matching contributions. And there is no savings account that is universally available to all children.

Current law permits anyone to save on behalf of a child through a standard investment or savings account or state-law

[1] The intellectual framework for Child Trust Funds in the U.K. is based on proposals advanced by Michael Sherraden of Washington University in St. Louis for asset-based welfare policies, the basic premise of which can be found in Michael Sherraden, Assets and the Poor: A New American Welfare Policy. Armonk, NY: M.E. Sharpe, Inc., 1991.

custodial accounts.[2] But these accounts enjoy no special tax benefits and their growth can, in fact, be adversely affected by the federal "kiddie" tax.[3] There are also two tax-favored accounts under federal law for children: Coverdell Education Savings Accounts and state-based 529 plans. Both accounts reserve tax benefits largely for assets spent on education (only higher education in the case of 529 plans). The account belongs to the contributor, not to the child named as beneficiary. At any time, a contributor can change the name of the beneficiary or even withdraw account funds, subject to some tax penalties.

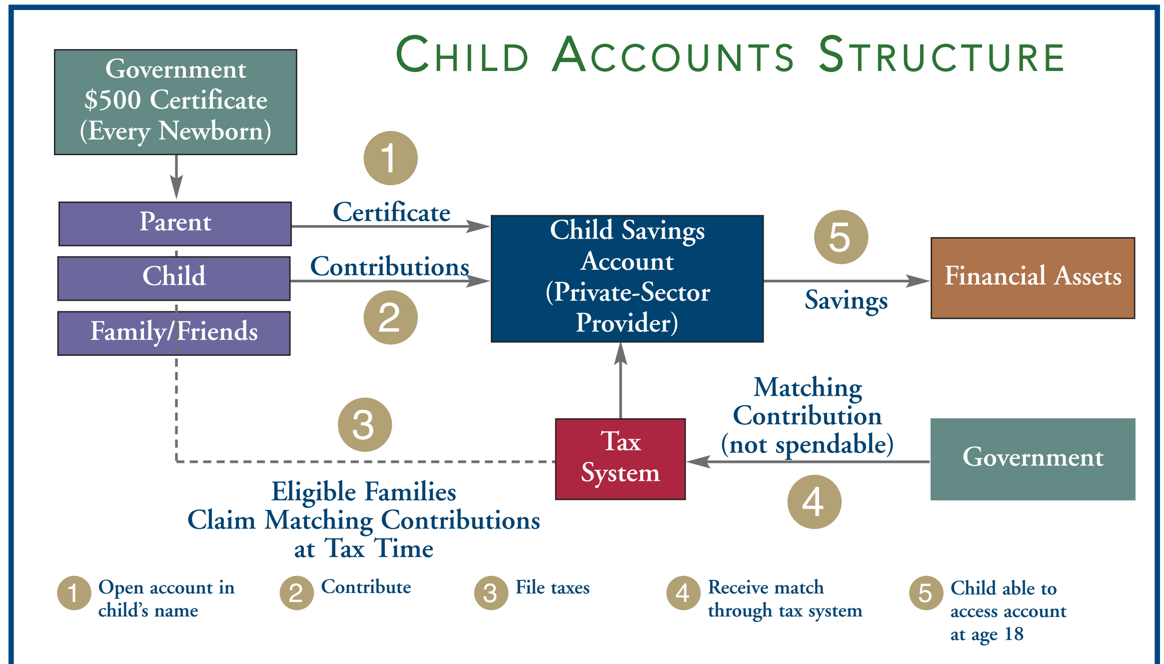
We envision a better way to encourage saving, sound investment, and the development of financial literacy for all U.S. children. The IFS vision of Child Accounts includes these key elements:

- At birth, each child will be given a $500 certificate for an investment account.
- Parents will take these certificates to a participating financial institution to open an account, which will grow tax-free.
- Family, friends, churches, and charities will be able to add up to $2,000 a year in new contributions.
- Low- and moderate-income families will be encouraged to save through a 100% government matching contribution up to $1,000 annually ($2,000 maximum on all account contributions).
- The standard Child Account will be simple and safe, with one basic investment fund structured for an 18-year investment horizon and limits on account fees and expenses.
- Account funds will be locked up until the child reaches age 18. At that time, the assets can be used for any purpose.
- Child Accounts will offer additional incentives for children to use their accounts toward education, home ownership, business startup, or retirement income.

IFS is not alone in advocating a system of savings accounts for children. Proposals (summarized in Appendix B) for similar accounts have previously been introduced in Congress. These

[2] These accounts are created under uniform statutes regarding gifts or transfers to minors.

[3] The "kiddie" tax found in Internal Revenue Code §1(g) is designed to discourage higher-income taxpayers from transferring substantial assets to children to take advantage of their lower tax rates.



proposals share some features with Child Accounts, but there are also some critical distinctions.

IFS's Child Accounts are uniquely structured to be universal and endowed through modest government contributions, to restrict access to assets until age 18 but provide unrestricted use thereafter, and to be delivered through the private sector.

The Power of the Match

Matching contributions are a powerful incentive to save. Many existing savings vehicles, including the popular 401(k) plan, typically feature matching contributions to stimulate saving by Americans at all income levels.[4]

Matching contributions are also effective incentives among the lower-income families who may find it most difficult to save. Results from demonstration projects with Individual Development Accounts, which are matched savings accounts currently offered by non-profit organizations around the country, show that low-income Americans can and will save for long-term goals.[5] In addition, H&R Block has tested the impact of matching contributions on saving by low- and moderate-income Americans through its Express IRA. The company found that, when given

[4] The ASPIRE Act also includes a matching provision, and the proposed PLUS accounts would require a compulsory employer match. Please see Appendix B.
[5] Information on this project is available at http://www.cfed.org/focus.m?parentid=31&siteid=374&id=374.

the right opportunity and right incentive, low-income households will save some or all of their tax refunds in an IRA. More customers contributed to the IRA when a higher match was offered, and these customers also tended to have higher saving rates than those offered a lower match (or no match at all).[6]

The feasibility of matched savings accounts for children has been tested through a multi-year national demonstration project called SEED (Saving for Education, Entrepreneurship, and Downpayment). Led by the Ford Foundation and other funders, the SEED Policy and Practice Initiative first received funding in 2003 to establish partnerships nationwide "to develop, test and impel matched savings accounts and financial education for children and youth."[7] SEED also includes a program to establish 1,500 college savings plan accounts among randomly selected infants that includes a scalable delivery system within Oklahoma's 529 college savings plan.[8]

As of December 31, 2006, 11 sites around the country had 1,220 active participants who had saved approximately $1.5 million through a variety of contribution sources. On average, each child had an account balance of about $1,179.[9] Although SEED is demonstrating the power and potential of these accounts, the success of a larger-scale program will depend on participation from the public and private sectors.

THE POWER OF THE MATCH

Mary comes from a low-income family earning about $20,000 a year that can afford to contribute only $20 per month to her Child Account. Because she qualifies for a match, Mary's account receives a 100% match. With continuous contributions over 18 years, she will have over $14,000 (over $8,000 in today's dollars) in her Child Account when she is 18.

John comes from a middle-income family that earns about $60,000 per year and contributes $50 per month to his Child Account. His Child Account is not eligible for a match. After 18 years, his Child Account will be worth over $16,000 (about $10,000 in today's dollars).

The government match enables low-income families to build a substantial financial asset for their children.

[6] Esther Duflo, William Gale, Jeffrey Liebman, Peter Orszag, and Emmanuel Saez, "Saving Incentives for Low- and Middle-Income Families: Evidence from a Field Experiment with H&R Block," The Retirement Security Project, Policy Brief No. 2005-5, May 2005.
[7] More information can be found at http://www.seed.cfed.org.
[8] More information can be found at http://gwbweb.wustl.edu/csd/SEED/SEED.htm.
[9] More information can be found at: http://gwbweb.wustl.edu/csd/SEED/SEED_research_papers/SEED_account_monitoring_0307.pdf.

IFS views matching contributions as an essential component of Child Accounts for low- and moderate-income families. Matching contributions provide a strong incentive to save that helps low- and moderate-income families' accounts grow and keep pace with their higher-income counterparts. For example, many of these families would not be able to contribute $166 each month ($2,000 a year). With the match, they could reach the same $2,000 with a more feasible contribution of $83 a month. Although a matching policy adds some administrative complexity to Child Accounts, the positive behavioral effects are well worth it.

Matching contributions will also help small accounts grow more quickly, providing larger balances at age 18 and making the account economics more attractive to financial institutions. With only modest contributions over time, matching contributions make Child Accounts robust enough to give 18-year-olds a significant jump start on financial security in adulthood. A Child Account that receives only the initial endowment will be worth about $1,300 18 years later. If the maximum $2,000 is contributed each year, the account will be worth approximately $56,000 ($33,000 in today's dollars) after 18 years.

Delivering the match through the tax system, as IFS proposes, also reduces the administrative complexity of Child Accounts. The federal tax system already administers the Saver's Credit that provides rebates to some low- and moderate-income savers who can document their annual contributions to a retirement plan. Unlike the Saver's Credit, however, matching contributions *must* be deposited into Child Accounts. The tax system already has a vehicle for such deposits through its program permitting taxpayers to send tax refunds to multiple accounts through IRS Form 8888.

The Role of the Private Sector

There are roughly 4 million new births in the U.S. every year. Managing a Child Accounts program of this magnitude requires the expertise of private-sector financial institutions.

The IFS model of Child Accounts challenges the financial industry to provide accounts that are sustainable in the marketplace and provide maximum benefits for households. IFS's joint product research conducted with numerous financial firms reveals interest in this model. The private sector currently manages millions of accounts, many of them small, in employer-based and individual retirement plans.

In addition, many major private sector players already have the administration and investment management systems that Child Accounts will require. The private sector also has the relevant marketing, communications, and financial education materials to help stimulate Child Account contributions from friends and families. Incentivizing contributions over the accounts' 18-year horizon is central to the goal of creating robust child accounts.

Delivery of Child Accounts through the private sector is also useful because many families already have relationships with financial institutions and are familiar with their products and services. In addition, Child Accounts situated in the private sector will give many low- and moderate-income consumers a connection to the mainstream financial services industry they currently lack, building financial literacy and trust in financial products.

Other proposals (cited in Appendix B) look to the federal government to administer child accounts. The ASPIRE Act, PLUS Accounts, and KidSave all propose creating a government-run program similar to the Thrift Savings Plan (TSP) for federal employees. This approach would require building brand-new systems for record-keeping, contributions, communications, and investments, all housed within the federal government.

Although the TSP is a well-run, low-cost program, its direct costs are kept low in part because government agencies perform many necessary administrative services. TSP accounts are also relatively large (about $50,000 on average), which helps reduce the fees charged for

TABLE 1: Projected Growth in Child Accounts over 18 Years

	Year 1	Year 5	Year 10	Year 18
First-Year Cohort Accounts ***(billions)***	$2.8	$8.4	$17.1	$32.8
Cumulative Accounts ***(billions)***	$2.8	$27.8	$97.3	$316.3
Average Account Balance	$686	$1,359	$2,331	$4,081
Number of Accounts ***(millions)***	4.0	20.5	41.7	77.5

administrative and investment expenses. Scaling up the TSP for Child Accounts would be daunting. The TSP currently has less than 4 million total participants, while a Child Accounts program will enroll 4 million new accounts *each year*. The costs of building and maintaining a TSP-like program are uncertain but likely to be significant for taxpayers and account holders alike.

In the IFS model of Child Accounts, the private sector will compete for Child Accounts under the supervision of federal law and regulations. Many familiar financial institutions will choose to offer these accounts directly. Others, such as retail banks and other depository institutions, may not have the infrastructure or desire to become full providers. But it's likely they will partner with other institutions to offer Child Accounts—a universal program that reaches the families of every newborn—in order to retain their current customers and to acquire new ones.

Successful operation in the Child Account market will depend on companies being able to obtain significant market share. To assure profitability, companies must also maximize contributions to increase account assets. This means that successful companies will continually encourage families to make additional contributions—an economic incentive and marketing technique that would be missing in a government-delivered program. Table 1 shows potential aggregate assets based on the assumptions described in Appendix C. These projections indicate that Child Accounts will grow into a market of approximately $100 billion within ten years, with average account balances over $2,000.

Because profitability depends on increasing assets, market participants will have a strong incentive to maximize additional contributions from friends and families. Through communications and other familiar marketing techniques, the private sector has the tools

to stimulate strong saving behavior. In addition, for many families, sending monthly contributions to a familiar financial provider may be more appealing than using a new government entity.

Advocates for a government-run system believe that an intermediary like the federal government is necessary to protect these accounts from unfair industry practices. The IFS plan instead builds strong consumer protections directly into the design of the accounts themselves.

Child Accounts feature three important protections: 1) a simple account design, including no withdrawals until age 18; 2) a limit on fees; and 3) an automatic investment into a fund designed to maximize growth over time while minimizing risk. Capping fees *will* challenge the industry. But the blend of simple account structures and standardized customer choices will keep costs low. For example, if fees are limited to 1.5% as they are in the U.K., the initial revenue on a $500 account would be a modest $7.50.[10] To make these accounts profitable, the private sector must continually encourage families to make additional contributions. The standard investment fund will be structured for an 18-year investment horizon to minimize complexity and risk and maximize growth in the early years, moving to more conservative investments as the child ages.

The IFS model for universal Child Accounts asks the private sector to do what it already does well for millions of American savers and investors: provide an effective delivery, administrative, and investment structure.

At the same time, Child Accounts provide a well-designed structure with the potential to provide every child with significant assets at age 18. With built-in consumer protections, matching contributions, prohibition on withdrawals until age 18, but unrestricted use thereafter. Child Accounts carefully balance the financial industry's need to make relatively small accounts on a massive scale profitable with the ultimate policy goal of giving young adults a robust financial asset for their transition to adulthood.

The blend of simple account structures and standardized customer choices will keep costs low.

[10] The actual annual operating costs for an account of this size are likely to be in the neighborhood of $20-$30, largely due to the fixed per-account costs of record-keeping and communications regardless of account size. For a more detailed account of administrative costs, please see Estelle James, James Smalhout, and Dimitri Vittas, "Administrative Costs and the Organization of Individual Retirement Account Systems: A Comparative Perspective," Policy Research Working Paper WPS2554. Development Research Group, The World Bank, February 2001.

TABLE 2: Projected Federal Outlays for Child Accounts *(Billions)*

	Year 1	Year 5	Year 10	Year 18
Annual Endowment	$2.000	$2.062	$2.143	$2.279
Annual Match	$0.093	$0.530	$1.095	$2.046
Cumulative Outlays	$2.093	$11.709	$26.597	$57.344

Benefits and Costs at the Federal Level

With a relatively modest initial endowment, matching contributions for low- and moderate-income families, and consistent contributions, Child Accounts have the potential to grow into significant financial assets. But Child Accounts promise more than economic returns. They also set families and children on an 18-year journey toward greater financial literacy and better savings habits.

As Table 2 indicates, the federal dollars required to fund Child Accounts are not insignificant. But private, not public, dollars primarily drive asset growth. Analyses (described in more detail in Appendix C) indicate the following:

- Child Accounts will require a $2.1 billion public investment for the first year, and $26.6 billion over 10 years ($20.7 billion endowment; $5.9 billion match).
- After the first three years, private contributions and investment income exceed the government's initial contribution.
- Based on modest family contributions and investment growth, the Child Accounts market is projected to reach $100 billion over ten years. Public funds would represent only one quarter of this total, and three quarters would come from private funds and asset growth (returns).
- With a $50 per month contribution (or $25 with a match), a Child Account would be worth about $16,000 (about $10,000 in today's dollars) in 18 years. That amount would pay for two years of tuition at a community college today, as well as a third year at an in-state public college. This amount would also be significant seed capital to start a small business or purchase a franchise.

An Alternative Approach: Beginning with the States

A federal program for Child Accounts offers many advantages such as universal access, uniform laws and regulations, and a larger market to encourage broad-based industry participation and minimize account costs. Although a federal program for Child Accounts is the ultimate goal, piloting such a program on a smaller scale is also feasible.

Caguas, the second largest city in Puerto Rico, is the world's first municipality to create a program of universal children's accounts. Announced in October 2006 and launched in early 2007 with an initial investment of $1 million, each account will have an initial government endowment of $200, and parents will be able to contribute to the account as the child grows. [11]

Several U.S. states are already considering a program of savings accounts for children. California's legislature introduced a bill in February 2007 to create a California KIDS Account for every newborn,[12] and Kentucky established a bipartisan "Cradle to College" Commission to consider whether to endow every newborn in Kentucky with a funded college savings account.[13] In Illinois, legislation to create an Illinois Children's Savings Accounts Task Force passed the Senate and has now moved to the House. The task force will review and recommend program options and create an implementation plan to give every child born in Illinois, to Illinois residents, a savings account. [14]

Several states have taken a different approach, adding state-matching contributions to their existing 529 college savings plans. Maine's 529 program (called the NextGen Plan) allows every family who opens an account with an initial contri-

TABLE 3: Characteristics of Sample States

	State A	State B
Annual births	50,000	100,000
Median family income	$45,000	$60,000
% Low-income Families ***(under $40,000)***	45%	30%
% Middle-income Families ***($40,000-$100,000)***	40%	45%
% High-income Families ***(over $100,000)***	15%	25%

[11] More information can be found at http://www.newamerica.net/files/CSA%20two%20pager.pdf.
[12] More information can be found at http://www.newamerica.net/node/4929.
[13] More information can be found at http://www.cradletocollege.ky.gov/.
[14] More information can be found at http://www.povertylaw.org/news-and-events/poverty-action-report/april-2007/illinois-may-soon-have-children2019s-savings- accounts.html.

bution of at least $50 to apply for an initial matching grant of $200.[15]

The cost of launching the IFS model of Child Accounts at the state level varies with the size of the state and the distribution of income within that state. Consider the two states described in Table 3 (see page 15), which differ significantly in size and wealth.

Table 4 illustrates the costs and growth in assets in Child Accounts in these sample states. In State A, the smaller and poorer state, government outlays will total approximately $26 million in the first year, increasing to $34 million by the fifth year, with a cumulative outlay of $152 million over five years and $353 million over ten years. Assets held in Child Accounts will rise from $34 million in the first year to $334 million by the fifth year, $1.2 billion after ten years, and over $3.7 billion over eighteen years upon full implementation. The first graduates of the program would have approximately $387 million in Child Accounts in the aggregate at age 18.

In State B, a larger, wealthier state, government outlays will total approximately $52 million in the first year, increasing to $63 million by the fifth year, with a cumulative outlay of $287 million over five years and $644 million over ten years. Assets held in Child Accounts will rise from $70 million in the first year to $721 million by the fifth year, $2.5 billion after ten years, and over $8 billion over eighteen years upon full implementation. The first graduates of the

TABLE 4: State Child Accounts, Government Outlays, and Asset Growth

	State A	**State B**
Government Outlays *(Millions)*		
Year 1	$26.5	$52.0
Year 5	$34.3	$62.5
Year 10	$44.4	$77.0
Year 18	$61.3	$100.8
Cumulative, 10 years	***$353.4***	***$643.9***
Account Asset Growth *(Millions, unless indicated)*		
Year 1	$34.1	$69.9
Year 5	$333.7	$721.3
Year 10	$1.2 billion	$2.5 billion
Year 18	$3.7 billion	$8.3 billion
First-Year Cohort, at Year 18	***$386.6***	***$861.5***

[15] More information can be found at http://www.cfed.org/focus.m?parentid=31&siteid=2166&id=2184.

program would have approximately $861 million in Child Accounts in the aggregate at age 18.

In addition to government funds, Child Accounts at the state level would require a significant role for the private sector in carrying the accounts, as well as a new legal structure. Today there is no single account structure that accommodates the distinctive features of Child Accounts, including account ownership by the child, restricted funds until age 18 and unrestricted use thereafter, limitations on fees, and defined investment options. Appendix D provides a model state statute that would enable states to establish and maintain a program of Child Accounts.

Conclusion

Child Accounts won't solve poverty today. Instead, they are a long-term investment in children and their financial futures. Available to all children, this universal program makes saving a universal experience and a hands-on lesson in financial literacy for all children. Universality also engages people close to the child in a real-life experience that teaches better saving and investing skills and boosts the financial aptitude of adults, too.

Child Accounts encourage choice and responsibility as a first step for young adults to secure their futures. While many would use their accounts for higher education, others may need to buy a car, a suit, or a computer to get a first job. Some children may waste their funds, of course. Some will indeed fall prey to the schemes of others (and they would be able to turn to the legal system for recourse). But many others will make good choices. Permitting unrestricted use of account assets at age 18 is a risk we choose to take, knowing that we have 18 years to teach these children, and their families, about basic financial principles and skills.

The IFS model for Child Accounts represents a new way forward—one that bridges the current divide between many working families and the U.S. savings system. For families, it offers every child, regardless of income, an opportunity fund to launch them into adulthood. For the nation, it represents an extraordinary opportunity to change our national savings behavior for the better and enable more Americans to save, invest, and own.

Child Accounts are a long-term investment in children and their financial futures.

Appendix A: About the Child Trust Fund in the United Kingdom

Under the leadership of former Prime Minister Tony Blair and then Chancellor of the Exchequer (now Prime Minister) Gordon Brown, the U.K. launched its universal Child Trust Fund (CTF) program in 2005.

The U.K. gives families of all newborns a voucher for £250 (about $500) and an additional £250 to children from low-income families. Additional contributions of up to £1200 or roughly $2,400 each year are permitted. CTFs belong to the child, and at age 18, assets may be used for any purpose.

When children reach age 7, their accounts receive a "top-up": an additional government contribution of £250 (and an additional £250 for low-income families). An interdisciplinary curriculum dubbed "Money Week" will be established in schools to coincide with the "top-up" contribution at age 7, and providers are already developing their own financial literacy materials. At age 18, CTFs will automatically roll over into a tax-free, adult savings account (called an Individual Savings Account, or ISA) but young adults will be able to withdraw their funds without restrictions.

The private sector had a significant role in the design of the program, and financial institutions are central to the program's success. Families open a CTF by redeeming their voucher with a participating private-sector institution. Private-sector institutions service CTFs, including marketing the accounts (and receiving vouchers), facilitating and tracking contributions, making and changing investments, and sending out annual statements. Providers are required to offer a basic CTF (called a "stakeholder" product) that caps fees at no more than 1.5% each year. These "stakeholder" CTFs are popular, representing about 75% of the CTF market.

Although the U.K. experiment is new, its initial reception has been very promising. A baseline survey by the

University of Bristol of parental behavior before and after the introduction of these accounts reveals positive effects on savings behavior.[16] Awareness of the Child Trust Fund is very high and parents are interested in making contributions: 77% expect to make additional contributions and 38% expect to make regular contributions (at a median value of £24 per month). Since the introduction of the Child Trust Fund, 32% of accounts are receiving regular contributions, mainly made by parents.

The Children's Mutual, which in 2006 had the largest market share of CTFs, has had extremely positive results with regular, automatic deposits. About one-third of families in the first year signed up for such deposits; between July and December of 2006, that number had grown to about 50%.[17]

[16] Elaine Kempson, Adele Atkinson, and Sharon Collard, "Saving for Children: A Baseline Survey at the Inception of the Child Trust Fund," Personal Finance Research Centre, University of Bristol (U.K.),. September 2006.

[17] Personal interview with David White, February 9, 2007. Earlier testimony with similar results includes David White's remarks at the New America Foundation/United States Congress Savings and Ownership Caucus event, September 27, 2006.

Appendix B: Comparison of Child Account Proposals in the United States

	ASPIRE	PLUS	401Kids
Objective	Universal child accounts for home-ownership, education, and retirement	Universal retirement accounts for children and American workers[18]	Enhancing Coverdell Education Savings Accounts to encourage greater saving for children
Sponsor(s)	None yet in 110th Congress	Sen. Jeff Sessions (R-AL)	Rep. Judy Biggert (R-IL)
Endowment	$500/$1,000[19]	$1,000	None
Match	Yes. Maximum income eligible for match varies by version of bill.	Compulsory for employers, none from government	None
Contribution Cap	$2,000/year	$5,000/year	$2,000/year under age 19; no further contributions
Account Management	Thrift Savings Plan	Thrift Savings Plan	Private sector
Account Ownership	Child	Child	Child
Repayment of Initial Endowment	At age 30	None	None
Distributions	Higher education, home purchase, or retirement	Retirement; some loans may be permissible beforehand	Education at any age, home purchase, or retirement rollover
Rollovers	To Roth IRA	None	To Roth IRA before age 30
Account Liquidation	N/A	N/A	Required at age 30
Contributions, Tax Treatment	After-tax	After-tax	After-tax
Earnings, Tax Treatment	Tax-free	Tax-free	Tax-free
When Distributed, Tax Treatment	Tax-free if used for qualified expenses after 18	Tax-free at age 59 1/2	Tax-free if used for qualified purposes

[18] All American workers would have accounts with minimum 1% employee and 1% employer contributions after age 18 (up to first $100,000 of salary).

[19] $1,000 initial contribution for families earning below $46,242 at the 2006 threshold.

	Young Saver's Accounts	KidSave	Child Accounts
Objective	Eliminating the earned income requirement from Roth IRAs so that they can be child savings vehicles	Universal retirement accounts for children as a supplement to Social Security	Universal retirement accounts for any purpose
Sponsor(s)	Sen. Sam Brownback (R-KS); Rep. Nydia Velazquez (D-NY)	Rep. Jerry Weller (R-IL)	None yet in 110th Congress
Endowment	None	$2,000	$500
Match	None	None	100% for eligible families
Contribution Cap	$5,000/year	$500/year under age 19; no further contributions	$2,000/year
Account Management	Private sector	Thrift Savings Plan	Private sector
Account Ownership	Child	Child	Child
Repayment of Initial Endowment	None	For five years, beginning at age 30	None
Distributions	Education, home purchase, or retirement	On or after beginning to receive Social Security benefits	Any use after age 18
Rollovers	None	None	To Roth IRA
Account Liquidation	N/A	N/A	To be determined
Contributions, Tax Treatment	After-tax	After-tax	After-tax
Earnings, Tax Treatment	Tax-free	Same as Thrift Savings Plan	Tax-free
When Distributed, Tax Treatment	Tax-free if used for qualified purposes	Same as Thrift Savings Plan	Tax-free after age 18; not permissible beforehand

Appendix C: Assumptions and Outputs for Child Accounts

IFS calculations for market size and cost of government outlays are based on the following model of family income and likely savings behavior.

Using census data regarding population growth projections and the distribution of family income, the 4 million children born in the U.S. each year are divided into three categories—low-, middle-, and high-income—and three types of savings patterns—"non-savers," "moderate savers," who make modest contributions, and "aggressive savers," who tend to maximize account values. Table 5 describes the distribution of families in this analysis.

Using these behavioral assumptions, each of these nine groups is tracked for 18 years of saving, assuming consistent behavior: each group contributes or does not contribute, accounts held by low-income families receive a government match on their savings, and each account receives investment income during the year.

For modeling purposes, a 1.5% fee is deducted from the account at the end of each year and transferred to the account provider to cover both account maintenance and applicable fees of the underlying investments. This replicates the Child Trust Fund policy in the U.K., which offers a basic account with a 1.5% cap on variable fees and no fixed fees.

All accounts are invested in a lifecycle fund that is re-allocated toward bonds

TABLE 5: Distribution of Families by Income and Savings Behavior

Type of Family	Income Range	Non-Contributors	Moderate Contributors	Aggressive Contributors
Low-Income (35%) (Match-Eligible)	Under $40,000	80%	15%	5%
Middle-Income (45%)	$40,000-$100,000	70%	25%	5%
High-Income (20%)	Over $100,000	60%	30%	10%

TABLE 6: Individual Account Growth

Type of Saver	Monthly Contributions	Year 5	Year 10	Year 18
Non-Savers	$0	$695	$934	$1,295
Low-Income Moderate	$20, matched 1:1	$3,319	$7,214	$14,437
Middle-Income Moderate	$50	$3,791	$8,301	$16,388
Middle-Income Aggressive	$100	$7,586	$19,370	$42,966
High-Income Aggressive	167($2,000/year)	$11,224	$26,772	$55,771

and cash as the child ages, resulting in a projected 8% rate of return until age 6 and decreasing thereafter, reaching a 4.6% return at age 18. Individual account growth is not adjusted for inflation. However, present-value calculations are offered.

Table 6 reveals that, depending on contribution levels and investment performance, Child Accounts can grow in 18 years to more than $1,200 without further contributions ($750 in today's dollars), or as much as $55,000 ($33,000 in today's dollars) if contributions are maximized. They represent a market of approximately $100 billion within ten years, with average account balances over $2,000. The cost to government over ten years is approximately $27 billion. Each year, as accounts mature, the total government contributions to that cohort are leveraged more than eight times by private contributions and investment income.

Appendix D: State Child Accounts

MODEL STATE CHILD ACCOUNTS STATUTE[20]

I. Establishment of Child Accounts Program.[21]

The legislature hereby declares its intention to establish a program of savings accounts to enable children who are residents of the state to acquire the habit of thrift and accumulate financial assets for their transition to adulthood. This statute, and amendments thereto, hereby establishes a savings account program for children and such program shall be known and may be cited as the [name of state] "Child Accounts Program."

II. Definitions and Special Rules.

a. "Account Provider" means (1) any bank as defined in Code Section 408(n), and (2) any other entity of a kind that has been approved to hold Child Accounts by the Treasurer, based on a finding that such entities are subject to sufficient governmental or regulatory oversight, possess suitable internal controls to ensure the safety and soundness of amounts held in Child Accounts, and capable of providing the same level of protection to customers' personal information, such as a bank (defined above).

b. "Certificate" means a certificate issued by State, in such form as is prescribed by regulations, on behalf of an Eligible Child enabling participation in the [name of state] Child Accounts Program.

c. "Child Account" or "Account" means an account established on behalf of an Eligible Child with an Account Provider in accordance with the provisions of this statute, amendments thereto, and regulations thereunder.

d. "Code" means the Internal Revenue Code of 1986, as amended.

e. "Cost of Living Adjustment" means, with respect to any amount specified herein as being adjusted annually by a Cost of Living Adjustment, an increase in such amount by an amount equal to such dollar amount multiplied by the adjustment determined under Code Section 1(f)(3) for the calendar year, but substituting the calendar year in which this statute becomes effective for "calendar year 1992" in subparagraph (B) thereof. If any amount after such adjustment is not a multiple of $100, such amount shall be rounded down to the next lower multiple of $100.

f. "Eligible Child" means a child who is born on or after January 1 of the year following the year in which the Act is enacted and who is a Resident of State.

g. "Federal Poverty Level" means the most recent poverty income guidelines published in the relevant calendar year by the United States Department of Health and Human Services.

h. "Qualified Eligible Child" means an Eligible Child who is a Resident of State, has not yet attained age 18, and whose family household income was not more than 200% of the Federal Poverty Level in the preceding calendar year.

i. "Resident" means a resident of State for purposes of the Child Accounts Program as defined by regulations.

j. "Responsible Person" means (1) an individual who has parental responsibility for a particular Eligible Child, as determined under regulations promulgated by the Treasurer, (2) for Accounts established under Section IV.c, the Treasurer or its designee, or (3) the Eligible Child associated with an Account, when that child attains [age 16] [the age at which a minor may des-

[20] IFS is grateful for the assistance of Roger Wise, Mark Perlow, and the law firm of Kirkpatrick & Lockhart Preston Gates Ellis LLP in drafting this model statute.

[21] Text in brackets indicates provisions specific to an individual state.

ignate a successor custodian under [Section 18(d)] of State's Uniform Transfers to Minors Act or [Section 7(a)] of State's Uniform Gifts to Minors Act].[22]

k. "Rollover" means (1) in the case of a Contribution, a contribution to an Account for the benefit of an Eligible Child that is transferred or deposited within 60 days of the distribution from an account for the benefit of the same Eligible Child, established under a program of another state that is substantially similar to State's Child Accounts Program, and (2) in the case of a Distribution, a distribution from an Account that is transferred to or deposited in such an account within 60 days of the distribution. An in-kind Rollover Contribution will only be accepted in the discretion of the Account Provider.

l. "State" means [name of state].

m. "Treasurer" means the Treasurer of State.

III. Child Account Requirements.

An account shall be treated as a Child Account only if it satisfies the following requirements:

a. The Account shall be opened with an Account Provider.

b. The written governing instrument creating an Account shall

   i. provide that it is held by the Responsible Person as custodian for the benefit and in the name of the designated Eligible Child;

   ii. provide that it is the sole Account held for the benefit of such Eligible Child;

   iii. provide that the Eligible Child is beneficially entitled to the investments under it, including all income and gains arising from such investments;

   iv. provide that instructions may be given to the Account Provider with respect to the management of the account only by the Responsible Person named in such instrument; and

   v. provide that investments under the Account will be invested in the investment option determined in accordance with Section VI.

c. Except for Rollover Contributions, no contribution shall be accepted unless it is in cash.

d. Except for Rollover Contributions, the aggregate contributions to an Account in any calendar year shall not exceed $2,000. Such $2,000 amount shall be increased annually by the Cost of Living Adjustment.

e. No withdrawals shall be permitted from the Account before the Eligible Child associated with the Account attains age 18; provided that an earlier distribution may be made as part of a Rollover Distribution or upon the death of such Eligible Child, as provided in Section X.a.

f. Fees, expenses, and any other charges in connection with an Account may only be assessed in any calendar year as provided in Section VII.

g. An account shall not constitute an Account under this section unless the written governing instrument provides that assets in the Account may not be assigned or alienated. Any assignment of, or agreement to assign, an interest in an Account is void. Any pledge or use of an interest in an Account as collateral or security for a loan shall be of no force or effect. On the bankruptcy of an Eligible Child or Responsible Person with respect to an Account, no interest in the Account may be claimed by any trustee or other person acting on behalf of the creditors of such Eligible Child or Responsible Person.

[22] All states, except for South Carolina and Vermont, and the District of Columbia, have now adopted the Uniform Transfers to Minors Act.

IV. Opening and Transfers of Accounts.

a. Each year following the year of enactment, the Treasurer shall issue a Certificate in the name of each Eligible Child born in that year to the Responsible Person for that Child. The Treasurer shall determine the identity and address of each such Eligible Child and his or her Responsible Person under regulations to be issued hereunder.

b. A Responsible Person may establish an Account for the Eligible Child named in the Certificate by submitting such Certificate and a written application meeting the conditions set forth in Section III to an Account Provider. An Account Provider to which an application and Certificate have been submitted on behalf of an Eligible Child must open an Account and notify the Treasurer of such Account, in accordance with regulations promulgated by the Treasurer.

c. The Treasurer shall cause an Account to be opened for each Eligible Child for whom a Certificate has not been redeemed within 12 months of its issuance with such Account Providers as the Treasurer selects, in accordance with regulations promulgated by the Treasurer. [The Treasurer shall open such Accounts in proportionate numbers with the five Account Providers that established the most Child Accounts in the immediately preceding calendar year.] The Treasurer will cause the money in the Account to be invested in the default investment option, as set forth in Section VI.e below. The Treasurer or its designee shall act as the Responsible Person for any Account established pursuant to this Section.

d. The Treasurer shall issue regulations to establish procedures for changes in the Responsible Person upon the resignation, incapacity, or death of the current Responsible Person; the Eligible Child's attainment of the age specified in clause (3) of the definition of Responsible Person; or to permit an individual who has parental responsibility for a particular Eligible Child, as determined under regulations promulgated by the Treasurer, to become the Responsible Person for an Account established pursuant to Subsection c above.

e. Upon the written application of the Responsible Person, an Account Provider must transfer an Account to another Account Provider, in a form and during a time window once each calendar year to be determined by the Treasurer in regulations; provided that the whole of the investments in the Account are to be transferred.

V. Contributions and Withdrawals.

a. Initial State contribution: The Treasurer shall cause to be paid to each Account Provider that has notified the Treasurer of receipt of a Certificate the amount of $500 within thirty days of the surrender of such Certificate. [Such $500 amount shall be adjusted annually by the Cost of Living Adjustment.] The Account Provider shall credit the Account for such Eligible Child with the amount of such payment.

b. Subsequent contributions: In any calendar year, any person, state, or local government (or agency or instrumentality thereof), or organization described in Code Section 501(c)(3) and exempt from taxation under Code Section 501(a) may make additional contributions to an Account for the benefit of the Eligible Child associated with that Account, subject to the annual contribution limit of Section III.d above.

c. Matching contributions: The amount of contributions made to an Account of a Qualified Eligible Child in any calendar year pursuant to Section V.b shall be matched by State on a dollar-for-dollar basis up to a maximum of $1,000, subject to the aggregate annual contribution limitation set forth in Section III.d above. Such $1,000 amount shall be increased annually by the Cost of Living Adjustment. The Treasurer shall establish procedures for the claim and payment of such matching contributions.

d. Withdrawals: Upon attaining age 18, the Eligible Child associated with an Account may request a withdrawal of all or any portion of the amounts in the Account. No other person, including the Responsible Person, may request a withdrawal at any time, except for Rollover Distributions or as provided in Section X.a.

e. Loss of Residency Status: No contributions may be made to Accounts for children who are not Residents. The Responsible Person may request a Rollover Distribution of such Account.

VI. Investments.

a. The Responsible Person is responsible for selecting the investments for an Account.

b. An Account Provider may offer only two types of investment options: a basic investment option and a principal-preservation product.

c. The basic investment option is a target-date investment fund that is designed to provide varying degrees of long-term appreciation and capital preservation through a mix of equity and fixed-income exposures based on the investor's age and the year in which the investor will reach his or her eighteenth birthday.

d. The alternative investment option is a principal-preservation investment fund, as defined in regulations promulgated by the Treasurer.

e. The default option for any Account for which the Responsible Person has not selected an investment option is the target-date fund with a target date at or before the year that the Eligible Child will reach his or her eighteenth birthday.

f. The assets of the Account shall not be commingled with other property except in a common trust fund or common investment fund that meets the descriptions above for a target-date fund or a principal-preservation fund.

g. Investment options may be changed by the Responsible Person once each calendar year, during a time window to be determined by the Treasurer in regulations.

VII. Limitation on Fees.

Annual fees for the management of, and all other expenses in connection with an Account (including any sales charges and fees and expenses with respect to any investment fund in which the Account's assets are invested), may not exceed [1.50%] of the net asset value of the Account. Such fees and expenses shall be deducted from the Account.

VIII. Taxes.

a. For State income tax purposes, no amount shall be includible in gross income of the Eligible Child associated with an Account with respect to any contribution to such Account, and no amount shall be includible in gross income of such Eligible Child or any contributor to such Account on behalf of such Eligible Child, with respect to any earnings on or distribution from such Account.

b. No income tax deduction or loss shall be allowed for contributions to or withdrawals from an Account.

c. For State gift and estate tax purposes, any contribution to an Account on behalf of an Eligible Child shall be treated as a completed gift to such Eligible Child that is not a future interest in property.

IX. Penalties.

a. It shall be unlawful for any person to use fraudulent, manipulative, or deceptive devices or to make any material misrepresentations in connection with an Account or in connection with qualification to be an Account Provider.

b. The [name of state financial regulatory agency] shall be authorized to commence administrative proceedings under [statute describing and authorizing administrative process] against any person for violations of Section IX.a, and is authorized to seek and to obtain a civil penalty from such a person.

c. The maximum amount of penalty for each act or misrepresentation willfully committed in violation of Section IX.a shall be $5,000 for a natural person or $50,000 for any other person.

d. Notwithstanding Section IX.a, the maximum amount of penalty for each act or misrepresentation committed with fraudulent intent in violation of Section IX.a shall be $50,000 for a natural person or $250,000 for any other person.

X. Miscellaneous.

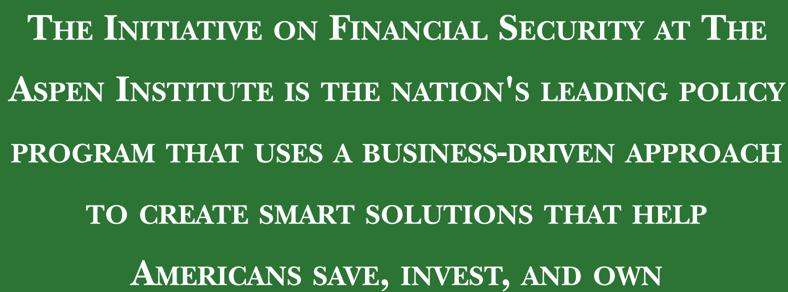
a. Death of an Eligible Child: In the event of the death of an Eligible Child, the assets of his or her Account shall be distributed to the Eligible Child's estate or according to the laws of intestacy of State.

b. Means testing: Account assets will not be considered for purposes of determining eligibility for any state benefits, such as student financial aid or healthcare benefits.

c. Privacy: All personally identifiable information concerning Responsible Persons and Eligible Children obtained in connection with Accounts shall be confidential, and any disclosure of such information shall be restricted to purposes directly connected with the administration of the Child Accounts Program.

d. Regulatory authority: The Treasurer shall have the authority and power to issue regulations under this statute.

e. Statements: An Account Provider shall provide Account statements to each Eligible Child and each Responsible Person at least once each year within 60 days after the end of the calendar year to which they relate. The statement shall identify the contributions made during the preceding calendar year, the total contributions made to the Account through the end of the period, the value of the account at the end of such period, and any other information prescribed by statute. An Account Provider shall provide similar statements upon any Rollover Distribution or other distribution from an Account, and upon the transfer of an Account to another Account Provider on the effective date of transfer. An Account Provider shall prepare and file such reports and information relating to Accounts as is required by federal and state law.



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