CHILDREN'S SAVINGS ACCOUNT – A REVIEW OF RESEARCH ON THE INVESTMENT IN THE FUTURE OF ILLINOIS' CHILDREN & FAMILIES

Like most parents, Sandra wants the best for her eleven-year-old twin daughters, Nichole and Nachelle. As a single parent attending college, Sandra was exposed to the high cost of college; she also knew these costs would only rise by the time her daughters were college-bound, an important goal for her and her children. In 2005, when Nichole and Nachelle's elementary school was chosen as a site for the children's savings accounts pilot through the Saving for Education, Entrepreneurship, and Downpayment (SEED) program, Sandra knew first hand that "saving for my children's college education will help me in the long run with their college expenses."

Saving for her daughters' futures was not always easy. At the onset of the SEED program, Sandra struggled to make regular contributions to her children's savings accounts. The day-to-day expenses of raising two daughters in Chicago kept Sandra from saving for the future. With persistence and financial planning, Sandra began "...cutting back on spending and sticking to a budget."

By the second year of the SEED program, Sandra was making regular quarterly deposits into both of her daughter's savings accounts. The support from SEED program staff and the financial education her daughters received helped her create new spending and savings habits; the matched savings also created an incentive that Sandra felt she could not forgo.

Sandra's savings patterns have persisted beyond the end of the SEED program, creating an ever-increasing nest egg for her daughters' futures. Through financial education, support from program staff, and the incentives of matched savings, Sandra now teachers her daughters the importance of savings for the future through her own actions. Because of the help from a children's savings account, Sandra and her daughters will not only have savings for college, but have learned about the importance of saving for the future, providing skills that will help them attain and maintain financial stability for the rest of their lives.

Executive Summary:

Children's savings accounts are innovative financial products opened at birth that support children and families in savings for their child's future goals of education, job training, homeownership or entrepreneurship. The creation of the Children's Savings Account Task Force gives Illinois a unique opportunity to increase the savings, assets, and financial skills of its residents – boosting the long-term financial stability of the state. Within the context of shrinking savings rates and rising debt, Illinois Public Act 95-0358 mandates that the Task Force develop an innovative plan to encourage savings, asset attainment, and financial literacy. Fulfillment of these goals will lessen the current trend toward debt accumulation and support positive savings behaviors for future generations of Illinois residents.

> ***The Children's Savings Account Task Force is charged with :***
>
> - ***Increasing the levels of financial literacy and savings in Illinois; and***
> - ***Increasing the number of children in Illinois who own assets and who attend post-secondary education or training, purchase a home, or open a small business.***

This paper lays out important research, laws, and best practices relevant to the design and development of a children's savings account plan in Illinois. It also provides questions for the Task Force to discuss in developing important components of a children's savings account program for Illinois. These issues and the respective questions include:

Financial Education – Knowledge development and skill building that incorporates hands-on savings behaviors into educational curriculum are key to promoting effective financial education within a statewide children's savings account program.

Questions for the Task Force: In what way will the CSA plan incorporate age- and skills-appropriate education into the savings activities to maximize the potential for developing statewide financial literacy? How can programming be incorporated into new educational activities to develop comprehensive financial education for all CSA accountholders?

Including the Unbanked – A statewide children's savings account program has the opportunity to engage unbanked families by incorporating of targeted strategies into the financial product.

Questions for the Task Force: How will the CSA plan provide high-touch services to clients without a great deal of experience with the banking industry to ensure ease and comfort? In what way can the unbanked become new bank customers through the experiences of using a CSA? How can a CSA plan be used concomitantly to benefit both the financial institutions and the low-income unbanked residents?

Overcoming Participation Barriers – Evidence suggests that small design elements, such as universal eligibility and automatic enrollment, greatly increases the participation rate of savings programs and can be applied to a children's savings account program to increase its success.

Questions for the Task Force: How will the CSA plan differentiate itself from other market-based financial products to ensure all Illinois residents have the opportunity to save and invest in the future? How will the Task Force incorporate provisions to ensure ease in contributing to the accounts at small amounts? What mechanisms will be put in place to ensure an inclusive or universal program?

Economic Mobility – A statewide children's savings account program has the potential, if designed and marketed correctly, to encourage economic mobility and mitigate many of the current macro-economic trends to the contrary.

Questions for the Task Force: How will the CSA plan support the goal of long-term economic mobility? Will the plan provide for limits or guidelines on the use of savings and investment to support children in achieving sound assets that will maximize the benefit to the child and her community?

Aspirational Impacts – A statewide children's savings account program can have a significant impact, not just on the short-term asset purchase, but on the longer-term orientation toward the future for many Illinois residents.

Questions for the Task Force: In what ways can the CSA plan capture the various behavior changes – i.e. aspirations, educational attainment improvements – that will result? How will these projected and real outcomes be translated into policy goals to help with the successful passage of the CSA plan created by the Task Force?

Initial Deposits and Matched Savings – Various incentives and product features, such as initial deposits and matched savings, can help to encourage more people to develop savings behaviors and increase the use of the accounts.

Questions for the Task Force: Will a CSA plan incorporate an initial deposit and matched savings component to boost the savings habits of all residents? How can the savings accounts of lower-income residents incorporate a progressive form of initial deposits or matched savings to increase their savings? What are ways to cover the costs associated with an initial deposit or matched-savings component?

Existing Products – Several savings vehicles exist that might allow for a children's savings account program; modifications to these products might allow for the framework of a statewide children's savings account program.

Questions: How will the CSA plan allow for maximum flexibility and ease to encourage all kinds of contributions, but still be protected to ensure only the child beneficiary can use the accounts? Would an existing vehicle serve all the purposes of a CSA, or can an alternative product be developed?

This paper is not intended to recommend any specific features of a children's savings account plan. Nor does it exhaust all the possible issues or questions in developing a children's savings account program. However, it does include all the available research and policy suggestions on savings and asset-building programs across the country and in the United Kingdom. Each issue raised highlights questions for the Task Force to consider in designing their CSA Plan. Taking the issues highlighted into account, the Children's Savings Account Task Force can utilize a base of knowledge to help inform their efforts in developing an effective program that can serve the needs of the next generation of Illinois residents.

CHILDREN'S SAVINGS ACCOUNT – A REVIEW OF RESEARCH ON THE INVESTMENT IN THE FUTURE OF ILLINOIS' CHILDREN & FAMILIES

Introduction:

The personal savings rate in the United States recently dipped into the negative, the lowest since the Great Depression. As the cost of gasoline, housing, education, medical care, and food continue to rise, consumers' incomes have remained stagnant. Illinois inflation-adjusted median household income declined $1,547 between 2001 and 2005.[1] Despite owing more than they own, Illinois households continue to use credit cards, payday loans, and other consumer installment loans as a safety net to cover the costs of important living expenses such as car repairs, medical bills, and groceries. A typical household in Illinois has $1,782 in credit card debt, and overall household debt of $13,384.[2] These issues are more pressing in minority communities. The median net worth of a non-white household in Illinois is $12,100, compared to $128,444 in white households.[3] The dismal economic forecast for the next few years will only exacerbate these problems – putting financial stress on families already stretching to make ends meet. ***The lack of savings is a serious issue that demands a solution that not only educates people about appropriate ways to spend and invest their money, but also includes plans to increase asset ownership.***

[1] 2007 Report on Illinois Poverty. www.heartlandalliance.org/Maip/illinoispoverty
[2] 2008 Report on Illinois Poverty. www.heartlandalliance.org/Maip/illinoispoverty
[3] Illinois Asset Poverty Index. www.illinoisassetbuilding.org/data/illinois-asset-poverty-index

Through the creation of the Children's Savings Account Task Force, Illinois has a unique opportunity to focus on strategies to build savings and increase asset ownership for all Illinois residents. Illinois Public Act 95-0358 requires the Task Force to review, recommend, and develop a strategic implementation plan for providing a savings account at birth for every Illinois child.

Children's savings accounts (CSA) are innovative financial products aimed at helping children attain lifelong financial education through savings and investment. Use of the account is deferred until the child becomes a young adult, when she or he can attain an important asset such as a college education or home. Opened at birth with an initial deposit and linked to financial education, CSAs have the ability to enhance children's aspirations, parents' hopes, and teachers' expectations, providing opportunities for the next generation.

The Children's Savings Account Task Force is charged with :

- ***Increasing the levels of financial literacy and savings in Illinois; and***
- ***Increasing the number of children in Illinois who own assets and who attend post-secondary education or training, purchase a home, or open a small business.***

This paper highlights applicable research, laws, and best practices relevant to the goals of the Task Force. The following sections focus on the various issues involved in developing a CSA plan and providing all residents in Illinois with opportunities for savings and asset building. Each section highlights background information on the following issues, their relevance to CSAs, and concludes with several questions pertaining to the respective issue for Task Force members to ponder in designing their plan.

- Financial Education
- Including the Unbanked
- Overcoming Participation Barriers
- Economic Mobility
- Aspirational Impacts
- Initial Deposits and Matched Savings
- Existing Products

This paper is not intended to make recommendations to the Task Force, but to provide an overview of the findings and common knowledge in the asset-building field relevant to the development of a CSA plan for Illinois.

Financial Education: The Power of Knowledge and Practice

A children's savings account plan can promote the long-term financial education of Illinois children and families. The behaviors associated with savings are inherent in a CSA plan; however, there are also opportunities to promote financial skills and knowledge development to maximize the child's future asset-building capacity. Appropriate financial education can teach important attitudes and behaviors about how to save, invest, spend, and build long-term assets.

Increasing interest in financial education has generated a variety of efforts aimed at raising the financial literacy of Illinois residents. The Illinois School Code requires 9th to 12th grade classes include instruction on consumer education. Students must be taught the basic concepts of financial literacy – budgeting, savings, banking, income taxes, installment purchases, and investing – and the "role of consumers' interactions with agriculture, business, labor unions, and the government in achieving the goals of a free enterprise system."[4] The Office of the Illinois State Treasurer has a division of financial education, within which a variety of financial education programs are geared toward youth and adults. The *Bank at School* program brings banks to elementary schools, where students can learn from expertise in the financial community and have the opportunity to open a savings account at their school. Financial education is offered through the University of Illinois Extension Campus to Illinois residents. The federal government supports various financial education courses and events though the Federal Reserve Bank. The Money Smart program out of the FDIC includes curriculum, train-the-trainer programs, and resources to support financial education.

Despite the success of these programs in teaching the appropriate uses of money, there are still many gaps in the provision of financial education and training to produce a financially literate state. Many of the programs and services offered in Illinois are voluntary. The participants self-select, and are often eager to learn about financial management; therefore, studies of program effectiveness are not always valid or reliable. The mandate applied to Illinois schools are enforced by rules from the Illinois State Board of Education, which require teachers to integrate financial education into other course curriculum, but offer little guidance on how to integrate them. Those schools with innovative programs such as banks on campus provide the unique skills and education only to those lucky enough to have the services available to them.

Research on financial education highlights the heightened impact of incorporating financial education into savings account ownership. Individuals participating in education and first-account ownership programs gained greater saving - approximately $700 more per year - than first-time account owners without financial education did.[5] In one example, over 70% of participants in first-time savings continued with savings behaviors after the program ended because they had learned the importance of savings through financial education as well as created a habit of saving each month.[6] Participants in an Individual Development Account (IDA) program[7] with financial education who earned less than $20,000 annually had an average savings rate of almost 5% and average account balances of approximately $800.[8] Participation in an initial-savings account program led indi-

[4] (105 ILCS 5/27-12.1) (from Ch. 122, par. 27-12.1). www.ilga.gov.
[5] Baker, Christi and Doug Dylla. "Analyzing the Relationship between Account Ownership and Financial Education" New America Foundation. September 2007. www.newamerica.net.
[6] Schreiner, Mark, Michael Sherraden and Margaret Clancy. (2002). "Saving Performance in the American Dream Demonstration." St. Louis, MO: Center for Social Development, Center for Social Development at Washington University.
[7] Individual Development Accounts (IDAs) are savings accounts that enable people with low incomes to save and build assets through matched savings. Every dollar that is saved in an IDA will be matched with donations from government agencies, non-profit organizations and private companies.
[8] Baker, Christi and Doug Dylla. "Analyzing the Relationship between Account Ownership and Financial Education" New America Foundation. September 2007. www.newamerica.net.

viduals to seek out other financial products and education to succeed. In one case, 30% of a program's customers went on to obtain other financial products.[9]

The benefits to integrating financial education and account ownership are particularly strong for youth, who learn financial skills and habits that can secure lifelong financial health. A survey of findings from the Savings for Education, Entrepreneurship, and Downpayment (SEED) Demonstration Project, a CSA model, show the following:

- 86% of youth participating in financial education curriculum demonstrated an increase in financial knowledge or behavior when dealing with money.
- Three months after participating in a financial education course, 58% of youth participants improved their spending habits, 56% improved their savings habits, and 39% identified starting a savings account as the most important impact of the program.
- One program targeted at youth savings for postsecondary education found that youths' involvement in account programs encouraged other family members to save and/ or pursue postsecondary education.

Although financial education remains a critical component to helping individuals and families attain and maintain financial stability, the CSA plan provides an opportunity to incorporate education with real, hands-on savings practices. This combination of education and behavior change reinforce each other and provide the greatest impact.

Questions for the Task Force: In what way will the CSA plan incorporate age- and skills-appropriate education into the savings activities to maximize the potential for developing statewide financial literacy? How can programming be incorporated into new educational activities to develop comprehensive financial education for all CSA accountholders?

Including the Unbanked

An important, yet often overlooked, aspect of financial stability is the need to bring unbanked customers into the mainstream financial services industry. Despite the fact that a children's savings account program is targeted at children, each child's parent will have to interact with some form of financial institution to ensure their child has an account. Unbanked parents will most likely result in unused children's savings accounts and a missed opportunity for long-term financial stability. Currently, 43 percent of adults in Illinois do not have an interest-bearing account – either checking, savings, or investment account.[10] Research shows that those without a bank account most likely do not have the financial "know–how" to make the needed investment decisions for their children's savings account.[11] Successfully integrating parents into the mainstream banking industry

[9] Baker, Christi and Doug Dylla. "Analyzing the Relationship between Account Ownership and Financial Education" New America Foundation. September 2007. www.newamerica.net.
[10] 2007 Report on Illinois Poverty. www.heartlandalliance.org/Maip/illinoispoverty
[11] CFED – 2007-2008 Assets & Opportunity Scorecard – Illinois. www.cfed.org

will provide opportunities to teach parents and their children about financial products available to them.

It is important to understand the characteristics of unbanked residents to develop a program that meets their needs. Research finds that four out of five unbanked families make less than $25,000 a year, and two out of five have annual incomes of less than $10,000.[12] More than half of all unbanked households are nonwhite or Hispanic, and some studies estimate that as many as one third of all nonwhite households are unbanked.[13] Neighborhoods with higher percentages of African-American and Hispanic residents have a greater likelihood for unbanked residents.[14] One survey of federal benefits recipients found that of those recipients without a bank account, 59 percent had less than a high school education.[15]

To address this population, it is also important to understand why they are unbanked. A study by the Federal Reserve Bank found that 18.5 percent of unbanked families reported they "did not like dealing with banks."[16] Findings from research with low-income households are consistent with this: 22.1 percent of unbanked households reported a desire to keep their financial records private, and 17.6 percent said they were "not comfortable dealing with banks."[17] Other common reasons include: "bank fees are too high" and "bank minimum balance requirements are too high."[18] These feelings of discomfort result from both practical and emotional feelings. They also have a general distrust of banks with what little assets they have, believing banks and other financial will misplace or misuse their money.

Several customers have been kept out of mainstream banking because of past mistakes with overdrawn accounts or unpaid bills. Even when they do get their financial situation in order, the ease and variety of services - from notary services to bill payment - at the alternative banking institutions (i.e. check cashers), create a disincentive to get back into the mainstream banking system. In addition, many low-income residents fear their participation in the mainstream financial system will cause them to lose their public benefits, even when their assets, if liquidated, could not make up for the loss of the benefits.[19]

Research also shows that contrary to popular belief, there are no real correlations between the presence of banks and their lack of use, either in relation to the distance to banks in a neighborhood or the lack of bank branches.[20] In other

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[12] Arthur B. Kennickell, Martha Starr-McCluer, and Brian J. Surette, "Recent Changes in U.S. Family Finances: Results from the 1998 Survey of Consumer Finances," Federal Reserve Bulletin 86 (January 2000): 1-29.

[13] Barbara A. Good, "Bringing the Unbanked Onboard," Federal Reserve Bank of Cleveland, Jan. 15, 1999.

[14] Vermilyea, Todd and James Wilcox. "Who is Unbanked, and Why: Results from a Large, New Survey of Low-and-Moderate Income Adults." Federal Reserve Bank of Chicago, Conference on Bank Structure and Competition. May 2002.

[15] Booz Allen & Hamilton and Shugoll Research, Mandatory EFT Demographic Study, Sept. 15, 1997, conducted for U.S. Treasury Department.

[16] Results from the 1998 Survey of Consumer Finances.

[17] John P. Caskey, "Reaching Out to the Unbanked," Inclusion in the American Dream: Assets, Poverty and Public Policy. Oxford University Press. (July 2005). edited by Lisa Morris and Michael Sherraden

[18] Caskey, John P. "Lower Income American, Higher Cost Financial Services, Madison, WI: Filene Research Institute, 1997.

[19] Vermilyea, Todd and James Wilcox. "Who is Unbanked, and Why: Results from a Large, New Survey of Low-and-Moderate Income Adults." Federal Reserve Bank of Chicago, Conference on Bank Structure and Competition. May 2002.

[20] Vermilyea, Todd and James Wilcox. "Who is Unbanked, and Why: Results from a Large, New Survey of Low-and-Moderate Income Adults." Federal Reserve Bank of Chicago, Conference on Bank Structure and Competition. May 2002.

words, even when a bank is present in a community, the unbanked continue to avoid using it because of residual fear and mistrust from past experiences.[21]

Significant numbers of Illinois residents, many of whom are lower-income, do not use the mainstream banking industry for financial services. A CSA plan has the potential to bring many parents to the banking system through proper financial education and skills building, as well as mechanisms to repair their credit and overcome previous negative experiences limiting their access to mainstream financial institutions. After universal children's accounts were initiated in the UK, studies found that about 40% of parents entered into other savings plans after setting up their child's account.[22] CSAs can also be used to link Illinois residents to the education of children and their parents about banks and the use of banks to improve their financial futures.

Questions for the Task Force: How will the CSA plan provide high-touch services to clients who lack experience or trust with the banking industry to ensure ease and comfort? In what way can the unbanked become new bank customers through the experiences of using a CSA? How can a CSA plan be used concomitantly to benefit both the financial institutions and the low-income unbanked residents?

<u>Overcoming Participation Barriers</u>

In theory, most savings products offered through financial institutions are available to all; however, many remain out of reach for a subsection of Illinois residents for a variety of reasons. Previous negative experiences and perceptions of difficulty setting up savings and investment accounts inhibit people from opening up an interest-bearing account.

In creating a financial product aimed at increasing the savings and assets of all Illinois children, it is wise to note the inherent benefit of universal eligibility in overcoming barriers that might inhibit some residents from participating in programs. Stigma is associated with public programs that provide benefits to select recipients. Studies have revealed that even when individuals meet the eligibility requirements for a government-run program, if there is a requirement to "qualify" for or elect to enroll in they are much less likely to enroll and participate.[23] Many people avoid participation in mean-tested programs even when they are eligible; universality in eligibility and automated enrollment overcomes these barriers.[24] For example, recipients of universal programs like Social Security and Medicare are not associated with stigma for receiving benefits; the majority of Americans participate in such programs without stigma or shame. A universal children's savings account product that guarantees all residents the opportunity for savings and investment would increase participation.

[21] Vermilyea, Todd and James Wilcox. "Who is Unbanked, and Why: Results from a Large, New Survey of Low-and-Moderate Income Adults." Federal Reserve Bank of Chicago, Conference on Bank Structure and Competition. May 2002.
[22] Bynner, J.B. & Paxton, W. (2001). *The Asset Effect.* London: Institute for Public Policy Research
[23] Stuber, Jennifer; Schlesinger, Mark. Sources of Stigma for Means-Tested Government Programs. Social Science & Medicine, vol. 63, no. 4, pp. 933-945, Aug 2006
[24] WELFARE FRAUD AND WELFARE STIGMA. Gideon Yaniv. National Insurance Institute, Israel. Paper presented at the 2nd International Research Conference on Social Security. Jerusalem, 25-28 January 1998.

In addition to universal eligibility, a key method other savings programs have used to overcome obstacles to participation and ensure all participants have access to savings is automatic enrollment and account initiation. Research from employer-based retirement savings programs suggest that automatic enrollment with opt-out options result in a much higher participation rate than those with optional enrollment.[25] In some cases, the participation in 401(k) plans doubled at companies when they instituted an automatic enrollment procedure.[26] Participation also remains high across the work life of the employee.[27] Automatic enrollment has been found to be particularly successful at increasing the savings participation of low- and moderate-income workers, a population that would be particularly impacted by the children's savings account plan.[28]

A third design feature for overcoming participation barriers is the absence of a minimum deposit requirement. Financial experts and program practitioners agree that when minimum deposits are set too high, low-income participants will often skip-out on savings because they cannot afford the reduction in their income to save.[29] Allowing low-income participants to contribute small amounts of money encourages the savings behavior without limiting their ability to meet immediate expenses. If necessary, programs should set a minimum deposit requirement at $5 or $10 helps limit barriers to savings.[30]

Slight modifications and small design elements that make savings easier will greatly increase a CSA product's success. Incorporating features that reduce participation barriers increases everyone's opportunity to save and invest in their child's future.

Questions for the Task Force: How will the CSA plan differentiate itself from other market-based financial products to ensure all Illinois residents have the opportunity to save and invest in the future? How will the Task Force incorporate provisions to ensure ease in contributing to the accounts at small amounts? What mechanisms will be put in place to ensure an inclusive or universal program?

Economic Mobility

The immediate problems of the home mortgage crisis and rising state and federal budget deficits get much attention in the news media, but a more important problem has developed over the past decade – the declining ability of residents to remain in the middle-class. Teaching children savings habits and financial education provides opportunities to increase their economic mobility and invest in fu-

[25] Brigitte C. Madrian & Dennis F. Shea, 2001. "THE POWER OF SUGGESTION: INERTIA IN 401(k) PARTICIPATION AND SAVINGS BEHAVIOR," The Quarterly Journal of Economics, MIT Press, vol. 116(4), pages 1149-1187, November.
[26] Barr, Michael, Sendhil Mullainathan, and Eldar Shafir. "Behaviorally Informed Financial Services Regulation." New American Foundation. October 2008. www.newamerica.net.
[27] Choi, James, David Laibson, Brigitte C. Madrian, and Andrew Metrick. 2004b. 'Employees' Investment Decisions About Company Stock.' In Pension Design and Structure: New Lessons from Behavioral Finance, edited by Olivia Mitchell and Stephen Utkus. Oxford: Oxford University Press.
[28] Barr, Michael, Sendhil Mullainathan, and Eldar Shafir. "Behaviorally Informed Financial Services Regulation." New American Foundation. October 2008. www.newamerica.net.
[29] Bair, Sheila, "*Improving Access to the U.S. Banking System Among Recent Latin American Immigrants,*" Multilateral Investment Fund, Washington, D.C., 2003.
[30] T. Gibbons & M. Croes, personal communication, June 2008.

ture generations. Children today will most likely not fare better, economically, than their parents did. A recent study on economic mobility found that, in 2004, the inflation-adjusted incomes of men in their 30s were an average of 12 percent less than incomes of men in their father's generation at the same age.[31]

Research applying the wealth transition matrix – a common measure of intergenerational correlations of wealth – reveals that adult children tend to fall in the same or adjacent wealth quintiles as their parents (Figure 1). Most of the movement between the lower quintiles is between the lower quintiles – only one rung up the ladder.[32] In other words, a large majority of children born into the lowest income group remain poor, and a majority of children born into the highest income group remain wealthy. This phenomenon of limited social mobility at either end of the wealth distribution spectrum is what researchers call the "stickiness" of economic mobility.[33] This stickiness is an indicator that individuals at the bottom of the income spectrum have trouble and often are unable to get ahead in the U.S.

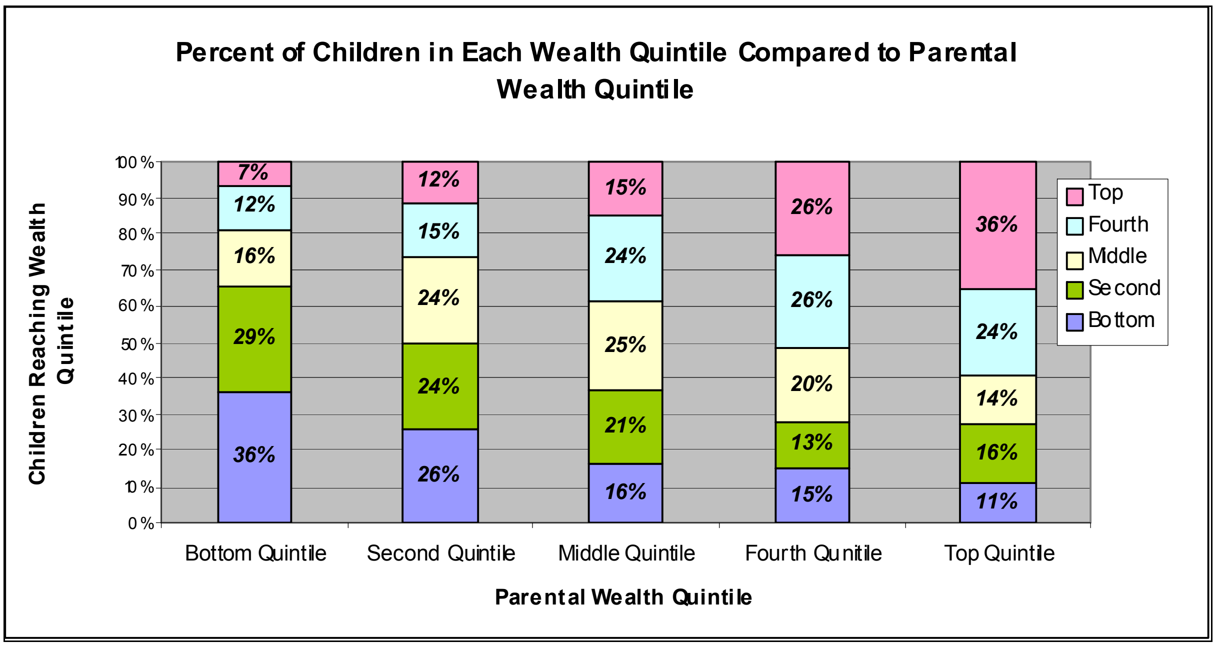

Figure 1 (all races/ ethnicities)

The lack of economic mobility looks even bleaker when focusing on African-Americans (Figure 2). About 45% of middle-income African-American children end up falling to the bottom of the income scale over a generation, compared to 16% of white children — meaning that even solidly middle-class African-American families lead fragile economic lives.[34] Additionally, 40% of African-American adult children born to parents in the fourth quintile fall to the second

[31] Issacs, Julia, Isabell Sawhill, Ron Haskins. Getting Ahead of Losing Ground: Economic Mobility in America. The Brooking Institute, Economic Mobility Project. February 2008. www.brookings.org.
[32] Charles, Kerwin Kofi and Erik Hurst. 2003. "The Correlation of Wealth Across Generations." *Journal of Political Economy*. 111(2): 1155-1182.
[33] Issacs, Julia, Isabell Sawhill, Ron Haskins. Getting Ahead of Losing Ground: Economic Mobility in America. The Brooking Institute, Economic Mobility Project. February 2008. www.brookings.org.
[34] Issacs, Julia, Isabell Sawhill, Ron Haskins. Getting Ahead of Losing Ground: Economic Mobility in America. The Brooking Institute, Economic Mobility Project. February 2008. www.brookings.org.

quintile, where as only 13% of all children fall to the second quintile. In other words, almost half of African-American adult children born to upper-middle class parents end up falling to the lower-middle class when they become adults.

As families continue to fall behind, the importance of helping residents save, invest, and attain assets becomes even more critical to economic stability. The children's savings account plan will put many on the road toward achieving economic stability, providing opportunities for asset and wealth attainment not just to lift those falling behind, but to increase the wealth of all Illinois residents.

Innovative programs like CSAs can help increase the economic mobility of all Illinois residents. By teaching children and families the skills and behaviors to save and invest in the future, Illinois residents can increase their economic stability and support mobility for themselves and their children, helping to reverse a nationwide trend.

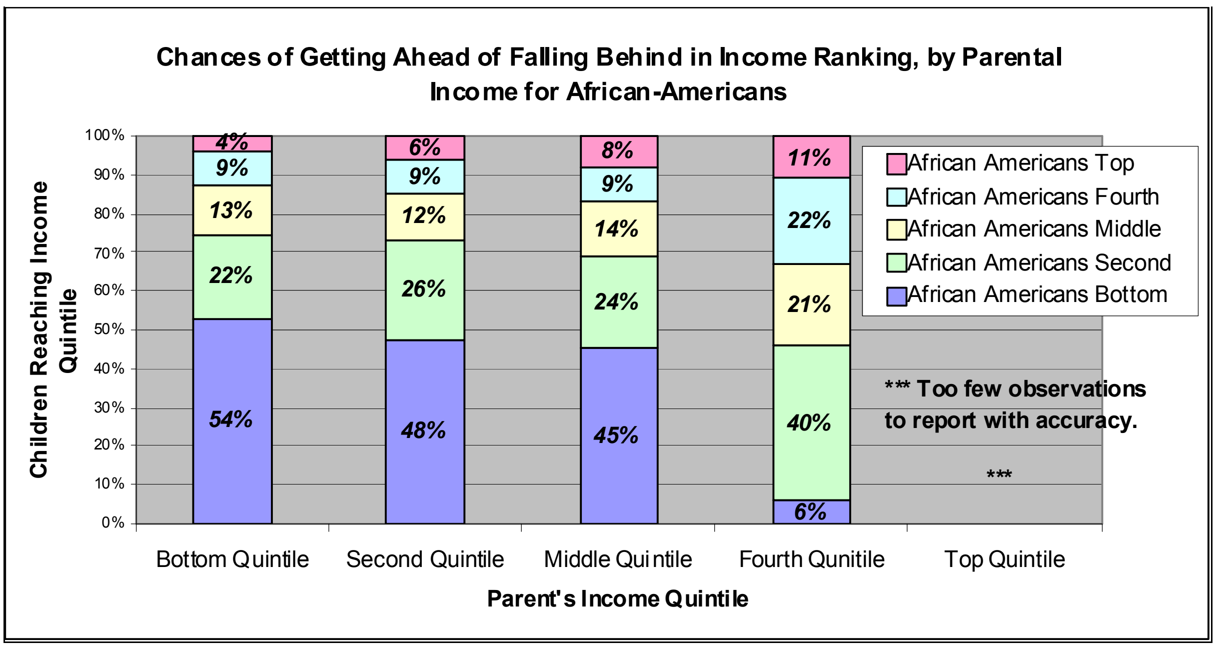

Figure 2 (only African-Americans)

Questions for the Task Force: How will the CSA plan support the goal of long-term economic mobility? Will the plan provide for limits or guidelines on the use of savings and investment to support children in achieving sound assets that will maximize the benefit to the child and her community?

Aspirational Impacts

Unlike income, assets give children and families resources designated for the future, changing their outlook on life.[35] By providing the opportunities for longer-term savings and investment, a child's (and family's) world-view is changed. The child develops a stake in their future as well as the will and the means to shape

[35] Bynner, J.B. & Paxton, W. (2001). *The Asset Effect.* London: Institute for Public Policy Research

it. For example, if every child had the resources to go to college, their efforts in junior high can be different. CSAs support the development of the resources needed to fulfill these aspirations.

Assets themselves are found to have a positive impact on an individual's aspirations for the future. Research indicates that the presence of an asset, such as a savings account, has impacts on the well-being of an individual beyond the monetary value of that asset itself. Among adult participants in an Individual Development Account (IDA) program, 93% reported they were more confident in the future, 59% reported they are more likely to make educational plans, 59% reported they are more likely to work or stay employed, and 57% reported they are more likely to plan for retirement, because of their asset account.[36] A parent's IDA changes the expectations, attitudes and aspirations of their children.[37] Youth accountholders in CFED's Savings for Education, Entrepreneurship, and Downpayment program report seeing their accounts as enhancing their hopefulness about the future, particularly as it pertains to college.[38]

Research supports the positive effects of asset-building strategies – demonstrating that, with assets, people increase savings, invest in their community, aspire toward educational goals, and strive for personal advancement. Findings from asset-building programs suggest a virtuous cycle - having assets leads to positive attitudes and behaviors, and positive attitudes and behaviors lead to greater asset ownership. Adult participants in an IDA program said they actually worked more and increased their earnings, because of their asset account.[39] As accountholders bought homes and started new businesses, they reported new incentive to care for their property and become involved in the community.[40] Holding assets at age 23 is associated with later positive outcomes such as better labor market experience, marriages, health, behaviors & political interest.[41]

CSAs provide the opportunity for children to save and invest, but also have aspirational impacts – providing hope for a bright future. If all children in Illinois had the opportunity to open a savings account at birth, their parent and children would have a sense of security and more options when they grew up. Teachers would feel the investment in their student's education would have an impact, because they knew resources obstacles for higher education were no longer a barrier for the children in their classroom. Homework, studies, and good grades would be seen as important for children who aspire to go to college and beyond. The impacts of a children's savings account program are more difficult to quantify in the short-term, but translate into significant positive effects when seen as having an aspirational impact for Illinois residents.

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[36] Moore et al. (2001). Saving, IDA programs, and effects of IDAs : A survey of participants. Downpayments on the American Dream Policy Demonstration: A national demonstration of Individual Development Accounts. Washington University in St. Louis, George Warren Brown School of Social Work, Center for Social Development.
[37] Page-Adams, D. (2001). *Assets, Healthy and Well Being: Neighborhoods, Families, Children and Youth.* Washington University in St. Louis, George Warren Brown School of Social Work, Center for Social Development.
[38] Scanlon, E. & Adams, D. (2005). In Depth Interviews with SEED Youth: Profiles of Participants in a Pilot Study. (CSD Working Paper 05-25). St. Louis: Washington University, Center for Social Development.
[39] CFED American Dream Demonstration. (n.d.) The first large-scale test of Individual Development Accounts. Retrieved March 10, 2007, from http://add.cfed.org/index.html
[40] Bynner, J.B. & Paxton, W. (2001). *The Asset Effect*. London: Institute for Public Policy Research
[41] Bynner, J.B. & Paxton, W. (2001). *The Asset Effect*. London: Institute for Public Policy Research

Questions for the Task Force: In what ways can the CSA plan capture the various behavior changes – i.e. aspirations, educational attainment improvements – that will result? How will these projected and real outcomes be translated into policy goals to help with the successful passage of the CSA plan created by the Task Force?

Initial Deposits and Matched Savings – Encouraging Behavior Change

For many Illinois residents, learning how to save is the first step in building assets. This involves both a change in understanding the importance of savings and in spending behaviors to set-aside money for savings. Initial deposits create an advantage of long-term interest gains. Matched savings similar federal and private programs for savings such as employer-sponsored 401(k) programs, create incentives for individuals and families to contribute to savings accounts. Both have been found to help enhance savings.

The inclusion of an initial deposit into the children's savings account program helps boost the overall savings. Early findings from research on pilot children's savings account programs with initial deposits show that the initial deposit can be the key to providing initial motivation for new savers.[42] The initial deposit also takes advantage of compound interest on the accounts. For example, an initial deposit of $1000 into an account with a 6 percent interest rate would yield almost $3000 after 18 years. By adding $50 a month for the entire 18 years of the child's life the account would come to more than $22,000.

Matched savings have been used in asset-building programs targeted at low-income individuals and families to increase their savings behaviors and overall assets. The idea is rather simple, match the savings an individual contributes to an account. By matching the funds, low-income individuals begin to value savings, because the amount in which they contribute is increased, much the same way that employees value vesting in a retirement or pension fund. An individuals' willingness to integrate savings habits into their financial behaviors are encouraged and rewarded.

Research on design elements for children's savings accounts found that not only do parent's save more if an initial deposit and matched savings component are available, but that without these design elements, a reliance only on private contributions "would tilt the distribution of account holders toward higher income families," mitigating the universal impact.[43]

The federal government has supported this idea over the past eight years with the creation and reauthorization of its Assets for Independence (AFI) program, which supports the development of matched savings programs for low-income people.[44] A report from the U.S. Department of Health and Human Services released in February 2008 highlight key findings from Individual Development Ac-

[42] Correspondence with Margaret Clancy, Policy Director, Center for Social Development at Washington University.
[43] Butrica, Barbara, Adam Carasso, C. Eugene Steuerle, and Desmond Toohey. 2008. "Children's Savings Accounts: Why Design Matters." The Urban Institute. Opportunity and Ownership Project. www.urban.org.
[44] Bush, George W. (2000) "New Prosperity Initiative", speech in Cleveland, Ohio, April 11.

count (IDA) program participants.[45] Prior to enrolling in AFI, 52% of participants did not have a savings account and 91% had never used direct deposit. Since 1999, participants in about 390 programs have saved more than $38 million in their IDAs.

CSA design elements of an initial public investment and progressive matched savings create incentives, build on compound interest, and increase the private contributions to these accounts for individuals and families at all income levels.

Questions for the Task Force: Will a CSA plan incorporate an initial deposit and matched savings components to boost the savings habits of all residents? How can the savings accounts of lower-income residents incorporate a progressive form of initial deposits or matched savings to increase their savings? What are ways to cover the costs associated with an initial deposit or matched-savings component?

Existing Products

The goals of a CSA program rely on a financial product with:

- Options for multiple uses;
- A "lock box" feature that limits the use of the account;
- The maximum return on investment possible;
- Low administrative fees; and
- Interface with a financial institution to encourage use by families unfamiliar with mainstream banking institutions.

There are no existing account structures providing the kind of flexibility and savings needed for families to save for their child's future. Current law allows parents to save for their children through custodial accounts, many of these accounts belong to the contributor, not the child named as the beneficiary. The contributor can change the name of the beneficiary or withdraw account funds. Many existing savings vehicles have an earned-income provision, which limits the ability of grandparents and other family members to contribute to the accounts with ease and flexibility – e.g., at birthdays and other important events in the child's life. In addition, the products currently available for children's savings accounts are targeted toward higher income families. They require minimum monthly contributions or minimum balances that are difficult for some residents, limiting their impact on lower- and middle-income residents who do not have significant amounts of money to save each month. Some of the current financial vehicles that have been proposed as vehicles for children's savings accounts are:

529 College Savings Plans*:* 529 college savings plans, named for the federal tax code creating them, are savings and investment accounts restricted for use

[45] Assets for Independence Seventh Annual Report to Congress.
http://www.acf.hhs.gov/programs/ocs/afi/seventh_interim_report.pdf

on college expenses. Federal tax code exempts 529 college savings plan accounts from tax liability. In these accounts, savings grow tax-free, and are not taxed upon withdrawal unless the funds are not used for educational costs at a post-secondary school. There is no time limit on their use. The penalty for unqualified use is 10% of the earnings, and taxes are then due on the earnings. Illinois has one of the best 529 plans in the country; however, of approximately 1,210,000 residents aged 18 to 24, only an estimated 29.5% were enrolled in some form of higher education – community college or university.[46] Those not intending to go to college are unable to use 529 plans for savings toward other assets – homeownership, entrepreneurship. In addition, 529 plans are not savings products for low-income residents because fees can be high on small savings amounts and, if not used correctly, they have the potential to negatively impact a child's financial aid eligibility.[47] Some states have recently implemented a form of children's savings accounts by using state funds to match savings deposited by low-income families into state run 529 college savings plan.

Coogan Accounts: Coogan accounts are trust accounts required by the states of California and New York as a condition of issuance of work permits for minors who wish to work in the entertainment business. All children under 18 years of age who receive earned income from work in California or New York are required to have 15% of their income from the entertainment business set aside into one of these accounts via direct payment from the employer. Coogan accounts function similar to broker-sold investment fund products, offering a portfolio of stocks and bonds from which to choose. A parent or guardian can be the trustee of such an account, but withdrawals are not permitted until the trustee turns the funds over to the child at age 18. Coogan accounts are a true "lock box" accounts where no one but the designee can withdraw the funds. There are limitations for using such accounts for CSAs, such as the potential for high fees and low rates of return. Modifications to the Coogan account structure could provide a flexible financial product that can accept small, regular contributions and that cannot be use by the trustee or child until the child is 18 years old. Other states, counties, and CSA researchers are exploring options to modify Coogan accounts for use.

Uniform Transfer to Minors Act/ Uniform Gifts to Minor Act (UTMA/ UGMA): The Uniform Transfer to Minor Act and the Uniform Gifts to Minors Act are accounts that function similar to a trust, allowing parents, grandparents, or others to transfer funds, including property and securities, to a child. Unlike a trust, no separate tax return is required. A bank or other designee serves as the custodian of an account and directs the investment. If a parent is the custodian, no custodial fee is assessed; if the bank is the custodian, a fee may be charged. The parent may not use funds except for the child's benefit, including college tuition. Control of an UTMA/UGMA account must be turned over to the child at age 21. These savings accounts do count as the child's asset for college financial aid calculations. There are some tax advantages to an UTMA/UGMA. A child's unearned investment income is tax-exempt up to $850. (At an 8% return on invest-

[46] Estimates based on Illinois Board of Higher Educaiton enrollment statistics. www.ibhe.org
[47] Clancy, Margaret and Michael Sherraden. "The Potential for Inclusion in 529 Savings Plans: Report on a Survey of States." Center for Social Development. Washington University in St. Louis. December 2003. gwbweb.wustl.edu/csd/.

ment, that would make an account of $10,625 tax-free). The next $850 income is taxed at a rate of either 5% or 10%, depending on the type of income.[48] Income above $1700 is taxed at the parent's marginal tax rate, and after age 17, income is taxed as for a single adult. UTMA/UGMAs typically have limitations on small contributions and charge large fees, especially on small dollar-amount transfers.

Coverdell Education Savings Account*:* Coverdell Education Savings Accounts give ownership of the savings account for a child's education solely to the parent. The total contributions for the beneficiary of this account cannot be more than $2,000 in any year. The beneficiary will not owe tax on the distributions if they are less than a beneficiary's qualified education expenses, including tuition, books, and fees, at an eligible institution. The tax advantages are limited if the distribution exceeds education expenses – i.e., a portion will be taxable to the beneficiary and will be subject to an additional 10% tax. There are also contribution limits for based on income. If there is a balance in the Coverdell ESA at the time the beneficiary reaches age 30, it must be rolled over to another Coverdell account for another family member.

Individual Retirement Accounts*:* IRA contributions are after-tax, and not tax-deductible. Only earned income can deposited into a IRA. IRA rules permit withdrawals prior to retirement, without penalty, for first-time home purchase and post-secondary education; other distributions are penalized at a rate of 10% for earnings on contributions.

Although there are a variety of financial products available from which to create a CSA plan, no financial product can be used to create a CSA accessible to all Illinois residents without modification. The design features discussed in this paper are not addressed within the existing financial products. Current savings vehicles could provide the basic framework from which to develop an appropriate product for children's savings accounts.

Questions: How will the CSA plan allow for maximum flexibility and ease to encourage all kinds of contributions, but still be protected to ensure only the child beneficiary can use the accounts? Would an existing vehicle serve all the purposes of a CSA, or can an alternative product be developed?

Conclusion

As dismal economic forecasts loom in everyone's mind, the creation of an inclusive, accessible children's savings account plan has the opportunity to strengthen the economic stability of future generations of Illinois residents. The children's savings account plan could create a generation of savers, making a positive, long-term impact on the state of Illinois. Illinois will benefit from the assets attained through savings and investment by creating a more prepared workforce, financially secure families, stable communities, a stronger economy, and

[48] As part of the Tax Increase Prevention and Reconciliation Act signed into law on May 17th, the "Kiddie Tax" age was increased from 13 to 17, retroactive to January 1, 2006.

increased future tax revenue. Children's savings accounts will lay a solid foundation for future generations' educational attainment, homeownership or entrepreneurship opportunities. Through the development of a plan that incorporates all Illinois residents, the Task Force can put Illinois back on the right track for economic prosperity.

For more information about IABG and asset-building efforts in Illinois, contact Chris Giangreco (773.336.6073 or support@illinoisassetbuilding.org).

IABG is co-chaired by Heartland Alliance for Human Needs & Human Rights and the Sargent Shriver National Center on Poverty Law.