Child Development Accounts (CDAs) are savings or investment accounts for long-term developmental goals, including postsecondary education. Available as early as birth, CDAs aim to encourage lifelong asset accumulation. Sherraden and others have proposed a universal (i.e., for all children) and progressive (i.e., greatest subsidies for the poorest children) national CDA policy. A universal policy has many advantages, the most important of which are political stability and the creation of an asset-building culture. Progressive policy is essential if all children are to be included in lifelong asset building.

The Center for Social Development’s vision is fully inclusive, with automatic enrollment and initial deposits for every child born in the United States and savings matches for low- and moderate-income families. Fortunately, achieving a universal and progressive policy has been clearly demonstrated in the SEED for Oklahoma Kids (SEED OK) experiment and put into practice in Maine, using 529 college savings plan platforms.

Moreover, SEED OK findings reveal early positive outcomes of CDAs with assets. For example, having a CDA with assets supports mothers’ mental health, mothers’ educational expectations for their children, and child development. Such encouraging results are not necessarily associated with the amount of savings that parents and others contribute to a CDA. Rather, it is an account with assets that seems to matter for attitudinal and perhaps behavioral outcomes.

Promoting a “culture of thrift” is also important, but this is not the only purpose of CDAs.

In the United States, the largest CDA programs have been built on existing 529 college savings plans. For example, the Nevada College Kick Start program automatically deposits $50 into a 529 account for every public school kindergartner in the state. In 2014, about 70,000 students were enrolled in Kick Start. Maine’s College Challenge is the first statewide universal CDA in the nation. Benefitting more than 40,000 children in 2014, this program automatically deposits $500 into a 529 account on behalf of every child born in Maine. Both Nevada and Maine’s 529 plans offer savings matches to state residents.

In this brief, we describe several features of direct-sold 529s that make these plans especially well-suited to CDAs. Some of these features distinguish 529 plans from credit union or bank savings accounts. Families need low-cost checking or savings accounts to pay bills, conduct routine financial transactions, and accumulate short-term savings. However, bank accounts are not the best option to accumulate assets for long-term goals. Long-term in nature, CDAs should have the potential for investment growth, restrictions on use, and other characteristics. To extend the benefits of early asset accumulation to all children, inclusive features such as automatic enrollment and automatic deposits are essential. The following points show why 529 plans are the best existing platform for inclusive, progressive CDAs.
State Sponsorship Enables Inclusion

State governments sponsor 529 plans. For a number of reasons, this leads to greater inclusion of low- and moderate-income families.

1. **State governments can promote asset building for all families.** States can select and negotiate with 529 providers to offer competitive fees and other inclusive features. Acting on their own, asset managers do not actively seek clients of all income levels. Public control of 529 plans leads to more inclusive policies and practices.

2. **All children can be included.** States can use official birth records to make automatic deposits into 529 accounts to benefit every newborn. This approach includes all children, not just the most advantaged, those in public schools, or any other subgroup.

3. **States can make automatic deposits without a Social Security Number (SSN), making universal enrollment possible.** Government agencies and other non-profit organizations can open 529 accounts without naming a beneficiary. In Maine’s and Nevada’s opt-out CDA programs, all grants are deposited into a single master account, and children’s SSNs are not required.

4. **Some 529 plans provide progressive savings matches.** In 11 states, 529 plans offer savings matches to encourage saving and support asset accumulation. Many 529 savings match programs have a progressive design where the largest match is offered to families with the lowest incomes.

5. **State sponsorship enables collaborations for greater inclusion.** Collaborations can broaden outreach, simplify participation for families, and create efficiencies for statewide CDAs. For example, through a partnership between Rhode Island’s Treasurer’s Office, Department of Health, and Higher Education Assistance Authority, parents may enroll their newborns in the statewide CDA by checking a box on the form used to register a birth and request an SSN. Louisiana uses tax records from the state Department of Revenue to automatically calculate a progressive match based on household income. Some states partner with schools to distribute information about 529 plans. States also hold outreach activities at libraries, state fairs, and other places or events to reach families with young children.

6. **Innovations for inclusive state 529 policies can inform a future national CDA policy.** States have served a historic role as “laboratories for democracy,” very often creating social policy models that are later adopted as national policy. It is likely that the inclusive 529 innovations in the states will play this role.

The Legal and Accounting Structure of the 529 Platform Is in Place

Named after the Internal Revenue Code section, 529 plans were created to facilitate saving for postsecondary education. Federal and state regulations and accounting structures are in place to support this goal.

7. **Account restrictions and tax reporting are established.** Because 529s are restricted investment accounts, account beneficiaries can use initial deposits, savings matches, and earnings only for postsecondary education. These restrictions, along with reporting of withdrawals on Internal Revenue Service Form 1099-Q, prevent or discourage the use of CDA funds for noneducational purposes.

8. **Funds are excluded broadly from federal Supplemental Nutrition Assistance Program (SNAP) and state public benefit calculations in some states.** Federal legislation excludes all tax-preferred education accounts, including 529s, from asset tests in SNAP. In at least 18 states, 529 assets are exempted from public benefit eligibility tests.

9. **Savings are protected from creditors in some states.** Twenty-eight states provide statutory protection of 529 accounts from creditors. Such protection exempts account funds from attachment, execution, and seizure for the satisfaction of debts. Creditor protection is sometimes extended to accounts owned by state residents participating in 529 plans of other states.
10. Providers make distributions directly to higher education institutions. For 529 plans, the structure is in place for providers to distribute funds directly to qualified schools and training programs. This feature ensures that 529 funds are used for educational purposes. Bank savings accounts and other financial products do not have a structure for such distributions.

11. Contributions are not restricted to in-state 529 plans. Contributions are allowed but typically not incentivized outside one’s state of residence. However, six states offer “tax parity,” which allows a tax deduction to be taken for contributions to any state 529 plan. Moreover, 14 states have either no state tax or offer no 529 college savings plan tax deduction. Therefore, there is an opportunity to participate in an out-of-state plan, sometimes without loss of any financial incentives.

Centralized Administration Creates Efficiencies and Sustainability

All participants in a state 529 plan are in the same system, and a single organization carries out all the accounting and recordkeeping functions.

12. Centralized recordkeeping creates coherence. Central administration of 529 plans facilitates automatic enrollment and automatic deposits. Program adjustments are efficient. Administrative errors are reduced. Central recordkeeping also creates a unified database for monitoring and evaluation. This is crucial in the early stages of innovation to allow for corrective action, and fundamental in the long-term for reporting and oversight.

13. Economies of scale make an inclusive policy financially sustainable. Centralized accounting of investment functions creates economies of scale that lower costs. Moreover, including the full population in one CDA policy enables fees from larger, more profitable accounts to support smaller, less profitable accounts.

14. Some 529 program managers facilitate effective state policy design. Many states have implemented or are investigating inclusive models and creative private and public funding of 529 plans. Some of these states use the same program manager. Thus, for example, the 529 program manager made operational changes, which facilitate automatic deposits for kindergarten students in Nevada, that can benefit other states’ plans. Systematic policy design across many states can be a positive step toward a national policy.

The 529 Platform Facilitates Asset Building

State 529 plans have a number of features that support saving and asset accumulation.

15. Deposits in 529 plans have potential for investment growth. Unlike bank savings accounts, which offer negligible interest rates and no opportunity for market gain, 529 accounts are typically invested in funds that appreciate or depreciate with the financial market. Age-based funds—the most popular 529 investment—shift assets from more aggressive to more conservative investments as the beneficiary approaches college age. Since 2008, Maine’s College Challenge program has invested just over $20 million in an age-based fund in the NextGen 529 college savings plan. With market gain through October 2014, balances total about $25.5 million.

16. 529 plans simplify investment decisions. The potential for investment growth is an attractive feature of 529 plans, but having numerous investment options is overwhelming for many people. 529 plans offer a limited selection of funds and sometimes a default investment for those who do not make a selection. By investing in a 529 plan’s age-based funds, account owners can benefit from automatic changes to their investments without initiating such changes.

17. Many 529 plans require low or no minimum initial contributions. Individual mutual funds often require $3,000 or more to open an account. Though state direct-sold 529 plans typically have a minimum initial contribution, the majority can be opened with $25. Utah and five other states have 529 plans with no minimum contribution requirements.
18. Many 529 plans have low fees. Across all state direct-sold plans, the average annual fee for a passively managed age-based fund is 0.37%. Aggregated dollars from account owners allow the 529 plan to purchase a mutual fund’s higher asset classes, which carry lower fund expenses. Lower expenses increase investment returns for all participants.

19. 529 plans facilitate electronic gifts from family and friends. Online 529 services such as eGift or Ugift allow family and friends to contribute to a child’s college savings account via a unique code or link.30

A Platform Is Required for Inclusion and Progressivity

Child Development Accounts aim to extend the benefits of early asset accumulation to all children, with the ambitious goal of changing life trajectories. Without automatic enrollment and initial deposits, though, most children will not have college savings. Only an inclusive and progressive CDA policy can achieve universality. Collectively, the features of state college savings plans discussed here make them the best existing platform to achieve universal accounts for children.

Similar to Individual Retirement Accounts and 401(k) plans, the tax benefits of 529 plans primarily benefit upper-income families. Lower-income families typically have little or no income tax liability, and fewer financial resources to invest in 529s. However, inclusive and progressive features can be incorporated—indeed, have been incorporated—into 529 plans. Public control of 529 plans combined with centralized accounting provides a policy structure and platform that enables universal and progressive innovations. In contrast, there is no such policy structure in bank savings accounts or individual savings vehicles in the private market. Bank savings accounts may be an appropriate platform for smaller, local programs, and we support them. Some municipal CDAs are using local savings products, but there is no evidence that these are expanding at scale statewide. In our view, progressive and inclusive asset accumulation on a large scale cannot be achieved through ordinary savings vehicles.

In this regard, it is important to note that states are “voting with their feet.” Statewide CDAs inevitably turn to the 529 platform, with very successful policy innovation and implementation. In 2015, Rhode Island joins Maine and Nevada as states that automatically deposit funds into 529 plans for young children. By far the greatest proportion of all CDAs in the United States—over 80% and increasing—use 529 platforms.

There is continuing discussion and legislation proposing a federal child account policy, typically with bipartisan support. While federal legislation may not pass for some time, state 529 innovations will inform and nudge consideration of a national policy. If the goal is a policy that extends to a state or to the nation as a whole, then a policy infrastructure, such as existing 529 plans in the states, will serve as the platform. To be sure, not all state 529 plans have desirable features for inclusion. Improvements to such plans are needed, but as many states have demonstrated, the potential is there. As Sherraden has observed, “the 529 infrastructure is an enormous but underutilized ‘public good’—like interstate highways or the internet—waiting to be designed to serve all families in America.”

Endnotes

1. Sherraden (1991) introduced the CDA policy concept (see also Goldberg, 2005). Recently, the proposal for universal, progressive CDAs has been articulated in Cramer and Newville (2009); Beverly, Elliott, and Sherraden (2013); and Sherraden (2014).

2. See Beverly, Elliott, & Sherraden (2013) and Beverly, Clancy, Sherraden (2014).

3. College savings plans, often called 529 plans after the relevant section of the Internal Revenue Code, are tax-preferred investment plans established and managed by states. Investments in 529s grow tax free, and withdrawals are not taxed if used for qualified education expenses. Many states allow contributions to be deducted from state income taxes.

4. See http://collegekickstart.nv.gov/families/FAQ.
5. Because enrollment is automatic unless parents opt out, the CDAs in Nevada and Maine are known as opt-out programs. Some other CDAs are voluntary or opt-in, which means that parents must enroll their children, often by opening a 529 or savings account. In early 2014, Maine’s College Challenge changed from an opt-in to an opt-out program (Clancy & Sherraden, 2014).

6. Broker-sold 529 plans have higher fees than direct-sold plans and lack some of the features described in this brief. Our discussion of 529 plans assumes direct-sold plans.


9. Maine’s statewide College Challenge uses the state birth records and 529 plan to create CDAs for approximately 12,500 newborns each year (Clancy & Sherraden, 2014). The SEED for Oklahoma Kids statewide policy model and experiment used 2007 birth records to automatically open a 529 account for every newborn in the study’s intervention group (Beverly, Clancy, & Sherraden, 2014).

10. See Clancy & Sherraden (2014) and http://collegekickstart.nv.gov/. However, both programs aim to obtain the children’s SSNs over time. Obtaining the child’s SSN sometime after the automatic deposit can enable the state to report family or other savings for the child and the CDA funds on a single statement and ensure proper identification of the beneficiary when the funds are disbursed later for postsecondary education. Under a national at-birth CDA policy, SSNs would likely be shared as a matter of policy.


15. Regulations for 529 plans require modification if CDAs are to support other types of development.

16. If personal contributions are withdrawn from a 529 account for a non-qualified use, the earnings (but not contributions) are subject to state and federal taxes and a 10% federal penalty. State revenue departments enforce these withdrawal restrictions by issuing Form 1099-Q. See http://www.collegesavings.org.


22. For example, Ascensus College Savings, the program manager for Nevada’s 529 college savings plans, manages 529 plans in 17 states. TIAA Tuition Financing, Inc. is the program manager in 11 states. Also, the Utah Educational Savings Plan acts as the account service provider for CDAs in California and a multistate program based in New York.


26. Some nonage-based funds also offer automatic portfolio rebalancing.

27. Though the majority of state direct-sold 529 plans require $25 to open an account, 11 states have lump-sum minimum contribution requirements that are higher. These minimums are very high—$250—in Alaska, Florida, Maryland, New Mexico, and South Dakota. Alabama, Colorado, South Carolina, Nebraska, Utah, and West Virginia have no minimum contribution requirements. See http://savingforcollege.com.

29. The total annual fee for all investments in the nation’s largest direct-sold plan, New York’s 529 plan, is 0.16%. See https://www.nysaves.org/content/home.html.


32. See Beverly, Kim, Sherraden, Nam, & Clancy (in press); Clancy & Sherraden (2003), and Nam, Kim, Clancy, Zager, & Sherraden (2013).


34. See Corporation for Enterprise Development (2014a).

35. See Sherraden (2009, p. 3).

References


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