CHILD ACCOUNTS: 
THE APPROPRIATE ROLE FOR THE PRIVATE SECTOR

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ABSTRACT

In the United States, there is a long tradition of public-private partnerships in delivering financial products to the American people. That is, the government enacts a legal plan structure to encourage savings and asset accumulation, and the financial industry then develops and delivers products to implement the policy through a retail model. This suggests that new policies, such as a Child Accounts policy of savings accounts for children, should adopt a retail model. Although common ground exists among advocates on the contours of a Child Accounts policy, including a clear and strong role for the government, there has been a continuing debate about the appropriate role of the financial industry.

The Initiative on Financial Security (Aspen IFS) at the Aspen Institute has conducted four years of research into the potential for a delivery system based on a retail model for Child Accounts. This report begins with a discussion of the inherent advantages of a retail model as well as some of the perceived obstacles. The paper next describes two stages of research – consultation with industry leaders and in-depth work with industry design teams – into the feasibility of the retail model. It then outlines how the government could structure the retail model with critical consumer protections and enforce compliance to protect the interests of children.

Aspen IFS can report a number of key findings. Industry experts have endorsed the concept of a retail model. Aspen IFS research illustrates that the significant scale of the program trumps the small balance problem. Child Accounts can be delivered economically because they are a product whose costs are fairly low and are fairly flat over time. In addition, costs should decline as the program matures and as competition for market share increases in the industry.

Regardless of the delivery model chosen, certain functions will be performed by the government and certain functions will be performed by the financial industry. The question, then, is not really one of kind but of degree. On balance, critical system delivery questions all favor a retail model. Through a retail model, large numbers of previously-unbanked Americans can be brought into the financial mainstream. Given its research, the advantages of a retail model, and the long-standing tradition of public-private policy partnerships in the United States, Aspen IFS concludes that, because a retail model is financially viable and feasible, it should be the preferred option for delivering Child Accounts.
INTRODUCTION

The Obama Administration has signaled strong interest in creating a policy for making savings accounts for adults widely available through the workplace. That goal dovetails with a long-standing effort by policy advocates to expand the availability of saving and investing accounts to all Americans but, perhaps surprisingly, especially to children. Savings accounts for children are now viewed as a critical new mechanism for promoting individual development along with economic opportunity and mobility.\(^1\) The core values for such a policy are that such accounts should: (1) be universal in the sense of providing a connection to the financial mainstream; (2) make lifetime saving a possibility; (3) be progressive in the sense that lower-income Americans receive greater financial incentives to save; and (4) be a means for building financial assets that appreciate and endure.

A policy for Child Accounts (CAs) has five central features. First, children receive a certificate at birth entitling them to a government endowment to start an investment account. Second, the policy encourages the children themselves, as well as others – such as family, friends, churches, and employers – to make additional contributions to the accounts. Third, the government -- federal and/or state -- encourages saving by low- and moderate-income families through matching contributions. Fourth, accounts offer an investment program to enable contributions to grow. Fifth, no withdrawals can be taken from an account until a child reaches age 18.

Although common ground exists among advocates on the contours of a Child Accounts policy, including a clear and strong role for the government, there has been a continuing debate about the appropriate role of the financial industry. In building such a program, there are essentially three models from which to choose:

- **INSTITUTIONAL MODEL:** A program with the federal government performing account establishment and administration and all other functions except for investment management, which is contracted out to the private financial services industry (perhaps in combination with other back office operations). Analogous models include the Thrift Savings Plan for federal employees and state-sponsored 529 College Savings Plans. The original ASPIRE Act proposed this type of model for a national CA policy.\(^2\)

- **RETAIL MODEL:** A program with the government creating and enforcing a regulatory structure of investment accounts (sometimes with contributions), but with the financial services industry performing all other functions. Analogous models include Individual Retirement Accounts, the Saver’s Credit, and Health Savings Accounts.\(^3\)

- **HYBRID MODEL:** A two-stage program where accounts begin in an institutional model but, after they grow to a specified size, are allowed to transfer out of the government-based program and into a retail model. The most recent version of the ASPIRE Act is based on the hybrid model.\(^4\)

Among many advocates of a CA policy, the institutional model is the preferred delivery system for several reasons. First, many believe that the financial services industry would not be interested in CAs because too many accounts would have small balances and be unprofitable. Second, many also believe that a retail model is impracticable because too many families for whom the policy is primarily intended are not participants in the industry. Third, many believe the government is needed to play a central role as an intermediary to ensure fair treatment of participants.
The Initiative on Financial Security (Aspen IFS) at the Aspen Institute has conducted four years of research into the potential for a retail model delivery system for CAs. This paper reports on the results of that research. Its findings challenge the conventional wisdom about the merits of an institutional model and make the case for a feasible and pragmatic use of the retail model in delivering CAs.

**The Rationale for a Retail Model**

In the United States, the retail model is the pre-eminent delivery system for investment accounts. The private pension system boasts millions of savings accounts held in employer-based plans, and millions of Americans own other financial assets held in investment accounts in banking, brokerage, mutual fund, life insurance, and similar industry companies. To serve the needs of American investors, the financial services industry has created a vast infrastructure of supporting systems -- both for the delivery of client services through the front-office and for account investment and administration through the back-office. Individual investment accounts perhaps seem simple; but operationally, they require sophisticated systems for marketing and disclosure, investment options and management, government and client reporting, and account administration (e.g., accepting contributions, allocating contributions to investment options, implementing investment changes, crediting accounts with earnings, issuing account statements, and answering account holder questions).

A retail model could offer several advantages to a CA policy. The existing industry infrastructure could be used as the delivery system, thus providing ease of implementation. In addition, a retail model is arguably better for consumers, providing the millions of families currently outside the financial mainstream with a direct connection to it. As a result, these families could gain easier access to a host of other routinely-available services -- savings and checking accounts, for example -- which payday lenders and similar non-regulated companies now provide at much higher cost. Finally, the industry has the capacity, and indeed the self-interest, to market savings. The industry thrives when more people save and more people save more, so it has developed sophisticated systems for increasing customer activity. Therefore, a retail model could help drive saving behavior, using the industry’s marketing and communications functions to expand account contributions significantly and to help the policy achieve its primary goal of giving every child a substantial financial asset for the transition to adulthood.

In addition, the United States has a history that testifies to the ability of the financial services industry to take public policies initiated by the government and to shape and expand them into mass-market products and services. One such example comes from the history of homeownership in the United States. In 1900, fewer than half of American households (46.5%) owned their own homes, and homeownership rates remained relatively unchanged from 1900 through 1940, when typical mortgages required a 50% down payment with a 3- to 5-year repayment schedule. After World War II, new government policies changed the mortgage industry. Under Federal Housing Administration (FHA) insurance programs, down payment requirements were reduced and payment schedules expanded. After the Federal National Mortgage Association (Fannie Mae) was created to purchase loans from financial institutions, and FHA established the 30-year mortgage program, the homeownership rate rose to nearly 62% by 1960. When homeownership rates remained relatively flat for the following 30 years, it became clear that lower-income families were under-represented as homeowners. In response, in 1992, the Federal Home Loan Mortgage Corporation (Freddie Mac) announced the next major product change with the creation of its Affordable...
Gold Program, which made mortgage loans available with as little as a 5% down payment. Homeownership rates rose once again; in 2005, they reached a new high of 69%. This rate includes low- and moderate-income homeowners who qualified for traditional mortgages under these programs without having to resort to the now questionable “sub-prime” mortgages that have led to the current worldwide financial crisis.

The history of Individual Retirement Accounts (IRAs) is similar. In 1974, as part of the Employee Retirement Income Security Act (ERISA), Congress provided tax benefits for retirement savings by workers without a pension plan at work through Individual Retirement Accounts (IRAs). The financial industry then marketed IRAs as a new savings product. In 1981, the Economic Recovery Tax Act opened IRAs to all workers under 70½ years of age, enabling the financial industry to expand the IRA market significantly. Participation immediately quadrupled from 3.6% of all returns in 1981 to 12.6% of returns in 1982 -- and continued to rise to a peak of 15.9% in 1985.

These examples illustrate how public policies can play a role in initiating and developing a broad social program that subsequently becomes suitable for universal distribution through private industry. Other examples include the federal program for student loans as well as the housing construction stimulated by the Low-Income Housing Tax Credit. In all of these cases, the government provided leadership and incentives sufficient for financial institutions to turn public policy into private-sector products, to assume responsibility for customer identification, marketing, underwriting, sales, and servicing, and to enable the products to reach broader market segments through expanded delivery systems.

**ASPE IFS RESEARCH INITIATIVE**

**STAGE ONE: INITIAL REVIEW**

Despite the historical record in favor of a retail model, it is not an obvious first choice. CAs are a unique policy. There is no historical precedent for the delivery of a universal account system covering millions of Americans. Many in the industry have expressed concerns over whether a government-initiated, industry-delivered partnership is appropriate for such a policy. Some obstacles raised by the industry itself are:

- A retail model would not be profitable enough to be sustained by the industry –
  - Too many accounts would have low balances, driving up costs; and
  - Unlike all other financial products, providers would be required to take all consumers.
- In some cases, current banking and securities laws would not allow all firms to become providers and, in other cases, not all firms would have the capacity to do so, thus limiting the broad availability of CAs.
- Some firms would not participate without special incentives, such as credit under the Community Reinvestment Act (CRA).

Other objections have been voiced by child advocates and public policy specialists, including:

- The industry cannot deliver a cost-effective product to low- and moderate-income families.
- The government is needed as an intermediary between families and the industry to assure fair treatment.
- The government must be a watchdog to prevent exploitation of unsophisticated savers.

For the past four years, Aspen IFS has been testing these beliefs in research devoted to analyzing the feasibility of a retail model for CAs. Aspen IFS conducted its initial
research through in-house analysis and model design, and in close consultation with numerous experts and mid-level staff of the companies represented on the Aspen IFS Advisory Board, which represented the major segments of the financial services industry. This phase of the research analyzed the three models for industry involvement in delivering CAs described above: (1) an institutional model based on the 529 plan experience and the Thrift Savings Plan for federal employees; (2) a hybrid model initially structured through an institutional model but with accounts permitted to transfer to a retail model after reaching significant size; and (3) a retail model.

In early 2006, these models were presented in Chicago to the Chief Executive Officers of the Aspen IFS Advisory Board companies. In a wide-ranging discussion, these industry experts reviewed the models critically and evaluated their utility both for their firms and for the industry as a whole. Presented with Aspen IFS projections, industry experts initially believed that a retail model for CAs was not sustainable. Many thought that a CA policy could only be implemented as a CRA-type approach -- that is, one that gives banks regulatory credit for projects promoting social goals such as serving low- and moderate-income consumers. Even though the industry could theoretically provide a platform for such a product, many were skeptical that it could achieve profitability, even at the lowest acceptable level.

There was overwhelming agreement, however, that CAs represented an overall positive initiative for children, their families, and social policy goals. Not all firms, such as investment banks, believed that CAs would be attractive to their clients or suitable for broker-sold accounts, but they were interested in the intellectual challenge of designing such a market. Not all firms, such as credit unions, had the capacity to offer an investment product currently, but some, especially consumer financial services providers, did see it as a potential business opportunity. A number of firms saw the potential of CAs for building many new customer relationships, acquired easily, that they could keep and grow over many years. In addition, some saw the value of CAs as the ability to retain existing customers in an enhanced relationship.

In the end, one model was rejected – the hybrid model. This model was viewed as the worst of both worlds: it did not give the volume of business to selected firms that an institutional model would; and it did not give the industry the ability to compete for business, grow assets, and develop customer relationships from the beginning of the account that a retail model would. As one Board member summed up the discussion, “the fundamental decision from a business perspective is between an institutional or retail model.”

Debate between the institutional and retail models was inconclusive. The discussion confirmed initial impressions that an institutional model might have some cost advantages in the delivery of CAs, particularly for low- and moderate-income families. Yet, there was also recognition that a retail model might better serve the policy goals of stimulating greater participation and growing more accounts to a significant size.

**Stage Two: In-Depth Analysis**

The Chicago meeting also included a presentation of the retail model for Child Trust Funds (CTFs) just then beginning operation in the United Kingdom (U.K.). The Advisory Board was intrigued by this initiative and questioned if such a retail model could be implemented efficiently and successfully in the United States. This posed a deeper research challenge for Aspen IFS, given that the institutional model offered a role to financial institutions that was limited to investment management but was easier to understand and price.

The Advisory Board companies requested that Aspen
IFS conduct further research and offered access to their product design staffs and other in-house expertise. Two central questions drove this stage of the research. First, could a retail model for CAs be structured to take advantage of the scale, efficiency, and reach of the industry and to be attractive to large segments of the industry? Second, in what ways could a retail model better achieve the policy goals of CAs than an institutional model?

**The U.K. Experience**

Aspen IFS began this stage of its research by analyzing the primary example of a retail model for CAs currently in operation – the Child Trust Fund (CTF) program that has been in effect in the U.K. since 2005. In the U.K., every child born on or after September 1, 2002, receives a certificate for £250 (about $397) with an additional £250 contributed for low-income children. Parents open accounts by redeeming these certificates at a participating financial institution. Accounts can receive additional contributions of up to £1200 (about $1,905) every year, and the government contributes an additional £250 (again doubled for low-income children) when the child reaches age 7. No withdrawals can be made before age 18, but withdrawals are unrestricted thereafter. At that time, accounts automatically become adult savings accounts with continued tax-free treatment and unrestricted withdrawals.

The role of the government is to approve companies that wish to participate in the CTF and to regulate the program. In all other respects, CTFs are an industry-delivered product. There are currently over 40 approved providers and over 70 distributors of CTFs, and the majority of distributors have a direct relationship with a single approved provider. CTFs were designed with important consumer protections. First, providers are required to open up CTFs for all customers presenting a certificate. Second, standard CTFs are required to offer two types of investment options: (1) a “stakeholder” account, which features a target-date fund invested in equities in the early years and then increasingly in fixed-income instruments after the child reaches age 13; and (2) a fixed-income option. Fees for the stakeholder CTF, which is the default option, are capped at 1.5% annually. Parents can also choose a non-standard account without a fee cap. Stakeholder accounts have proven popular, and over 80% of CTFs (including accounts opened by the government for children with unredeemed certificates) are stakeholder accounts.

As of December 31, 2008, over 4.5 million children in the U.K. have received certificates for CTFs. Three years since the program’s enactment, there are some clear signs that the CTF policy is succeeding, even though some improvements could be made. For example, about 75% of all CTFs are opened by families directly, a favorable take-up rate when compared to similar products. In addition, some 30% of family-opened accounts are receiving additional contributions, and private savings already equal 55% of what the government has contributed.

The choice of a retail model also seems vindicated. The industry organized itself to create a new product and deliver it to millions of accounts in a very short period of time. CTFs are now widely available through a variety of mainstream and specialty firms, including mainstream banks, thrift institutions, credit unions, and mutual fund companies. For most, profit margins on these accounts are small, and many recognize that the key to profitability is attaining sufficient market share. For others, CTFs are viewed as an important means for retaining and attracting customers and for stimulating increased take-up of other financial products.

**Application of the U.K. Experience to the United States**

The success of the U.K.’s CTF policy indicates that a retail model has potential in the United States. One
One factor arguing for a retail solution is the extraordinary number of accounts a CA policy would create. In the United States, there are over 4 million children born every year. In 18 years, the program would grow to 72 million accounts in operation. Over 40 years, over 160 million people would have had a CA. As Figure 1 illustrates, the potential size of the program dwarfs the existing programs that the industry currently serves or that the government operates.

Even with such a large potential market, it is clear that a retail model for CAs represents both challenges and opportunities for the industry, as illustrated in Table 1. Unlike current retail products, a universal CA would require the industry to serve millions of families currently not fully integrated into or even a part of the financial mainstream. To the extent such customers have low financial sophistication and limited access to technology, the costs of providing accounts will increase. Second, many account balances would be small. The industry would have to provide additional customer services and education to drive the additional contributions necessary for profitability. Third, if the U.S. policy included a fee cap, it would be a challenge to deliver child accounts profitably. Although this feature is an important consumer protection, it would constrain revenues significantly. In addition, because there are no fee-capped products in the United States today, the industry is not experienced in designing or delivering products with such a feature.

Aspen IFS next assembled experts from Advisory Board companies to an in-depth review of the competing models. Attendees represented such specialties as marketing, investment management, tax, and law. Three working groups, one for each model, analyzed Aspen IFS projections and identified the advantages and challenges of each. In the full group discussion that followed, the hybrid and institutional models were judged to be very weak.
Although the group did not unanimously prefer the retail model, over 75% did. And the general sense of the meeting, even among those who did not prefer the retail model, was that it had obvious merit and potential. Those who did select the retail model mentioned a number of factors for their choice. One was the ability of the market to drive innovation in child accounts.

You’ve got flexibility in choice. . . . An open architecture and competition. I think it’s really easy to see that’s going to drive creativity in the marketplace. It’s going to drive new features that we can’t possibly think or plan ahead for.

### Table 1: Challenges/Opportunities for the Financial Industry in a Retail Model for CAs

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<th>Feature</th>
<th>Opportunities and Challenges</th>
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<tr>
<td>4 Million New Accounts Each Year</td>
<td><strong>Opportunities</strong>&lt;br&gt; • Large new market: in 5 years, 20 million accounts (500% larger than the Thrift Savings Plan, 250% larger than the 529 plan market, and 175% larger than all 401(k) accounts managed by Fidelity)&lt;br&gt; • New product that can attract new customers and retain existing ones&lt;br&gt; • Cross-sell of other financial and non-financial products geared to children and families&lt;br&gt; <strong>Challenges</strong>&lt;br&gt; • Low initial balances&lt;br&gt; • Some accounts will grow faster than others</td>
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<tr>
<td>Basic, Simple Investment Options</td>
<td><strong>Opportunities</strong>&lt;br&gt; • Given number and volume of accounts, aggregate market could be very attractive&lt;br&gt; • Limited investment options allow account pooling and simplification, driving costs down&lt;br&gt; • Relatively safe way to introduce families to equity investing&lt;br&gt; <strong>Challenges</strong>&lt;br&gt; • Not all firms (e.g. credit unions and some banks) have existing capability for investment accounts, although they could partner with other firms&lt;br&gt; • Some households may be risk-averse, particularly given current economic climate</td>
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<tr>
<td>Consumer-Friendly Cap on Fees</td>
<td><strong>Opportunities</strong>&lt;br&gt; • Because per-account costs remain flat for most of the account’s lifespan, significant potential for revenue growth as accounts grow&lt;br&gt; • Consumers able to select any provider without fear of predatory fees; providers driven to differentiate themselves on other terms&lt;br&gt; • To remain competitive, providers driven to offer incentives for savings and to reduce costs through economies of scale&lt;br&gt; <strong>Challenges</strong>&lt;br&gt; • Fee cap may be a challenge to providers in initial years&lt;br&gt; • Some providers may choose not to enter the market until it becomes more attractive</td>
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<td>Universal Account System</td>
<td><strong>Opportunities</strong>&lt;br&gt; • Development of marketing and outreach strategies for all American families, not just the mass affluent&lt;br&gt; • Opportunities for financial literacy and creating habits of thrift through actual financial decisions, creating better consumers in general&lt;br&gt; • Potential for financial institutions to improve public image&lt;br&gt; <strong>Challenges</strong>&lt;br&gt; • Local civic and nonprofit networks will need to be involved to ensure broad participation across geographic, ethnic, and socioeconomic groups&lt;br&gt; • Providers will also need customer service standards that meet the needs of all Americans, including unsophisticated financial consumers</td>
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Accessibility was another positive factor.

[A retail model says] if you [industry firm] want to play in this space and you want to allow people to redeem their voucher with you, you have to at least offer this basic minimum product that has a very low minimum threshold. . . . If you want all the rich people to come to you with their vouchers, you’ve also got to have accounts that would be accessible to a lower-income consumer, so that there’s a broader range of accessibility.

Others saw the behavioral change that a retail model could re-enforce.

I think one of the good things about the voucher is that you’re encouraging the parent to take the first step. And they have to be proactive and get engaged. . . . Hopefully, the next step would be engaging them to actually put their own contributions in, which I think is important. . . . A good way to encourage this philosophy of saving and investing and making it a pattern in their lives.

Most persuasive to the attendees were discussions about whether, from a cost perspective, a U.K.-model CA could be feasible in the United States. As one participant noted, there are a variety of approaches that could be taken to drive down costs.

You’ve got marketing costs, you’ve got administrative costs, and you’ve got investment costs. In terms of administration costs . . . these have got to be individual accounts in a sense of recordkeeping. However you might be able to save money by pooling the investments into a program that everybody recognizes, you still have to keep those individual accounts. And a lot will depend on how you design those accounts, and how many transactions they have, and how many statements they have in terms of how expensive they are.

The group discussed the various costs of marketing and distribution, record keeping and custodial services, investment management, administration and legal services, and customer service and communications required by individual investment accounts. In addition, it reviewed approaches that had been used in the UK to limit these costs and considered how costs could drop over time under various scenarios of account growth.

As a result of this discussion, even the issue of a fee cap became more acceptable to the participants. One participant said,

Fee cap. When I first heard it walking in, I cringed and said, “Oh my God, that’s the worst thing I’ve ever heard.” But after I got used to it, I said, “The real big picture here is that you’re trying to create investment accounts for people.” And to the extent that there is a tradeoff -- they’re going to have to pay 150 basis points to get into this show -- I can buy that. I think the end goal of people getting tax-efficient investing and compounding is much more powerful than the 150 [cap], if that makes everybody -- all the participants that have to do all the work -- comfortable.

This finding of tolerance for a fee cap was critical. It revealed that, through some relatively simple product alteration, a retail model could be sustainable with a fee limit near the 1.5% cap imposed in the U.K. By simplifying some services -- such as replacing four quarterly statements with one or not providing hard copies of prospectuses and annual reports -- a CA could be provided by participating firms within a fee cap of 1.5%, or possibly even less.

Industry participants were comfortable with this approach. As one noted,
First of all, there is some beauty in simplicity. . . . One of the big issues we talked about in the groups a lot yesterday was on low-dollar accounts and how to solve those kinds of problems. . . . So instead of a quarterly statement mandate, you’ve got to do an annual statement mandate. Instead of a full blown prospectus every year, you do a simple buyer prospectus one-time only. You really have to look at those items which take away the real marginal cost of doing the business and get that administrative cost down.

Even though a fee cap in the vicinity of 1.5% seemed feasible, it was clear that first-year costs were going to be higher. CAs must be marketed to get as many parents as possible to redeem the certificate. Whether firms use advertising, giveaways, or financial incentives, these all cost money and are less effective with the general public than with existing clients. The cost can be averaged in over 5, 10, or even the full 18 years, but the first-year costs are generally higher. Firms should be able to recoup these costs in later years, however, especially as revenue grows with increases in account balances. As Bernard Wilson, former Vice President of H&R Block, noted,

Our experience showed that educating the customer and allowing her the ability to act immediately was the most labor intensive and the most expensive part of the account process but one that yielded benefits over time. In our IRA business we were able to generate additional contributions to the account in a second year which was good for the customer and brought the company an additional benefit of customer retention. . . . In looking at child accounts, our expectation was that through our face-to-face interactions we would be able to generate sustained annual contributions to the account at tax time. We saw that these contributions — even when modest — could yield important growth in the account and improve ongoing profitability.

Aspen IFS research from this operational stage has revealed that the cost issues in offering a CA, while a challenge for any new financial product, can be managed even over the short run by a variety of financial institutions.

**Key Conclusions**

After four years of research, Aspen IFS can report a number of key findings. In Aspen IFS’s report, *Savings for Life: A Pathway to Financial Security for All Americans*, the Advisory Board endorses the concept of a retail model for CAs. The members of the board believe that the significant scale of the program trumps the small balance problem. They believe they can deliver a product where the costs are fairly low and are fairly flat over time. They also believe that costs will decline over time as the program matures and as competition for market share increases - a key requirement for profitability. The size and universal nature of CAs represent an important new market for the industry that will include large numbers of previously-unbanked Americans as potential customers. While not all segments of the industry will find CAs an attractive business opportunity, there will be many who will find it an important tool for retaining current customers and attracting new ones. In addition, there is a belief that the social policy behind CAs is important to the country and should be embraced by the industry.

**The Role of Government in the Retail Model of Child Accounts**

Over and above the economics of a retail model, one frequent argument against it is that such a model will not provide sufficient consumer protections for children and their families. Many advocates argue that, to maintain the integrity of the policy, the government must be the key intermediary with the industry – throughout the life of the accounts in the case of the institutional model, and at least at the outset in the case of the hybrid model.

But there are problems with these assumptions. First,
there is no precedent in the United States for the federal government operating an investment program through an institutional model, except in its role of employer for its own employees. Second, there is a precedent in the U.K. for a retail model with strong consumer protections that could readily be adapted to U.S. practice. Because it currently does not exist, a legal plan structure must be defined to implement CAs, regardless of delivery method. The legal structure will require, at a minimum, a governing statute and regulations. These will define who is entitled to a CA, how initial government contributions will be transferred to accounts, what matching contributions are available and how they may be claimed and transferred to accounts, who controls an account while the child is a minor and when does the child assume control, when distributions are permitted, what the investment program will be, what tax treatment applies to accounts, and what penalties apply to individuals who commit fraud or abuse of account assets. The government will define and regulate these features of the policy, no matter which delivery model is chosen. How much additional regulation for the purpose of consumer protection might a retail model require? Three issues seem key to regulating industry behavior.

**Eligible Providers**

A CA policy delivered through a retail model should include a definition of and requirements for eligible providers. This would ensure that only reputable firms are eligible to market CAs and that their behavior is subject to strong federal government regulation as a back-stop. There are three alternatives for this definition. First, the policy could utilize existing IRA regulations to define which firms are eligible to be providers. Currently, the tax code permits banks and financial institutions regulated by state or federal law to market IRAs. Other institutions can apply to the Treasury Department for approval. Alternatively, the policy could adopt the requirement in the U.K. where the government approves each provider on a case-by-case basis. The U.K. has issued extensive regulations that define the type of firms that may apply to be a provider, the rules providers are required to follow, and the consequences imposed for rule violations. The United States could also adopt some combination of these two systems by, perhaps, establishing higher qualifications for CA providers than is now required for IRA providers.

**Permitted Investments**

A CA policy delivered through a retail model (and perhaps through an institutional model as well) should specify and define the types of permitted investment options. The U.K. provides three basic alternatives: (1) a savings account, invested in interest-bearing instruments; (2) an equity account, like a brokerage account, invested in any of the wide range of securities authorized by the government; and (3) a “stakeholder” account, invested in a mutual fund that features equity investments in the early years and gradually moves to less risky investments when the child reaches age 13. The stakeholder account is the default option for children whose parents fail to redeem their certificates. It is also the most popular option for accounts opened by families.

In the United States, there is no precedent for defining permissible investments for an investment account such as a 401(k) or brokerage account by statute or regulations. Nevertheless, the private pension system, especially in 401(k) plans, is evolving in that direction. For the first time, the Pension Protection Act of 2006 endorsed the concept of “default” investment funds for 401(k) plans. Employers who add these to their plans are relieved of many of their fiduciary responsibilities. The Department of Labor has released regulations that specify what types of funds may qualify as default funds, known as “Qualified Default Investing Alternatives.” This example from the world of qualified pension plans may provide a good
model for a CA policy and indicate potential acceptance of an investment menu defined in statute, as is done in the U.K.

**Fee Caps**

An important consumer protection in the U.K. is the imposition of a 1.5% fee cap on stakeholder accounts, which all CTF providers must offer. This requires all market participants to offer an account operating under a fee cap. Because the key to profitability is market share, competition drives down fees for these accounts, benefiting account holders. In addition, a fee cap helps with transparency so that prospective customers can compare the stakeholder accounts on both costs and returns. Given the large number of providers and distributors involved in the U.K. market, it seems clear that the fee cap has not been a deterrent to industry interest in CTFs.

Again, in the United States, there is no precedent for a required fee-capped product in an investment account offered through a retail model. Whether a CAs policy should have a fee cap and, if so, what that fee cap should be remains a political question. However, there is reason to believe that the industry would be willing to accept such limitations for two reasons. First, the policy objectives for CAs argue for such a cap. Second, based on Aspen IFS research, it seems feasible that large segments of the industry would be willing and able to enter a CA market even under such constraints.

A regulatory structure for CAs delivered through a retail model could also feature other consumer protections. These could include a requirement that providers must accept all customers and/or make financial literacy information available. Regardless of the exact legal structure, the U.K. has shown that, through careful design, it is possible to deliver a CA policy through a retail model that includes critical consumer protections.

**Conclusion**

In the United States, there is a long history and tradition of a public-private partnership in delivering financial products to the American people. That is, the government enacts policies to encourage savings and asset accumulation, and the financial industry then develops and delivers the specific products. There is no precedent for an entirely government-run delivery system of private accounts for every citizen. This suggests that new policies and products, such as CAs, could, with appropriate protections, follow the retail model. Nevertheless, for various reasons, many CA advocates have rejected the retail model, arguing instead that an institutional model is the preferred option. With the financial industry itself often skeptical, many believe the case is closed. As Aspen IFS has shown, this conclusion is too hasty.

Under any CA program, certain functions will be performed by the government and certain functions will be performed by the financial industry, regardless of the model used to deliver CAs. For example, only the government has the ability to ensure that all children have an account and to provide meaningful matching dollars for low- and moderate-income families. In turn, only the financial services industry has the technology for implementing investment decisions and performing other account management functions.

So the question, then, is not really one of kind, but of degree. Beyond funding, the singular role of government is to write regulations that define eligible providers and investments and enforce those regulations for the benefit of the children. Government can also be used to set fee caps and standards for education and communications. Finally, government can play a critical role in providing basic information about CAs and assisting families with connections to account providers. But the remaining system delivery questions all favor
a retail model. The financial sector, not the federal government, has the experience and expertise at customer communications, record-keeping, sales, and marketing. And, account simplicity and familiarity can only exist in the private sector.

Furthermore, two of the core values for a national CA policy among CA advocates, as noted in the Introduction, are best achieved under a retail model. First, only the retail model can make low- and moderate-income Americans valued customers of a financial institution that has the ability to connect them to other mainstream financial products and services such as checking accounts, automobile loans, home loans, student loans, credit cards and retirement accounts.19 In that sense, only the retail model can bring low- and moderate-income Americans directly into the financial mainstream. Second, the retail model would arguably be the best means of building financial assets that appreciate and endure – because only under a retail model would the financial interests of the account holders and the account providers be aligned. Both individuals and financial institutions would want to see the accounts grow as large as possible by the time the child turns 18. That provides an incentive that would not exist under an institutional model where operating a program of savings accounts is only one of the many functions that government performs.

Moreover, there is a political value to aligning a CA program with a large and important industry. A retail model gives financial institutions – a fairly powerful political force – a continuing stake in the success of a CA policy, a fact that should not be overlooked. For example, even with overwhelming public support and a successful 80-year history, Social Security is constantly under attack from those who want to dismantle this government policy or significantly undermine it. Supporters of CAs should expect nothing different, no matter how successful a program it becomes. It will need more than children and families to sustain and defend it. When political forces wane and economic circumstances change, children, families, and CA advocates will want – and need – the financial industry on their side. A retail model would align their interests with the goals of the CA policy, and the success of that model would secure their support.

The only outstanding issue, then, is whether a retail model is financially workable and feasible. Only if the answer is negative should an institutional model be pursued. Otherwise, given all the advantages of a retail model as well as the long-standing practice in the United States, the retail model should be preferred.

The four years of Aspen IFS research, financial modeling, and extensive interactions with leaders from all segments of the industry show that a retail model can meet the feasibility test. While the small account size initially concerned industry leaders, the scale of the entire program – 4 million new accounts each year – can make it profitable for the industry. While a fee cap would be a hurdle, the research showed that the costs of offering CAs could also be relatively low – and, more important to the industry, could be more than offset by the vast numbers of new customers obtained. It turns out, conventional wisdom notwithstanding, that the retail model can and would work.

The U.K.’s choice of a retail delivery system was pragmatic and correct. The government moved boldly to create a system of CAs but left it to the private financial industry to deliver a first-class product. And the industry is making it work. The case for choosing a retail delivery system in the United States is beyond the stage of innovation and experimentation. The U.K. experience, combined with the ability of U.S. institutions to play a comparable role, argues for this sensible direction in CA policy.
ENDNOTES


3 For the purposes of the following discussion, the term “financial services industry” refers to firms that are subject either to federal regulation or in the case of the insurance industry, state regulation. Such firms include state-chartered banks and trust companies that belong to the Federal Reserve System and are regulated by the Board of Governors for the Federal Reserve System, state-chartered banks that do not belong to the Federal Reserve System and are regulated by the Federal Deposit Insurance Corporation, national banks that are regulated by the Controller of the Currency, federally-chartered credit unions that are regulated by the National Credit Union Administration, federal savings and loans and federal savings banks that are regulated by the Office of Thrift Supervision, and firms in the securities industry that are regulated by the Securities and Exchange Commission.

4 The revised ASPIRE Act was introduced in the House in 2007 (H.R. 3740) and the Senate in 2008 (S.3557). No action was taken on the measure.


11 The Community Reinvestment Act is a federal law that encourages depository institutions to help meet the credit needs of their communities, including low- and moderate-income neighborhoods.

found in *Savings for Life*, available at www.aspenifs.org.


14 This paper uses a conversion rate of £1 = US$1.6, the rate in effect on May 27, 2009.


17 Internal Revenue Code §408(n).

18 U. S. Department of Labor Regulations §2550.404c-5.

19 In an institutional model, the account holder would have a direct relationship with the government for account services and functions. The financial services industry would merely provide back-office investment and perhaps other administrative functions to the government. In a retail model, the account holder would have a direct relationship with the financial company providing the account. For example, a 529 plan uses an institutional model with the government playing a central administrative role while an IRA is based on a retail model of a direct connection between account holder and account provider.


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