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THE ASSETS AGENDA 2006: Policy Options to Broaden Savings and Asset Ownership by Low- and Moderate-Income Americans

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The purpose of this issue brief is to summarize a federal public policy agenda to broaden savings and asset ownership opportunities for low- and moderate-income Americans.[2] It reflects our latest and best thinking, and draws heavily on the work of many experts focusing on various facets of savings and asset-building policy.[3] The menu includes calls for new structures and policies, as well as changes to existing tax systems, government programs and financial products.

We continue to share President Bush's vision for an "ownership society," although public policies to achieve that must be directed at the bottom half of the population, most of whom save and own little. The current state of ownership in America, based on recently released data from the Federal Reserve, is presented and discussed below.

SUMMARY

Policy Area	Proposals
Establish Children's Savings Accounts	*Enact the America Savings for Personal Investment, Retirement, and Education (ASPIRE) Act *Enact "Young Saver's Accounts" *Consider 529 college savings plans as a platform for universal children's savings accounts
Encourage and Match the Savings of the Working Poor	*Enact an "EITC Savers Bonus" *Offer tax credits to financial institutions and employers that match savings of low-income customers and employees *Improve the Savers Credit *Add 529s, Coverdells, IDAs, and other savings products to the list that eligible for the Savers Credit *Encourage firms to adopt inclusive policies for defined contribution plans *Enact, and possibly match, "Automatic IRAs" *Improve the Administration's Retirement Savings Account (RSA) and Lifetime Savings Account (LSA) proposals *Expand Individual Development Accounts (IDAs) *Enact Universal 401(k)s *Enact a "Retirement Investment Account (RIA) Plan"

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[2] This piece serves as a compliment to the Asset Building program's State Policy Options issue brief, forthcoming.

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Connect Tax Refunds to Savings Products	*Encourage the IRS to allow tax refunds to be split among multiple accounts *Set goals and performance measures for the IRS to promote savings *Expand the Earned Income Tax Credit (EITC) *Allow tax filers to purchase savings bonds with part of their refunds *Increase funds to low-income tax preparation sties to support financial education and counseling
Make Section 529 College Savings Plans More Attractive to Low-Income Families	*Require a low-cost investment option *Facilitate better disclosure and comparison of 529 plans *Collect better data on who saves and benefits from 529 plans *Provide more flexibility for plan owners who need to change a beneficiary *Create a state innovation fund *Add 529s to the list of products eligible for the Savers Credit *Support matching grants to low-income savers
Foster Access to Mainstream Financial Services ("Bank the Unbanked")	*Fix the Electronic Transfer Account (ETA) and expand its availability *Allow tax filers to open accounts directly from their tax forms *Strengthen the CRA and expand the service test *Capitalize an Innovation Fund for financial institutions to facilitate R&D focused on under-banked consumers
Improve on and Encourage the Use of Savings Bonds	*Put Savings Bonds back on tax returns *Offer Savings Bonds with preferred terms for lower-income persons *Offer tax credits to employers and financial institutions that offer Savings Bonds to lower-income employees and customers *Encourage low-income persons to redeem their Savings Bonds at providers of homes, higher education, and retirement products *Improve marketing of and access to Savings Bonds *Consider reducing the minimum holding period back to six months *Investigate the creation of Savings Bonds with prize-linked savings
Improve the Financial Literacy of Children and Adults	*Mandate the completion of a personal finance course for high school graduation *Create opportunities for adults to receive financial education in conjunction with opening a bank account or saving for retirement *Support legislation requiring state to provide financial education to TANF recipients *Support public awareness campaigns that create demand for financial education *Create incentives for employers to provide financial education in the workplace *Ensure access to financial planning services
Revise Asset Limits in Public Assistance Programs	*Eliminate asset limits from eligibility considerations *Raise asset limits *Exclude certain asset holdings, such as savings for education and retirement; a car; and EITC refunds
Expand Access to College and Post-Secondary Education	*Expand need-based grant aid *Increase funding for college readiness programs *Ensure student aid can be adapted to nontraditional students' needs
Expand Homeownership Opportunities for Lower-Income Families	*Make the homeowner's mortgage interest deduction refundable *Enact a refundable First-Time Homebuyers' Tax Credit *Increase use of the Family Self-Sufficiency program *Preserve rental housing subsidies that support affordable housing
Support Microenterprise Development	*Provide new and informal businesses with better information about self-employed tax options *Create an alternative source of funding for small business and incentives for saving *Remove the obstacles preventing low-income people from pursuing self-employment *Help the SBA better serve very small businesses *Maintain programs that currently assist microentrepreneurs
Enable Recent Hurricane Victims to Build or Rebuild Assets	*Designate Series I Savings Bonds as "Katrina Bonds" *Provide homeownership tax credits for evacuees who lost or never owned their own homes *Provide a $5,000 "Katrina Tax Credit" to jumpstart savings and asset building *Encourage financial institutions to offer simple, low-cost bank accounts

Improve Asset Accumulation Opportunities for TANF Recipients	*Enhance and improve the flexibility of Individual Development Accounts *Establish a Savings and Ownership Fund
Strengthen Laws to Protect Assets	*Increase the oversight of the homebuying and refinancing processes, especially in the sub-prime market *Provide federal oversight and coordination of now state-regulated alternative financial services providers *Reduce the cost of tax preparation and restrict the marketing of Refund Anticipation Loans *Protect consumers from abusive credit card practices

BACKGROUND

To understand the inherent challenge in creating an inclusive ownership society, it is useful to consider what ownership in America looks like today. Recent data from the Federal Reserve's Survey of Consumer Finances estimates that the median family net worth in 2004 was $93,100, and the mean value was $448,200.[5] Over the last three years, the median rose 1.5 percent, while the mean rose 6.3 percent, indicating larger increases in net worth for high income households.[6]

Family Net Worth[4] (in thousands of 2004 $)		
	Mean	Median
1998	83.1	327.5
2001	91.7	421.5
2004	93.1	448.2

Aided by policy incentives, Americans build wealth in both financial and non-financial assets. Between 2001 and 2004, financial assets as a share of total assets fell 6.3 percentage points, to 35.7 percent. This is the lowest share recorded by the survey since 1995. Of the non-financial assets, the primary residence accounts for the largest share, representing roughly half of the value of non-financial assets of all families in 2004.[7]

This past year the homeownership rate remained near its historic high of 69 percent. The minority homeownership rate, which historically has lagged the overall population, remains just under 50 percent, although the Hispanic homeownership has increased 2.8 percent over the last two years, an impressive rise.[8] The median value of the home was estimated to be $160,000 in 2004 for all families, and $246,800 for those families that were homeowners; these figures increased from 2001 by well over 20 percent[9] This demonstrates that home equity continues to play a central role in asset holdings, and is particularly important for many low-income and minority families. While their homeownership rates are lower, home equity makes up 77 percent of total assets for lower-income families and 55 percent of total assets for minority families.[10]

While home equity represents the single largest component of household wealth, families store resources in a variety of other assets, such as bank accounts, stock investments, and retirement accounts. The percentage of families holding assets varies considerably. It is estimated that in 2004 over 91 percent of families had money stored in checking or savings accounts, while only 20.7 percent owned stock directly in a company. Furthermore, 15 percent owned shares of a mutual fund, 17.6 percent owned savings bonds, and 24.2 percent had assets held in a life insurance policy. Meanwhile, over half of all families (49.7 percent) had a personal retirement account, such

[4] Bucks, Kennickell, and Moore (2006)
[5] ibid (2006).
[6] ibid (2006).
[7] ibid (2006).
[8] U.S. Department of Housing and Urban Development (2006).
[9] Bucks, Kennickell, and Moore (2006).
[10] Di (2003).

as an IRA or a 401(k).[11] This figure represents a decline from three years earlier when the percentage of families owning a retirement account exceeded 52 percent.

Percentage of Families Holding Assets by Asset Type

	Stocks	Mutual Funds	Savings Bonds	Retirement Accounts	Bank Accounts	Life Insurance
Income Percentile						
Less than 20 percent	5.1%	3.6%	6.2%%	10.1%	75.5%	14.0%
20 percent-39.9 percent	8.2%	7.6%	8.8%	30.0%	87.3%	19.2%
40 percent-59.9 percent	16.3%	12.7%	15.4%	53.4	95.9%	24.2%
60 percent-79.9 percent	28.2%	18.6%	26.6%	69.7%	98.4%	29.8%
80 percent-89.9 percent	35.8%	26.2%	32.3%	81.9%	99.1%	29.5%
90 percent-100 percent	55.0%	39.1%	29.9%	88.5%	100.0%	38.1%
All Families	**20.7%**	**15.0%**	**17.6%**	**49.7%**	**91.3%**	**24.2%**

Source: Bucks, Kennickell, and Moore (2006)

The percentage of families holding assets is strongly correlated with their incomes. Compared to those households in the top 10 percent of income, households in the bottom forty percent of income were far less likely to own stock, retirement accounts, and transaction accounts. The differences in retirement asset holdings are especially revealing. The number of families owning a retirement plan drops to 10.1 percent for families making $18,900 or less, while well over 70 percent of those making more than $53,600 have a retirement savings account.

Beyond differences in what households own, there are also differences in how much they own. The mean net worth is over $448,000 but the top 20 percent of families by income own over 80 percent of the wealth. Families in the bottom 40 percent by income own approximately 5 percent of the nation's wealth. Another dimension with which to examine wealth holdings is race. In general, minority households own less than ten cents for every dollar of wealth owned by a typical non-Hispanic White family.[12] Even though their income is roughly two-thirds of that of White families, their wealth is only 10 percent as much.

Distribution of Net Worth

Percentile of Net Worth	1995	1998	2001	2004
25	12,300	11,500	13,500	13,300
50	70,900	83,100	91,700	93,100
75	197,800	242,100	301,100	328,500
90	469,000	572,100	780,900	831,600

Source: Bucks, Kennickell, and Moore (2006)

The promise of an ownership society will dissipate if it is used only to further concentrate the wealth of those already financially secure. In order to promote a true ownership society, we must first significantly broaden access to asset ownership by those who own little or nothing. The current proposals in the Administration's 2007 Budget

[11] Bucks, Kennickell, and Moore (2006). Includes only all employment-based defined contribution plans plus IRAs and Keogh plans, but not defined benefit plans.
[12] Wolff (2004); Kochar (2004).

that focus on Social Security, health savings, and retirement accounts fail to get us all the way there.[13] Following are a set of proposals that would.

POLICY OPTIONS

1. Create Universal Children's Savings Accounts

One of the most novel and promising ways to achieve a universal, progressive asset building system over time would be to provide each generation of children a restricted, start-in-life asset account at birth, an idea first proposed by Michael Sherraden and, separately, by former IRS Commissioner Fred Goldberg.[14] These accounts would establish a universal platform and infrastructure to facilitate future savings and lifelong asset accumulation. While every child would have an account, it would especially benefit the 26 percent of white children, 52 percent of black children, and 54 percent of Hispanic children who start life in households without any resources whatsoever for investment. Different versions of children's savings accounts have been proposed over the last several years by Members of Congress; most, however, are not progressive and are focused on building only retirement assets (most notably former Senator Bob Kerrey's "KidSave" proposal. However, in the last couple of years, proposals have emerged from both Democrats and Republicans for progressively funded children's savings accounts that could be used for buying a home and going to college, in addition to retirement. These include the ASPIRE Act and Young Saver's Accounts (described below), as well as a proposal under development in the House of Representatives for "401Kids." Outside the U.S. a couple of great models are the at-birth Child Trust Fund in the U.K, which has already established well over 2 million accounts, as well as Canada's new program for "Learning Bonds," which also can be established at birth. Finally, the privately-funded SEED Initiative[15] operating in 12 sites across the U.S., is providing highly valuable insights into policy design.

- **Enact the America Saving for Personal Investment, Retirement, and Education (ASPIRE) Act.** Sponsored by a strong bi-partisan coalition of legislators in both the House and the Senate, the ASPIRE Act was originally introduced in July 2004 and reintroduced in April 2005 by Senators Santorum, Corzine, Schumer and DeMint, and Representatives Ford, Kennedy, and English. The ASPIRE Act would provide every child with an account at birth—called a KIDS Account—that would be endowed with $500 and supported with progressive, targeted savings incentives until age 18, at which point it could be used for going to college, buying a home, or building up a nest-egg for retirement.[16] Specifically, children from households earning below the national median income receive a one-time, supplemental deposit up to $500 and would be eligible to receive an additional $500 match for voluntary savings deposited each year. Voluntary contributions to the account would be tax-free and could not exceed $1,000 per year. Access to account funds would be restricted until the accountholder reaches the age of 18, and parents or legal guardians would control investment decisions until that time. To ensure that families make good decisions regarding the account, financial education would be offered to kids and their parents.

- **Enact "Young Saver's Accounts."** If fiscal constraints do not permit something as ambitious as the ASPIRE Act to move forward, Congress can enact a "Roth IRA for kids" called Young Saver's Accounts, or YSAs. YSAs would allow parents, for the first time, to direct contributions to Roth IRA accounts for their children, not just for themselves. YSAs were introduced by Senator Max Baucus in March 2006 as part of the *Savings Competitiveness Act,* and a similar provision was introduced in July 2005 in the House by Rep. Connie Mack as part of the *Lifetime Prosperity Act.* Presently, there are no age restrictions on who can own a Roth, but children must have earned income in order to contribute. As a result, very few kids open Roths, leaving the overwhelming majority of kids with no tax-benefited, restricted way of saving for a first-home, college, or retirement (YSAs, like existing Roths, would permit penalty-free

[13] For an analysis of the President's 2007 budget proposals, see *The Assets Report: A Review, Assessment, and Forecast of Federal Assets Policy*, available at AssetBuilding.org.
[14] See Cramer (2004) for details.
[15] See http://seed.cfed.org.
[16] See http://www.AspireAct.org.

withdrawals for college and first-home purchase, in addition to retirement). YSAs, if enacted, would be Roth IRAs in every way, except that the parents' earned income would determine how much could be contributed. This would allow contributions from kids, parents, grandparents, and others. It would also be clarified that: (1) contributions to the child's YSA will apply toward the parent's annual limit (now 4,000 for those 49 and under, going up to $5,000 in 2008); (2) as a Roth, contributions to YSAs from low-income families would qualify for the Savers Credit, a federal matching program for low-income savers; and (3) savings in YSAs would be disregarded in determining eligibility for means-tested programs.

- **Consider 529 college savings plans as a platform for universal children's savings accounts**. As the Center for Social Development points out, since 529 accounts are already designed to help children and their families save for a significant asset, a post-secondary education, this account structure could form a basis for both a universal children's savings account program, as well as be revised to allow for other asset building purposes. 529 plan features such as the ability to subsidize the cost of small accounts with larger ones, centralized accounting, a menu of investment options, and the state's role in providing outreach and incentives for participation, could serve as the "plumbing" behind a system which provides an account a birth for every child. The state of Kentucky is exploring just such a possibility. State Treasurer Jonathan Miller and Secretary of State Trey Greyson have proposed a Cradle to College initiative which would provide a college savings account for every child born in Kentucky; currently, a Commission is refining this idea and identifying long-term financing options. Also, beginning this year, the state of Oklahoma—as part of the SEED Initiative—will deposit $1,000 into the 529 accounts of 1,000 newborns and compare the outcomes to 1,000 newborns who did not receive any deposits.

2. Encourage and Match Savings for the Working Poor

Experiments with IDAs, H&R Block's "Express IRAs," and other matched savings experiments for the working poor throughout the world over the last decade have yielded some very useful insights for constructing a set of policies going forward. Four key lessons are worth highlighting. First, we have learned that the poor can save—but *how* they save is interesting. The key insight is that people save in response to structures or institutions—savings is not just a function of income or preferences, as neoclassic economists have argued. Second, the poor have multiple savings needs, not just one, and not just long-term asset accumulation. At a minimum, policy should support savings for short-term, emergency needs; savings for durable goods, like automobiles and washing machines; and savings for long-term asset accumulation. Third, small changes to existing systems and products can produce larger results. That is, new financial products, new tax credits, and new delivery systems do not need to be, and generally should not be, created to achieve our goals. Small changes, for example, to Roth IRAs or the EITC can leverage billions of dollars of new savings. And fourth, while it is critical to develop the right financial *products*, Michael Sherraden and others have recognized that most savings in this country occurs through savings *plans* (such as 401(k) plans, the Thrift Savings Plan, and 529 College Savings Plans), many of which embody the key "institutional determinants" of saving that Michael Sherraden and others have articulated.

- **Enact an "EITC Savers Bonus."** Anyone eligible for the EITC who receives a refund would be offered the option to save a portion of their refund (automatically on their tax return, assuming "split refunds" moves forward as planned) in any existing savings product—IRAs, Roths, 529s, 401(k)s, ESAs, HSAs—and if they do so their savings would be matched on a 1-1 basis, up to $500. The match would be delivered as a higher EITC refund—an "EITC Savers Bonus"—and would be deposited directly into the savings product. This may be more politically acceptable than creating a new refundable tax credit, and would ensure that the government match is saved directly into the account.

- **Offer tax credits to financial institutions and employers that match savings of low-income customers and employees.** Rather than expanding the EITC, which could meet some resistance, build on the IDA tax credit model but extend the credit to savings by low-income persons who save in IRAs, Roths, 529s, 401(k)s, or any financial product offered by employers or financial institutions. A provision should be included, also modeled on the IDA tax credit, which enables the credit to be transferred to non-taxpaying entities such as credit unions, tribal governments, and CDFIs. This also has the political advantage of being scored as a "tax expenditure," which are easier for Congress to pass, instead of as a "direct outlay," which an expanded refundable tax credit would be.

- **Improve the "Savers Credit."** The 2001 tax bill created a new voluntary individual tax credit—the Savers Credit—to encourage low-income workers to contribute to existing retirement products (IRAs, 401(k)s, etc). However, the credit is flawed in several important ways. It is not refundable, and it offers only a modest matching contribution. Consequently, it benefits only a small proportion of those technically eligible. For example, only about 20 percent of filers get any benefit, while only one in one-thousand persons gets the full benefit. Mark Iwry of the Brookings Institution, who helped design the Savers Credit, suggests four ways to improve the credit: (1) make it refundable; (2) expand eligibility—instead of a 50 percent credit that phases down to 20 percent for joint filers with AGI over $30,000, the 50 percent savers credit should be expanded to cover joint filers with significantly higher incomes within the middle-income range, for example, up to $60,000, phasing out at about $70,000 to $75,000; (3) smooth the phase-down of the credit to resemble IRA income eligibility, instead of the "cliffs" now in effect; and (4) make it a permanent feature of the tax code, rather than letting it expire, as the Administration proposes to do. These fixes will increase its price tag by about $5 billion a year, but would offer a meaningful retirement incentive for families currently left out.[17] The pension bill currently under consideration in Congress will address the Savers Credit; while refundability is not likely to be achieved at this time, the credit could be made permanent, extended for two years, or indexed for inflation.

- **Add 529s, Coverdells, IDAs and other savings products to the list of products eligible for the Savers Credit.** If the goal is to promote savings for low-income workers in general, and not just retirement savings, a range of existing savings products—529s, Coverdells, Health Savings Accounts, and IDAs, for example—could be added to the list of products that would trigger the Savers Credit. Certainly one could argue that one's health, and pre-retirement assets—especially a first home and post-secondary education—are critical elements of retirement security. It also should be noted that IRAs already permit penalty-free withdrawals for buying a first home and post-secondary education. This change, however, would represent a significant philosophical shift in the purpose of the credit.

- **Encourage firms to adopt inclusive policies for defined contribution plans, such as "opt-out" instead of "opt-in" enrollment, automatic allocation, and automatic escalation.** According to the Brookings Institution, only about one-half of employers offer their employees 401(k) retirement plans. Roughly three-quarters of employees choose to participate, but participation tends to be linked with income. The problem is that currently workers are required to actively choose to participate in a company 401(k), or "opt-in." Many workers, especially low-income workers, choose not to do so. However, compelling research data has shown that participation in retirement savings plans increases if workers are automatically enrolled rather than compelled to sign up. In one study by Madrian and Shea, this "opt-out" approach was found to increase participation from 36 percent to 86 percent when employed at a Fortune 500 company, and the increase was higher for lower-income workers. Auto-enrollment provisions are likely to become law this year as part of the large pension reform package now under consideration in Congress.

- **Enact and possibly match "Automatic IRAs."** This proposal, developed by the Brookings Institution and Heritage Foundation and supported by AARP, is aimed at the 71 million workers employed by small businesses that do not offer a pension plan to their workers. Firms not offering 401(k)s, 403(b)s and the like could instead offer automatic payroll deductions into IRAs. Employers would inform employees of this savings option and would have the choice to either obtain from each employee a decision to participate or not, or automatically enroll employees (and then allow the employee to opt-out). While low-income workers would likely be reached through this proposal, there are no matching funds involved.

[17] For more information, see *The Saver's Credit: Expanding Retirement Savings for Middle- and Lower-Income Americans*, by William Gale, J. Mark Iwry, and Peter Orzsag.

Under the Auto IRA proposal, firms that do set-up Auto-IRAs would qualify for a one-time, small tax credit to offset their administrative costs; one could propose that this tax credit could be expanded to cover matching funds provided to lower-income employees.[18]

- **Improve the Administration's Retirement Savings Account (RSA) and Lifetime Savings Account (LSA) proposals.** The Administration's 2007 Budget proposes creating a new set of tax-preferred retirement savings accounts, including Retirement Savings Accounts (RSAs) and Lifetime Savings Accounts (LSAs). While RSAs are, of course, restricted to retirement savings, LSAs are designed to encourage savings for any purpose, and thus deserve some support. Contributions to LSAs and RSAs, which would be after-tax, would be capped at $5,000 per year but earnings and withdrawals would be tax free. LSAs and RSAs would be open to everyone regardless of income or age. In their current form, they would offer higher-income households tax sheltering opportunities, while offering no savings incentives to lower-income households. These proposals could be improved by placing an income limit on eligibility and providing matching deposits for lower-income families, delivered through existing refundable tax credits or tax credits to financial institutions that offer LSAs and RSAs.

- **Expand Individual Development Accounts (IDAs)** Individual Development Accounts are matched savings accounts typically restricted to buying a first home, pursuing post-secondary education and training, and starting a small business. IDAs can be expanded in two ways. First is by passing the *Savings for Working Families Act* (S. 922 in the Senate and H.R. 4751 in the House). SWFA would authorize tax credits to financial institutions that set-up and match (up to $500 per person per year) the IDAs of 900,000 persons over a seven-year period, a proposal supported by the Bush Administration. However, in order for the IDA tax credit to work effectively, Congress should strongly consider three changes to this legislation: (1) the cap on the number of accounts eligible for the tax credit should be removed; (2) the reporting and performance requirements should be eased and simplified; and (3) the prohibition on financial institutions against charging accountholders fees on IDAs should be removed. The second way to expand IDAs is to support the reauthorization of the federal Assets for Independence Demonstration Program. In 1998 Congress authorized this 5-year, $125 million IDA demonstration program, which awards grants on a competitive basis to community-based organization to run IDA programs. The program, which now provides the vast majority of funding for IDAs throughout the U.S., should be reauthorized by Congress. Reauthorization has been delayed for two years now, but full funding for the program has continued without interruption. In the reauthorization process, Congress should relax the requirement that the federal funds must be spent in exactly the same ways as the non-federal funds required that must be raised in order to secure the federal AFIA grant.[19]

- **Enact "Universal 401(k)s."** Universal 401(k)s, proposed separately by Michael Calabrese of the New America Foundation and Gene Sperling of the Center for American Progress, would offer all Americans, regardless of their employment status, generous savings incentives and automatic savings opportunities that generous employer-provided 401(k)'s now offer their employees. The components of a citizen-based, Universal 401(k) include: (1) $2-to-$1 government matching contributions for initial savings of low-income families and $1-to-$1 matches for middle-income families; (2) a new flat refundable tax credit of 30 percent for savings done by all workers; and (3) a single, portable account that benefits families by continuing to provide strong savings incentives for parents who take time off to raise children or who are between jobs. To facilitate deposits into Universal 401(k)s, automatic payroll deductions would be offered by employers. For very low-income workers who might initially have very small account balances, or who are otherwise unable to navigate the process of setting up and managing a private account, a "clearinghouse" (modeled after the federal TSP) could be set up and empowered to create "default" accounts for such workers.

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[18] For more information, see *Pursuing Universal Retirement Security through Automatic IRAs*, by J. Mark Iwry and David C. John.

[19] See www.cfed.org for more details on IDA policies.

- **Enact a "Retirement Investment Account (RIA) Plan."** The similar RIA Plan, developed by the Conversation on Coverage, would create a government-authorized, privately-run central clearinghouse to accept worker contributions to retirement savings accounts. The plan is aimed at providing more individual workers who do not now have a plan with access to an automatic payroll-deduction retirement savings plan through their workplace; additional contributions could also be made, possibly directly through a tax return. Employers who do not now offer plans can provide access to their workers for this plan without significant new burdens, since they will not have to administer the plan or take fiduciary responsibility for the investment choices of their employees. Employers could make contributions and matches of employee contributions to the RIA. This plan could also be designed in ways that progressive government contributions and matches of employee contributions could be made.

- **Improve 529s, and reward or encourage the matching of 529 plans.** Bi-partisan bills have been introduced in the House and Senate making the 529 tax benefits, which expire in 2010, permanent. No one doubts these will pass. As the Center for Social Development and New America Foundation have argued, 529s are very regressive, doing little for low-income savers who have the greatest need to save for and attend college. Presently, seven states—Louisiana, Utah, Colorado, Maine, Michigan, Minnesota, and Rhode Island—match the savings of their low-income residents who save in their 529 plans. The federal government could support states that choose to offer matching grants targeted to low-income families saving in 529 plans by reimbursing those states through direct grants. More ambitiously, the federal government could set up a formula so that states with the lowest rates of college attendance would receive more federal matching funds for contributions to 529s. Alternatively or in addition to providing funding to states offering matching funds, the federal government could encourage private companies to offer incentives to their employees to save in 529s. The Education Savings Act of 2005 (HR 3585) would allow employers to provide matches directly to their employee's 529 plans without the employee having to pay income tax on their employer's contribution. The Oklahoma legislature considered a proposal (OK Senate Bill 927) to give tax credits to employers who provide matches or other donations directly to their employees' 529 plan accounts. These proposals represent two viable strategies to encourage employers to support the 529 savings of their employees.

3. Connect Tax Refunds to Savings Products

Families will save more if the process of savings is made easy and accessible. One way to do this is to offer a mechanism that supports savings in a near universal activity – the process of filing taxes. This tax season the IRS will send out tax refunds totaling over $230 billion, with an average amount of well over $2,000 for those families that receive one. These cash infusions are often the best chance people have to save in any given year. This is particularly true for lower-income families. Over 20 million lower-income families—one in six taxpayers—received an average $1,700 boost to their refund from the Earned Income Tax Credit (EITC), a refundable tax credit designed to reward work. The Child Credit is another vital source of tax refunds. Recent research finds that many Americans—including lower income ones—can and will save their refunds if offered appropriate incentives and a clear way to do so. The challenge for policymakers is to facilitate and incentivize the savings of tax refunds into existing—and possibly new—savings products.

- **Encourage the IRS to allow tax refunds to be split among multiple accounts.** Under this proposal, people could deposit their refund into any account of their choosing, including IRAs, 529 college savings plans or a variety of other products. Right now, taxpayers have only one choice; refunds are issued in a lump sum. It would be easier for people to save if they could split their refunds between "money to save" and "money to spend." The Administration has signaled their intention to implement this change to the tax filing process by the 2007 tax year; it should be encouraged to keep to this implementation schedule, and then actively publicize this change as part of a national savings campaign.

- **Set goals and performance measures for the IRS to promote savings by tax filers.** The Treasury and IRS should develop performance measures and track progress toward goals to: (a) increase tax returns that are sent by direct deposit to tax filers' bank accounts; and (b) increase the percentage of tax filers that deposit into IRAs as part of the tax filing process. While the IRS has a set of performance goals to help gauge their success in providing taxpayers' assistance and education, they do not have one regarding electronic payments. Therefore, an electronic payments performance target should be adopted.

The first performance measure would be driven by a goal that a certain percentage, for example, 80 percent, of all filers will receive their refunds by direct deposit. Sending refunds electronically would not only decrease costs for the IRS but would spur more filers to open bank accounts, a prerequisite for the direct deposit of refunds. Refunds sent to the temporary accounts set up for Refund Anticipation Loans would not count towards this goal. The second performance measure would be driven by a goal that a certain percentage, for example 30 percent, of tax filers open or deposit a portion of their refunds into IRAs in connection with the tax filing process. Finally, the IRS should also set a deadline that it will achieve these goals by some future date, for example, by 2009, to enable the agency to work with financial institutions.

- **Expand the Earned Income Tax Credit (EITC).** An expansion of the EITC, in addition to enabling more low-income Americans to save, would provide tax relief to lower-income working families. Previous expansions of the EITC have proven to be effective at providing work incentives and lifting families out of poverty. A well-crafted expansion would increase the maximum credit for working families with three or more children, expand the credit for married, two-earner couples, and expand the credit for families with two or more children. An expanded EITC program will create larger tax refunds, which in turn can be linked to savings products.

- **Increase funds for low-income tax preparation sites to support financial education and counseling.** Congress should increase federal funding by $50 million to support the expansion of important IRS initiatives aimed at low-income families, such as outreach regarding the EITC and the Child Credit. The receipt of tax returns presents an opportunity for low-income families to connect to financial services and products and learn about investments and savings. Linking tax preparation with savings and/or investment tools, such as Individual Development Accounts (IDAs), would increase asset-building knowledge. To meet these goals, tax preparers need resources to (1) hire and train counselors and (2) develop software to maintain client information. Policy-makers must more adequately fund and support the development of tax preparation sites and education efforts to identify families who qualify for such assistance and maximize potential income tax return benefits

In addition, as mentioned in the following sections, other related tax time proposals include an EITC bonus for recipients who save at least a portion of their refund into a restricted savings account, and allowing tax filers to purchase a Savings Bond with at least a portion of their refund on their tax return.

4. Make 529 College Savings Plans More Attractive to Low-Income Families

Qualified Tuition Plans, commonly called 529 college savings plans, after the applicable section of the federal tax code, were implemented in their present form in 2001. These state-sponsored plans help families save for their children's college education, or an adult may open an account to use for their own post-secondary expenses. While the structure of most state-run 529 plans offers a useful savings platform, the federal tax incentives associated with these accounts primarily restrict benefits to middle- and upper-income families. The 529 platform needs reform in order to entice more people to plan for their future and ensure that their children are able to get on the path of wealth building, a path that often begins with education.

- **Require a low-cost investment option.** States generally offer two types of 529 college savings plans to choose from: a direct sold plan and a broker sold plan. The direct sold plan generally has more inclusive features, such as lower fees, lower contribution requirements, and relatively conservative investment options such as age-adjusted and guaranteed return portfolios, which could be attractive to lower-income families. States should be required to offer at least one direct sold plan with these and other inclusive features. Direct sold plans offered by Alaska, Michigan, and Utah—which have consistently been among the best direct sold plans according to Morningstar—could serve as models.

- **Facilitate better disclosure and comparison of 529 plans.** Because they are created by state governments, 529 plan investments are not subject to federal security laws such as those covering most mutual funds. In addition, research shows that individuals saving in broker-sold plans were frequently doing so in out-of-state plans, even if they would potentially benefit more from saving in their in-state plans because of state tax incentives. This raises the question of whether brokers recommend plans that benefit themselves rather than seeking the best plan for their client. At a minimum, brokers should be required to inform clients about any benefits that exist from utilizing their own state's 529 plan. In addition, the federal government should support efforts to allow the easy comparison of all plans in a particular state and among states. Websites, such as savingforcollege.com, provide a simple comparison of 529 plans which could be promoted or serve as a model. Finally, states should be encouraged to market their direct-sold plans to their residents, which are usually a less expensive alternative to the broker-sold options.

- **Collect better data on who saves and benefits from 529 plans.** Because data is generally not collected about 529 plan accountholders' socioeconomic details, we do not know how plan ownership varies by income and which segments of the population benefit from these tax incentive the most. If this data were collected, it could help shape improvements to 529 plan policies in the future, helping to ensure that tax breaks and other incentives are serving their intended purpose. Useful data about the saving habits of low-income families in 529 plans could be gained from those states offering matching grants, since an application disclosing income must be provided.

- **Provide more flexibility for plan owners who need to change a beneficiary.** Currently, if a person named as a beneficiary does not use any or all of the funds designated for them in a 529 plan, that plan can only be transferred to a member of that beneficiary's family, such as a sibling, parent, or cousin. While this can work well for parents saving for a child, it may be unnecessarily inflexible for a charitable organization, such as a 501(c)3 nonprofit organization, which wishes to save for a particular beneficiary. For example, if a charity wanted to open up 529 plans for kids and then one of the beneficiaries did not use their account, it would have to be transferred to one of his family members, rather than another child the charity wanted to help. This provision should be expanded so that a non-profit organization can name any other person as a beneficiary instead of having to keep the 529 plan within just one family.

- **Create a state innovation fund.** A variety of state and private sector actors have enacted innovative programs within their 529 plans to primarily help low-income kids access college. For example, a few non-profit organizations have offered matches to families saving for college through parallel 529 scholarship accounts. In Oklahoma, 1,000 kids will receive a 529 plan with a starter deposit of $1,000 and financial education will be provided in hopes that they will continue to save for a post-secondary education. Coalitions are being formed in states such as Kentucky and Michigan to look into the possibilities of universal 529s for every child in the state with progressive savings incentives incorporated to help low-income families. The federal government could encourage these types of innovative activities by sponsoring a competitive grant process where states could receive awards to help seed these initiatives.

- **Add 529s to the list of products eligible for the Savers Credit.** The Saver's Credit currently provides a 50 percent match—in the form of a non-refundable tax credit—to low- and moderate-income people who contribute to a retirement account such as a 401(k) or IRA. To further promote savings in general, a range of savings products, including 529s, could be added to the list of products that trigger this credit. Certainly one could argue that pre-retirement assets – especially a post-secondary education – are critical elements of retirement security, and it should be noted that all IRAs already permit tax- and penalty-free withdrawals for post-secondary education.

In addition to these proposals, recommendations to exclude these accounts from public benefit eligibility considerations and to offer matches to low-income 529 plan savers are discussed in other sections of this brief.

5. Foster Access to Mainstream Financial Services ("Bank the Unbanked")

Somewhere between 10 and 20 million American families are "unbanked," meaning they don't own a basic checking or savings account. Many others are "under-banked;" they have a bank account but are not fully integrated into the financial mainstream. These families pay more for basic financial services, and the higher fees can trap users into an ever-increasing cycle of debt. The following recommendations aim to increase access by lower-income families to the provision of financial services.[20]

- **Fix the Electronic Transfer Account (ETA) and expand its availability.**
  Currently, the ETA is available only to those Americans who receive a recurring federal payment, like Social Security. Approximately 2 percent of federal benefits recipients have opened an ETA. Yet it is estimated that at least 4.5 million federal benefit recipients still do not have bank accounts.[21] The take-up rate is low because the ETA is not attractive to either consumers or banks. For consumers, the account lacks functionality. For banks, there is an insufficient volume of small accounts. The Treasury Department should give banks greater flexibility to offer customers a range of options with different fee structures, as long as the bank continues to offer at least one low-cost option that is available to any federal benefit recipient regardless of past banking history. The need for a basic bank account is high and the ETA continues to represent a potentially useful infrastructure for providing access to financial services – particularly if account eligibility guidelines are expanded and banks are given greater flexibility to better tailor the product to meet consumers' needs. Further, the ETA should be made available to a broader segment of unbanked consumers, especially those who receive tax refunds.

- **Allow tax filers to open accounts directly from their tax forms**. With a check of a box, tax filers should be able to open a checking, savings, or IRA account directly on their tax forms. The IRS could achieve this goal in several ways. For instance, the IRS could solicit proposals for private financial institutions to provide low-cost quality accounts nationwide. Or, the IRS could create and maintain a web-based directory of financial institutions that open low- or no-cost accounts online for tax filers. The directory's URL address would be printed on all tax forms and it would be searchable by zip code.

- **Strengthen the Community Reinvestment Act (CRA), and expand the service test to encourage more retail banking activities aimed at lower-income, under-banked consumers.** The CRA is intended to encourage depository institutions to help meet the credit needs of the communities in which it operates, including low- and moderate-income neighborhoods. In recent years, some of the bank regulatory agencies have proposed reducing the number of banks subject to a full CRA exam. A limited exam would allow banks to choose among community development lending, services, and investments to apply to their CRA exam. This means that banks could play to their current strengths, ignoring opportunities to provide basic financial services or build bank branches in lower-income areas. The CRA has had an enormous impact in broadening access to credit for low- and moderate-income consumers. The exam and the service test need to be expanded, not curtailed.

- **Encourage state governments to link benefit cards to bank services.** All fifty states now administer food stamp benefits through Electronic Benefits Transfer (EBT) instead of the traditional paper coupons. Benefit recipients use plastic cards with personal identification numbers (PINs) to purchase eligible foods at authorized stores. States are also delivering other benefits—such as TANF—via EBT. The conversion

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[20] For more information, see *Breaking the Savings Barrier: How the Federal Government Can Build an Inclusive Financial System*, by Anne Stuhldreher of the New America Foundation and Jennifer Tescher of the Center for Financial Services Innovation.

[21] "Understanding the Dependence on Paper Checks: A Study of Federal Benefit Check Recipients and the Barriers to Boosting Direct Deposit," sponsored by the U.S. Treasury's Financial Management Service and conducted by the Federal Reserve Bank of St. Louis, 2004.

to EBT has largely been deemed successful. It has saved the federal government money, reduced fraud, and decreased the program's error rate. This success should be built upon by linking these cards to individually-owned bank accounts.

The federal government should set a performance measure that a certain percentage of each state's benefit recipients receive their benefits by direct deposit into individually owned bank accounts by a certain date. States that meet certain benchmarks on accounts opened could receive "TANF bonus awards," which currently reward states for various successes in their TANF programs.

- **Capitalize an Innovation Fund for financial institutions to facilitate R&D focused on under-banked consumers.** The Treasury Department should create an Innovation Fund to spur systemic change throughout the financial services industry by providing seed funding for financial services companies to develop products and services for un- and under-banked consumers. These R&D funds would encourage banks—and other financial services firms—to engage in the kind of intensive research and planning that they perform to develop products and services for higher income consumers. The Fund would seek to increase the reach of mainstream financial institutions into the under-banked market by encouraging innovation both in how products are structured and in how they are marketed and delivered. Ideally, products would bundle multiple functions, include a savings feature where feasible, use incentives creatively and be competitively and responsibly priced.

6. Improve on and Encourage the Use of Savings Bonds

Savings Bonds have a long history of financing wars (beginning in 1776 and continuing today through the designation of Series EE bonds as "Patriot Bonds") while, historically, meeting the savings needs of "small investors." Today, Savings Bonds are viewed by Treasury and many policymakers as, primarily, ways to finance government, and *not* primarily as a way to help more Americans save. However, because savings bonds are safe, low-cost, provide market-rate returns, are flexible, and do not require clearance through the "ChexSystem" or a bank account, they could be appealing to a broad range of Americans, and lower-income Americans in particular.[22]

- **Put Savings Bonds back on tax returns.** When Savings Bonds could be purchased directly on a tax return in the early 1960s, one's entire refund had to be used to do so. Assuming Treasury's "split refunds" efforts proceed as planned—meaning that this option would be available in 2007 for the 2006 tax filing season—one would have to use only a portion of one's refund to purchase a Series I or EE Savings Bond in one of the pre-determined denominations. Bonds could be issued in the primary filer's name or, possibly, they could be bought by the taxpayer for others, such as children and grandchildren. Apart from the internal administrative costs to develop the forms and systems, this proposal would cost the federal government nothing. This promising idea of putting Savings Bonds back on tax returns is slated to be piloted next tax season by H&R Block, in partnership with the Harvard Business School.

- **Offer Savings Bonds with preferred terms for lower-income persons.** To explicitly encourage lower-income Americans to purchase Savings Bonds, a new Series "O" (for "Opportunity Bonds") could be offered to persons in households below national or regional median income. Returns could be a half-percentage point higher than existing bonds, or bonds could be purchased at one-third of face value instead of one-half (as is currently the case for Series EE bonds). Savings Bonds purchased for lower-income kids could also have better rates, provided the bonds are redeemed after age 18 for higher education, a first home, or held until retirement. If the purchase of these bonds were linked with EITC refunds, EITC recipients could easily purchase a discounted Savings Bond and their eligibility could be assessed using IRS tax data. The downside of this approach, however, is that it is usually better to have

[22] For more information on Savings Bonds and their potential to help low-income Americans to save, see *Reinventing Savings Bonds: Policy Changes to Increase Private Savings*, by Peter Tufano and Daniel Schneider.

the same products available for all Americans regardless of income (to reduce stigma and resentment), and it requires the development of a new series of bonds, which could take years.[23]

- **Offer tax credits to employers and financial institutions that offer Savings Bonds to lower-income employees and customers.** Expansions of refundable tax credits are, of course, politically difficult to achieve, although there may be less resistance to expanded credits that must be saved. A potentially more appealing route, at least politically, would be to deliver the savings subsidy through employers and/or financial institutions that offer Savings Bonds to lower-income persons. Presently, through the Payroll Savings Plan, Savings Bonds can be purchased through some 40,000 employers (although, in practice, it may be substantially fewer than that). Under this proposal, tax credits could be offered to employers that enroll their lower-income employees in the Payroll Savings Plan. A modest tax credit could be offered to offset the costs of reaching out to lower-income employees, or a more ambitious credit could be offered if the employer covers some of the cost of purchasing the bond. Similar tax incentives could be offered to financial institutions which, of course, already offer and redeem Savings Bonds for the general population.

- **Encourage low-income persons to redeem their Savings Bonds at providers of homes, higher education, and retirement products.** Presently, Series I and EE Savings Bond issued after 1990 may be redeemed tax-free if used for post-secondary education (hence the designation of these bonds as "Education Bonds"). This provision, however, is of limited value to lower-income Americans who generally pay little or no income tax. If longer-term asset accumulation by lower-income Americans is a goal, the federal government could offer incentives for redemption for certain purposes, instead of incentives for purchasing them. Rather than redeem a Savings Bond at a bank, for example, a low-income bondholder would receive a $1,000-$5,000 bonus if redeemed at a participating asset provider (post-secondary institutions, mortgage providers, or financial institutions that offer IRAs), and this bonus would be offset fully or partially by the federal government through a tax credit or direct reimbursement. A change of law would be required to allow Savings Bonds to be assigned to or redeemed by third parties; presently, Savings Bonds are not legally transferable or assignable. Another option is to designate a new class of redemption agents that would include non-profit housing, community development, education, and asset-building organizations. Finally, if Savings Bonds were rolled into or converted to an IRA or other retirement products, complications would arise from the different tax treatment of the different products, although this could be minimized by restricting roll-overs to products that have tax treatment similar to Savings Bonds.

- **Improve marketing of and access to Savings Bonds**. Renewed public, private, and non-profit marketing of Savings Bonds should increase their appeal. Also, access points should go beyond banks and the internet-based TreasuryDirect to include the various places where low-income people are likely to shop and use services: check-cashers, grocery stores, Wal-Marts, post-offices, low-income credit unions, CDFIs, tax-preparation services, community development centers, and the like. Financial incentives could be provided to these outlets to promote Savings Bonds to their lower-income customers.

- **Consider reducing the minimum holding period back to six months.** Like all Americans, low-income Americans need savings tools to meet short, medium- and long-term needs. When Treasury, in January 2003, changed the minimum holding period on Series I and EE bonds from six to 12 months, this had the effect of making Saving Bonds less appealing to many lower-income Americans. On the other hand, the longer minimum holding period encourages longer-term saving—another worthy goal. It's not clear which of these options is better. One possible solution might be to continue to use the newer, 12-month minimum rules, but encourage Treasury to better publicize existing rules that allow penalty-free redemptions prior to 12 months in the case of a family emergency. Rules allowing early redemption in case of a natural disaster are well known, but family emergency rules are not, thus potentially reducing

[23] The Financial Services Roundtable has proposed a new "Series R" Savings Bond that would be specifically restricted to redemption in retirement, or rolled over into an existing retirement product, such as a 401(k) or IRA.

the appeal of Savings Bonds among certain low-income Americans. Alternatively, Treasury could exempt small withdrawals from the required holding periods.

- **Investigate the creation of Savings Bonds with prize-linked savings.** A different kind of Savings Bond product is offered in several countries which allows investors a chance to win daily or monthly cash prizes in lieu of collecting interest on their savings. The version of this product in the United Kingdom, the Premium Bond, awards more than one million cash prizes a month to investors, ranging from £50 to £1,000,000. Research conducted on Central and South American savings accounts tied to a prize feature has shown that these types of products can be quite popular among the unbanked and first-time savers. This suggests that low-income families in the U.S.—many of whom lack bank accounts and are not currently saving--might also be interested in a prize-linked savings product.

In addition to these ideas, other sections of the paper propose designating Series I Savings Bonds as "Katrina Bonds" to help hurricane relief efforts, and raising asset limits so that low-income families can purchase Savings Bonds without fear of becoming ineligible for programs such as TANF, Food Stamps, Medicaid, and SSI.

7. Expand Financial Education and Counseling Programs

All levels of government can and should play a role in ensuring that youth and adults are equipped with enough financial education to make good decisions. This role can complement and enhance the initiatives currently underway in the nonprofit and private sectors. The following recommendations ensure that financial education is taught alongside opportunities to save; is conducted at "teachable moments;" and spur demand for financial education so that people want to engage in learning more about their finances.[24]

- **Mandate completion of a personal finance course for high school graduation.** To ensure that all children become financially literate, states should require a personal finance course for high school graduation. In addition, financial education concepts should be integrated into existing material in grades K-8 and made part of the Standards of Learning tests mandated by the No Child Left Behind Act. States and local school districts should have the flexibility to draw from a variety of existing resources or craft their own curricula. These courses should then be evaluated for impact to discern which curricula and delivery methods work best. KIDS Accounts, or other universal accounts for savings and investments tailored to children, could be offered as part of this strategy to ensure that the financial education is relevant and can be acted upon by every child.

- **Create opportunities for adults to receive financial education in conjunction with opening a bank account or saving for retirement.** Many government-sponsored incentives to build assets through homeownership, matched savings accounts or other means include provisions mandating some sort of financial education or counseling. For example, a proposal for zero-down FHA home loans requires that participants complete a homeownership counseling class. State housing finance authorities, which offer below-market rate mortgage loans to first time homebuyers, often also have this requirement. These safeguards give participants the best chance of success, while giving the government offering the program or subsidy a better chance of a return on their investment. Whenever possible, when a government program is created to spur savings or asset building, a financial education component should be offered alongside.

- **Support legislation requiring states to provide financial education to TANF recipients.** The proposed TANF Financial Education Promotion Act (S 923) would mandate that states specify in their TANF plans how they will encourage financial literacy among TANF recipients. Attendance at financial

[24] For more information, see *Financial Counseling: A Meaningful Strategy for Building Wealth in the Latino Community*, by Beatriz Ibarra; and *Equipping Families for their Financial Futures: Policy Recommendations to Improve Financial Literacy*, by Leslie Parrish and Lisa Servon.

education seminars or classes would count as a work activity for recipients. Some state and local governments have already begun to offer this kind of training on their own. For example, the Illinois Human Services has partnered with Financial Links for Low-Income People (FLLIP) and the University of Illinois Cooperative Extension to provide a twelve hour financial education program which counts as a work activity.

- **Support public awareness campaigns that create demand for financial education**. While many financial education materials exist, consumer demand for financial education is not high among the general population. This may be because people "don't know what they don't know" and are unaware of how their lack of knowledge may be costing them money or opportunities. Public awareness campaigns could be one solution to this, similar to those for smoking, seat belts, and littering. Some have suggested that campaigns include celebrities such as Robin Leach or Donald Trump, or that the President could talk about the issue to raise its profile. These types of campaigns could teach parents how to talk to their kids about finances and how to model good spending behavior, similar to ads now that direct parents to resources on talking to their kids about drugs and other risky behaviors. Funding for these types of campaigns could be provided by private sector companies, many of which are now separately going about their own activities to promote financial literacy. Additional funding could also be generated through financial penalties imposed on financial services firms who engage in illegal predatory practices. One large-scale public awareness program already underway is the National Endowment for Financial Education's "Get Smart About Money" campaign which includes educational ad spots and a website with resources for people who want to learn to manage their personal finances.

- **Create incentives for employers to provide financial education in the workplace**. Financial education offered at the workplace can help employees avoid personal financial problems that can lower their productivity and cause higher absenteeism, turnover, and stress-related illness. Recently, the federal government began implementing a retirement financial literacy strategy to ensure all federal workers get the training and resources they need to set savings goals and take advantage of retirement savings benefits offered as part of their jobs. To help spur workplace financial education among private sector employers, tax credits could be offered to offset the costs associated with financial education and investment advice. In addition, the federal government can offer tips on how best to run a financial education program based on the implementation experience with its employees.

- **Ensure access to financial planning services.** Families may not only need to learn financial basics in a financial education class, but receive financial planning from someone who can look at their specific situation. However, low-income families may find this option unaffordable. Three proposals could help boost the supply of financial counseling for low-income individuals. First, a "Financial Service Corps" of financial and tax advisors, similar in structure to the Army Corps of Engineers or AmeriCorps, could be created. A tax credit to tax preparation firms (such as H&R Block) and financial institutions could help off-set some of their costs of training personnel and advising individuals that otherwise would not have access to a financial planner. A second option would be to issue vouchers directly to families who could seek out financial counsel. Finally, a grants program could be developed for community-based organizations which would hire and train financial counselors to serve their clients.

8. Revise Asset Limits in Public Assistance Programs

The application of low asset limits to determine eligibility for federal public assistance benefits is a huge disincentive for saving. One of the great policy achievements of the 1990s was that nearly all states raised their assets limits as part of their TANF plans. In addition, the majority of states have raised their asset limits on Medicaid above the federal minimum and almost all states have waived asset limits for providing Medicaid for children. While states continue to innovate where they have the flexibility to do so, an opportunity also exists to reform these limits at the federal level.[25]

- **Eliminate asset limits from eligibility considerations.** Eliminating asset limits entirely from certain programs should be considered and adopted where appropriate. Because states set the asset limits for TANF and Medicaid, the federal government has limited control over asset limits, with discretion primarily in the SSI and Food Stamp programs. However, the federal government could support states that choose to eliminate asset limits and commission research on the effects of this reform.

- **Raise asset limits.** Asset limits could be raised to a more realistic level in public assistance programs, so that families could save more without being penalized, and then indexed to inflation to keep pace with rising costs. The raising of asset limits will encourage families to save in a variety of saving products, including Savings Bonds. Unlike income limits, which are adjusted upwards on a regular basis, asset limits in some programs have remained the same for several decades. In effect, asset limits have caused eligibility to become more and more restrictive over time. Program funding levels may benefit from the recent change to a more temporary focus on administering assistance, but families will benefit more from a long-term plan of savings and asset-accumulation.

- **Exclude certain asset holdings.** Currently, employer sponsored 401(k) plans as well as IRAs generally are counted towards asset limits. Families needing to go on temporary public assistance therefore may have to spend down these retirement accounts even if they face a penalty in doing so. These families, who likely already lack sufficient retirement savings, will have even less – making it more likely that they will have to rely even more on public assistance once again when they are seniors. In line with excluding retirement accounts, contributions to 529s and other restricted education savings plans should also be excluded from eligibility consideration.

  Cars are often overlooked as "assets" because they quickly depreciate in value. However, the value of a car should not be measured only by its resale value, but by the utility it provides in giving families access to job opportunities across their region. This is particularly important for families living in rural areas or others working and/or living in areas lacking a convenient public transportation system. Currently, some programs do allow one car to be excluded per household or per driver and this should be the standard across all programs.

  Finally, low-income workers who receive an EITC refund should be allowed to save their refund for up to a year after receipt to pay for unexpected expenses, debts, and other purposes. This would help families pay for both expected and unexpected expenses throughout the year and offer greater protection from financial emergencies that could cause them to return to public assistance. This one-year time period has already been set in the Food Stamp program and the SSI program allows the EITC to be disregarded for nine months, so these precedents could be expanded to other programs which receive federal funding.

9. Expand Access to College and Post-Secondary Education

A post-secondary education is increasingly a necessity to secure a well-paying job, but also is often the first step to achieving security, acquiring assets, and building wealth. While educational attainment rates continue to rise across all race and income groups, persistent gaps remain between races and people of difference socio-economic backgrounds. Today, financial barriers prevent almost half of academically qualified low-income students from attending a four year college and almost a quarter from attending any college at all within a few years of high school graduation. In addition, there is less of a focus on need-based aid in the form of grants and a greater emphasis on loans, merit awards, and tax credits.

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[25] For more information, see *To Save or Not to Save: Reforming Asset Limits in Public Assistance Programs*, by Leslie Parrish.

- **Expand need-based grant aid.** While funding for the overall Pell Grant program has increased every year due to growing numbers of students meeting the eligibility criteria attending college, the maximum grant award an individual student can receive has been largely stagnant. Currently, the maximum Pell Grant award is a little more than $4,000—an amount which covers less and less of a college tuition as prices continue to increase. In addition, the Administration has proposed cutting the LEAP program which provides grants to states for needy students. A commitment needs to be made to increasing need-based grant aid more aggressively in the future. At a minimum, grant aid could be concentrated in the first two years of school so that lower-income students would be able to more easily obtain an Associate's Degree and then perhaps have more confidence in relying more on loans in later years to complete a Bachelor's degree.

- **Increase funding for college readiness programs.** One of the most important parts of making college more accessible is ensuring that every child receives a quality K-12 education so that they are prepared to succeed in college. They also must begin their school career with the expectation that college is within their reach. To this end, it is important to increase awareness and financial support of pre-college programs which have shown that they are successful. The TRIO and GEAR UP programs should be dramatically expanded so that far more than the current 10 percent of eligible students are able to take advantage of these programs. This expansion could be implemented through a variety of funding mechanisms which could be shared by federal, state, local, and nonprofit community groups.

  Innovative new ideas, such as the Early College High School Initiative demonstration conducted by Jobs for the Future and its partners, should also be explored as other possible parts of a comprehensive pre-college strategy. This initiative, which has been implemented in 19 high schools this year, will allow students to take college courses for credit during their junior and senior years. They can earn up to two years of college credit this way without paying any college tuition while being in a more intimate high school environment.

- **Ensure student aid can be adapted to nontraditional students' needs.** All grant, loan, and other assistance programs must be adapted to the new and growing majority of students who are currently classified as "nontraditional." Policies should not categorically exclude the large number of students who attend part-time or less while working, have parental responsibilities, or choose from new innovations in education such as web-based classes. These students may face additional costs such as child care, earn a salary over the very low threshold which disqualifies them for needed aid, or may need to take breaks from their schooling. All programs should be designed with enough flexibility to adapt quickly to students' changing circumstances and needs.

In addition, proposals to expand the use of IDAs, create KIDS Accounts, and match contributions to 529 college savings plans that are described in other sections of this report could also increase access to college.

10. Expand Homeownership

Homeownership is at the core of the American Dream. Supported by a steady stream of public policy interventions that have facilitated the purchase and continued ownership of homes, the rise in the national homeownership rate has been impressive. However, lower-income families face significant hurdles in becoming homeowners and do not benefit from most of the current policy incentives designed to promote homeownership. This can be addressed through a series of new policies, program, and reforms.

- **Make the homeowner's mortgage deduction refundable.** This mortgage interest deduction provides $70 billion a year in tax relief. Since the mortgage deduction is not refundable, the majority of the benefits go to higher income families who have larger tax liabilities. 54 percent of the homeowner's deduction goes to households earning more than $100,000 a year, and nearly 90 percent of this benefit goes to households with adjusted gross incomes over $50,000. Making the deduction refundable for more households earning under $50,000 will open up this subsidy to families on the cusp of achieving the American Dream. This change could be implemented in a revenue neutral manner by capping the mortgage amount at half of its current rate of $1 million and restricting it to one home per family.

- **Enact a refundable First-Time Homebuyers' Tax Credit**. The largest obstacle for most first-time homebuyers to overcome is saving for the down payment. This problem has only increased as home prices have risen. First-time homebuyers earning under $50,000 a year should be eligible for a dollar-for-dollar tax credit for money used as a down payment, up to a $10,000 amount. This tax credit should be made refundable to benefit families without high tax liabilities.

- **Increase use of the Family Self-Sufficiency (FSS) program**. The FSS program is one of the nation's largest programs designed to help working poor families increase their savings. When the earnings of Section 8 or public housing program participants increase, their rising rent payments are diverted into an escrow account which they can access after achieving self-sufficiency goals. While public housing authorities have the ability to open escrow accounts, they are required to identify designated case managers. HUD should either increase its dedicated funding to hire case managers or more effectively seek partnership with agencies already in the case management business. FSS has proven to be a successful model, and HUD should expand it by encouraging local partnerships between organizations with complimentary skill sets. Developing and publicizing FSS partnership arrangements will provide support for FSS practitioners by sharing best practices and entrepreneurial approaches to program growth.

- **Preserve rental housing subsidies that support affordable housing.** For many low-income families, affordable rental housing is often the first step towards homeownership, so programs aimed at expanding the supply of subsidized rental units need to be preserved.

11. Support Microenterprise Development

Microenterprises—businesses with five or fewer employees that can benefit from a start up or capitalization loan of $35,000 or less—are an important source of household income for many families. These self-employment wages can supplement entry-level employment opportunities, reduce a family's reliance on public assistance, and offer flexibility when families try to balance work-life issues in ways that traditional employment cannot. Yet public support for these programs, and the businesses they serve, has been fragmented and uneven.[26]

- **Provide new and informal businesses with better information about self-employed tax options.** Filing taxes is a key formalizing event in the life of a business. Moving businesses from the informal to the formal economy could provide incentives for small business owners to invest more in their businesses, and also enable these entrepreneurs to access the tax-favored asset building features that are only available through filing. Many low-income self-employed households claim EITC benefits which can, in part, offset liabilities of the self-employment tax. A self-employment-specific tax credit could expand on this, and could be coupled with a new high profile business and tax literacy campaign, informing new sole proprietors about business taxation and asset building options so they can make fully informed decisions about filing.

- **Create an alternative source of funding for small business and incentives for saving** Individual retirement accounts—IRAs—are an important asset-building tool. Currently, penalty-free withdrawals from IRAs for small business start-up costs are not permitted, nor can individuals borrow against these assets to capitalize their businesses. IRAs currently allow several pre-retirement uses that promote asset building and retirement security, including first-time home purchase and post-secondary education. Expanding these uses to small business capitalization makes sense, as doing so could provide another

[26] For more information, see *Policy Options to Support Entrepreneurship Among Low-Income Americans*, by Lisa Servon.

incentive for people to save and accrue assets. In addition, entrepreneurs could be given an alternative option of taking a loan against their IRA assets instead of making an early withdrawal which would help mitigate the concern that savers might lose their hard-earned assets to ill-conceived, risky ventures. Private lenders or the SBA could underwrite the loans and evaluate the merits of the proposed business plan, and minimum underwriting standards could be prescribed. More importantly, only partial security for the loan could be permitted, with the lending institution thereby assuming the risk of the loan balance.

- **Remove the obstacles preventing low-income people from pursuing self-employment.** Obstacles including a lack of affordable health care and, in some states, TANF requirements that inhibit entrepreneurship need to be minimized so that entrepreneurship is a more viable option. For example, to afford health care, low-income entrepreneurs need (1) subsidies; (2) an avenue to purchase health insurance that affords them access to administrative economies of scale and broad risk pooling; and, in the long run (3) broader health care system reform that will lower the trajectory of health care cost growth relative to wages, prices, and incomes. Association Health Plans are the most likely vehicles for fulfilling these needs.

  As far as TANF is concerned, states can allow recipients to participate in microenterprise development activities, but federal law does not encourage states to make this option available, or assist them in doing so. Changes and clarifications that could be made to federal law that may be beneficial include: (1) clarifying that self-employment can count as a TANF work activity; (2) clarifying that self-employment preparation can count as a TANF work activity, within the limits that apply to vocational training; (3) clarifying that the job search period that can count towards TANF work requirements also includes time spent in active exploration of self-employment potential; and (4) adding language to the TANF state plan requirements which specifies that state plans must describe the state's approach to encouraging and supporting self-employment.

- **Help the Small Business Administration (SBA) better serve very small businesses.** The mission of the SBA is to "maintain and strengthen the nation's economy by aiding, counseling, assisting, and protecting the interests of small businesses and by helping families and businesses recover from national disasters." However, the SBA defines a small business as one that has 500 or fewer employees. As a result, microenterprises are all but overlooked. Although the SBA has two programs targeted at microbusinesses, these programs could be greatly improved in order to better serve very small businesses. For example, the Microloan program, which is unique in that it combines training and technical assistance with loan capital, should be opened to a wider range of lenders and have better standards incorporated that would help document performance. In addition, the SBA's 7(a) loan program which offers several types of small business loan products through banks could benefit from changes such as creating a very small business loan initiative that would provide a 75 percent guarantee for loans of $25,000 or less.

- **Maintain programs that currently assist microentrepreneurs.** Some currently valuable policies and programs which help to create a more hospitable environment for low-income entrepreneurs have, in recent years, been threatened. In addition to generating new, creative ideas to maximize the potential of entrepreneurial energy among low-income groups, it is important to retain and improve existing programs. These include the Program for Investment in Microentrepreneurs (PRIME) and the Community Development Financial Institutions (CDFI) Fund.

12. Enable Recent Hurricane Victims To Build and Rebuild Assets

The recent hurricanes wrought havoc on families and communities across the Gulf Coast and poignantly revealed how the debilitating effects of poverty persist across the country. The rebuilding process should identify as one of its primary goals assisting affected families with building up long-term savings and assets as a means of reconstructing their financial lives. That is because families without a stock of assets to draw upon in times of need are vulnerable to unexpected events. Policies that enable families to save and build up resources offer a means to move out of poverty and increase their security. These policies will be most effective if they are delivered through a platform that is flexible and portable, one that works for evacuees regardless of where they re-settle as well as for others from the general population.

- **Deploy a "Financial Service Corps" of financial and tax advisors to evacuees.** To help families rebuild their financial lives and navigate through the range of relief programs, serious and ongoing financial counseling and tax-preparation assistance is needed. We propose a "Financial Service Corps" of financial and tax advisors, similar in structure to the Army Corps of Engineers or AmeriCorps. A tax credit could be created for tax preparation firms and financial institutions to help off-set some of their costs of training personnel and advising evacuees. Recognizing that many financial educators may work for non-taxpaying entities (non-profits, credit unions, etc.), a direct grant program could be administered by the existing Treasury-led Financial Literacy and Education Commission.

- **Designate Series I Savings Bonds as "Katrina Bonds."** Just as Series EE Savings Bonds were renamed "Patriot Bonds" following September 11th, Series I Savings Bonds could be designated "Katrina Bonds." Katrina Bonds would provide an opportunity for all Americans to contribute to the Katrina recovery effort while providing an easy, safe way for them to save for their future. I Bonds offer investors a fixed rate combined with semiannual inflation adjustments that will help protect purchasing power. Savings Bonds are, in general, an excellent place for low-income Americans and Katrina victims to save money—Savings Bonds are safe, investment risks are low, and no bank account is required for purchase.

- **Provide a homeownership tax credit for evacuees who lost or never owned their own homes.** Homeownership must be central to any rebuilding of lives or affected regions. A "Homebuyers Tax Credit" would be available to qualifying households for the three years after purchasing a home. The credit could be pegged to a percentage of purchase price with a cap of 6 percent and restricted by an appropriate income level as well. This kind of temporary tax relief targets families that are ready and capable of buying a home but deterred by the increased financial commitment in succeeding years. This policy would help augment demand for homeownership and be implemented as one part of a vigorous strategy aimed at increasing homeownership in the Gulf region and for evacuees any where they may decide to live.

- **Encourage financial institutions to offer simple, low-cost bank accounts.** In one recent survey of New Orleans evacuees, 70 percent lacked a checking or savings account as well as a usable credit card. Without a basic bank account, financial stability will be nearly impossible to achieve. Both the supply of and access to low-cost bank accounts in the private sector need to be increased. An easy way to achieve this would be to offer financial institutions a one-time payment to open "Electronic Transfer Accounts," or ETAs, which are low-cost accounts currently provided by the Treasury Department for people who receive recurring federal payments such as Social Security. Through participating financial institutions, the ETA could be made available to Katrina evacuees—provided banks would be given greater flexibility to tailor the product to meet their and the evacuee's needs. Tax credits could be offered to banks that offer ETAs, while direct payments from Treasury could be offered to credit unions and other non-taxpaying financial institutions.

13. Improve Asset Accumulation Opportunities for TANF Recipients. While TANF was recently granted another extension, opportunities still remain to increase access to savings and assets by TANF recipients.

- **Enhance and Improve the Flexibility of Individual Development Accounts (IDAs).** Many states have incorporated IDAs into their TANF programs to help families save and participate in financial education. Presently, The Personal Responsibility and Work Opportunity Act of 1996 specifies that TANF funding can be used for IDAs. Families can save for a post-secondary education, a home, or a small business, and these savings must come from earned income. The federal government could allow states the flexibility to determine the purposes for which IDAs can be used and have states outline these uses in their TANF state plans. In addition, the requirement that savings come from earned income could be amended to accommodate the needs of recipients who may rely on unearned sources of income, such as Native Americans and people with disabilities. This change would be consistent with language from the current Savings for Working Families Act language in S. 6, which does not include an earned income requirement.

- **Establish a Savings and Ownership Fund.** Congress could establish a Savings and Ownership Fund to encourage states to incorporate asset building strategies in TANF state plans. Currently, performance bonuses are awarded to states that lead the way in terms of caseload reduction, job placement, and other measures. States could explore options such as offering recipients children's savings accounts, 529 college savings plans, electronic benefit transfer to a bank account, linking EITC refunds to savings opportunities, and other initiatives. The federal government could award grants from the Fund on a competitive basis to help with implementation of these and other innovative ideas.

In addition to these proposals, asset limits could be eliminated from TANF programs and TANF recipients could be encouraged to establish banking relationship through the direct deposit of benefits. Both of these proposals are covered in other sections of this brief.

14. Strengthen Laws to Protect Assets

In recent years the fringe market for financial services has greatly expanded, increasing incidents of predatory financial practices that erode assets and drain savings.[27] While financial education efforts are critical to ensure that consumers make good financial choices, the market for providers of unscrupulous loans and financial services is vast, profitable, and poorly regulated. Predatory lending is responsible for the stripping of billions of dollars of assets from low-income families and communities each year. The Center for Responsible Lending estimates these annual losses amount to $9.1 billion as a result of predatory mortgages, $3.4 billion from payday loans; and $3.5 billion in other lending abuses, such as tax refund anticipation loans, overdraft loans, and excessive credit card debt.[28]

Some experts note that we have "dual" and unequal regulatory systems—one well-regulated for the mainstream, "high-road" providers, and the other weakly regulated for the alternative "low-road" providers. Policing this asset-stripping regime has been recently complicated by some of the high-roaders acquiring some of the low-roaders. Proposals to strengthen asset protection laws and curb predatory lending through tighter regulations on financial products ranging from mortgages to payday loans could include the following.

- **Increase the oversight of the home-buying and refinancing processes, especially in the sub-prime market.** The existing protections for high-cost home loans must be improved. This would include prohibiting equity stripping practices, such as excessive prepayment penalties and fees for payoff information, modification, or late payment; requiring a borrower receive counseling before entering into a high-cost loan; and prohibiting mandatory arbitration clauses on high-cost loans.

- **Provide federal oversight and coordination of now state-regulated alternative financial services providers.** Provisions could include limiting the number of loans to an individual each year, creating a minimum loan term for each loan of at least 60 days, establishing a borrower's right to repay the loan in installments. In addition, states with stricter laws could be empowered to effectively enforce their laws within their borders.

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[27] Howard Karger describes some of these disturbing trends in his recent book *Shortchanged: Life and Debt in the Fringe Economy.*
[28] See www.responsiblelending.org.

- **Reduce the cost of tax preparation and restrict the marketing of Refund Anticipation Loans.** The IRS should continue to expand the provision of free electronic filing. Further, it should ensure that (1) the free services are easier for eligible tax filers to access and navigate; 2) the marketing of Refund Anticipation Loans is limited; and 3) options to open IRAs online are included.

- **Protect consumers from abusive credit card practices.** This can be done by: (1) restoring the 14-day payment grace period before late fees are imposed; (2) notifying customers at least 15 days prior to unilaterally raising rates; (3) charging no late fees larger than the outstanding balance; (4) restricting bait and switch practices when customers are pre-approved at one rate but then offered a card with a higher rate; (5) requiring full disclosure and honest advertising; and (6) protecting youth from receiving cards without cosigners.

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