Investment growth is essential to building assets over time. Funds in Child Development Accounts (CDAs) have many years to accumulate—they are often opened at birth—but market appreciation can add substantially to the total savings for the child. In fact, the potential for growth is one important advantage of designing CDAs with 529 college savings plans instead of bank savings accounts. Being banked—having a low-cost checking or savings account—is important for paying bills, making routine financial transactions, and accumulating short-term savings. However, bank accounts are not the best vehicles for longer term asset accumulation. Although 529 plans have a limited number of investment options, some parents may be overwhelmed by the choices, which can delay or inhibit family saving. A growing number of 529 plan sponsors present a “quasi-default” investment for online enrollment, the method used by the vast majority of account openers. This innovation, which can benefit all prospective savers, is an alternative to immediately displaying the full list of investment options. This brief documents the potential of 529 plan investment growth and a quasi-default to increase savings in CDAs.

Investment Growth: Taking Advantage of a Long Time Horizon

The potential for investment growth is a key policy design element of CDAs. Early deposits in CDAs opened at the time of a child’s birth have about 17 years to grow before they are withdrawn for postsecondary education.

In the SEED for Oklahoma Kids experiment (SEED OK), CDA deposits are invested in the Oklahoma 529 College Savings Plan’s Balanced Fund Option, which is a mix of stock and bond funds. The $1,000 initial deposits invested in late 2007 were valued at $1,669 on September 30, 2017—an increase of more than 60% in less than 10 years—despite dropping to a low of about $700 during the Great Recession. As Figure 1 illustrates, CDA program deposits made early in a fund with growth potential can result in meaningful asset accumulation, even if families do not make personal deposits. Holding CDA deposits in a no-growth account means foregoing earnings, which could surpass the value of the initial investment.

Figure 1. Growth of the SEED for Oklahoma Kids CDA $1,000 Deposit: December 2007–September 2017

This figure graphs year-end values of the $1,000 initial deposit, except in 2017, when the data point is for September 30. Source: SEED for Oklahoma Kids account monitoring data.
Default Investment: Increasing Participation and Savings

Originally initiated by 401(k) plan sponsors, a default investment makes automatic enrollment in retirement savings plans possible because it allows employees to participate without choosing an investment. Although some employers adopted automatic enrollment and a default investment prior to the enactment of the Pension Protection Act of 2006, broader acceptance occurred only after the act provided protection from liability for sponsors of 401(k) and other defined contribution plans when certain guidelines are followed. (For example, one guideline specifies that the default investment must be diversified—typically a lifecycle, target-date retirement, or balanced fund.\textsuperscript{10}) A key objective of the law was to simplify enrollment and maximize employee participation. Automatic enrollment and a default investment are important: When they are in place, only a small portion of employees opt out, and this can substantially increase savings.\textsuperscript{11}

Similar to 401(k)s, a standard characteristic of 529 plans is a defined set of investment offerings, which typically include age-based, guaranteed, single, and balanced fund options. However, people may become stymied by even a few choices. As early as 2010, a small number of 529 plans began using a default investment in specific circumstances.\textsuperscript{12} For example, the Utah 529 plan designates a fund for account openers who fail to choose an investment on the paper application. (People who open accounts online must choose an investment.\textsuperscript{13}) Alaska designates an investment for state residents who check a box indicating that they want to open an account and deposit a percentage of their Permanent Fund Dividend into the state’s 529 plan.\textsuperscript{14} But there is no federal legislation guiding 529 plan sponsors and managers toward specific default investment characteristics and protecting them from liability for financial loss.\textsuperscript{15} This has made 529 plan managers reluctant to offer defaults. Thus, some 529 plans have introduced what we call a \textit{quasi-default investment}. Quasi-defaults can be particularly useful for CDAs because families are typically required to open their own accounts in order to make personal contributions.\textsuperscript{16}

\textbf{Quasi-Default: An Innovation to Simplify, Streamline, and Nudge}

For a quasi-default, 529 plan sponsors do not automatically invest initial contributions. Rather, the plan’s website presents a specific fund that applicants may affirmatively select and gives them the opportunity to view all investment options. Providing a quasi-default investment can simplify account opening (by reducing the amount of information an online applicant might view, for example) and streamline decision making (by presenting a specific option for consideration). These are important benefits for all prospective savers, but they are especially valuable for participants in inclusive initiatives like CDAs. The need to choose from an array of investments can create uncertainty for inexperienced investors. Presenting a specific investment may eliminate a potential barrier to account opening and saving.

Quasi-defaults can also nudge families toward a diversified investment. The typical quasi-default investment in 529 plans is age-based, a diversified mix of stock and bond funds that automatically becomes more conservative as the beneficiary approaches college age (similar to the automatic adjustments of a target-date retirement fund). In other words, an age-based fund offers a “set-it-and-forget-it feature.”\textsuperscript{17} That feature removes investment decisions over the long term. (Figure 2 illustrates the asset mix over time for a conservative age-based option.\textsuperscript{18} Currently, a large majority—66%—of direct-sold 529 plan assets are held in such funds.\textsuperscript{19} Also, the statewide CDAs in Maine, Nevada, and Rhode Island invest program deposits in an age-based 529 option.\textsuperscript{20}

ScholarShare 529, the California college savings plan managed by TIAA-CREF Tuition Financing, Inc. (TIAA), now displays a quasi-default. Individuals who open an

\textbf{Figure 2. NY’s 529 Conservative Age-Based Option: Investment Mix Over Time}

<table>
<thead>
<tr>
<th>AGE OF BENEFICIARY</th>
<th>0–4 years</th>
<th>5–6 years</th>
<th>7–8 years</th>
<th>9–10 years</th>
<th>11–12 years</th>
<th>13–14 years</th>
<th>15–16 years</th>
<th>17–18 years</th>
<th>19 years or older</th>
</tr>
</thead>
<tbody>
<tr>
<td>Stocks</td>
<td>R</td>
<td>R</td>
<td>R</td>
<td>B</td>
<td>B</td>
<td>B</td>
<td>B</td>
<td>G</td>
<td>G</td>
</tr>
<tr>
<td>Bonds</td>
<td>R</td>
<td>R</td>
<td>R</td>
<td>B</td>
<td>B</td>
<td>B</td>
<td>B</td>
<td>G</td>
<td>G</td>
</tr>
<tr>
<td>Short-term reserves</td>
<td>R</td>
<td>R</td>
<td>R</td>
<td>B</td>
<td>B</td>
<td>B</td>
<td>B</td>
<td>G</td>
<td>G</td>
</tr>
</tbody>
</table>

Adapted from New York’s 529 College Savings Program Direct Plan (2017, p. 5).
Figure 3. The ScholarShare 529 Online Account Application: Quasi-Default Investment Illustrated

A. Quasi-default presentation

B. When "yes" is selected

C. When "no" is selected

Adapted from ScholarShare.com. Copyright 2017 by the State of California.
account online are automatically presented the Passive Age-Based Option (Figure 3a). They can select “Yes” to invest 100% of their contributions in this fund (Figure 3b). If they instead select “No, I’d like to review more options,” they may choose to invest in any of the options offered by ScholarShare. Figure 3c shows a partial view of the investment options presented to an individual who declines the quasi-default. It is noteworthy that the ScholarShare 529 quasi-default follows the three principles articulated by Richard Thaler, the Nobel Prize-winning economist, to guide the use of nudges: (1) The nudge is transparent, not misleading; (2) opting out of the nudge is easy; and (3) the behavior being encouraged is expected to improve the well-being of those who accept it.21

The number of 529 plans with a quasi-default is growing. As part of a quasi-default rollout, all 529 plans managed by TIAA are expected to present a specific investment during online account opening. The process will be similar to that for California’s ScholarShare 529, which is the first of the nine TIAA-managed college savings plans to implement this innovation.22

Inclusive 529 Plan Innovations

First and foremost, CDAs aim to increase educational opportunity and achievement by providing college accounts and assets to all children.23 Over time, CDA earnings can be substantial, so investing deposits in an account with growth potential is essential. This is one of many reasons why 529 plans are the financial platform of choice for CDAs.24

The ideal CDA design would track the program and family contributions separately in a single, automatically opened account.25 But this design is not yet feasible, so it is important to continue to improve the process for opening 529 plan accounts to facilitate family saving. Recent and ongoing 529 plan enhancements include making websites easier to use and eliminating required minimum contributions.26 Another development is the presence of a 529 quasi-default investment. A quasi-default can simplify account opening, streamline decision-making, and nudge savers toward a specific, diversified investment. In sum, innovations like quasi-defaults are inclusive. They can benefit a large, diverse group of potential savers—well beyond those participating in CDAs.

End Notes

1. Beverly, Clancy, Huang, and Sherraden (2015); Clancy, Beverly, Schraderen, and Huang (2016). To learn about the positive impacts of the SEED for Oklahoma Kids CDA on nonfinancial outcomes (e.g., educational expectations, mother’s mental health, and child development), see Beverly, Clancy, and Sherraden (2016). For details on CDAs, see Sherraden (2014); Beverly, Elliott, and Sherraden (2013); and Clancy and Beverly (2017).

2. Another benefit of using 529 plan accounts for CDAs is that individuals who have previously owned only a checking or savings account can be introduced to low-cost investments with growth potential even though they have only a small amount to save. Clancy, Sherraden, and Beverly (2015) describe these and other features of direct-sold 529s plans that make them especially well-suited to CDAs.


4. For more on indecision and procrastination related to saving and investing, see, e.g., Madrian and Shea (2001) and Choi, Laibson, and Madrian (2009).

5. In 2017, over 90% of all new 529 plan accounts managed by TIAA-CREF Tuition Financing, Inc., were opened online (L. English, personal communication, October 16, 2017).


7. In 2007, then Oklahoma State Treasurer Scott Meacham chose this fund because of the long time horizon before the money will be used for postsecondary education (Gray, Clancy, Sherraden, Wagner, & Miller-Cribbs, 2012).

8. T. Allen, Oklahoma State Treasurer’s office, personal communication regarding SEED OK account monitoring data, October 30, 2017. See also Beverly et al. (2015).

9. Although CDA design encourages contributions from family members and others, personal saving is not a primary objective (Sherraden, 2014). And early experimental evidence from the SEED OK CDA indicates that many of the important impacts on parents and children occurred even if parents had not contributed (Beverly et al., 2016).

10. The Pension Protection Act allows sponsors of defined-contribution plans to designate a Qualified Default Investment Alternative. If the plan complies with several requirements, the fiduciary will not be liable for

11. One study of 642 defined-contribution retirement plans shows that those with automatic enrollment have a participation rate of 88% while plans with voluntary enrollment have a much lower participation rate of 46% (T. Rowe Price, 2016). A similar study of 460 plans affiliated with the Vanguard Group shows a 91% participation rate for plans with automatic enrollment and a rate of 42% for voluntary enrollment plans (Clark, Ukts, & Young, 2015).


13. Utah Educational Savings Plan (2017); Lassar et al. (2010).

14. The Permanent Fund Dividend is indirectly funded by oil revenue and has been paid by the state government to Alaska residents every year since 1982 (see http://www.apfc.org). For more on streamlined enrollment in the 529 plan through the Permanent Fund Dividend’s annual application, see Clancy, Lassar, and Miller (2009). In addition, Maine designates an investment for families that participate in the Harold Alfond College Challenge and open an account in the state 529 plan with a paper application but do not select their own investment (Clancy & Lassar, 2010).

15. As early as 2009, the Center for Social Development and New America recommended that the federal government provide guidance for default investments in 529 plans (Huelsman & Clancy, 2009).


18. Many 529 plans offer conservative, moderate, and aggressive age-based fund options. This example illustrates the glide path for the conservative age-based fund in New York’s 529 College Savings Program Direct Plan (2017).


20. The fourth statewide CDA, in Connecticut, will soon present an age-based fund as part of the 529 plan account-opening process (for this CDA, an individual account holds both personal and program deposits). See further discussion in Clancy and Beverly (2017).


22. In addition to the ScholarShare 529 in California, TIAA manages college savings plans in Connecticut, Georgia, Kentucky, Michigan, Minnesota, Oklahoma, Oregon, and Wisconsin. The quasi-default online function is currently available in the 529 plans for all of these states but is subject to state approval. Rollout is expected to be completed in 2018.


24. Approximately 86% of all CDA accounts nationwide use 529 college savings plans (S. Markoff, personal communication, October, 19, 2016).


References


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Authors

Margaret M. Clancy
CSD Policy Director

Sondra G. Beverly
Senior Scholar

Contact Us

Center for Social Development
George Warren Brown School of Social Work
Washington University in St. Louis
Campus Box 1196
One Brookings Drive
St. Louis, MO 63130

csd.wustl.edu

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