

REPORT TO THE BOSTON FOUNDATION

**THE CASE FOR AND THE DESIGN OF AN INCENTIVIZED SAVING PROGRAM FOR
MASSACHUSETTS**

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EXECUTIVE SUMMARY

Increasing access to higher education is an effective policy to decrease poverty and inequality. The individual benefits of college education are many, such as higher income, better health and mental well-being. Societal benefits include reduction of unemployment, crime, and dependence on welfare programs. However, as college tuition and fees are rising sharply every year, family income increasingly determines who can afford to attend college. There is evidence that providing incentives for lower-income families to save for college levels the playing field while increasing overall college resources. This is a viable alternative to our overreliance on borrowing to finance college.

Current financial aid system

The financial aid provided by federal and state governments covers less and less of the total college cost. Increasingly, parents and students are progressively relying more on loans to finance higher education. This is mainly due to the rise in college costs and has come despite the governments' very large increase in Pell grants, when the program switched from banks to the government as direct lender. Now the pressures stemming from the recession, as well as the structural problems of federal and state budgets are imposing a stubborn constraint on the government's education grants going forward.

Encouraging college savings

Encouraging college savings is a promising policy option. It is the opposite of borrowing, which at some point becomes an unsustainable strategy that contributes to the increase in college costs. The current incentive programs for college savings in the United States are regressive, providing more incentives for upper-income families. Given the right incentives, lower-income families can save. A growing body of literature has demonstrated the financial, academic, and social benefits of saving for college, especially for lower-income families. By being invested early in saving for college, parents and students are more likely to learn about the college application process and available financial aid, and to fulfill the academic requirements necessary to attend college. By motivating families to save for college, the total money available for higher education is increased, effectively decreasing the reliance on loans or higher amounts of grants.

Early awareness programs

Some states have established ambitious early commitment scholarship programs that cover most college costs. These programs significantly increase the performance and enrollment level of under-represented students. However, these programs are costly and lessons learned show that while college enrollment has increased, retention and completion rates remain low. A growing body of research has provided insightful recommendations about ways to improve retention and completion. In fact, there is some early evidence that when the programs undergo the necessary adjustments, they can deliver the intended results. However, even when perfected, these programs 'will not be an option for many states due to their high costs. While these programs' emphasis on early awareness provides parents enough time to save, they do not offer saving incentives directly.

Savings efforts around the world and the United States

Recognizing the social, academic, and financial benefits of saving, many countries have introduced different schemes of incentivized savings programs. Canada, Hong Kong, Hungary, Mexico, New Zealand, Puerto Rico, Singapore, South Korea, and the United Kingdom all differ in the kinds of incentives, seed money, matches, and tax benefits the offer.

In the United States, there have been pilot demonstration initiatives, such as the American Dream Demonstration (ADD) and the Saving for Education, Entrepreneurship, and Downpayment (SEED) Initiative. These pilots have generated a wealth of information regarding various designs for savings incentives programs. Another proposal for a large national project is currently under review, the College Savings Account Research Demonstration Project. This project will pair up with the existing Gaining Early Awareness and Readiness for Undergraduate Programs (GEAR UP) to provide 10,000 ninth graders with college savings accounts and match their deposits. This will lead to new research, evaluations, and lessons learned regarding incentivized saving accounts. The program is expected to start next year. While these initiatives are implemented at the Federal level, individual states have also experimented with incentivized college savings accounts. In the last decade, sixteen states have introduced matching grants for their 529 college savings accounts.

From theory to practice: Design considerations

These demonstration and state-level programs have revealed important information that should be considered by policy makers planning their own incentivized savings programs. These include important design features as well as options for funding resources. This report was mindful of the following elements when it developed suggestions for a potential pilot program.

- Accessibility/inclusiveness
- Incentives structure
- Financial education classes
- Financial aid and college application support
- Account vehicle options
- Program administration

Budgetary options

From various programs around the US

- State appropriations
- MEFA's revenues from 529 accounts fees and loans
- Private foundations- trust fund
- Partnering with GEAR UP program

New proposed sources

- Redirecting existing scholarships and grants as incentives for savings
- Challenge grants (state and private)
- Local scholarships redirected to become matches for savings accounts

Recommendation

This report recommends a pilot program to support parent savings and awareness that will encourage college attendance. A successful pilot would create public support for a state-wide program in the future. The pilot would include the following elements.

Purpose: To test the responsiveness of low-income families to college savings incentives. Responses to be measured by the effect of a college saving account on:

- high school completion
- college attendance
- college financing decisions
- college debt levels
- college graduation

Location: Up to five Gateway cities

Length: Two years (the evaluation period will be longer as the students' performance in college will be followed)

Eligibility: Families whose students qualify for free or reduced lunch and are in the ninth or tenth grade. Multiple students from one family are all eligible (up to 100 students per location, total of 500).

Program requirements:

- Families agree to save a minimum of \$500 in 529 accounts before students graduate from high school
- Families agree to attend a financial education course focused on college access

Incentives:

- 1:1 match for all savings up to \$500 per student
- Raffles of cash and/or laptops at meetings may also be included

Program administrators: Private nonprofit agencies to administer programs (to be determined). State agencies with specific skill sets such as MEFA, the Massachusetts Department of Higher Education, and the Treasurer's Office may be invited to participate.

Cost: \$ 250,000 per year

Funding sources: \$125,000 authorized by the Commonwealth as a challenge to be matched by philanthropic organizations.

REPORT

The benefits and increasing cost of higher education

College education is the primary determinant of economic success and the key mechanism of social mobility. It not only improves individual's financial status, but also her/his health, social, and emotional well-being (College Board, 2007). Higher levels of college enrollment result in significant societal benefits as well, such as reduction of unemployment, poverty, dependence on welfare programs, and crime. It leads to higher level of civic engagement, volunteer work, and generally healthier lifestyles (Baum & Ma, 2007).

However, family income remains a key determinant of who will attend college. As a result, students from lower-income families are disproportionately excluded from higher education. Among high-scorers in high school, 74 percent of upper-income students complete college compared to 29 percent of low-income students (US Dept of Higher Education, 2009). Another study shows that graduation rates of lower income students are related to the net price charged by universities, whereas the graduation rates of higher income students are not (Bowen, Chingos, & McPherson, 2009). The conclusion is clear: affordability of college remains a major obstacle for low-income families.

In the meantime, college tuition and fees are growing sharply. From 1982 to 2008, tuition increased by 439 percent, compared to a 147 percent increase in median family income (National Center for Public Policy and Higher Education, 2008). "This increase is costly for all families, but for low-income households it can be prohibitive since they have little discretionary income to reallocate to absorb those expenses" (Black & Huelsman, 2012, p.3). Table one presents the net college cost as a percent of median family income. It clearly indicates that the increase in college cost disproportionately affects lower-income households.

In addition, the financial aid available to lower- to-middle income families has declined drastically and is covering less of the total college cost. While in the 1970s, the Pell Grant covered about 77 percent of the cost of a four year public college, now it only covers about 30 percent of that cost (Knowles, 2010).

At public four-year colleges and universities	1999-00	2007-08	% points increased
Lowest-income quintile	39%	55%	16%
Lower-middle income quintile	23%	33%	10%
Middle income quintile	18%	25%	7%
Upper-middle income quintile	12%	16%	4%
Highest income quintile	7%	9%	3%
At public two-year colleges			
Lowest-income quintile	40%	49%	9%
Lower-middle income quintile	22%	29%	7%
Middle income quintile	15%	20%	5%
Upper-middle income quintile	10%	13%	3%
Highest income quintile	6%	7%	2%
* Net college costs equal tuition, room, and board, minus financial aid. The numbers may not add exactly due to rounding.			

Source: National Center for Public Policy and Higher Education, 2008

Encouraging college savings

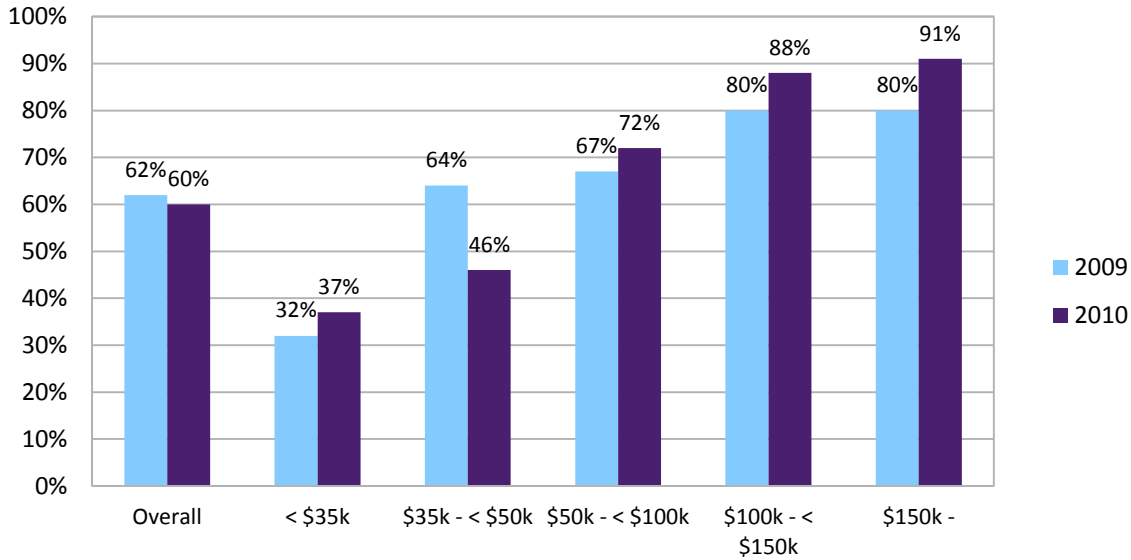
Fostering a saving culture is increasingly advocated as a solution to raising college affordability and attendance. There is a growing body of literature demonstrating the financial and academic benefits of saving for college. While savings help pay for college, scholars suggest that they actually accomplish more than that. Many studies have established a link between savings, wealth, and asset holding, and outcomes such as increased college expectations (college-bound identity), academic performance, and college attendance/completion (Elliott, Choi, Destin, & Kim, 2011; Black & Huelsman, 2012).

Elliott and Beverly (2010) found that among students reporting that they expect to graduate from a four-year college in the future, those who had college savings were four times more likely to attend college than those who did not have an account. Those who had a youth savings account in their names were seven times more likely to attend college than those who did not have an account. It is suggested that an increase in the perceived sense of control explains this difference. That is, when the student's name is on the account, she/he develops a stronger sense of ownership of the account, which contributes to a stronger determination to enroll in college. As detailed below, only some account vehicles allow for the child's name to be on the account.

Building on a small literature that suggests a positive relationship between assets and children's college-bound identity (Williams Shanks & Destin, 2009; Yadama & Sherraden, 1996), Elliot et al. (2011) explored the temporal ordering of the two by conducting a simultaneous test of competing theories of the same model. They found that children's savings in 2002 had a positive effect on children's college-bound identity in 2007. They recommend that rather than a program solely focused on savings, one providing financial education while fostering a college-bound identity may be the most effective strategy to increase account ownership and positive college outcomes. Similarly, other studies have shown that by saving and building assets, families increase their knowledge of money management, they plan for longer-term goals, and have a positive future orientation (Nam, Huang and Sherraden, 2008). Also, savings has been found to increase educational achievement by raising aspirations and expectations (Destin & Oyserman, 2009; Elliott, 2009; Zhan, 2006; Zhan and Sherraden, 2003).

The positive effects of saving are most salient to students coming from lower income families. Elliot et al. (2011) found that saving is a significant predictor of academic achievement in low- to-moderate income students, but not among high-income students. While about 60 percent of families save for college, savings is associated with higher income families (see figure 1) (Sallie Mae & Gallup, 2010). The Massachusetts Asset Development Commission also shows that 529 accounts are under-utilized by the targeted low-income families (MA Asset Dev. Commission, 2008).

Figure 1: Percentage of parents saving for college year-over-year, by income



Source: (Sallie Mae & Gallup, 2010)

Emphasizing the financial and academic benefits of savings for low-to moderate-income students, scholars have investigated the effects of saving incentives. Many studies found that seeding the accounts with some initial funds and incentivizing deposits by providing matches make it more likely that low-income families will save (Clancy, et al., 2006; Kempson, McKay & Collard 2005; Sherraden et al. 2005). Butica et al. (2008) found that match incentives more than triple overall contributions (from 4.5% to 15.1%) and that they significantly increase the contribution rate even in most economically disadvantaged families.

Waldner (2011), in her prize winning essay “In Defense of College Savings Plans: Using 529 Plans to Increase the Impact of Direct Federal Grants for Higher Education to Low- and Moderate-Income Students,” presents a convincing argument in support of incentivizing college savings. She shows that savings have the same effects as grants, as they represent money available for college that does not need to be repaid. Thus, Waldner suggests that the effect of existing grants could be doubled if they were tied to savings. That is, by depositing grant money as a match into savings accounts, families and students are encouraged to save, which effectively increases the amount of money available for college. Since the existing grant money is redirected as match incentives, this comes at no additional cost to the state, but still increases the total money available for higher education since families or students have deposited their own money as well. Waldner argues: “This sum of money [\$500] would be a better incentive if the government could use it to encourage the family to pledge an additional \$500 toward the student’s education. IF that can be done, the amount of the grant received by the student is no longer \$500 of federal aid, but instead is \$1000” (p. 13).

Current financial aid system

Scholarships and grants

State and federal governments spend billions on financial aid each year. Scholarships and grants are an effective way to alleviate the financial cost of college and increase low-income students’ attendance. Grants have been shown to have the most weight in lower-income students’ cost and benefit calculations regarding college enrollment (Usher, 2006). Grants immediately alleviates the lack of cash

flow and do not need to be repaid. Dynarski found that aid eligibility increases college attendance and that "... a \$1,000 increase in the grant aid for which a person is eligible increases ultimate educational attainment by about 0.16 years and the probability of attending college by about four percentage points" (Dynarski, 1999, p. 36). However, as discussed above, statistics show that the financial aid available for low-income students increasingly cover less of the total college cost. Long and Riley (2007) found that low-income students "[...] have significant unmet financial need even after accounting for all grants and loans that are currently available" (p.42).

Another problem is that students do not do not receive the relevant information regarding availability of financial aid in a timely manner. For instance, in a survey of eleventh graders whose families did not go to college in Indiana, 69 percent did not think that they can afford college (Learn More Indiana, 2007). The perception that college is not affordable leads to many students putting less importance on their performance and grades during high school. By the time they learn about the availability of financial aid, the window of opportunity for college preparedness is quickly closing, rendering them uncompetitive.

For those who are driven and aspire to go to college, the complexity of college preparation and the financial aid application process is another problem (Dynarski & Scott-Clayton, 2007). "Rather than promote access, college admissions and financial aid processes often create a series of barriers that the poorest students must overcome to get to college" (De La Rosa and Tierney, 2007, p.1). The increasing cost of college, the lack of proper academic preparation, and the complexity of the college and financial aid application processes constitute significant obstacles, especially for low-income and first-generation students.

Loans

As the costs of higher education increase and the amount of financial aid decreases, parents and students have progressively turned to loans as a way to finance college. "The total volume of education loans disbursed doubled from \$55.7 billion (in 2011 dollars) to \$113.4 billion between 2001-02 and 2011-12" (College Board, 2012). A new study estimates "that that two-thirds (66%) of college seniors who graduated in 2011 had student loan debt, with an average of \$26,600 for those with loans" (The Project on Student Debt, 2012, p.2). It is usual that those with debt marry others with debt, increasing the family's burden. The estimated current student loan debt outstanding, including both federal and private student loans, has reached more than one trillion dollars (Rampell, 2012). Repaying these loans has become increasingly difficult. For the 2009 cohort, the default rate within three years of their first payment was 13.4 percent in 2011 (US Dept. of Education, 2012). The delinquency rate for students' loans rose to 11 percent in the July-September quarter of 2012, higher than the delinquency rate on credit cards (Federal Reserve Bank of NY, 2012). The National Consumer Law Center's survey shows that defaults are most likely higher for low-income students. While these numbers are alarming, they still do not reflect the full scope of the problem. As the Federal Reserve explains, "These delinquency rates for student loans are likely to understate actual delinquency rates because almost half of these loans are currently in deferment, in grace periods, or in forbearance and therefore temporarily not in the repayment cycle. This implies that among loans in the repayment cycle, delinquency rates are roughly twice as high" (O'Shaughnessy, 2012).

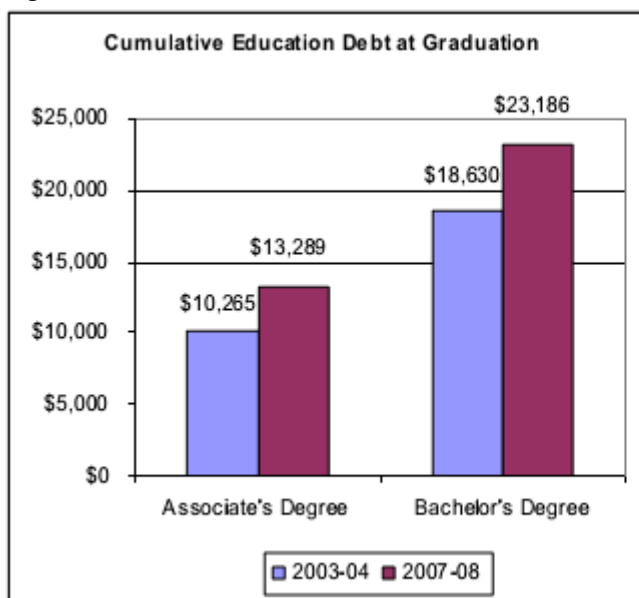
From Figure 2 and Figure 3, we can deduce that students from lower income families are borrowing more. These figures show the percentage of students graduating with debt, and their cumulative debt according to whether they are Pell Grant recipients or not. Pell Grant recipients who attend a four year college are significantly more likely to have loans (86.9%) than non-recipients (50.2%). They also have a higher amount of debt (\$24,671) than non-recipients (\$21,266).

While students' loans may have helped many who would have not been able to afford college otherwise, there are reasons to believe that this allowed universities to increase tuition and fees (Prosser, 2012). This only means that more loans will be needed in the future, which is an

unsustainable solution. Moreover, loans are increasingly burdening our younger generations. If the student debt continues to grow at this rate, it will also negatively affect the economy, as young graduates are increasingly delaying purchases that would otherwise feed economic growth.

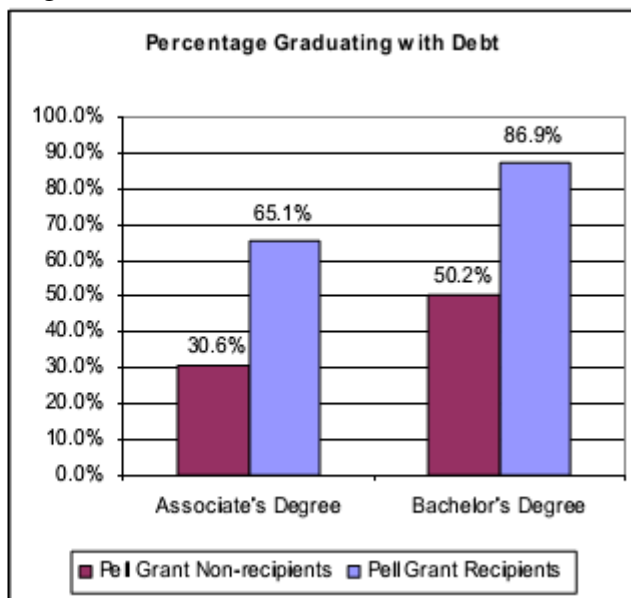
The collection of student debt is especially punitive not only because the loans are not relieved in bankruptcy, but also because the government as lender uses its full powers as fisc to collect its loans. Debts are collected through tax liens and denial of welfare payments, food stamps, Medicare/Medicaid, and social security payments, all of which affects the poor disproportionately.

Figure 2:



Source: Kantowitz, 2009

Figure 3:



Early commitment/awareness scholarship programs

Many states have implemented early commitment scholarship programs. They make a promise of financial assistance for college in return for a commitment from the student and his/her family that the student will meet certain requirements, such as maintain a minimum grade point average and be a good citizen. Scholars have demonstrated that the early promise of adequate financial aid not only helps students meet college costs, but can also help the family overcome other barriers to college. Students who know that college is an affordable option are more likely to prepare academically and be invested in finding the necessary help and information to enroll. Thus, these early commitment initiatives seek to provide a solution to the two greatest barriers for low-income students, affordability and academic preparation (Blanco, 2005). Most, but not all, of these programs are targeted to low-income students.

Examples of early commitment scholarship programs across the United States

- Indiana's Twenty-first Century Scholars Program
- Oklahoma's Higher Learning Access Program
- College-bound Scholarship Washington
- Early Commitment to College Program California
- Rhode Island's Children Crusade Scholarship
- The Wisconsin Covenant program (no guaranteed scholarship)

The following programs do not restrict eligibility to the neediest students:

- Georgia's HOPE Scholarship
- Florida's Bright Futures Program
- Nevada's Millennium Scholarship
- Colorado's CollegeInvest Early Achiever Scholarship

It is clear that increasing the financial aid in a targeted manner is an effective solution to closing the gap between under-represented and well-represented students. It provides financial relief only to those who need it. Unlike loans, this does not allow universities to increase tuition. However, as the Indiana Twenty-first Century Scholars program demonstrates (see appendix for a closer look at this program and its evaluation), these programs are expensive. In the context of Massachusetts, it seems unlikely that such a program would be established for now. While all of the need-based grants in Massachusetts amount to approximately \$95 million per year, in Indiana, the amount reaches \$220 million. Establishing such a program would require strong public and legislative support as it is a very targeted redistributive program demanding significant funds. Instead of state appropriations, which are difficult to ensure over the long term, some states have relied on revenues from proceeds from lottery sales, tobacco settlements, or taxes on tobacco products. If state funds are not an option in Massachusetts, perhaps these other sources of revenue could be considered.

In addition, these programs could also be expanded to include a savings component. In fact, the emphasis on early awareness provides enough time for families to save a considerable portion of college expenses. At this time, none of these programs provide incentives for savings. In light of the literature showing the positive effects of savings on academic performance and college attendance/completion, introducing saving incentives to these programs could increase their effectiveness.

Savings efforts around the world and the United States

Recognizing the social, academic, and financial benefits of saving, many countries have introduced different schemes of incentivized savings programs. Several have elected to establish national Child Savings Accounts, which are not exclusively for financing higher education. Hong Kong, Hungary, New Zealand, and the United Kingdom seek to promote asset building in general, so they do not restrict the use of the amount saved. Mexico, Puerto Rico, and South Korea restrict the use of savings to higher education, housing, and starting a business (in South Korea, weddings are also included). Singapore's program seeks to promote education, but if the savings are unused after the beneficiary is 30 years old, it can be used for any purpose. All of these programs provide different kinds of incentives, seed money, matches, and tax benefits (for more information see: Cheung & Delavega, 2012; Loke & Sherraden, 2009).

Canada has a program similar to the United States' 529 college savings accounts. Established as early as 1972, the Registered Education Savings Plans (RESPs) are college saving accounts with significant tax benefits. The Canada Education Savings Grant (CESG) was created in 1998 so that the government can provide matching incentives for all families (20% of the \$2,500 in annual contributions made to an RESP account). In 2004, the Canada Learning Bond (CLB) was established to specifically encourage low-income families by providing seed money and additional match incentives. In 2005, CESG was expanded to allow an additional 10 percent to 20 percent on each dollar of the first \$500 deposited, depending on family income. These additional matching incentives for low income families and efforts to better publicize the programs have led to an average annual growth rate of 37 percent for low-income families opening new accounts. (CESG Annual Statistical Review, 2011). Additional state-level incentives programs also exist in Alberta and Quebec.

In the United States, there have been pilot demonstrations across the states, such as the American Dream Demonstration (ADD) and the Saving for Education, Entrepreneurship, and Downpayment (SEED) Initiative. These pilots have generated a wealth of information regarding the various institutional designs for savings incentives programs, which will be covered in more detail below. Another proposal for a large national project in the US is currently under review, the College Savings Account Research Demonstration Project¹. This program will pair up with the existing Gaining Early Awareness and Readiness for Undergraduate Programs (GEAR UP) to provide 10,000 ninth graders with college savings accounts and match grants for their deposits. This will lead to new research, evaluations, and lessons learned regarding incentivized saving accounts. The program is expected to start next year.

Also, there have been various incentivized savings programs directly implemented by states in the last decade. Sixteen states have introduced matching grants for their 529 college savings accounts; one is not operational yet and two have been discontinued (see table 4 for more details). Some states have initiated smaller scale programs. In Iowa, the Office of the State Treasurer has partnered with College Aid, which administers GEAR UP for Iowa, to increase students' and parents' awareness of and access to the 529 college savings plan. The state has earmarked funds to award eight prizes of \$1,000 as seed money for 529 college savings plans (they are distributed via drawings of GEAR UP parents who completed a survey) (Doe, 2012). While North Carolina does not offer any seed or match funds, the local GEAR UP program is charged with leveraging community support for seed and match dollars to support GEAR UP families in their savings for college.

Table 2: Matching grants for college plans across the United States

State	Name of Program	Total Max. Match	Funding Source
Arkansas	Aspiring Scholars Matching Grant Program	\$2,500	529 Administrative fees
Colorado	Matching Grant Program	\$2,500	529 Administrative fees, revenues from loans
Kansas	KIDS Matching Grant Program	\$600	Appropriations
Louisiana	Earning Enhancements	\$2,400 to \$4,800	Appropriations
Maine	Initial Matching Grant	\$200	529 Administrative fees
Michigan	State Matching Grant Program (discontinued in 2009)	\$200	Appropriations
Minnesota	State Matching Grant Program (discontinued in 2011)	\$400	Appropriations
Missouri	MOST-Missouri's 529 College Savings Plan	\$2,500	529 Administrative fees, revenues from loans
Nevada	Silver State Matching Grant Program	\$1,500	529 Administrative fees, revenues from

¹ For more information refer to: <https://www.federalregister.gov/articles/2012/06/01/2012-13232/proposed-priorities-gaining-early-awareness-and-readiness-for-undergraduate-programs-college-savings#h-21>

State	Name of Program	Total Max. Match	Funding Source
			loans
North Dakota	College SAVE Matching Grant Program	\$300	529 Administrative fees, revenues from loans
Rhode Island	CollegeBoundfund	\$5,000	529 Administrative fees
	Matching Grant Program	\$2,500	529 Administrative fees
San Francisco	Kindergarten to College (K2C)	\$50 to \$100	City budget
Texas	Texas Save and Match (not active yet)		“Texas Match the Promise Foundation” – as 2011 about \$183,000
Utah	Fast Forward Matching Program	\$400	529 Administrative fees, revenues from loans

In Massachusetts, the 529 plans are administrated by the Massachusetts Educational Financing Authority (MEFA). MEFA is a non-for-profit self-financing state authority that does not rely on state of federal appropriations. MEFA works with Fidelity Investments, which manages the tax advantages and age-based savings strategies. Massachusetts’ 529 plans are not as progressive as other states’. There are no seeding or matching incentives for low- to moderate-income families. Massachusetts is among the six states that have state income tax and do not provide a state tax deduction for contributions to 529 accounts². However, money withdrawn for qualified higher education expenses is exempt from state income tax. Massachusetts is one of the few states that does not have any special provisions allowing recipients in its Temporary Assistance for Needy Families (TANF) program to exclude funds held in a restricted account from countable assets (MA Asset Development Commission, 2009). Families are disqualified from TANF if they hold more than the \$2,500 limit in savings. The same is true for the Supplemental Security Income (SSI) program (asset limit of \$2,000). This penalizes those families who made an effort to save by disqualifying them from welfare programs, and encourages more spending to remain eligible. Massachusetts college savings plan is regressive. In fact, research show that less than 1.3 percent of 529 accounts are held by families having assets under \$15,000 (excluding primary residence) (Massachusetts Asset Development Commission, 2008).

Institutional designs options for college savings accounts

The pilot demonstrations and state-level programs mentioned above have revealed important information that should be considered by policy makers planning their own incentivized savings programs. These include important design features as well as options for funding resources, covered in greater detail below. This report is mindful of the following elements in its consideration of a potential pilot program.

² The other states are California, Hawaii, Kentucky, Minnesota, and New Jersey.

ACCESSIBILITY/INCLUSIVENESS

Eligibility

The eligibility requirement will determine who the program is targeting. There are various options in determining eligibility. Some programs allow every account holder to benefit from the provided incentives; others restrict the matching grants and seed money to families under a certain income. Some use a progressive structure, e.g., in Canada the percentage of every dollar matched increases as income decreases. Other plans provide different match rates (1:1, 2:1, 3:1, and 4:1) depending on family income. A simpler eligibility condition is to provide incentives for all families that qualify for free or reduced price lunch.

Enrollment option: opt-out or in

An important policy consideration regarding incentivized savings accounts is their degree of inclusiveness. Procrastination, inertia, indecision, and lack of awareness and understanding have been identified as common reasons for not opening an account (Han & Sherraden, 2009; Lassar, Clancy, & McClure, 2010). Lower-income families are most negatively affected. Typically, low-income families have lower awareness of such programs; hence they build up their children's assets at a much slower pace. Studies have shown that the positive effects of automatic account opening are most evident among those who are traditionally low savers: younger employees, lower-paid employees, and African-Americans and Hispanics (Choi, Laibson, & Madrian, 2004; Madrian & Shea, 2001).

A way to offset this effect is to implement an automatic enrollment with an opt-out option. In SEED, Oklahoma's pilot experiment, researchers found that if an account was automatically opened, nearly 100 percent of families accepted it (one family opted out due to religious reasons). In the control group, only 2.3 percent opened an account. In contrast, in Maine, the decision to enroll was left to the parents and enrollment was low. As a part of the Harold Alfond College Challenge, parents have the choice to open a 529 account and be eligible for a \$500 seed deposit. It was envisioned that this \$500 would provide enough of an incentive for enrollment, but it was far from sufficient to achieve universal enrollment. Moreover, the participants were mostly middle and higher income families.

If near-universal enrollment is desired, automatic enrollment with an opt-out option is the strategy (Huang, Beverly, Clancy, Lassar, & Sherraden, 2011). As we will discuss later, if automatic enrollment is not present, then simplicity of the application process is key to increasing account ownership.

It is important to note that automatic account opening does not necessarily increase saving amounts. Actually, the level of deposits is often lower in an automatic account opening plan than in an opt-in plan, especially when the default contribution rate is low (Choi, Laibson, & Madrian, 2004; Madrian & Shea, 2001). Automatic enrollment can also lead to many accounts being unused, increasing the administrative and maintenance costs.

Eliminating asset limits

There is a wide consensus that asset tests to determine eligibility to certain welfare programs are significant disincentives to save for low-income families. Eliminating them is a widely advocated recommendation, and in fact, most states have excluded 529 accounts from Temporary Assistance for Needy Families (TANF) asset limit.

Ease of application

If automatic enrollment (with opt-out option) is not a part of the design then a simple application process is essential to increase participation in the program. An application that singles out straightforward and safer investment options is more attractive to low-income families who can be discouraged by complicated financial language. For instance, Maine's two step application process was

complicated, which dissuaded many, especially low-income families, from enrolling.

Fees and deposit requirements

Lower or no account fees and smaller deposit requirements increase enrollment rates of lower-income families.

Opening accounts at birth, kindergarten, middle school, or any time

The longer the life of the account, the more savings and earnings accumulates. However, even though parents think they should start saving for college when their child is two years old, they actually do not start saving until the child is six years old (FinAid, 2004). Since many studies show the positive aspects of college savings, such as fostering a college-bound identity, increasing family engagement, and encouraging students and families to learn more about financial aid availability and the college application process, starting college savings accounts during middle school or the first years of high school may be desirable.

INCENTIVES STRUCTURE

Tax benefits, deductions, credits, refundable or not

One overarching finding is that tax incentives granted to 529 accounts do not appeal to low- to medium-income families and are regressive. The primary benefit of a 529 plan is its exclusion from income, which disproportionately benefits higher income taxpayers (higher brackets). In fact, Waldner (2011) shows that since there is no restriction on the number of accounts in each beneficiary's name across the states, the 529 plans can be used as a tax shelter by high-income tax-payers. Also, the plans offer no federal incentives for the taxpayers in the zero income bracket who can make no use of an exclusion or deduction. Refundable credit would provide an incentive to low- to moderate-income families. However, Waldner (2011) argues that "empirical evidence has shown that people are more incentivized by the matching grant than the equivalent credit" (p. 14).

Incentives – Matching and seeding

Several studies found that seeding and matching can make saving more attractive to low-income families (Clancy, et al., 2006; Kempson, McKay & Collard 2005; Sherraden et al. 2005). They also help increase accumulations at a faster rate. SEED experiments show that seed deposits help accumulation, but contrary to expectation, they do not motivate families to save more. Match incentives are found to more than triple overall contributions (from 4.5% to 15.1%) and they significantly increase the contribution rate even in most economically disadvantaged families (Butica et al., 2008).

Match rate

High match rates reduce risk of unmatched withdrawals and risk of exit, but they do not affect average monthly net deposit (AMND) (Han & Sherraden, 2009). Higher match rates increase savings (Mason, et. al 2009), but do not motivate families to save more of their own money.

Yearly cap for match

Higher savings targets result in higher AMND and reduced risk of exit. Match caps are usually perceived as goals, so the higher the cap the greater the saving effort (Lassar, Clancy & McClure, 2011; Han & Sherraden, 2008). Higher match limits are likely to motivate families to save more, but they also increase the cost of the program.

The ease of the procedure to apply for match

Account holders are often dissuaded from applying for a match grant, especially when the amount deposited is small. Omitting separate savings match applications increases savings (Lassar, Clancy &

McClure, 2011). For instance, to avoid this problem, Louisiana residents are simply asked to complete a one-time application for the state's 529 savings incentive program (START) to receive their annual match. In addition, Louisiana uses state Department of Revenue tax records to automate match eligibility.

Savings goal

Fidelity Investments' and MEFA's Sixth Annual College Savings Indicator Research report of 2012 indicates that in Massachusetts, 19% of parents plan to pay all of their children's college costs, and 75% of parents plan to pay a portion of it, while 6% of parents do not plan to pay any of their children's college costs. On average, Massachusetts parents envision paying for 59% of the total cost of college, hoping to get additional financial support through grants, scholarships, and loans. However, the study shows that in reality, average families are on track to meet 23% of this 59% savings goal. This means that families will on average cover only 13% of the total college costs (a decrease from 24% last year)³. The saving goal for a potential college savings program should take these numbers into consideration. Even for the average 529 account holders, who are typically middle- to upper-income families, the average savings goal is relatively low.

Other considerations

Increasing the difficulty of withdrawal is an appreciated feature for most families, who do not want the temptation to dip into their savings. Transferability of unused funds to other family members is also desired in case the parents worry that their child decides not to attend college. Increasing access to the account and facilitating contributions are measures that promote overall savings. Electronic funds transfer, online sign up and access to account, payroll deduction options, and allowing friends and family to make contributions can all help increase savings.

FINANCIAL EDUCATION CLASSES

Financial education is positively associated with savings (Han & Sherraden, 2009; Curley et al., 2005; Schreiner et al., 2002). Since financial education is costly to deliver, for policy purpose, it is beneficial to know the most productive hours of education. The American Dream Demonstration showed that 10 to 12 hours of financial education significantly increase AMND, but additional hours have little effect. The study suggests that 6 to 12 hours of financial education is all that is needed to have large impact on savings (Schreiner, et al, 2001). Also, it was found that incentivizing participation to financial education was positively associated with increased savings. In fact, the incentive can be the only significant source of deposit for lower income families (Sherraden, et al., 2012).

Another policy consideration is whether the classes should be geared to parents, students or both. *I Can Save* (ICS) matched savings program for elementary school (2003-2007) in Missouri introduced an after school club where children learn about financial issues and 'earn' small amounts to deposit in their ICS accounts. Children were exposed early on to saving habits and were going to the bank monthly to deposit their earnings. The long-term benefits of this program are still to be seen.

While establishing an early understanding of saving is important, students can benefit from learning how to manage their finance. Once they enroll in college, many students do not know how to make a budget and manage their money. Parents on the other hand, are the main contributors to college savings account, so enhancing their knowledge about savings products and services can increase their engagement and their savings performance. To decrease the cost of providing financial education as a part of a college saving program, it is optimal to partner with banks, organizations, nonprofits, and/or higher education institution that already have know-how on the subject. The partner's curriculum could be adapted to the specific needs of the program and delivered by their personnel.

³ For more information, refer to: <http://www.fidelity.com/inside-fidelity/individual-investing/college-savings-indicator-2012>

FINANCIAL AID AND COLLEGE APPLICATION SUPPORT

Family support and involvement is important in the process of college preparation, financial aid and college application. However, first generation and/or low-income families often do not have the knowledge necessary to successfully orient, prepare, and guide their children into post-secondary education (Cabrera & La Nasa, 2000). This information gap results in lower college enrollment rates among these families (Cunningham, et al., 2007; Ishitani & Snider 2004). Providing families and students with financial aid application support and college application guidance can help improve the enrollment rate. Families will already be invested in the idea of higher education as they save for college, thus they will be more receptive to such information. Also Elliot, et al. (2011) show that asset building programs that increase both savings and college-bound identity are more effective at increasing account ownership and positive college outcomes than those solely focused on savings. Again, partnering with organizations that have expertise in delivering such program is most effective.

ACCOUNT VEHICLE OPTIONS

Individual Development Accounts (IDAs)

An IDA is a special matched savings account designed to help low-income individuals save for home ownership, education, a small business, or other approved use. The length, match rate, and structure of IDA programs vary, but they are required to offer some sort of financial education. The American Dream Demonstration (ADD) was the first large IDA experiment with 13 programs across the United States. It was developed and guided by the Corporation for Enterprise Development (CFED) over four years (1997-2001). The Center for Social Development (CSD) at Washington University in St. Louis evaluated the demonstration. In Massachusetts, the budget for IDA match was eliminated in the FY 2010 budget⁴.

Coverdell Education Savings Accounts (formerly known as IRAs)

These are tax-sheltered accounts established under the uniform Transfers to Minor Act (UTMA) that allow for savings to grow tax free until withdrawn. If the distributions are less than the qualified education expenses at an eligible institution, the beneficiary will not owe taxes⁵. The savings are to be used for education only (secondary, post-secondary, or job training). These accounts have the child as beneficiary and the financial institution as custodian, with generally a parent or guardian as designated responsible individual (Howard et al., 2010). These accounts only allow \$2,000 deposit a year, which can be a limiting factor.

529 college savings accounts

These accounts are offered by every state and are the primary college savings vehicle. These accounts are to be used strictly for post-secondary education or job training. The accounts have federal tax benefits and some states allow contributions to 529 accounts to be deducted from state income tax. As mentioned above, some states also provide seed and match incentives to encourage savings and attract low-income account holders. If the savings are not used by the designated beneficiary, the funds can be transferred to another child in the family. The 529 plans usually come in two forms, tax advantaged savings accounts or prepaid tuition programs. In Massachusetts, the equivalent of these plans are UFund and UPlan, respectively. There are about ten million 529 accounts nationwide (Black & Huelsman, 2012). These accounts are mostly utilized by middle- to upper-income families. Although there have been many efforts to increase their accessibility to low-income families by decreasing initial

⁴ See: <http://www.masscap.org/assetdev.html>. Also, there are proposed items in the FY 2012-13 budget, for an amount of \$50,000 to \$100,000, but it is likely already allocated to a specific program.

⁵ For more information, refer to: <http://www.irs.gov/uac/Coverdell-Education-Savings-Accounts>

deposit amount, eliminating account fees, and minimum monthly deposit requirements, only about 9 percent of account holders have are reported to have annual incomes below \$50,000 (Bearden, 2009).

Traditional and Roth Individual Retirement Accounts (IRAs)

These accounts are designed to provide retirement income, but early withdrawals are allowed for education and home purchases. These accounts are tax-sheltered and they receive the most advantageous treatment from a financial aid perspective (Howard et al., 2010). However, since the deposits must be made from earned income by the account owner, it might not be suitable for children's accounts. It may be a good option for older youth who have a job.

Regular savings accounts

These accounts allow for the most flexibility of use, and are a more familiar product. However, they do not have federal or state tax benefits and they earn significantly less compared to other account options. They are not suitable for large scale programs, although the City and County of San Francisco has partnered with City Bank, for their innovative Kindergarten to College program (K2C), as other account vehicles were not suitable to their desired scheme. In fact, to avoid tax issues, the K2C accounts do not earn interest. "Instead sub-accounts are awarded a 'growth amount' similar to interest, but a student will only receive the growth match if they use the funds for post-secondary education" (Phillips & Stuhldreher, 2011). The K2C program shows that innovative solutions can be created to circumvent certain problems.

PROGRAM ADMINISTRATION

The selection of the program administrator for an incentivized savings program depends on the account vehicle used. The sixteen states already implementing such programs use their 529 college savings plan and the agency entrusted with administering and managing the program is also responsible for following, recording, and reporting account activity, as well as tracking, calculating, and distributing savings incentives. If the 529 structure is not used, the financial institution hosting the selected account vehicle would be the ideal candidate for managing the incentivized program. However, the City of San Francisco's experience demonstrates that finding a financial institution willing to accept the responsibility and the expenses of such program is not easy (Phillips & Stuhldreher, 2011). For a potential pilot program, the administrative and financial burden could be shared by partnering with organizations already administering such programs, such as Families United in Educational Leadership (FUEL), the Midas Collaborative, or uAspire (formerly known as ACCESS).

FUNDING SOURCES

Funding ideas from various programs around the US (see table 4 above)

State appropriations: Some states (Kansas, Louisiana, Michigan, and Minnesota) have used appropriations for their 529 college saving match programs.

MEFA's revenues from 529 accounts fees and loans: In Arkansas, Colorado, Maine, Missouri, Nevada, North Dakota, Rhodes Island, and Utah, the state agencies administering the 529 plans use revenue from plan fees and loans to finance the match program.

Private foundations/trust fund: Texas has tried an innovative funding scheme. A trust, the *Texas Match the Promise Foundation*, was created to accept private donations that will fund the prospective match program. Since 2009, the trust has accumulated \$183,000. The match program has not started yet.

Partnering with GEAR UP program: Some states have earmarked funds in their 529 college savings plans for GEAR IP.

New proposed sources

Redirecting existing grant money as incentives for savings: Existing grants and scholarships (local, private, state, or federal) could be used as match incentives for college savings (Waldner, 2011). This comes at no additional cost, since existing funds would be used to match savings accounts, which would only be redeemable if the student uses the savings and match for higher education purposes.

Challenge grant (state and private money): The state can initiate a challenge in which private organizations and foundations would contribute half of the cost of the program.

RECOMMENDATION

This report recommends that Massachusetts designs and carries out a pilot program to support parent savings, learning, and awareness that will encourage their children to attend college. It is hoped that a successful pilot would create public support for a state-wide program in the future. Using the experience and success of other states' programs as outlined above, [the commission/TBF] recommends the following general structure for the pilot.

SCENARIO FOR PILOT MATCHING GRANT PROGRAM

Providing matching funds to encourage savings for college

The pilot program would be established in five school districts, with 100 participants in each location. To be eligible, the student should be in ninth or tenth grade and eligible for free or reduced lunch program. The program would have an automatic enrollment with an opt-out option. The pilot would be a two years program, where the participants would be asked to save \$500 over the two years. The program would match dollar for dollar (1:1), which would result in \$1000 total savings per student at the end of the program. The suggested account vehicle for the pilot is the 529 college savings accounts with Fidelity/MEFA. The match would be deposited directly into the account. The estimated total cost of the program is \$250,000 per year, with some additional funds for administration.

Possible elements of a pilot

Various sources of funding should be considered to finance the pilot program, including local organizations, private foundations, and state appropriations. An innovative funding scheme would be to use existing MassGrant money to match the savings accounts. The grant would trickle into the savings accounts as matches while the student is still in high school. When the student applies for financial aid, the amount already disbursed into his/her savings account would be discounted from the MassGrant award he/she is eligible for. In this funding scheme, since the student would have already been eligible for this grant money, the family does not receive any additional incentives. However, in terms of research and evaluation, it would be very interesting to investigate if the behavior of saving for college alone increases financial aid awareness, high school performance, and college enrollment.

Financial literacy education, tutoring sessions for saving families, and financial aid and college application support programs would be very beneficial since it has been demonstrated that they significantly increase savings and academic performance. As suggested, these courses would be delivered in short sessions and would not exceed 12 hours. However, since these programs are expensive and require personnel and expertise, partnering with organizations already active in delivering such program could be a cost-effective solution.

The location of the five school districts could be selected from among Massachusetts' gateway cities. These urban centers typically have average household income below the state average and a higher educational attainment rate below the state average.

The pilot program should be designed so that an effective evaluation of the program can be undertaken. The evaluation would assess the responsiveness of low-income families to college savings incentives. Responses to be measured by the effect of a college saving account on:

- high school completion
- college attendance
- college financing decisions
- college debt levels
- college graduation

All of these outcomes could be compared with representative group of non-participants.

The lessons learned from the evaluation would inform the realization of an effective and well-targeted state-wide program. In the future, when funds are available, a progressively incentivized college savings program, accessible to all eligible low- to moderate-income families, can be designed according to the best practices from the pilot and other national programs.

SCENARIO FOR STATE MATCHING GRANT PROGRAM

Providing matching funds to encourage savings for college

A structure similar to the pilot program with \$500 savings goal and a 1:1 match rate could be implemented for a state level program. The number of participants would be greater, up to 2,500 families. The estimated cost of such a program would be \$1 million per year.

Possible additional services

A state level program would also benefit from offering a financial literacy education, tutoring for saving families, and financial aid and college application support programs. To increase college affordability and reward families who are savings, colleges could issue scholarships for students who have a college savings account.

APENDIX
Indiana’s Twenty-First Century Scholars Program

With its bold early commitment program, the State of Indiana promises full tuition and fees to attend its fifteen public colleges to its seventh and eighth graders who commit to fulfill the Scholars’ pledge. These students are also given college preparation support through mentoring, tutoring, and college visits (see table 3 for full description of eligibility, scholars’ pledge, benefits, and requirements for renewal). The program also offers support programs for parents, such as college preparation workshops, financial aid workshops, regional parent conferences, study skills, time management, CORE 40, and parent advocacy workshops (Jones, 2008).

Table 3: Description of the Twenty-first Century Scholars Program

Eligibility	Be an Indiana resident, and US citizen or eligible non-citizen Be enrolled in seventh and eighth grade at a state-approved school (before 2011, it used to include sixth grade as well) Income no more than to qualify for federal free and reduced price (after 2011, will be re-evaluated every year)
Pledge	Graduate from a state-approved High School with at least a 2.5 GPA (for class of 2014 and before, it is 2.0 GPA) Must participate in an academic success program Not commit any crime and not use drugs or alcohol Apply for admission to an Indiana postsecondary institution as a High School senior Apply on time for state and federal financial aid
Benefits	Support for college preparation Full tuition and fees guaranteed for eight semesters Coverage of any remaining costs if already receiving other financial aid
After High School	Use scholarship within one year (instead of two) Participate in an academic success program (after 2011) As freshmen, meet satisfactory academic progress (after 2011) As sophomores, maintain at least a 2.25 GPA (after 2011) As juniors and seniors, maintain at least a 2.5 GPA (after 2011)

Source: compiled by author using the Twenty-first Century Scholars Program website:
<http://www.in.gov/ssaci/2345.htm>

Evaluations of the program and lessons learned

Evaluations of the program show that it is well-targeted.

Table 4: Students characteristics whether they are Twenty-first Century Scholars or FAFSA fillers

	Twenty-First Century Scholars	FASFA Fillers
First Generation College Students	60.30%	43.60%
Single-parent families	54.50%	30.20%
Average family income	\$25,842	\$62,178

Source: Indiana Commission for Higher Education (2011)

The program decreased the enrollment gap between historically underrepresented and well-represented students (Stransky & Good, 2009). In terms of high school academic performance, Scholars perform better than their peers (St. John, 2011). 70% of Scholars completed Core 40 diplomas compared to 60% for all students (Orr, 2008). Scholars have more access to advanced courses and they are four times more likely to enroll in a four-year university (Stransky & Good, 2009). Their use of loans is also greatly reduced. Another study showed that Scholars are more likely to graduate from high school (79%) compared to all students (76%), and especially compared to low-income students (59%) (SSACI, 2007). All of the studies evaluating the Twenty-first Century Scholars Program confirm that high school performance, college preparedness, and college enrollment have improved, and the program is a success in reducing inequality and providing more college access to low-income and/or first generation students.

The program, however, has not delivered in terms of retention and completion rates (this outcome resulted in some changes in 2011, discussed further below). For instance, among the 1999 cohort, 32% of Scholars graduated from an Indiana four-year public colleges, compared to 30% of low-income students and 48% of total students. While the scholars performed slightly better than low-income students, they greatly underperformed compared to all students. Since the majority of Scholars were found to be academically well-prepared for college, other variables must explain their inability to persist. A thorough qualitative study of the Scholars found that the following aspects were lacking: identification and communication system for Scholars after high school, transition and support programs targeted to Scholars, follow-up mentoring and support services during college, additional financial support specifically for books, room, and board (Smith 2008). Similarly, an evaluation from Lumina Foundation (2008) found that the financial aid that Scholars received, although very generous, was simply not enough. They also stressed the importance of targeted orientation, mentoring, tutoring, and learning community programs, and expressed concerns that their availability varied substantially across campuses.

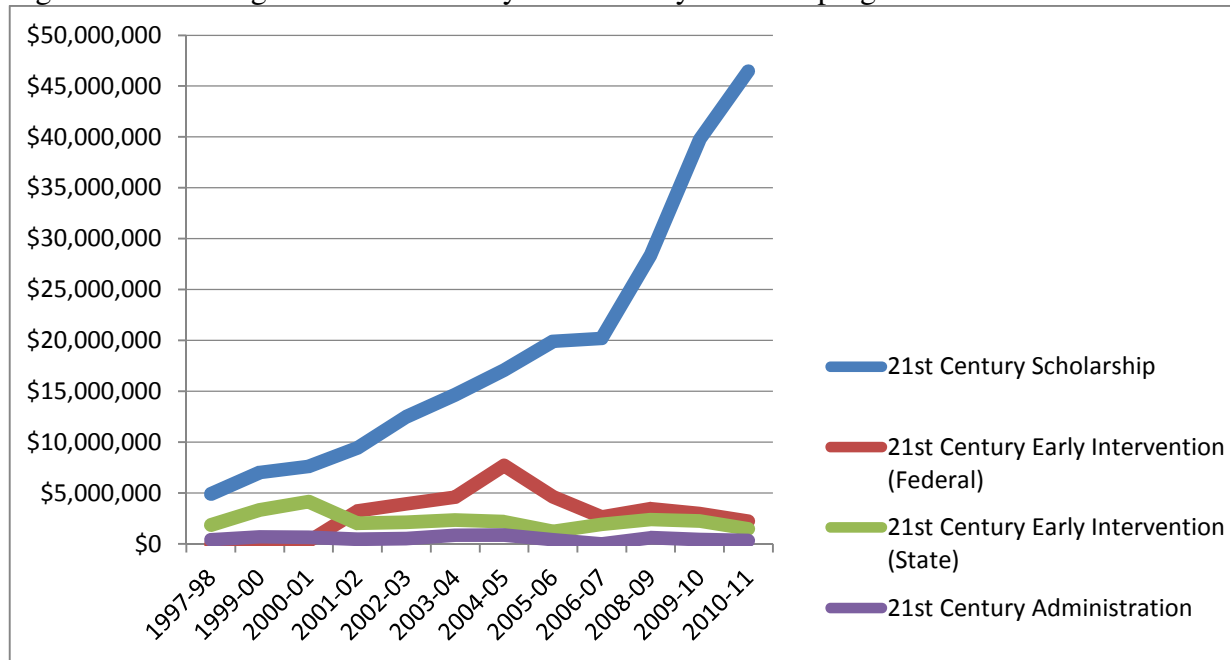
After these evaluations and lessons learned, the Twenty-first Century Scholars program was modified (see table 3, changes indicated in red). The grade requirements have been raised in the hope that it will further improve college readiness, and high school and college performance. The requirement of reporting to a mentoring/tutoring program has been strengthened. There has been more emphasis on the requirement that participating public, private, and proprietary colleges and universities provide adequate mentoring programs to support the academic and social needs of the Scholars. Also, a new outreach support model for the Scholars program has been recently established in 2012. The central Twenty-first Century Scholars Office employed new regional outreach coordinators, which will help centralize and standardize the various programs across colleges and universities. Some universities, like Indiana University Bloomington, Indiana University Southeast, and Purdue University, have created a special office for Scholars enrolled at their institutions. In addition, many participating colleges and universities offer special incentives for Twenty-first Century Scholars who attend their institution, including additional grant money to help cover educational expenses outside tuition to application and housing fee waivers. For instance, IU Bloomington has created the *21st Century Scholarship Covenant* to meet the remaining needs after tuition and fees, based on the family's expected contribution, so that students can close the financial gap that prevents them from enrolling in or completing college. It is of course too early to evaluate the effects of these changes.

The Twenty-first Century Scholars program is considered a success and the modifications are expected to improve college level performance. While the program has inspired other states to do the same, a major deterrent is the cost of the program. Such an ambitious program requires significant and continuous public funding. What is more, the Twenty-first Century Scholars program is only 'last-dollar' aid. That is the Pell Grant and any other state or private grants are applied first, and only the remaining is covered by the Twenty-first Century Scholars program. In fact, Indiana already funds a generous need-based grant program, the Frank O'Bannon grant, which generally covers 80 to 100

percent of the tuition and fees minus the expected family contribution. This grant is funded through appropriations made by the Indiana General Assembly and amounts to about \$170 million dollars annually.

The growing popularity of the program brought more enrollment, which significantly increased the cost of the Twenty-first Century Scholars program, especially after 2005.

Figure 4: Increasing Cost of the Twenty-first Century Scholars program



Source: Data compiled by the author using State Student Assistance Commission of Indiana annual Activity and Program Report.

Between 2005 and 2010, 13 to 18 percent of the annual budget for O'Bannon grants was redirected to meet the increasing cost of the Scholars program (St. John, 2011). This was deemed unsustainable and unfair as it took funds away from other need-based students. Thus, in 2011, a fiscal change was instituted and the Twenty-first Century Scholars program is no longer supported by other scholarship programs. Moreover, the income eligibility of the scholars is to be re-evaluated each year, as it was found that about 20% of scholars were no longer eligible in the following years. This is expected to save about \$9 million per year (Hayden, 2012).

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