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Saving for College in Maine A Review of Current and Prospective Programs

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Saving for College in Maine
A Review of Current and Prospective Programs

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For

Maine Community Foundation

May 2004

Table of Contents

1. Introduction and Summary 3
The Cost of College
Saving for College
Structured Savings Programs in Maine
Building Expectations
Designing a New Initiative
Prospective Programs
Next Steps

2. Background on Savings and Assets 11
Current Figures
Paying for Education
Savings Targets

3. Maine Savings Programs 14
Individual/Family Development Accounts
NextGen College Investment Plan

4. Other Savings Programs 16
Individual Development Accounts
Lifelong Learning Accounts
Savings for Education, Employment, and Downpayment
U.K. Children's Trust Fund
Tax Incentives
Prepaid Tuition
Individual Retirement Accounts
Series EE Bonds

5. Program Results and Evaluation 20
Maine Savings Programs
i. Maine Family Development Account Coalition
ii. Coastal Enterprises Inc.
iii. Washington Hancock Community Agency
iv. NextGen College Investment Plan
v. Drawbacks of Existing Maine Programs
vi. Advantages of Existing Maine Programs
Results of the American Dream Demonstration
i. Rural Results - Participation
ii. Rural Results - Administration
iii. Match Rates

6. Synthesis of the Issues 25
Program Need
Program Success

Eligibility
Fund Usage
Incentives
Funding
Third-Party Contributions
Administration
Marketing
Federal and State Legislation
Effects of Assets on Aid Eligibility

7. Prospective College Savings Programs ……………………………………..34
- I. Maine Children's Development Accounts – Nonprofit Based
  - i. Eligibility
  - ii. Fund Usage
  - iii. Incentives
  - iv. Third-Party Contributions
  - v. Funding
  - vi. Administration
  - vii. Marketing
  - viii. State Legislation
  - ix. Summary
- II. Maine Children's Development Accounts – Institution Based
  - i. Eligibility
  - ii. Incentives
  - iii. Administration
  - iv. State Legislation
  - v. Summary
- III. Maine Individual Learning Accounts
  - i. Eligibility
  - ii. Fund Usage
  - iii. Incentives
  - iv. Third-Party Contributions
  - v. Funding
  - vi. Administration
  - vii. Marketing
  - viii. State Legislation
  - ix. Summary

8. Conclusion……………………………………………………………46

9. References……………………………………………………………47

1. Introduction and Summary

The Cost of College

Maine's recent high school graduates are not pursuing postsecondary education at the same rate as their national peers. Of those who graduated high school in 2000, 54.3% enrolled in postsecondary education the following fall (National Center for Education Statistics, 2002). This is below the New England average of 63.3% and the national average of 56.7%.

This lag is felt even more deeply in Maine's rural communities. For various reasons, rural students have historically had lower rates of college attendance than their urban and suburban peers. In a 2000 national survey, 58.8% of recent rural public high school graduates were attending colleges and universities, compared to 68.2% of urban and suburban graduates; although 10.1% of rural graduates were attending technical schools, compared to 7.5% of their urban and suburban peers (National Center for Education Statistics, 2002). These differences may reflect disparities in income, preparation, aspirations, perceptions of returns to education, and a variety of other factors.

Affordability may be one of the primary factors contributing to Maine's lower college attendance rate. Without an accumulation of savings, finding the resources to pay large lump sums for postsecondary education is often very difficult, particularly for low-income households. Full-time undergraduate tuition for in-state students currently costs $2,040 per year at Maine's community colleges, and roughly $4,297 at the university system. These figures do not include extra costs for fees, books, transportation, room and board, and forgone earnings.

In *Measuring Up 2002,* the National Center for Public Policy and Higher Education reports for each state the percentage of income needed by families in the lowest income quintile to pay tuition and fees at the lowest-priced state colleges. This is a rough measure of affordability because it does not take into account financial aid or the additional costs of college attendance; however, it gives us an idea of what low-income households are facing. By this measure, Maine's poorest families would have to spend about 20.7% of their annual income for one child to attend a community college. This ratio is almost double the national figure of 11.9%. By this measure, Maine was 6th highest in the nation and 3rd highest in New England.

A 2002 study by the Mitchell Institute reported that 35% of Maine high school juniors and seniors felt that it was "somewhat" or "highly" likely that money would be the determining factor of whether or not they attended college. The same study reported that 34% of parents with children age 12 to 18 felt that finances would be "somewhat" or "highly" likely to determine whether or not their child attended college. Financial concerns are likely stronger for rural households, which have lower average earnings than urban households.

These findings suggest that addressing the real and perceived cost barriers involved in postsecondary education could increase the number of Maine students attending college. Furthermore, an effort to raise educational attainment will be most effective if it is targeted toward students who are most hindered by affordability issues, namely those from low-income and rural households.

Saving for College

In the Mitchell study, 58% of parents of Maine high school juniors and seniors said they were "actively saving money to help finance a college education." However, "higher-income households [were] significantly more likely to be saving than lower-income households." These findings are consistent with a national survey that found 64% of households with children under age 18 were saving for college (Investment Company Institute, 2003). However, only 40% of households with annual incomes under $50,000 were saving, compared to 65% and 72% of households with incomes between $50,000 and $74,999, and $75,000 or higher, respectively.

Current use of state and federal education savings plans (529 plans and Coverdell Education Savings Accounts) reflects a similar effect of income on savings. In 2003, the median income of households using one of these plans was $99,200, and median household financial assets, including employer-sponsored retirement plans and excluding primary residence, were $129,100 (Investment Company Institute, 2003). For comparison, in 2002 the median income of all households with children under age 18 was $52,336 (U.S. Census Bureau, 2003). The median income of 529 and Coverdell users is so high because fewer low-income households than high-income households are saving through these plans.

This suggests that many low-income earners are not using the principal savings tools available to them. Many non-saving households are not even aware of those opportunities. In a nationwide survey, 42% of households with children under age 18 that were not saving for college were unaware of state-sponsored prepaid tuition plans; 44% were unaware of state-sponsored college savings plans; and 57% were unaware of Coverdells (Investment Company Institute, 2003). Even if families are aware of these plans and prepared to save, there is evidence that under some circumstances they reduce the amount of need-based financial aid for which low-income students are eligible (Ifill and McPherson, 2004).

Structured Savings Programs in Maine

Several organizations within Maine are helping low-income families accumulate assets through structured savings programs. The Maine Family Development Account Coalition, Coastal Enterprises Inc., and the Washington Hancock Community Agency together administer several hundred Individual and Family Development Accounts (IDAs and FDAs) throughout the state. These accounts are designed to help low-income households accumulate savings with which to purchase a "productive" asset that will generate long-term benefits, such as a home, postsecondary education, and small-

business capital. Account holders are generally required to set asset goals, meet regular savings commitments, and attend financial education courses. In return, they receive generous matches to their deposits. A deposit of one dollar is matched with two or more dollars from another source, creating a strong incentive to save. Local community organizations that administer the accounts work closely with participants to ensure their success. Similar programs nationwide are demonstrating that low-income earners *can* save through structured programs.

The State of Maine offers a 529 college savings plan, the NextGen College Investment Plan, which is administered by the Finance Authority of Maine (FAME). As with most state 529 plans (named for Section 529 of the Internal Revenue Code), earnings and withdrawals are exempt from state and federal taxation if used for qualified education expenses. Additionally, new account holders with family incomes at or below $50,000 can receive an initial match of up to $200. In following years, those account holders can receive up to $100 annually in match funds.

Both IDAs and NextGen accounts are helping some Maine families save for college expenses. However, IDA programs face continual funding challenges and time limits, and are serving small, targeted populations. NextGen accounts serve a larger population, but do not provide low-income holders the generous incentives that IDAs offer. Also, evidence suggests that the tax benefits offered by 529 plans may not be suitable for very low-income earners with low tax liabilities (Parish, 2004).

Building Expectations

Whether for lack of resources, knowledge, or desire, many low-income households are not saving for their children's future education expenses, and many of Maine's recent high school graduates are not continuing on to college. In light of these findings and current movements within the state, the time seems right for a college-savings initiative that strives for inclusiveness and impact. *Inclusive* means that the program will reach out to populations for which college attendance has not been a viable option, and it will do so by gathering broad support from Maine's policy makers, businesses leaders, educators, nonprofit representatives, and service providers. *Impact* means that the program will target people on the cusp of college attendance and for whom affordability is likely to be the determining factor. In Maine, those people generally come from low-income and rural households.

A program to increase college savings among Maine families would do more than increase the amount of financial resources available to recent high school graduates. It would spark a change of attitudes and expectations. In today's economy, a high school diploma is no longer enough to guarantee financial security; postsecondary education is becoming a necessity. A savings program for young children will inspire the early idea of college as a realistic goal and the expected next step after high school. It will promote college for all children as a state priority, and demonstrate the availability of outside assistance to help make a college education attainable.

A college savings program for young children will also act as a vehicle for informing families early and often about all aspects of postsecondary education. Through marketing, public information sessions, quarterly statements, and other outreach activities, the program will continually remind parents and guardians of the value of college attendance, the importance of planning, the availability of aid, and so forth. The delivery and content of this information will vary according to the child's age, in order to give families the right information at the right time. By supporting the expectation of college attendance for all children, a savings program will increase the likelihood that dreams become reality.

Designing a New Initiative

This report presents designs for three possible college savings initiatives for rural and low-income Maine families. The ultimate goal of all three is to increase the number of students pursuing postsecondary education. The strategy for achieving this goal is to help households with young children prepare for higher education expenses by developing sustainable saving habits. The primary aim of this strategy is to instill the idea that college is a realistic and worthwhile goal for all Maine children. The expectation is not that this program will create enough savings for all families to cover the full cost of college attendance.

A large portion of this report is background information on various savings programs, both in Maine and elsewhere. Examining the strengths, weaknesses, and results of existing initiatives helps to inform the design of a widely accessible children's saving program – something that has never been realized in this country. This examination begins to reveal the types of questions that decision makers will face as they choose which initiative to pursue and how to implement it. The following is a partial list of those questions:

- **Who will be eligible to open accounts?**

Many savings account programs across the nation target low-income households. Programs in the United Kingdom and Singapore are examples of the exception: universal accounts available to children of all households. Universal accounts pose both opportunities and challenges. The potential to change personal and public expectations, and to increase aspirations and attainment on a large scale, is appealing. The big challenges of universal accounts are cost and administration.

- **How will account funds be used?**

Different programs follow different guidelines for the use of account funds. For education expenditures, programs generally define the types of institutions, degrees, and job training that qualify as eligible pursuits. Some programs limit education expenditures to tuition and fees. Others cover computers, room and board, transportation, books, and related expenses.

- **How will the program encourage participation?**

Most savings programs offer matched deposits and/or tax incentives to encourage participation. The source of match funds may be governmental agencies, private donors, nonprofit organizations, financial institutions, employers, or a combination of those. Funding for tax incentives comes from taxpayers, either through state or federal legislation. Another incentive is the opportunity to "lock in" tuition rates at postsecondary institutions through prepaid tuition programs.

- **Who will administer the accounts?**

A statewide program to create and maintain savings accounts for rural and low-income children would be a considerable administrative undertaking. Program designers will have to consider the best level of account administration. Local administration may offer important advantages in terms of participant contact and trust, while state administration may offer advantages of scale. One must also consider which organizations have the most frequent and meaningful contact with parents and guardians of young children. Which organizations have the credibility and experience to work closely with parents toward achieving a long-term goal? Which organizations have the administrative capacity to handle a large number of savings accounts with deposits coming from multiple sources?

- **How will the program balance flexibility and accountability?**

Savings initiatives have to find a balance between encouraging and rewarding participation through flexibility and ensuring the program's continued existence through accountability. Flexible fund usage may increase participation. However, most savings programs specify appropriate uses, and most require participants to make regular savings commitments and attend financial training. The most appropriate balance between accountability and flexibility may depend on the program's ultimate goal. A program to encourage financial planning would probably utilize different guidelines than a program to achieve the particular outcome of increased college enrollment.

- **How will the program affect participants' eligibility for financial assistance?**

Many public assistance and financial aid programs (e.g., Temporary Assistance for Needy Families, MaineCare, Pell Grants) set income and asset thresholds that determine eligibility. In some cases, encouraging a household to save might affect its eligibility for other forms of assistance. A program to encourage saving needs to consider the other incentives that participants may face.

- **How will the program be marketed?**

The success of an ambitious savings initiative will rest on a broad range of parties, including policymakers at all levels, educators, representatives from community organizations, businesses, and financial institutions, and the media. Gaining the support

and commitment of these parties will require thoughtful and strategic marketing. The program must also be sold to participants. Outreach efforts should go beyond information on the technical aspects of the program to address the broader issue of why education is important. Some parents may not feel that attending college should be a priority for their child.

- **How will the program operate amidst existing initiatives and legislation?**

Throughout the state and nation, there are a variety of community-based savings programs from which to draw inspiration. There is also a wealth of legislation to consider. Designing an effective, broad-based initiative in Maine may require utilizing the most advantageous components of existing programs, laws, and regulations, and perhaps proposing new ones.

Prospective Programs

The following paragraphs briefly outline the designs for three savings programs for Maine families. These examples are meant to serve as a starting point for discussion. We are not proposing that all of the programs be pursued. Indeed, we are not necessarily recommending that any of the programs be pursued. Nor do we propose that these guidelines and methods are the only viable strategies for an effective savings program. An appropriate program for Maine will emerge from thoughtful discussions among individuals and organizations statewide, and may look very different from the programs described below.

- **Program I**

The first program is Maine Children's Development Accounts (MCDAs) administered by local nonprofit agencies already serving low-income residents. The goal of this program would be a college savings account for every Maine child of a low-income household. These accounts would emulate IDAs in the use of matches, savings commitments, and financial counseling. Funding would come from Maine's existing 50% tax credit for contributions to IDA programs. Currently, the credit is not widely used. This program would push for expansion of the credit to MCDA programs while encouraging its use through a broad informational marketing campaign. This framework could expand to serve residents of all income levels, but this report limits discussion to low-income households, the traditional recipients of IDAs and FDAs.

- **Program II**

The second program is identical to the first in almost all elements except administration. Unlike most matched-savings programs across the country, these accounts would not be administered by community organizations or state agencies. Instead, Maine's financial institutions would assume the administrative, legislative, marketing, and outreach efforts necessary to promote wide scale use of MCDAs.

The prospect of a substantial new source of savings deposits (and thus a long-term profit stream) could entice financial institutions to promote wide scale use of MCDAs. Given the right incentives, financial institutions would assume the tasks of recruiting new account holders, providing financial counseling, and encouraging continual account contributions. They may even undertake the marketing of the tax credit, since the program's long-term viability would rely on its use. Financial institutions could draw on their connections to employers to encourage third-party contributions to MCDAs.

This is a unique program that would be the first of its kind in the nation. Its goal would be a college savings account for every Maine child.

- **Program III**

The third prospective program is Maine Individual Learning Accounts (MILAs), which are modeled after the Council for Adult and Experiential Learning's Lifelong Learning Accounts (LiLAs). Similar to 401K plans, MILAs would be universally available, privately managed, and portable between jobs. Employees would contribute into their own accounts and employers would match those contributions up to a given amount. Ideally, both parties would receive a tax credit on their contributions. Funds from these accounts could be used for work-related education for the account holder or the postsecondary education of a dependent. CAEL is hoping to establish state LiLA programs and is considering Maine as a possible test site. If that happens, the LiLA framework could expand to include the use of account funds for a dependent's education. This initiative is unique because it presents a framework for sustainable match funds through employer contributions.

- **All Programs**

If successful, all three programs should increase the number of students attending Maine's postsecondary institutions. Since those institutions are potential beneficiaries of the program, it may be appropriate for them to contribute some kind of match, either cash or in-kind. For example, a college could offer account holders an automatic grant equal to 25% of their account balance. This would create a savings incentive with financial aid funds that likely would already have gone to students. This grant could be marketed as part of the match rate, i.e., "deposits will be matched dollar-for-dollar: 75% in cash upfront and 25% in-kind when the child enrolls in a public institution in Maine." Note that this policy could be undesirable if institutions end up giving more money to higher income earners who have been able to save than to lower income earners who have not saved as much.

Financial institutions are potential beneficiaries of the first and third programs, in addition to the second. They would benefit from holding new account funds for long periods of time. In exchange for that privilege, they could offer services such as free financial counseling and account management.

In all elements of account use and administration, a new savings initiative would strive for flexibility and simplicity. In order to increase participation, eligible fund uses would be inclusive and accommodating. Account funds could be used for associate, bachelors, and advanced degrees, professional certificates, technical training, and even GEDs. In addition to tuition and fees, funds could be used for room, board, books, computers, transportation, and other expenses related to the pursuit of higher education. The initiative would also strive for simplicity in administration and regulation. While a certain level of administrative burden is unavoidable, the initiative would seek to achieve a careful balance between accountability and ease of implementation.

Next Steps

This brief investigation of college savings in Maine reveals several findings. First, Maine children are not continuing on to college as often as their national peers and financial considerations appear to be part of the reason. Second, savings for college is particularly low in households with lower-incomes. Third, asset-building programs both in Maine and elsewhere are demonstrating that low-income households can save through structured programs, given the right incentives.

This report begins to explore the idea of a broad savings initiative for Maine families. The report describes current levels of savings and assets among low-income households, describes existing Maine savings programs, outlines the most prominent or promising programs underway nationwide, and synthesizes some of the issues surrounding these programs. Finally, the report offers examples of three college savings programs that could help Maine children. Further research and discussions among leaders across the state will help refine these designs and move us closer to finding the most appropriate and promising program for our state.

Opening college savings accounts for a large portion of Maine families will be a bold, ambitious move. The initiative's success will draw on the foresight, courage, and hard work of a broad range of organizations and individuals from both the public and private sectors. If successful, the long-term rewards of increased college attendance will be matched only by the level of commitment required to realize the vision of a college experience for all Maine children.

2. Background on Saving and Assets

The first step of designing a college savings initiative is to assess the current level of savings among the potential target population, and to answer the question "Is there need for a savings program?"

Current Figures

Most low-income households have very few assets with which to pay for college or anything else. According to the Federal Reserve's 2001 Survey of Consumer Finances, the median level of financial assets for households in the bottom income quintile, with a household head age 25-65, was $280. This includes savings and checking accounts, certificates of deposit, savings bonds, directly held stocks, bonds, mutual funds, etc. This amount represents median assets at one point in time; those assets are lower at other times during a household's income cycle (i.e., immediately before a paycheck deposit). Median net wealth (financial and non-financial assets minus debt) for this group was $4,000. Only 33.6% of these families had a savings account, with median holdings of $400. Many households move into and out of the bottom quintile over time, so these figures may not necessarily reflect the circumstances of any given household over several years. However, the figures suggest that the poorest households do not have a significant amount of savings to spend on education, or anything else.

Some economists have attempted to create measures of poverty by asset holdings, rather than income (Haveman and Wolff, 2000). These measures generally assess the minimum asset resources needed to meet a family's basic needs over a given period of time if the household's income stream was interrupted. These measures suggest that the rate of asset poverty within the U.S. is double the rate of income poverty.

Paying for Education

Paying college expenses is a challenging undertaking for most families. The challenge becomes even greater without advance financial planning. One study found that parents who report some knowledge of the cost of postsecondary education "often" learn about it while their child is in high school, when it is generally too late to save effectively (Hossler and Vesper, 1993). Parents who began saving during their child's first year of high school would have to save almost $1,000 per year just to send one child to a two-year degree program immediately following graduation.[†] This would be difficult for many families. The study concludes that parents need information early and probably often, and that the information should not be so detailed as to discourage the parents of young children.

The likelihood of parents saving for college expenses greatly depends on their level of income. In a 2002 study by the Mitchell Institute, 58% of parents of Maine high school juniors and seniors said that they were "actively saving money to help finance a college

[†] This is a rough estimate based on MCCS current tuition and fees (approximately $2,890 per year) and savings/payment spread over six years (four during high school and two after).

education." Additionally, "higher-income households [were] significantly more likely to be saving than lower-income households." These findings are consistent with a national survey, which found that 64% of households with children under age 18 were saving for college (Investment Company Institute, 2003). However, only 40% of households with annual incomes under $50,000 were saving, compared to 65% and 72% of households with incomes between $50,000 and $74,999, and $75,000 or higher, respectively. Among households with incomes under $50,000, 76% who were not saving said that they "[could] not afford to save for college at [that] time," and 77% were not saving because they expected their child to receive financial aid.

Current use of targeted education savings plans (state 529 plans and Coverdell Education Savings Accounts) reflects a similar effect of income on savings: in 2003, the median income of a household using one of these plans was $99,200 and median household financial assets, including employer-sponsored retirement plans and excluding primary residence, were $129,100 (Investment Company Institute, 2003). For comparison, the median income of all households with children under age 18 during 2002 was $52,336 (U.S. Census Bureau 2003). The median incomes of 529 and Coverdell users are much higher because fewer low-income households are saving through these plans than high-income households.

These findings suggest that many lower-income households are not saving for future college expenses, and those that are saving do not appear to be using the most well known education savings plans.

Savings Targets

If a household decides to save for a child's expected college expenses, the monthly amount that it would have to save depends on: the child's age, the rate of interest earned on savings, and the rate of increase in the future cost of college. Tuition and fees for a full-time, in-state undergraduate in 2003-2004 were approximately $5,117 at the University of Maine System (weighted average) and $2,890 at the Maine Community College System (estimate). Starting with these figures, and using the financial calculator of The USAA Educational Foundation, we can estimate the average amount that a family would have to save to prepare for future education expenses.

If the rate of return on savings *equals* the growth rate of college costs, the average required monthly savings for a Maine household (per child) would be:

	Starting age		
In-state tuition and fees	Newborn	5 years old	10 years old
2 years at a community college in Maine	$48	$58	$81
4 years at a public university in Maine	$170	$204	$286

If the interest rate on savings *is 2% greater than* the growth of college costs, the average Maine household's required monthly savings (per child) would be:

	Starting age		
In-state tuition and fees	Newborn	5 years old	10 years old
2 years at a community college in Maine	$39	$51	$75
4 years at a public university in Maine	$140	$179	$266

These estimates both overstate and understate the amount of savings ultimately needed to send a child to college. They overstate by not taking into account any financial aid that the student may receive. During the 1999-2000 academic year, 55.3% of all undergraduate students nationwide received some form of aid, and 72.5% of full-time students received aid (National Center for Education Statistics, 2002). However, these estimates understate the amount of savings needed by not including room and board, books, or any other costs related to the pursuit of higher education, which can be significant. On average, these additional costs are about as much as tuition and fees at the university system.

These figures prompt several observations. First, the earlier a household begins to save for a child's education, the less it needs to save each month. Targeting young children may increase the likelihood of households meeting savings goals. Second, these savings levels are much higher than the monthly savings totals observed in existing savings programs that are underway nationwide. For instance, low-income participants in the American Dream Demonstration (the largest known IDA program to date, see section 5 of this report) made average monthly net deposits of $19.07.[‡] If Maine's low-income earners behave similarly to the 2,000 participants in that program, then they will have difficulty meeting any of the above targets. Third, increasing the rate of return on account holdings, or decreasing the rate of growth of college costs, will decrease the amount that a household needs to save. The long-term rate of return may be difficult to influence. Program administrators can work to minimize program costs and account fees, but larger economic factors that determine interest rates will be beyond their control. The rate of growth of college costs may be influenced through work with the legislature or through contracts with individual institutions or systems of institutions.

[‡] Net deposits are the total amount of deposits made over the account's lifetime minus unmatched withdrawals (withdrawals used for purposes other than eligible asset purchases). Average monthly net deposits are total net deposits divided by the number of months during which the account was open.

3. Maine Savings Programs

Several nonprofit organizations and state agencies in Maine oversee programs to aid asset accumulation and college savings. Their practices and results offer important insight into how a new program could best navigate the current legislative and political landscape. These groups are also potential partners in a new savings initiative.

Individual/Family Development Accounts (IDAs/FDAs)

Family and Individual Development Accounts (similar programs with slightly different guidelines for matches and funding sources) are designed to help low-income households accumulate savings with which to acquire a "productive" asset that will generate long-term benefits, such as a home, postsecondary education, or small-business capital. Account holders are generally required to set asset goals, meet regular savings commitments, and attend financial education courses. In return, they receive generous matches to their deposits. Each dollar deposited by an IDA or FDA holder is matched by two or three dollars from program funds (match rates vary by program). Local community organizations that administer the accounts work closely with participants to ensure their success.

Maine passed legislation for an FDA program in 1997. That legislation established a committee to advise the legislature, community organizations, and the Finance Authority of Maine (FAME) on FDAs. In 1999, eleven nonprofit FDA programs in Maine formed the Maine Family Development Account Coalition (MFDAC). FAME approved MFDAC to oversee and administer local FDAs. MFDAC submits an annual report to FAME, which then reports to the state legislature.

Maine's legislation specifies that only recipients of TANF and individuals with an annual household income below 200% of the federal poverty line are eligible to open FDAs. The current match rate for all MFDAC accounts is 2:1, meaning that each dollar deposited by an account holder is matched with two dollars from other sources. State legislation limits annual match deposits at $2,000 and accounts with more than $10,000 are not eligible for match contributions. Account funds can be used for: "education, job training, purchase or repair of a home, purchase or repair of a vehicle for access to work or education, capitalization of a small business, health care costs over $500 not covered by private or public insurance or [another] basic necessity." Unapproved withdrawals used for other purposes are subject to a 15% penalty and forfeiture of match funds.

The State does not provide any direct funding to the coalition. Funds deposited into or withdrawn from FDAs do not receive any state or federal tax benefits. However, in 1999, the State approved a 50% tax credit for donations to FDA programs (qualifying donations are capped at $200,000 per year). Those donations can be used as match funds. According to Heidi Loughlin of MFDAC, the tax credit currently is not being utilized very much, perhaps for lack of marketing. In 2003, MFDAC reported donations from only eight businesses and individuals, one of whom claimed a tax credit.

Coalition agencies currently use funding acquired through the federal Assets for Independence Act (AFIA), which must be matched 1:1 with funds from another source. Fundraising is done by the coalition as a group; contributions from various sources across the state are pooled and redistributed.

People's Heritage Bank currently holds the FDAs administered by coalition agencies. MFDAC issues an annual request for proposals to financial institutions in an effort to secure the best rates possible. Program administrators work closely with financial institutions to show them the long-term payoff of participation: small businesses may need loans down the road; homeowners may need a mortgage or a home equity loan; participants may need student loans; etc.

Two Maine organizations offer IDAs and FDAs but are not part of the coalition: Coastal Enterprises Inc. (CEI) and Washington Hancock Community Agency (WHCA). The accounts offered by these organizations employ the same basic framework used by MFDAC. They vary slightly by funding source, monthly savings obligations, match rates, and eligible account uses. CEI receives AFIA funds, while WHCA supports its program through contributions from a regional community foundation and local banks. Both organizations are currently looking for new funding with which to continue their programs.

NextGen College Investment Plan

FAME administers Maine's 529 savings plan, the NextGen College Investment Plan. As with most state 529 plans (named for Section 529 of the Internal Revenue Code), earnings and withdrawals are exempt from state and federal taxation if used for qualified education expenses. The minimum contribution to open an account is $250, or $50 if participants arrange for monthly automated deposits of $50 or more. New account holders with family incomes at or below $50,000 can receive an initial match of up to $200. In following years, those account holders can receive annual matches up to $100. The annual "Maine Administration Fee" on NextGen accounts is 15 basis points. However, if the account holder or beneficiary is a Maine resident, and the account holds over $1,000, FAME refunds that fee in January of the following year.

4. Other Savings Programs

Individual Development Accounts

Maine's IDA programs are reflective of similar programs nationwide. Generally, IDAs are administered by community organizations operating under state and/or federal guidelines. The programs help low-income individuals and households accumulate savings with which to purchase a "productive" asset that will generate long-term benefits. IDA programs generally require participants to make monthly or annual saving commitments and to attend financial training on topics such as budgeting, reducing debt, and repairing bad credit. Participants' account deposits are matched with funds from other sources. Match funds are generally held in a separate account and are released through a program administrator when an asset is purchased. Emergency withdrawals are also generally permitted to prevent eviction or foreclosure, or for living expenses after a job loss.

- **State Legislation**

As of May 2003, 34 states had passed IDA/FDA legislation, and about 500 community organizations in 49 states were administering programs, an estimated 20,000 accounts nationwide (Edwards and Mason 2003). The only state to legislate a program specifically for children was Oregon. In 1991 and 1993, Oregon passed legislation for Children's Development Accounts, but the initiatives have never been funded.

Eight states and Puerto Rico are currently contributing general revenue funds toward IDA programs, either for match or administration (Center for Social Development, 2004). Maine is not among them. The magnitude of state support varies. Pennsylvania has shown significant, sustained support. It appropriated $500,000 for IDAs in 1999, $1,500,000 in 2000, $1,500,000 in 2001, and $1,076,000 in 2002. Other states, such as Connecticut, Maryland, Colorado, and Illinois, have appropriated smaller amounts (roughly $50,000 to $500,000) once or twice during those same years.

Ten states offer tax credits on contributions to IDA programs, ranging from 5% in Connecticut to 75% in Oregon. Seven of the ten states, including Maine, offer 50%. The extent to which these credits are utilized varies widely by state and, according to one study, seems to depend on marketing and outreach efforts (Gunn, Jacob, and Lewis 2003). Several states have considered tax exemptions on account deposits but currently Iowa is the only state to have implemented them. Iowa offers a refundable tax credit of 20% of deposits for account holders with incomes below 150% of the poverty line, and 10% for holders with incomes between 150 and 200% of the poverty line.

- **Federal Legislation**

The 1998 Assets for Independence Act (AFIA) authorized the U.S. Department of Health and Human Services to spend $125 million for a 5-year IDA demonstration project. (AFIA will likely be reauthorized in 2004, with modifications.) The funds are available

on a competitive basis to nonprofit organizations throughout the country. Organizations that receive funds must follow certain guidelines for their IDA programs, including:

- Federal matching funds can only be used for first-time home ownership, postsecondary education, or to start or expand a small business.
- Participants' deposits must come from earned income.
- Each dollar from the AFIA grant must be matched 1:1 by contributions from other sources, and the organization administering the IDAs must have those matches banked before it can access federal funds.

Lifelong Learning Accounts (LiLAs)

The Council for Adult and Experiential Learning (CAEL) is pursuing Lifelong Learning Accounts (LiLAs) as a way to reform the financing of adult education. Similar to 401K accounts, individual LiLAs would be universally available, privately managed, and portable between jobs. Funds from these accounts can be used for work-related education. Employees contribute into their own accounts and employers match those contributions up to a given amount. Third parties can also contribute, and CAEL has created a conceptual framework for federal and state tax credits for account holders and their employers.

CAEL maintains that LiLAs benefit participants through educational achievement and career advancement, and employers through improved retention and recruitment. They are currently running three pilot projects involving restaurant workers in Chicago; manufacturing and public sector workers in Fort Wayne, Indiana; and healthcare workers in San Francisco. These fields were chosen because they typically have a predominance of low-wage, low-skill workers. In the pilot projects, employee and employer contributions are matched with funds from a broad group of private foundations and public agencies.

CAEL is hoping to establish state LiLA programs and is considering Maine as a possible test site. Several leaders in Maine have established the LiLA Partnership to explore collaboration with CAEL. The Partnership includes representatives from the State Treasurer's Office; the Departments of Labor and Education; Maine Centers for Women, Work, and Community; the university and community college systems; and trade associations. The Partnership proposes to initially introduce accounts in a few select employment sectors, such as information technology, precision manufacturing, or tourism, under the leadership of the Maine Department of Labor.

Savings for Education, Employment, and Downpayment (SEED)

This 6-year pilot project, sponsored by the Corporation for Enterprise Development, is probably the closest in spirit to the savings initiative that we are currently considering. This project aims to create 1,100 asset-building accounts for infants and/or children at ten sites across the country. Each site focuses on a specific age group and has its own account guidelines concerning uses, matches, etc. The accounts require an initial deposit of $200-$1,000 that is immediately matched. Up to an additional $1,000 match is

available for deposits made by family, friends, or the child. Some programs include benchmark incentives and finance classes. SEED funds can be used to pursue higher education, start a small business, buy a home, or fund retirement, and become available after the child turns 18. At one site, fund usage is limited to education; after an initial period of matched savings opportunities, accounts will be rolled into 529 plans. At other sites, funds can be used for home ownership, small business enterprises, vehicle purchase, postsecondary education, or job skills training, and use of funds becomes unrestricted once the account holder turns 21. Most accounts are just being opened now, so the results of the project are not yet available.

United Kingdom Children's Trust Fund

The British parliament is currently considering legislation that would establish a Children's Trust Fund for all U.K. children born on or after September 1, 2002 (The Children's Mutual, 2004). When parents claim Child Benefit (a per-child entitlement paid to all guardians of children), they would receive a voucher to open a Child Trust Fund at a financial institution of their choice. (A similar system in the U.S. might be receiving a voucher when one claims a child as a dependant on one's tax form.) The voucher would be for £250, or £500 for low-income families. Parents, relatives, and friends could add about £1,200 per year to the account, and businesses, charities, and other groups could also contribute. The fund would grow tax-free and would be accessible only to the child, after his or her 18th birthday. There would be no restrictions on how the money was used.

Tax Incentives

Federal and state governments reward saving for education through a variety of tax incentives, most notably Coverdell Education Savings Accounts and 529 plans. Both Coverdells and 529 plans allow tax-free savings for postsecondary education. Earnings and withdrawals of after-tax contributions grow tax-free if used for eligible education expenses (otherwise they are subject to a 10% penalty). Both plans can be used for tuition, fees, room, and board at qualified postsecondary institutions.

Coverdells and 529s differ in several important ways. First, 529 plans allow account holders to make larger contributions. Annual contribution limits are $2,000 for Coverdells, and up to $22,000 for 529s (for married couples). Second, 529 plans may help students leverage more financial aid. During the college financial aid process, 529 plans are counted as an asset of the account holder (i.e., the parent or guardian), while Coverdell's are counted as an asset of the student. This means that a larger portion of the Coverdell account balance is included in calculations of the student's expected family contribution. Third, unlike 529s, Coverdells can be used for elementary and secondary education expenses. Fourth, financial institutions administer Coverdells and state governments offer 529s. Lastly, some states have established 529 prepaid tuition plans that allow account holders to save toward attendance at a state institution.

While tax-preferred savings plans provide incentive to some households, they are less likely to influence those with low incomes and low tax liability (Parish, 2004). Nationwide, about 8% of households are using 529 savings (not prepaid) plans and 10% own Coverdells (Investment Company Institute, 2003).

Prepaid Tuition

About one-third of states have 529 prepaid tuition plans that serve the dual purposes of guaranteeing students a fixed tuition rate at a public postsecondary institution and acting as an education savings account (National Association of Financial Aid Administrators, 2004). These programs generally involve selection of a target tuition level (e.g., four years at public university, two years at community college plus room and board). Account holders can "lock in" rates at current levels and avoid the risk of paying higher future rates when their children enter college. Some states offer tuition discounts for parents who open accounts for newborns. Account holders agree to make fixed monthly payments, the size of which depends on the age of the child and the chosen savings target. Payment plans also serve as traditional savings accounts since students can transfer funds to other institutions (even out-of-state) if desired. However, all states institute some form of penalty for canceling the account or attending a school not covered by the original agreement (e.g., $150 or 2% of earnings). Nationwide, about 7% of households are using prepaid tuition plans to save for college expenses (Investment Company Institute, 2003).

Individual Retirement Accounts (IRAs)

Contributing to a traditional Individual Retirement Account can be an effective way to save for a dependent's future college expenses. IRA withdrawals to pay for a dependent's education receive the same preferential tax treatment as other eligible withdrawals. Given the tax incentives of many IRAs, this method of college saving can be good for some households. In a 2003 nationwide survey, 20% of parents with children under age 18 were "very" or "somewhat" likely to use IRA withdrawals to help pay for college (Investment Company Institute, 2003). As with tax-advantaged savings accounts, households with lower incomes are less likely to utilize IRAs than those with higher incomes. A Census Bureau survey taken between November 1999 and February 2000 found that only 8% of individuals with annual incomes under $20,000 owned an IRA, compared to about 24% of those with incomes over $50,000.

Series EE Bonds

Series EE federal government bonds are primarily designed for those saving for postsecondary education, either for the bondholder or a dependent. Interest earned on the accounts is completely or partially exempt from federal income tax if used for certain education expenses, including tuition and fees and excluding books, room, and board. EE bonds come in denominations as low as $50. These bonds could be a straightforward way to match or reward savings by participants in a structured savings program.

5. Program Results and Evaluation

Maine Savings Programs

i. Maine Family Development Account Coalition (MFDAC)

MFDAC is currently comprised of ten community action agencies and the Maine Centers for Women, Work, and the Community. The program is small but growing. In 2000 there were about 55 accounts, and in 2003 there were 109 (Finance Authority of Maine, March 2004). As of December 31, 2003, the average account balance (without match) was $810. The coalition is funded partially through federal AFIA grants, and hence must follow AFIA guidelines. Accounts can only be used to buy a home, start or expand a business, or pursue postsecondary education. MFDAC agencies could open accounts for alternative uses, but they would not be able to access AFIA match money for them.

ii. Coastal Enterprises Inc. (CEI)

Since 1999, CEI's program has resulted in 136 account withdrawals, mostly purchases, some emergency withdrawals, and a few account closures (Lorom, 2004). As of January 31, 2004, there were 103 account holders. Their average savings was $1,795 (without match). For lack of funding, CEI currently is not opening new IDAs. Like MFDAC, this program is funded through an AFIA grant. CEI is working to secure match funds so that it can access more grant money. They currently have a waiting list of 300 individuals who would like to open an account.

iii. Washington Hancock Community Agency (WHCA)

The Washington Hancock Community Agency is not part of the MFDAC, but follows FDA guidelines very similar to those of the coalition. Funds can be used for vehicle replacement, small-business capitalization, and home ownership. The match rate is 2.5:1 and participants save $40 per month for twelve months (Moulton, 2004). Hence, at the end of one year participants have saved $480 and their match is worth $1,200. WHCA has administered about 25 accounts since it began its FDA program. There are currently two open accounts, which will be closing soon, and funds available for two more. The Maine Community Foundation and several local banks have provided funding for the FDAs. WHCA is currently looking for additional funds with which to continue the program. The agency is considering expanding eligible account uses to include vehicle repair, postsecondary education, and medical expenses over $500.

iv. NextGen College Investment Plan

As of December 31, 2003, 5,796 Maine families held approximately $54 million in NextGen accounts, with involvement varying across the state (Vigue, 2004). Cumberland County had the highest overall participation (2,351 accounts averaging $11,162) and Piscataquis County had the lowest participation (28 accounts averaging $5,555). Annual administration fees on NextGen accounts equal 15 basis points.

However, if the account holder or beneficiary is a Maine resident, FAME refunds fees in January of the following year. Only accounts with over $1,000 are eligible for this refund.

NextGen accounts are managed by Merrill Lynch, which gives the State 15 basis points annually on the total value of all holdings. That money goes toward account maintenance, as well as a matching program. New account holders with family incomes at or below $50,000 can receive an initial match of up to $200. In each following year, those account holders can receive up to $100 in match funds. As of December 31, 2003, FAME had awarded 796 initial matching grants and 330 annual matching grants (Vigue, 2004). These matches are unique among state 529 plans nationwide. As of March 2003, Maine was one of only five states to offer match incentives to lower-income earners in its college savings plan (Clancy, 2003).

v. Drawbacks of Existing Maine Programs

Since most FDA and IDA programs currently operating in Maine follow federal guidelines, the accounts can only be used for the applicant's education, and not a dependent's. (This could change when AFIA is reauthorized. The Senate has passed an amendment that would allow IDAs to be used for dependents. The House is now considering the amendment.) There are no age guidelines for opening an IDA, as long as the household is eligible (MFDAC currently has one 16-year-old participant), and parents could help contribute toward a child's account. However, the funds must be saved and utilized within five years (a limitation of the time period for which match funds are available), so this is not an appropriate vehicle for saving for children. The spending time limit could also discourage some adults. Depending on how long they have to save, they could incur education expenses well after funds are available. For example, this program would not help someone who wanted to save for four years and then go to school for four years.

NextGen accounts are better structured to support long-term savings. Yet as previously discussed, the tax benefits created by state 529 plans may not provide adequate incentive to low-income households with low tax liabilities. Even the initial $250 minimum contribution, or monthly $50 automated deposits, may be too high for some families. These minimums are high compared to most other states. Seven states have equivalent minimums, four have higher, and thirty-nine have lower minimum contribution levels (Clancy, Orszag, and Sherraden, 2004). Also, it requires a certain amount of knowledge, commitment, and financial sophistication on the part of parents to open one of these accounts. The extent to which many low-income households know about these opportunities and how to pursue them is unclear.

vi. Advantages of Existing Maine Programs

A strong advantage of both IDAs and 529 plans is that they are well-established programs that are incorporated into other relevant programs. For instance, the national network of IDA practitioners has influenced the federal government to pass legislation that excludes

funds in IDAs from consideration when determining eligibility for Temporary Assistance for Needy Families (TANF) and Medicaid assistance. Similarly, state 529 plans enjoy tax benefits at both the state and federal level. During the financial aid process, 529 accounts are included in parents' assets, rather than students', and hence are not counted as heavily in calculations of expected family contribution. Creating an entirely new program that benefits from the same breadth of recognition as these two could be difficult.

The useful aspects of 529 plans and IDAs could be productively utilized. Since length of participation in current IDA programs is generally limited, allowing participants to transfer their IDAs into 529s at the end of the program would allow participants to save for longer periods (Clancy 2003). This option would combine the match incentives of IDAs with the long-term advantages of 529s. Currently, Oregon and Pennsylvania are the only states that allow IDAs to be used in this way.

Results of the American Dream Demonstration (ADD)

In 1997, the Corporation for Enterprise Development began the American Dream Demonstration. This initiative tracked over 2,000 IDA participants at 14 sites across the U.S. The site projects lasted for four years and an additional two years were dedicated to program evaluation. Overall, ADD demonstrated that low-income households can save. This is very important. It shows that low-income households can take the lead role in a project aimed at increasing their available assets.

Post-program analysis shows that ADD participants from all 14 sites made average monthly net deposits[§] of $19.07 and the median average monthly net deposits of the individual sites was $9.83 (Schreiner, Clancy, and Sherraden, 2002). About 20% of matched withdrawals were for postsecondary education. Program analysis of all ADD participants found that attending financial education courses was positively associated with savings outcomes. This may reflect the level of commitment of participants who attended the classes, and not necessarily the impact of the course material. Asset ownership, participant's education level, and direct IDA deposits were also associated with higher savings.

It is important to note the lack of information on the individuals' savings habits before they participated in ADD. It is impossible to know whether they were shifting money out of other forms of savings and into IDAs. However, it may be enough to know that they saved and that many achieved their asset goals.

[§] Net deposits are the total amount of deposits made over the account's lifetime minus unmatched withdrawals (withdrawals used for purposes other than eligible asset purchases). Average monthly net deposits are total net deposits divided by the number of months during which the account was open.

i. Rural Results – Participation

One ADD study limited its analysis to a small sample of participants in rural Minnesota (Grinstein-Weiss and Curley, 2003). As of March 31, 2001, average monthly net deposits were $24.43, and participants had deposited money 9 out of 12 months on average. Of the Minnesota participants, 56% intended to use their DAs for home purchases, 26% for businesses, and 18% for postsecondary education. Several factors were significantly correlated with participants' average savings: health insurance, dependency ratios, direct deposits, and receipt of TANF.

- Having health insurance was positively related to savings. Individuals with health insurance may have more reliable employment, fewer out-of-pocket health expenses, more discretionary income to contribute toward both the insurance and the IDA, or may be more risk averse and thus more motivated to save for the future.
- Higher dependency ratios (the number of individuals in a household per adult) were associated with higher average monthly savings. This could suggest that individuals with children feel more pressure to save for future expenses.
- Participants who used direct deposit arrangements saved more per month than those who did not. Direct deposits may facilitate the saving process and decrease the likelihood that money earmarked for saving will be used for other purposes. Or, making arrangements for direct deposit may reflect a higher level of commitment toward saving.
- Participants who were receiving TANF saved less per month on average than those who were not. This could be due to the incentives created by the programs. Or, receiving TANF may reflect other household characteristics that are correlated with lower saving.

ii. Rural Results – Administration

The same study included results of a survey of rural IDA program administrators and staff. Those individuals felt that rural programs had an advantage over urban programs in that participants generally trusted the community organization with which they were working. They also felt that smaller programs allowed for more one-on-one contact with participants. They felt that rural programs had a funding disadvantage because they generally had fewer local sources to draw from than urban programs. Rural programs also faced transportation challenges; it was sometimes difficult for participants to attend education classes at distant facilities. Program administrators felt that IDA guidelines should be flexible enough to respond to the unique needs of their target populations. This might mean allowing the purchase of cars, which may be essential for some rural residents hoping to pursue employment or education.

iii. Match Rates

ADD used match funds to encourage participant deposits. However, the match rate varied by site. Some participants faced a 1:1 match, while others had 2:1 or higher. A study of 807 ADD participants found that higher match rates corresponded to slightly

longer participation in the program and lower participant savings (Schreiner, 2001). For example, average savings over twelve months ranged from $411 for participants facing a match rate of 1:1, to $376 for 2:1, and $314 for 3:1. However, higher match rates corresponded to higher average asset accumulation (savings plus match): $823 for 1:1, $1,127 for 2:1, and $1,259 for 3:1. Overall, the study concluded that higher match rates increase participation and total asset accumulation, but do not increase aggregate personal savings among participants. Thus, a program's desired match level should depend on its goal: to increase participation, to increase participant saving, and/or to increase participant assets.

6. Synthesis of the Issues

Program Need

In 2000, 54.3% of Maine's recent high school graduates enrolled in postsecondary education (National Center for Education Statistics, 2002). This is below the New England average of 63.3% and the national average of 56.7%. Affordability may be one of the primary factors contributing to Maine's lower college attendance rate. In a 2002 study conducted by the Mitchell Institute, 35% of Maine high school juniors and seniors felt that it was "somewhat" or "highly" likely that money would be the determining factor of whether or not they attended college. In the same study, 34% of parents with children aged 12 to 18 agreed that finances would be "somewhat" or "highly" likely to determine whether or not their child attended college. Financial concerns are likely stronger for rural households, which have lower average earnings than urban households. These findings suggest that addressing the real and perceived cost barriers involved in postsecondary education could increase the number of Maine students attending college.

The previous review of savings and asset trends shows that most low-income households do not have adequate savings to spend on education, or anything else. The unmet need gap faced by many students is further evidence of insufficient private funds and/or financial aid. During the 1999-2000 academic year, the national average unmet need gap of full-time undergraduate students was $2,747 at public 2-year colleges and $2,369 at public 4-year institutions (National Center for Education Statistics, 2004).

In summary, lack of financial resources is clearly a cause of the low college attendance rates of Maine students. The minimal savings of most low-income households contributes to this resource need. Low usage rates of the most common college savings programs by low-income earners suggest that many are not even aware of the opportunities available to them. It is safe to say that programs to encourage private saving for education are needed in Maine.

Program Success

A review of savings programs, in Maine and nationwide, shows that low-income households can save through structured programs with attractive match incentives. Naturally, levels of savings vary by individual and household, but programs across the country have shown that motivated individuals with low incomes can set aside money on a regular or semi-regular basis. In reviews of these programs, lack of participation is not known to be a limiting factor.

Failure to build broad-based community and political support has hurt some savings programs. In Oregon, for instance, support dwindled for CDAs when one of the program's key legislative champions resigned to pursue other interests and political control of the state House of Representatives switched parties (Stein and Friedman, 2003). Local organizations did not implement CDAs because the new legislation did not provide an initial funding source (the legislation established a tax credit for contributions to CDA programs).

Lack of funding challenges all known savings programs that provide a match incentive. To date, most programs have drawn on donations from private foundations and federal appropriations. These sources are generally one-time grants, which inherently limit the length and size of pilot programs. No known program has established a sustainable long-term source of funding. LiLAs present a theoretical framework for using employer contributions as a renewable source of funds, but the program is still drawing heavily from other private and public sources.

In short, a large-scale savings program targeted to rural and/or low-income Maine residents can succeed. Its success or failure will depend largely on forming a strong network of supporters and securing a renewable funding source.

Eligibility

All savings programs must specify who will be eligible to participate. While the incentives offered through tax-advantaged savings accounts are available to taxpayers at all income levels, most savings programs that employ a match incentive target low-income households. Universal programs offer the potential to change personal and public expectations on a large scale. The big challenge of universal accounts is their cost. Restricting the number of participants lowers a program's funding and organizational needs, which may be appropriate given the size of the administering agencies and their limited funding timeframes. However, it limits a program's ability to facilitate long-term saving.

Targeting a specific income group today will mean that in ten or twenty years, the program will be serving some people who don't need it, and not serving some who do. A household's economic circumstances change over time. Some households with low incomes when a child is born will have high incomes when the child is older. The reverse will also happen.

Geographic mobility is also an issue for a long-term program. Again, this is something for which programs with shorter time frames have not generally had to plan. A program targeted toward rural households will have to accommodate migration into and out of rural areas.

These problems suggest that a long-term savings initiative may have to accommodate account holders at all income levels and in all locations (at least within the state). This could mean offering universally accessible accounts or targeting accounts toward specific populations and preparing to adjust them for participants whose incomes and/or locations change.

Fund Usage

It seems likely that broad account usage will encourage the participation of parents and guardians of young children, although we don't know to what extent. Parents do not know the future desires or abilities of their child. They do not know whether they'll want

to attend a public or private institution or a trade school, or whether they'll enter into a one-, two-, or four-year program. Authorizing as many uses as possible should increase participation.

Allowing broad use of account funds may also increase the interest and support of institutions that would potentially receive those funds. Allowing as many entities as possible to cater to account holders should strengthen support, and perhaps funding, for the program.

Incentives

The main programs discussed in this report employ two incentives to encourage saving: tax advantages and match contributions. Of those two, tax incentives are less easy to understand or utilize without a certain level of interest, knowledge, or professional assistance. They have the additional drawback of appearing somewhat roundabout and delayed. Participants may not know exactly how much money they will receive or when they will receive it. However, many states have creatively leveraged these incentives. Prepaid tuition programs offer clear savings targets and transfer the risk of tuition increases from families to institutions. Parents must weigh the possibility of reduced future tuition with the commitment to send their child to a particular college or set of colleges.

Nationwide, tax-advantaged education savings accounts are not widely used among lower-income households. As previously noted, in 2003 the median income of a household using a state 529 plan and/or Coverdell Education Savings Account was $99,200 and median household financial assets were $129,100 (including employer-sponsored retirement plans and excluding primary residence). These figures, much higher than corresponding income and asset levels for the general population, show that the programs are more widely used by households with higher incomes than lower incomes. In addition to reflecting a lack of knowledge, low usage by low-income earners may reflect savings disincentives created by the treatment of assets in the determination of financial need when students enter college (Ifill and McPherson, 2004).

Match incentives may be more promising. The programs that are shown to be working for low-income savers have at least two things in common: participants face a match incentive and the incentive is easy to understand. With match programs, the level of match is simple to calculate and recognition is immediate. For example, participants know that if they deposit $10 into their account, they will receive another $10 in match. The ease of understanding match programs is a combination of their structure and presentation.

Funding

Thus far, funding for all known match programs has been in 3-5 year increments because programs have drawn from one-time funding sources such as foundation grants and state or federal appropriations. Some states have also allocated TANF and Community Development Block Grant (CDBG) funds to IDA programs. No known program has

secured a sustainable source of funding. Funding limits restrict the length of time that participants are guaranteed enrollment in the program. Discussions with program administrators suggest that funding is a frequently recurring challenge. No match programs have maintained savings incentives for the length of time that would be necessary for college accounts for very young children. The challenge to a long-term program (i.e., 18 years or more) will be finding a sustainable funding source.

Potential contributors include financial institutions, postsecondary institutions, and taxpayers. Financial institutions will benefit from account deposits, so they may be willing to contribute free or low-cost services, such as account management, financial counseling, and marketing. Postsecondary institutions will also benefit from a successful savings initiative, since they will be the ultimate recipients of much of the account funds. Hence, postsecondary institutions might be asked to contribute match funds, either cash or in-kind (e.g., a tuition discount for account holders, a partial match of account funds). Many states are asking taxpayers to support IDA programs, either through tax credits for donors or through direct appropriations for match funds or account administration. One can make the argument that taxpayers will benefit from IDAs as more residents pursue education (perhaps using less state financial aid), earn higher incomes, pay more taxes, and use less public assistance.

Third-Party Contributions

Third-party contributions are an attractive potential source of both deposits and matches. These parties could be family and friends of account holders, civic organizations, schools, or employers. By augmenting deposits, third-party contributions could amplify the account holder's ability to utilize match funds and ultimately increase the amount of funds available for education. On the match side, contributions toward match funds could ensure a program's longevity.

Nationwide, almost one-third of parents with children under age 18 expect to receive financial assistance to pay for college from the child's grandparents, and 6% anticipate contributions from an aunt or uncle (Investment Company Institute, 2003). These findings suggest that creating a mechanism for third-party contributions will be an important element of a college savings plan.

LiLAs present a promising framework for sustainable match funds through employer contributions. CAEL theorizes that participation in the program will reduce employee turnover and produce long-term benefits to employers. As previously discussed, CAEL is pursing opportunities to implement a statewide LiLA pilot project, and the organization is considering Maine as one of the state sites. Although LiLAs are currently intended for adult students pursuing work-related training, they could potentially be used for a dependent's education, if program guidelines were modified. If Maine LiLAs established a framework for transferable, employer-supported education accounts, the framework could be expanded to include a dependent's education. Coordinating with CAEL to plan this expansion might be more efficient than creating an alternative program.

Administration

Currently, the administrative burden of match savings programs nationwide rests on community organizations. This presents both advantages and challenges. Community organizations can build on close community ties and the trust of local residents. However, they sometimes have fewer funding sources from which to draw. Alternatively, 529 and tax credit plans are generally offered by state agencies with fewer local ties and more financial and administrative resources.

Administrators of savings programs report that participants' trust of the administering agency may be important for sustained account usage. This suggests that at least part of the administration should be done by an entity with strong community ties. However, some form of centralized agency will be necessary to facilitate legislative, marketing, and fundraising efforts. This is the model used by MFDAC.

Alternatively, relinquishing some administrative duties to a third party, such as a financial institution, could reduce administrative costs and increase the amount of funds available for matches. Most legislation specifies that no more than 10-15% of program funds can go to administration. Hence, shifting the administrative burden onto a third party could potentially save up to that amount.

Marketing

There are at least two marketing challenges for any savings program. The first is gaining the support of the necessary legislative and private entities needed to implement and sustain the program. The second is gaining the interest of participants. Regarding the first challenge, the history of the stalled Children's Development Account (CDA) initiative in Oregon suggests that broad, bipartisan support is important for the successful realization of a wide scale savings initiative. A recent paper, co-authored by one of the key proponents of Oregon CDAs, offers the following lessons for CDA advocates attempting to pass state legislation (Stein and Friedman, 2003):

- Champions are essential, and at least one champion must be a legislator.
- Form a comprehensive organizational strategy for legislative activity, advocacy, communications, and assistance from outside organizations (e.g., CAEL, CFED).
- Adjust legislative and policy strategies to changing political realities to help sustain the project over the long run.
- Link the CDA philosophy to broader issues of the day (education reform, economic development, etc.) to capture a larger audience.
- Prepare for a long implementation process; passing CDA legislation will most likely be a multi-year endeavor.

A recent report by the Ford Foundation sites three strategies for gaining broad political support for programs targeted toward the poor. The first is to begin by covering the most vulnerable of the population, for instance children and the elderly, and then broaden the program after establishing a record of accomplishment. The second is to universalize the program to include the middle class. The third is to present a cost-benefit analysis

assessing the program's ability to generate long-term savings for taxpayers. The Ford report cautions that using political pathways to implement a program can lead to "one-size-fits-all" guidelines that may not be appropriate for some communities.

Methods of reaching potential and actual program participants, the second marketing challenge, would most likely vary by location, income level, and child age. Marketing efforts should likely be informed by community-level organizations that are familiar with local conditions, events, and attitudes. However, it is unclear which community organizations have the most meaningful contact with potential account holders and which would employ the most effective marketing tactics. Which organizations are most appropriate will likely depend on who is eligible to open accounts. Some organizations have close contact with low-income earners and very little contact with other individuals, while other organizations have contact with a range of income earners but may not be as closely connected to them.

Recent findings suggest that underutilization of some current college savings tools may stem from lack of effective marketing. Many households that are not saving for college are not even aware of the opportunities available to them. In a nationwide survey, 42% of households with children under age 18 that were not saving for college were unaware of state-sponsored prepaid tuition plans; 44% were unaware of state-sponsored college savings plans; and 57% were unaware of Coverdells (Investment Company Institute, 2003). In the same survey, households with incomes and financial assets under $50,000 were most likely to have consulted friends and family about the best way to save for college, while households with higher incomes and assets were more likely to have consulted newspapers, newsletters, or magazines. To effectively market a savings program, it will be important to recognize and utilize the existing networks that deliver financial information to the target participants, whether of low-, middle-, or high-income.

Marketing a tax credit to private donors is a third potential challenge. Several states offer a tax credit for contributions to IDA programs and the extent to which these credits attract donations varies. Maine's 50% credit has not been widely used. A report by the Center for Social Development notes:

> "State utilization of community development credits… does not seem to appear to depend as much on the size of the allowable credit as one might think. For example, Colorado (that allocated $25 million in tax credits annually) has had great success in attracting donations with 25 percent credits, while the 50 percent credits in Arkansas and Maine have leveraged less than $50,000 to date between the two states. It appears that strategic marketing and outreach efforts are the best predictors of successful leveraging of credits, provided that state advocates have an effective state law and adequate allocation of credits to work with" (Gunn, Jacob, and Lewis, 2003).

In short, achieving a widespread savings initiative will require effective marketing to at least three groups: those who can implement the program, those who can utilize the program, and those who can fund the program.

Federal and State Legislation

IDAs are increasingly being recognized in federal and state policies regarding taxation and public assistance. Specifically, IDAs are being granted preferential tax treatment and being excluded from calculations of aid eligibility. Judging by interest and momentum, IDAs will likely gain more recognition in the future. This makes IDAs attractive. Local IDA programs can tap into a nationwide network of similar programs, and any policy gains made by that network will benefit local account holders.

As IDAs have established a record of accomplishment, many states have allowed more flexibility in service delivery and fund usage. This is a trend to be mindful of while designing a savings program in Maine. In the early days of IDAs, many states included heavy regulations in their legislation to prevent the misuse of accounts and matching funds (Edwards and Mason, 2003). Many states have since relaxed those guidelines. This trend may come from legislators becoming more familiar and comfortable with the programs, or from recognition that some regulations were hindering the programs' effectiveness.

Compared to other states, Maine's IDA legislation does not stand out as overly restrictive or overly generous. One unique Maine policy is the 15% penalty on unapproved withdrawals (Center for Social Development, March 2004). For similar misuses, other states do nothing, terminate participation, or rescind match funds. There are at least two policies adopted by other states that Maine has not passed. First, some states have appropriated funds from state general revenue, TANF, or CDBG for match and/or administrative costs. Second, two states allow the conversion of IDAs into 529 plans. This convertibility would be required for an IDA program intended for long-term education savings. This would allow account holders to benefit from preferential tax treatment if they were no longer eligible for match, and would provide a place to hold account funds where they could earn more interest than in a typical savings account.

Effects of Assets on Aid Eligibility

- **Financial Aid**

Accumulating savings may affect a family's eligibility for need-based financial aid by increasing the amount that it is expected to contribute toward college expenses. This phenomenon is due to the method by which financial aid is distributed. A student's level of financial need is determined from the Free Application for Federal Student Aid. Information from this application determines a student's estimated family contribution (EFC). The EFC is the annual amount that the student and/or family is expected to contribute toward the cost of education. If the EFC is lower than the cost of attendance at an institution, then the student is said to have financial need. Scholarships, grants, and loans are then allocated to meet that need.

The formula for EFC protects a certain amount of assets for the household's future use ("asset protection allowance"). The following table is an excerpt of the 2004-2005 asset protection schedule.

Age of older parent	Assets protected (if there are two parents)	Assets protected (if there is one parent)
25 or younger	$0	$0
30	$12,400	$5,900
40	$37,200	$17,600
50	$47,900	$22,000
60	$63,000	$28,100
65 or older	$73,700	$32,300

Source: U.S. Department of Education

In addition to these protected assets, the EFC formula excludes home equity (for a primary home) and retirement funds. Subtracting the asset protection allowance from the remaining assets gives the household's "available assets." Each year, 12% of the parent's available assets and 30% of the student's available assets are included in the family's EFC. Also, any interest earned on those assets is counted as income, and included in EFC. Ultimately, those assets and interest reduce the calculation of financial need on a dollar-for-dollar basis, thereby reducing the amount of financial aid for which the student is eligible.

The threshold for asset protection is what ultimately matters in regards to the development of a savings program for Maine students. If families are below the threshold and extra assets would push them over it, then they could lose aid. A savings program for newborns would have the additional challenge of predicting the financial circumstances of a household 18 years into the future – a virtually impossible task. Without knowing the profile of potential participants, it is difficult to estimate whether funds in a college savings account would affect the amount of aid available to them. However, it seems likely that these funds would not push most low-income households over the asset protection threshold.

The current value of an IDA is not included as an asset when calculating EFC (Finance Authority of Maine, 2004). However, withdrawals of match funds will be counted as income, just like other forms of public assistance. Needless to say, higher incomes result in higher EFCs.

Observations by one IDA program administrator in Maine suggest that adverse effects on aid eligibility have generally not been a problem. One notable safeguard for IDAs is that funds are held in two accounts, one for the participant's deposits and one for the match. This minimizes the potential for asset accumulation to penalize a participant during the financial aid process. Also, match funds are paid directly to the institution, so participants never have to pay income tax on those funds.

Funds from NextGen accounts are included in parents' assets, rather than students', and hence are not counted as heavily in calculations of EFC. Currently, a student is expected to contribute 30% of their assets per year toward the cost of education and, as previously discussed, parents are expected to contribute 12%. Hence, counting account funds as parents' assets causes a relative decrease in EFC that could increase the amount of financial aid for which the student is eligible.

- **Public Assistance**

Similar to financial aid, asset accumulation could affect participants' eligibility for public assistance. In Maine, recipients of food stamps, MaineCare, and TANF can have no more than $2,000 in "countable" assets. Funds in IDAs are excluded from that calculation. The Welfare Reform Act of 1996 prohibits funds in IDAs from counting toward asset limits for federal means-tested programs, which include TANF. According to one Maine IDA administrator, welfare eligibility effects have not been a problem (Loughlin, 2004). Program administrators of LiLAs and SEED accounts also report that this has not been a significant issue for their participants. In general, this is a potential issue of which to be mindful but not one that has been burdensome for other programs.

7. Prospective College Savings Programs

The above analysis reveals the need for a structured program to encourage sustained, long-term savings for the future college expenses of Maine's youngest citizens. This section outlines three possible programs that could help fill this need. The first is Maine Children's Development Accounts (MCDAs) administered by local nonprofit organizations, the second is similar accounts administered by financial institutions, and the third is employer-based, portable education savings accounts similar to LiLAs.

These programs are examples meant to illuminate issues and serve as a starting point for discussion. We are not recommending that all or any of the programs be pursued. Nor do we propose that the guidelines and methods described below are the only viable strategies for an effective savings program. An appropriate program for Maine will emerge from thoughtful discussions among individuals and organizations statewide, and may look very different from the programs described below.

It should be noted that the aim of all three programs would be to instill the idea of college as an obtainable and worthwhile expectation for all Maine children. The programs would help to inspire the notion of college as the obvious next step after high school graduation, and would demonstrate the availability of outside assistance to help make college affordable. However, the programs would not be expected to generate enough savings for all families to cover the full cost of college attendance.

Through public information sessions, quarterly statements, media campaigns, and other outreach activities, these programs would seek to inform families about all aspects of postsecondary education early and often. This benefit would be realized whether a savings account held $2,000 or $20,000 when a child graduated high school. In fact, one survey of state-sponsored college savings accounts nationwide found that 45% held less than $5,000 (Investment Company Institute, 2003). An ambitious program would continually remind parents and guardians of the value of college attendance, the importance of planning, the availability of aid, and so forth. The delivery and content of this information would vary according to the child's age, in order to give families the right information at the right time. By supporting the expectation of college attendance for all children, a savings program should increase the likelihood that dreams become reality.

When considering the following programs, it may be helpful to have a rough estimate of the match funds that may be needed. Suppose the State opened accounts for each of the roughly 15,000 children projected to be born in Maine each year (Maine State Planning Office, 2003). Saving at least $1,000 by the time of high school graduation might be a realistic monetary goal for those children. Matching $1,000 for each child would cost roughly $15,000,000 per year once the program was fully implemented. This number would be lower if the State opened accounts only for children born into low-income households. According to the Current Population Survey, during 2000-2002 an average of 36.3% of Maine children under age 19 lived in households with incomes at or below 200% of the federal poverty line (U.S. Census Bureau, 2004). Hence, a program for

"low-income" families would be serving only about 5,500 of the newborns per year. Matching $1,000 for each child would cost roughly $5,500,000 per year.

I. Maine Children's Development Accounts – Nonprofit Based

The goal of this MCDA program is a college savings account for all Maine children living in rural low-income households. This program emulates the Children's Development Accounts passed in Oregon. It is unique from the other two programs in that accounts are available only to low-income families and are administered by community non-profit organizations already serving low-income residents. This framework could expand to serve residents of all income levels, but this discussion limits coverage to low-income households, the traditional recipients of IDAs and FDAs.

i. Eligibility

Low-income families living in rural Maine communities would be invited to open MCDAs for newborns and young children. "Low-income" could be defined as a percentage of the federal poverty line or by other eligibility guidelines already employed for public assistance in Maine. Ideally, parents would open accounts for young children in order to maximize the time that they have to save. A logical policy would be to select a date after which all low-income children of a certain age are eligible to participate in the program (e.g., all children born after January 1, 2000). Inevitably, there would be children born before this date who would not enjoy the benefits of the program. No matter what date was chosen, there would be children who fell on both sides of the line. Although the program would not actually take anything away from older children, program advocates should be prepared to acknowledge this issue. This could mean developing an alternative program for older children of low-income households, however, that possibility is not explored in this report.

As previously mentioned, restricting the number of participating households lowers a program's funding and administrative needs. However, income mobility means that in several years, some households that are earning middle or high incomes would hold MCDAs, and some households whose incomes had dropped since their children were born would not have an account. A long-term program will have to accommodate income mobility by allowing participants to retain accounts in some form if their incomes surpass eligibility guidelines. In this case, the best option might be to transfer MCDAs into a 529 plan. This would require new state legislation (see "State Legislation" in this section). Similarly, a program targeted toward rural households will have to accommodate migration into and out of rural areas. If a household moves to a non-rural area that does not qualify for MCDAs, then their account could be converted into a 529 plan.

MCDA holders would be able to make deposits from both earned and unearned income, in order to encourage participation from as many potential savers as possible. This is a change from current IDA guidelines.

ii. Fund Usage

These accounts would be used for postsecondary education. Guidelines for eligible uses within that category would seek to be as inclusive as possible. Account funds could be used for associate, bachelors, and advanced degrees, professional certificates, technical training, and even GEDs. In addition to tuition and fees, funds could be used for room, board, books, computers, transportation, and other expenses related to the pursuit of higher education. Offering a broad array of account uses should encourage participation among parents who may not know the future desires or abilities of their child.

If an account beneficiary did not pursue postsecondary education by a certain age, perhaps 25, then the participant's deposited funds, plus interest, would become accessible to the beneficiary, to be used at his or her discretion. However, match funds would be lost if the account was not used for education expenses. If a child died before entering college, then the account holder would receive the deposited funds, plus interest. If a household left Maine before the child reached college-going age, then the deposited funds, plus interest, would be converted into a 529 plan of the account holder's choice.

iii. Incentives

MCDAs would employ match incentives to encourage saving. The match rate would depend on the amount of funding available and the estimated number of potential account holders. If the program was restricted to low-income households, then eligibility would be determined annually. Account holders would only receive match funds if their household income was below a certain threshold. If their income rose above that threshold, then they would still benefit from preferential tax treatment and financial services negotiated by the MCDA program. They might also choose to convert their account into a 529 plan. Additional incentives beyond matches could be benchmark rewards (e.g., $50 bonus for saving 9 out of 12 months, $50 bonus for high school graduation) or the ability to lock-in tuition rates at Maine postsecondary institutions.

In the unlikely event that a family saved enough money to pay for their child's expenses at the highest priced public institution in Maine, then the family would not receive additional match funds, regardless of its income level.

If successful, this program could increase the number of students attending Maine's postsecondary institutions. Since those institutions are potential beneficiaries of the program, it may be appropriate for them to contribute some kind of match, either cash or in-kind. For example, a college could offer account holders an automatic grant equal to 25% of their account balance. This would create a savings incentive with financial aid funds that likely would already have gone to students. This grant could be marketed as part of the match rate, i.e., "deposits will be matched dollar-for-dollar: 75% in cash upfront and 25% in-kind when the child enrolls in a public institution in Maine." Note that this policy could be undesirable if institutions end up giving more money to higher income earners who have been able to save than to lower income earners who have not saved as much. This could happen if accounts were held by households whose incomes

had risen since their child was born, or if accounts were offered to households of all income levels.

Financial institutions are also potential beneficiaries of the program. They would benefit from holding account funds for long periods of time. In exchange for that privilege, they could offer services such as free financial counseling and account management.

iv. Third-Party Contributions

Ideally, MCDAs would establish a mechanism for contributions from third parties such as employers, schools, civic groups, and relatives. These gifts could be made through the community organization administering the account to avoid increasing the account holder's tax liability. Third-party funds could be treated exactly as participant deposits and matched accordingly, or they could not be matched in order to preserve funds. Third-party contributions should not detract from any match that account holders are eligible to receive on their own deposits. This would create a strong disincentive for third-party contributions.

v. Funding

This program would draw from Maine's existing 50% tax credit for contributions to IDA programs. Currently, the credit is not widely utilized. This initiative would push for expansion of the credit to MCDA programs while encouraging its use through a broad informational marketing campaign. Expanding the use of this credit should create a sustainable funding source that would not come with limiting program requirements, such as AFIA funds currently do. It may be necessary to draw from other sources in the early stages of the initiative, as utilization of the tax credit increases. Those sources would mainly be private and federal grants secured by local community groups and state agencies. Financial and education institutions might also contribute, and it is possible that the State could appropriate general revenue funds to help launch the program.

vi. Administration

As displayed by the ADD project, close contact with account holders and potential contributors is an advantage of small structured savings programs. For this reason, these accounts would be administered through community-based organizations that are familiar with their service area and can work with local financial institutions. A central agency would support and serve the community organizations, but would not have a governing role. The central agency would coordinate communication among local agencies, and legislative, marketing, and fundraising efforts. The administrative burden and reporting requirements of the central and local agencies, account holders, financial institutions, and participants should be as streamlined and simple as reasonably possible.

Like FDAs and IDAs, match funds for MCDAs should be held in a pooled match-fund account, and not in the account holders' names. This would prevent participants from

having to pay taxes on match or interest when it was removed. Also, this precludes match funds from being included in calculations of financial need.

vii. Marketing

Successfully launching this ambitious initiative would require broad support from both public and private sectors, from community organizations, financial and educational institutions, donors, and the potential long-term beneficiaries – Maine residents. This initiative would present at least three marketing challenges: gaining the support of the legislative, business, education, and financial communities; attracting participants; and increasing tax credit use. Gaining the support of the first group would require a flexible marketing strategy that focuses on the promising long-term benefits of MCDAs. These benefits are varied; which ones are emphasized should reflect current events and the target audience. For example, financial institutions might be interested in offering additional services to account holders. The potential for increased enrollment and completion might appeal to higher-education administrators. Advocates of self-empowerment and welfare reform might be attracted to an asset-based approach to financial aid.

A second marketing issue is participant-based. Tax and match incentives may not always be enough to encourage sustained contributions to the accounts. Some parents might first have to decide that college is a realistic and worthwhile goal for their child. Marketing to potential participants would require a broad campaign to promote the benefits of postsecondary education. Even motivated families might need that reminder if unforeseen circumstances divert attention away from their child's distant education expenses and toward more immediate needs. Getting families to begin and continue saving for college would require a sustained marketing effort. Promoting MCDAs to current and prospective account holders would be informed by the experiences of local account administrators and facilitated by the central agency.

Lastly, long-term funding for the program would depend on increased use of the 50% tax credit on donations to MCDA match funds. Getting individuals and businesses to utilize the credit would require a broad informational campaign directed at potential donors and their financial and tax advisors.

viii. State Legislation

Several elements of the MCDA initiative would require the active support of Maine's state legislature. In addition to the expansion of the FDA tax credit, the initiative would call for beneficial tax treatment of MCDAs. Contributions and interest should be exempt from state income taxes. Ideally, a refundable tax credit would be available on all MCDA deposits – a first for IDA-type programs in the U.S. Making a tax credit refundable ensures that it would benefit low-income earners with low tax liability. The tax benefits would also act as an additional indirect match to participant contributions.

Implementing MCDAs, as designed, would require the following policy changes:

- Allow IDA funds to be used for the education expenses of a dependent
- Allow IDAs to be converted into 529 plans
- Expand the IDA tax credit to include MCDAs

MCDAs would benefit from the following optional policy changes:

- Create a refundable tax credit on all IDA deposits
- Exempt interest from state income tax
- Allow deposits from unearned income

ix. Summary

Local nonprofit community organizations would administer these MCDAs to low-income families living in Maine's rural communities. Restricting the program to that income group would reduce the amount of funding needed to match participant contributions. However, income mobility would challenge the long-term effectiveness of the program. Funding for this program would come from a 50% tax credit on contributions to MCDA programs. Developing this funding stream would likely take a considerable amount of time and effort since the tax credit is not widely used today.

II. Maine Children's Development Accounts – Institution Based

The goal of this program is an MCDA for every Maine child. Unlike most savings programs across the country, these accounts would not be administered by community organizations or state agencies. Instead, Maine's financial institutions would assume the administrative, legislative, marketing, and outreach efforts necessary to promote widespread use of the accounts. This is a unique initiative that would be the first of its kind in the nation.

This program is identical to the nonprofit-based MCDAs in terms of fund usage, third-party contributions, funding, and marketing, and differs in eligibility, incentives, administration, and state legislation.

i. Eligibility

All households would be eligible to open accounts, regardless of income or assets. All accounts would receive the same preferential tax treatment and all households would be eligible for financial counseling and informational material. As discussed later, match rates would decrease as household incomes increase. Hence, households might face changing rates over time as their economic circumstances improve or worsen. The accounts would be structured as an attractive method of saving regardless of a household's income level.

Making accounts available to all households would address the challenges of income and geographic mobility (at least within Maine). If accounts were available only for children born into low-income households, then in several years some households whose incomes had risen since their child was born would still hold MCDAs, and some households

whose incomes had dropped would have missed the opportunity to open an account. Similarly, if accounts were available only to households living in one geographic location, then in several years, some households that had moved away would still hold accounts, and some that had moved in would not hold them. However, if an account holder moved out of Maine, then their eligibility for match funds would terminate.

As with nonprofit-based MCDAs, these accounts would be available to newborns and young children in order to maximize the amount of time that families had to save. All children born after a selected date would be eligible to participate in the program. Again, account holders would be able to make deposits from both earned and unearned income.

ii. Incentives

Match rates would vary from 1:1 for low-income households to 0:1 for households with high incomes. This means that every dollar deposited by low-income households would be matched with another dollar, and deposits by high-income households would not receive any match (besides interest). In between those two extremes, account holders would face varying match rates as their income rose or fell. However, the tax incentives provided to all accounts would make them attractive at any income level. Additional incentives beyond matches could be benchmark rewards (e.g., $50 bonus for saving 9 out of 12 months, $50 bonus for high school graduation) or the ability to lock-in tuition rates at Maine postsecondary institutions.

Match rates would also depend on the total amount already saved in the account. In the unlikely event that a family saved enough money to pay for their child's expenses at the highest priced public institution in Maine, then the family would not receive additional match funds, regardless of its income level. However, they would still benefit from preferential tax treatment and any advantageous fee reductions or interest rates negotiated by the MCDA program. They could also choose to convert their account into a 529 plan.

As with nonprofit-based MCDAs, program success would increase the number of students attending Maine's postsecondary institutions. Since those institutions are potential beneficiaries of the program, it could be appropriate for them to contribute match funds, either cash or in-kind.

iii. Administration

This program calls on Maine's financial institutions to assume the administrative, legislative, marketing, and outreach efforts necessary to promote wide scale use of the accounts. Financial institutions would assume those responsibilities because MCDAs should be profitable for them. The success of this unique initiative would rely partially on public trust of the integrity and ability of Maine's financial community.

The prospect of a new source of savings deposits (and thus a long-term profit stream) should entice financial institutions to promote widespread use of MCDAs by Maine families. Given the right incentives, financial institutions would assume the tasks of recruiting new account holders, providing financial counseling, and encouraging

continual account contributions. They might even undertake the marketing of the tax credit, since the initiative's long-term viability would rely on its use. Financial institutions could also draw on their connections to employers to encourage third-party contributions.

Shifting the responsibility of account promotion onto financial institutions would draw on the institutions' strong existing ties to Maine communities, marketing experience, and account management skills. It would also maximize the portion of donations that went directly to match funds, rather than to account administration, and minimize the budgetary and administrative burdens of community organizations and state agencies. However, a single, central organization, separate from financial institutions, would monitor account usage, share best practices throughout the state, and identify underserved populations, such as families without preexisting bank accounts.

iv. State Legislation

Realizing this MCDA initiative would require the strong support of Maine's state legislature. In addition to the expansion of the FDA tax credit, the initiative would call for beneficial tax treatment of MCDA funds. Ideally, a refundable tax credit would be available on all MCDA deposits. Making a tax credit refundable ensures that it would benefit low-income earners with low tax liabilities. The tax benefits would act as an additional indirect match to participant contributions.

Implementing MCDAs, as designed, would require the following policy changes:

- Allow financial institutions to administer IDAs
- Allow IDA funds to be used for the education expenses of a dependent
- Allow IDAs to be converted into 529 plans
- Expand the IDA tax credit to include CDAs

MCDAs would benefit from the following optional policy changes:

- Create a refundable tax credit on all deposits
- Exempt interest from state income tax
- Allow deposits from unearned income

v. Summary

Financial institutions would offer these MCDAs to all Maine families with children born after a certain date. Match rates would decrease as household incomes increase, so some households would face changing rates over time as their incomes rose or fell. Maine's financial institutions would assume the administrative, legislative, marketing, and participant-outreach efforts necessary to promote wide scale use of the accounts. In return, those institutions would receive a new source of long-term savings and the ability to offer some clients an interest rate of 100% or more, through match funds.

III. Maine Individual Learning Accounts

Maine Individual Learning Accounts (MILAs) are modeled after CAEL's LiLAs and would be an extension of that program. This section considers the possibility that CAEL chose Maine as a test site for bringing LiLAs to scale. LiLAs are currently aimed at adult learners. Similar to 401K accounts, employees contribute into LiLAs and employers match those contributions up to a given amount. This discussion considers expanding the program so that account funds could be used for the education of a dependent.

Offering education opportunities as a benefit of employment is not a new idea. According to the Maine Comprehensive Economic Development Database, 26.4% of Maine employers offer education reimbursement for full-time employees, and 9.2% offer it to part-time staff. More than 60% of employees working over 35 hours per week reported receiving tuition reimbursement as a benefit of their employment.

The idea of employers matching employee savings is not new either. 401Ks are a well-known benefit offered by employers. These retirement accounts allow employees to make pre-tax contributions that can be matched by employers. 401Ks are portable between jobs, which is an important goal for both LiLAs and MILAs. This means that an individual's account, including match funds contributed by an employer, is not lost if he or she switches jobs.

MILAs and LiLAs are unique among asset building initiatives because they present a structure for sustainable funding through employer contributions. Most savings programs draw from one-time funding sources such as foundation grants and state or federal appropriations. By engaging employers, MILAs and LiLAs seek to instill the idea of an educated population as a valuable asset and worthwhile investment for Maine's business community.

i. Eligibility

Any willing and able employer could offer these accounts to their employees; hence there would be no income guidelines for this program. However, program advocates could concentrate implementation efforts on geographic regions or employment sectors that traditionally lag in education attainment.

The only limiting requirement would be that account holders must be employed. Individuals who do not work, either by choice or circumstance, could not save for a dependent through this program. A complementary program could be developed to serve those who are not employed; however such a program is not discussed in this report.

ii. Fund Usage

LiLA holders may currently use funds for the pursuit of work-related training. MILA holders could use funds for that purpose or for the postsecondary education of a dependent. For accounts earmarked for dependents, usage guidelines would be very

similar to those for MCDAs. Eligible uses would seek to be as inclusive as possible. Account funds could be used for all levels of degrees: professional certificates, associate, bachelors, and advanced degrees, and even GED programs. In addition to tuition and fees, eligible uses could include room and board, books, computers, transportation, and other related expenses. If an account beneficiary did not pursue postsecondary education by a certain age, perhaps 25, or died before reaching college-going age, then employee deposits, plus interest and match, would become accessible to the employee, to be used at his or her own discretion. If an employee left Maine before the child entered college, then the deposited funds, plus interest and match, could be converted into a 529 plan of the employee's choice.

iii. Incentives

MILAs would create savings incentives similar to those of 401K plans. Employees could deposit money into the account directly from their paychecks and employers would match those deposits at a pre-selected rate. Employers could also contribute performance-related bonuses and benchmark awards. As with 401K plans, MILA holders could choose between several investment options.

As with MCDAs, the use of MILAs could increase the number of students attending Maine's postsecondary institutions. Since those institutions are potential beneficiaries of the program, it may be appropriate for them to contribute match funds, either cash or in-kind.

Potential incentives for employers include improved retention, a new recruitment tool, and a tax credit on contributions to employee accounts. Maine currently has one State program that assists employer support of education. Although it is not a tax incentive and not applicable to dependents, it illustrates the potential for State compensation to employers. The Governor's Training Initiative provides partial reimbursement for the cost of worker training to employers looking to expand, retain, or upgrade their current workforce. In 2002, the program serviced 83 employers and 7,992 employees (Mealey, 2003). State expenditures that year totaled $3,277,000.

iv. Third-Party Contributions

As currently designed, this program does not provide a clear mechanism for contributions from parties other than the employee and employer. However, state or private funds could be used to aid small businesses that were unable to offer a match. In that case, third parties could contribute toward match funds (and possibly receive a tax credit), but they would not be able to contribute directly into the accounts of designated individuals.

v. Funding

MILAs present a framework for a savings program with sustainable funding. The ultimate goal is for employers to be the main source of match funds. As previously noted, State or private funds could go toward administrative costs and aid to small

businesses that are unable to offer a match. Private donations toward those causes could receive a tax credit.

vi. Administration

The ultimate goal of MILAs is for employers to assume administrative responsibility of the accounts, as they now do for 401Ks, and for the accounts to become a standard employment benefit. However, this risks the possibility that only Maine's largest employers would be able to offer the accounts. Maine is a state of small businesses, many of which do not offer benefits to their employees. So, this initiative would require a central agency to aid businesses that needed assistance offering match funds and marketing the accounts to their employees. This agency should have strong ties to the business community and understand current economic conditions.

vii. Marketing

Pursuing MILAs would be advisable if Maine became a test site for LiLAs and LiLA advocates were receptive to the idea of expanding eligible uses to include the education of a dependent. Even with their support, gaining the commitment of employers would be a long process.

There would be at least two marketing challenges for MILAs. The first would be promoting the program to state legislators and business leaders. This task would be considerably aided by the efforts of the LiLA Partnership. The Partnership has already introduced the concept of employment-based asset building to many state leaders. This initiative would essentially expand the LiLA program by adding the education of a dependent to the list of eligible account uses. If LiLA advocates and policymakers accepted this expansion, then the work of marketing the program to employers would be undertaken by a single LiLA/MILA agency.

Employers would be responsible for marketing MILAs to current and prospective employees, with the assistance of the central agency. The central agency would act as a resource for communicating the benefits of advance planning for college expenses and the value of match incentives. This marketing could be done through on-site information sessions for employees, presentation materials, print media, etc.

viii. State Legislation

Creating MILAs would require the strong support of Maine's business community and state legislature. The LiLA Partnership has already begun the process of securing their backing.

Implementing MILAs would require the following legislative actions:

- Create a tax credit for employer contributions to MILAs
- Create a mechanism for providing State funding to businesses that are unable to provide match, on a competitive basis

MILAs would benefit from the following optional policies:

- Exempt employee contributions and interest earnings from state income tax
- Exempt withdrawals of match funds from state income tax
- Create a tax credit for contributions to the MILA program

ix. Summary

MILAs present a mechanism for employed Maine residents to save toward future education expenses with the help of their employers. MILAs are unique among the three prospective programs because they present a structure for sustainable funding through employer contributions. The accounts would be available to all employees of businesses that chose to participate in the program. Unemployed individuals or those working for a nonparticipating business would not benefit from this program. A complementary program could serve those individuals. MILAs expand the LiLA framework by including a dependent's education expenses as an eligible account use. Pursuing this program is advisable if Maine becomes a test site for CAEL's LiLA initiative and the LiLA Partnership endorses the effort to include the new use.

8. Conclusion

This investigation of college savings in Maine reveals several findings. First, Maine children are not continuing on to college as often as their national peers and financial considerations appear to be part of the reason. Second, savings for college is particularly low in households with low incomes. Third, asset-building programs both in Maine and elsewhere are demonstrating that low-income households can save through structured programs, given the right incentives. In light of these findings and current movements within the state, the time seems right for a college-savings initiative that strives for inclusiveness and impact. This report begins to explore examples of what that initiative could be. Further research and discussions with leaders across the state will help refine these plans and move us closer to finding the most appropriate and promising program for Maine.

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Prospective Program Comparison

<table>
<tr><th></th><th>MCDA – Nonprofit Based</th><th>MCDA – Institution Based</th><th>Maine Individual Learning Accounts</th></tr>
<tr><td rowspan="2">Eligibility</td><td>Maine residents are able to save for a dependent’s education.

No asset limits, possible income limits. This program could be limited to families that have low-incomes when their child is born.</td><td>Maine residents are able to save for a dependent’s education.

No asset or income limits, but match rates vary by income level.</td><td>Maine employees of participating employers are able to save for their own or a dependent’s education.

No asset or income limits.</td></tr>
<tr><td colspan="2">Deposits can be made from both earned and unearned income.</td><td>Deposits are made from earned income.</td></tr>
<tr><td>Fund Usage</td><td colspan="2">Acceptable account uses are as broad as reasonably possible. They cover all levels of certificates and degrees, and additional costs beyond tuition and fees (e.g., room and board, books).</td><td>Acceptable uses are work-related training for the account holder or postsecondary education of a dependent. In the case of dependents, acceptable account uses are as broad as reasonably possible.</td></tr>
<tr><td rowspan="3">Incentives</td><td>Match incentives for account holders.

Matches are eliminated if annual household income surpasses a given threshold, OR match rates decline as annual household income rises. (This depends on whether the program is targeted to all households or only low-income households.)

Benchmark awards are possible.</td><td>Match incentives for account holders.

Match rates decline as annual household income rises, until no match is provided.

Benchmark awards are possible.

Financial institutions receive a new source of long-term deposits and the ability to offer some clients an interest rate of 100% or higher.</td><td rowspan="2">Match incentives for account holders.

Match rates and benchmark awards are determined by employers.

Employers receive tax credit for match contributions.</td></tr>
<tr><td colspan="2">Financial institutions offers free financial services to account holders.</td></tr>
<tr><td colspan="3">All accounts grow tax-free and withdrawals are exempt from state income tax. Account holders receive free financial counseling. Higher education institutions offer discounted tuition and/or automatic match to account beneficiaries (discount and match rates determined by the institutions).</td></tr>
<tr><td>Funding</td><td colspan="2">Match funds come from private contributions to the MCDA program (subject to a 50% tax credit), with startup funds provided by private foundations and/or state appropriations.</td><td>Employers provide match funding. State provides employers a tax credit on account contributions.

Private contributions to the MILA program (subject to a 50% tax credit) go to businesses that are unable to provide a match.</td></tr>
</table>

Prospective Program Comparison

<table>
<tr><th></th><th>MCDA – Nonprofit Based</th><th>MCDA – Institution Based</th><th>Maine Individual Learning Accounts</th></tr>
<tr><td>Third-Party Contributions</td><td colspan="2">Third-party contributions to the program are redistributed by the central agency. Third -party contributions to individuals from employers, schools, civic groups, relatives, etc. are made through the community organization administering the account, and may are may not receive match.</td><td>Third-party contributions to the program only, not to individuals.</td></tr>
<tr><td>Administration</td><td>Administered by local non-profit organizations and supported by a central statewide agency.</td><td>Administered by local financial institutions and monitored by a central statewide agency.</td><td>Administered by employers and monitored by a central statewide agency</td></tr>
<tr><td>Marketing</td><td>A central agency markets to state officials and the general public for legislation, funding, and participation.

Local nonprofit agencies market locally to potential account holders.</td><td>A central agency markets to state officials and the general public for initial legislation, funding, and participation.

A central agency markets to financial institutions for program involvement.

Financial institutions market to potential account holders, with the assistance of a central agency.

Financial institutions join in marketing to state officials and the general public if subsequent funding or legislation is necessary.</td><td>A central agency markets to state officials and the general public for initial legislation and funding.

A central agency markets to employers for program involvement.

Employers market to employees, with the assistance of a central agency.

Employers join in marketing to state officials and the general public if subsequent funding or legislation is necessary.</td></tr>
<tr><td>State Legislation</td><td colspan="2"><u>Required for both</u>:
-Allow IDA funds to be used for the education expenses of a dependent.
-Allow IDAs to be converted into 529 plans.
-Expand the IDA tax credit to include MCDA programs.

<u>Required for Institution Based MCDAs</u>:
-Allow financial institutions to administer IDAs.

<u>Optional for both</u>:
-Create a refundable tax credit on all deposits.
-Exempt interest from state income tax.
-Allow deposits from unearned income.</td><td><u>Required</u>:
-Create a mechanism for providing private and/or state funding to businesses that are unable to provide match, on a competitive basis.
-Create a tax credit for employer contributions.

<u>Optional</u>:
-Exempt employee contributions and interest earnings from state income tax.
-Exempt withdrawals from state income tax.</td></tr>
</table>