

# Why a Roth IRA for the Baby Would Be a Blessed Event

When an infant is born, the hospital paperwork for parents includes birth certificate and Social Security number applications. Soon, though, there could be another document to fill out: a Roth IRA account setup form.

That's the thrust of the Roth Account for Youths Savings Act, or RAYS Act, introduced last week in the U.S. House of Representatives by Ruben Hinojosa (D-Texas).

The Roth application would be optional, of course.

Hinojosa's bill builds on several earlier attempts to create a tax-advantaged path for Americans to save at very young ages. If it becomes law, it could provide a significant boost to savings by lower-income Americans and could address a worrisome long-term trend: younger households' deteriorating balance sheets.

The legislation calls for a simple change to the eligibility rules for contributing to a Roth account. Currently, account owners must have earned income to contribute, though there is an exception for non-working spouses. Under the RAYS Act, contributions could be made to the accounts of children whose parents have earned income.

Were it law today, up to \$5,500 could be contributed this year from any source—parents, grandparents or family friends. Withdrawals would be subject to the regular IRA withdrawal restrictions—in other words, no penalty-free withdrawals before age 59 1/2, with the exception of education expenses or a home purchase.

Even small contributions made in a child's earliest years could turn into significant saving down the road, thanks to

the favorable math of compound returns. And since it's a Roth account, with contributions made with post-tax dollars, no tax is due on principal on withdrawal; investment returns also come out tax-free.

One important feature of this bill: It would exclude the Roth saving from means-testing calculations that qualify low-income families for assistance programs such as food stamps, Medicaid or college assistance.

The name "RAYS Act" is a nod to its intellectual godfather – Ray Boshara, director of the Center for Household Financial Stability at the Federal Reserve Bank of St. Louis. Boshara began developing ideas for youth savings accounts in a previous role as a vice president of the New America Foundation.

At a time when political polarization makes it almost impossible to get new ideas through Congress, Boshara's Roth-for-kids concept could have a chance because of its bipartisan DNA. A 2004-05 proposal, called Aspire Accounts, would have included a \$500 starter contribution from the federal government for all children at birth, with an additional \$500 for low-income kids. It died, in part because it would have cost \$38 billion over 10 years but also because it was attached to President George W. Bush's misbegotten attempt to privatize Social Security in 2005.

I'm not going to hold that against the current Roth-for-Kids proposal, because the idea is just too good. Boshara calculates that an initial contribution of \$500 to an infant's account, with subsequent annual contributions of \$250, would grow to \$131,800 at age 65, compared with just \$35,300 for an account started at age 25, assuming a 5 percent annual investment return (before fees).

Roth-for-Kids stems from research by the Center for Household Financial Stability focused on the health of household balance

sheets. Boshara takes a wide view of family financial health, looking at savings, credit and debt, homeownership, college saving, retirement security and financial literacy.

A series of research papers by the group, based on the Federal Reserve Board's Survey of Consumer Finances, finds that young people are falling behind older generations at an accelerating rate. Households in their 20s and 30s suffered the greatest loss of wealth during the Great Recession, and have been slowest to recover.

"We are finding that age, race and the level of education are the three strongest predictors of family wealth," he says. "And we're seeing something unprecedented – that younger generations have lower levels of wealth than their parents or grandparents. So we need to start the process of saving much earlier. Even waiting until someone is working is too late."

The research points to economic hardship throughout life for younger generations, and especially in retirement. Weaker balance sheets aside, these households also will be subject to the full brunt of cuts in Social Security benefits initiated in reforms passed in 1983, and possible future cuts to the program, as well as Medicare.

Roth-for-Kids bears some resemblance to President Obama's new MyRA accounts, which also technically are Roths and are structured as starter accounts aimed at getting people into the habit of saving. MyRa accounts will be administered by the U.S Department of the Treasury and invested in Treasuries with low – return and guarantees against loss of principal. And they would have no management fees. But Roth-for-Kids IRAs would reside at private-sector financial services firms, just like any other Roth account.

That difference points to a couple must-have features for Roth-for-Kids. First, they would need a simple set of mutual fund choices, since most account holders would be new to

investing. And savers would need to be guided toward low-cost fund options, since high fees can swallow up a good chunk of returns over time.

Boshara and other supporters have been talking with low-cost mutual fund providers and some foundations about ways to offer the accounts through schools or other points of interaction with kids and their families.

There's much more that could be done. Making account setup automatic for every child would boost take-up rates, just as auto-enrollment has done for 401(k) plans. A starter contribution from the government would be even better, an investment that would pay big dividends in greater household financial stability when those kids become older.

But this looks like a baby step in the right direction.

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*Editing by Douglas Royalty*

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