INVESTING FOR THE FUTURE: 529 STATE TUITION SAVING PLANS

HEARING

BEFORE THE

SUBCOMMITTEE ON
CAPITAL MARKETS, INSURANCE AND
GOVERNMENT SPONSORED ENTEREPRISES

OF THE

COMMITTEE ON FINANCIAL SERVICES
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RAHM EMANUEL, Illinois
DAVID SCOTT, Georgia
NYDIA M. VELÁZQUEZ, New York

CONTENTS

WITNESSES

WEDNESDAY, JUNE 2, 2004

APPENDIX

INVESTING FOR THE FUTURE: 529 STATE TUITION SAVING PLANS

Wednesday, June 2, 2004

U.S. HOUSE OF REPRESENTATIVES,
SUBCOMMITTEE ON CAPITAL MARKETS, INSURANCE AND GOVERNMENT SPONSORED ENTERPRISES,
COMMITTEE ON FINANCIAL SERVICES,
Washington, D.C.

The subcommittee met, pursuant to call, at 10:06 a.m., in Room 2128, Rayburn House Office Building, Hon. Richard H. Baker [chairman of the subcommittee] Presiding.

Present: Representatives Baker, Gillmor, Oxley (ex officio), Biggert, Capito, Kennedy, Tiberi, Brown-Waite, Kanjorski, Hooley, Sherman, Meeks, Inslee, Moore, Lucas of Kentucky, Crowley, Clay, McCarthy, Baca, Emanuel, and Scott.

Chairman BAKER. I would like to ask our meeting to come to order and welcome our witnesses to the table this morning.

This morning, the committee meets to examine the manner in which special State education enhancement programs function for the benefit of prospective college students and moms and dads, typically characterized as Section 529 plans. All States, with the exception of Washington and the District of Columbia, have established some 529 plan and make it available to their constituents.

While the SEC does not have direct supervisory responsibility for the conduct of the 529 plans, they do, under Federal securities law, exercise jurisdiction with regard to fraud and other misconduct as well as having direct responsibility to regulate the broker dealers and the municipal security dealers that sell interest in 529 plans. So there is a Federal nexus for some examination of the manner in which these plans are operated.

In the past several years, the committee has engaged in market-sector by market-sector review of current regulatory structure and determined the adequacy of current disclosure regimes, the transparency, suitability, the method by which the average consumer may judge whether a particular investment is appropriate for their needs.

Chairman Oxley has recently written the SEC with his own list of questions relative to the 529 plan disclosure requirements that raise several interesting points. One of the obvious and apparent conclusions that I have reached is, there is not, at least today, a national standard of conduct for a State 529 plan to provide comparability between States. If one is enrolled in a plan in State A and then subsequently moves to State B, there may be tax consequences to the individual that are not clearly understood or perhaps properly disclosed today. Whether or not the offering materials are substantially different in content and presentation from marketing materials, whether there is sufficiency in clear disclosure of fee schedules, many of these issues sound like repeats of the same questions on other subjects in months past. And so the committee's review of these matters is certainly understandable and appropriate given our market sector responsibilities.

I will say that, today, I feel we have invited individuals to give the committee insight into the manner by which 529 plans function that have already exhibited high standards of professional conduct and perhaps can give us insight into where the industry may be moving.

And I wanted to conclude my remarks simply with an observation. It may be that an enhanced self-regulatory model may work well here as well and that, by States conducting their own review and examination, could come to standards for comparability on a national scale that could perhaps result in recognition of some system that an individual 529 plan might receive a nationally recognized merit award or status or recognition, thereby indicating to a State who refuses to adopt the model code that there are certain elements of that State's plan which are perhaps aberrant or not sufficient to warrant such recognition.

I would much prefer to see a self-regulatory model at this point than having the Federal Government intercede into another area where their participation may not be necessarily welcome in the first place.

To that end, I certainly appreciate those who are participating in the hearing this morning. It is the beginning of our process of understanding, and we certainly will reach no conclusions before a thorough exchange of ideas has been provided to all stakeholders. With that, I yield such time as the gentleman may consume to Mr. Kanjorski.

Mr. KANJORSKI. Thank you, Mr. Chairman.

Mr. Chairman, in Pennsylvania, we take pride in reminding others of many wise observations of Benjamin Franklin. As I prepared for today's hearing, I was accordingly reminded of one of his more insightful reflections, "An investment in knowledge always pays the best interest." this statement is as true today as it was more than 200 years ago in part because of Section 529 tuition savings plans.

During the last decade, the cost of attending a university has increased 40 percent while the typical household income has increased just 12 percent. Additionally, the average cost of attending a 4-year university now stands at $34,000 for State institutions and at $90,000 for private colleges. Moreover, the price tag for a higher education is expected to continue to grow in the future, likely continuing to outstrip any gains in families' earnings.

Because Democrats and Republicans alike recognize that an investment in higher education continues to produce appreciable returns for individuals in society, we have worked cooperatively in recent years to help families cover this necessary financial expense. In 1996, for example, we joined together to create 529 plans. As a result, families today can use this instrument to set aside money for higher education purposes that grows free of any Federal tax.

Section 529 plans have grown greatly in popularity since their inception in the late 1990s, and they are now one of the most common ways to save for a college education. Total assets in 529 plans which stood at $2.6 billion at the end of 2000 rose to $8.5 billion at the close of 2001. They also doubled in value in 2003, reaching $35 billion and covering more than 4 million accounts by the year's end.

In addition, the experts at the Federal Research Corporation now predict that American families will invest $300 billion in 529 plans by 2010. The tremendous expansion of the tuition savings plans industry has now produced some predictable growing pains. Although we created 529 plans in the Federal Tax Code of 1996, we did not simultaneously implement a comprehensive regulatory regime to cover this financial product. As a result, some have begun to raise concerns about the need to improve the oversight of this sector of our financial system.

For the purposes of our securities laws, the States generally have oversight responsibilities for Section 529 plans. One problem that has received substantial attention in recent months with respect to the 529 plans concerns the disclosures that investors currently receive about the performance of these financial products. As we will hear later this morning, many States have begun to take action on their own to protect investors, including working to develop a model disclosure regime.

National authorities in recent months have also begun to examine 529 plans which remain subject to Federal antifraud rules and broker dealer sales practice requirements. Earlier this year, the Securities and Exchange Commission announced the creation of a task force to study the fee disclosure regime and sale of 529 plans. Additionally, we have learned that the National Association of Security Dealers is now investigating whether some brokers in selling out-of-State 529 plans ultimately exposed their clients to lower investment returns and higher State taxes.

From my perspective, it is very important to study these issues and for State and Federal regulators to take coordinated action to protect families who invest in 529 plans. Greater standardization in disclosing fees and expenses will facilitate direct comparisons in performance between the various 529 plans across State lines. I am therefore pleased that the College Savings Plans Network has begun the work needed to implement a comprehensive disclosure system that will provide a greater comparability of 529 plans for investors and help to ensure that we have access to the same quality of information as mutual fund investors.

As we proceed today, I hope they will also examine the interplay between 529 plans and the proposal by the Bush Administration to create life savings accounts. As currently conceived, LSAs will permit individuals to save money tax-free for any purpose, including higher education. A recent study by the Senate Finance Committee determined that, because LSAs would be more flexible than 529 accounts, they could compete with tax-favored savings programs for education, particularly among persons with limited disposable income. We should therefore explore today whether the increased flexibility of LSAs might undermine a family's well-intentioned efforts to save for a child's higher education.

In sum, Mr. Chairman, I commend you for convening today's hearings on 529 plans. We should conduct oversight of this growing segment of our financial marketplace in order to determine how we can make the present regulatory structure stronger. The observations of today's witnesses about these matters will help me in forming my opinions on these issues.

Thank you Mr. Chairman.

[The prepared statement of Hon. Paul E. Kanjorski can be found on page 45 in the appendix.]

Chairman BAKER. I thank the gentleman.

Mr. Oxley.

Mr. OXLEY. Thank you, Mr. Chairman. Obviously, welcome to our panel. I see some familiar faces out there.

We all know that there are few things in life more essential than a good education. Helping parents save and invest for their children's higher education is a vital public policy initiative, particularly in this environment of runaway tuition costs.

Success of the 529 tuition savings plans is good news, but it is not surprising. These programs offer all families, regardless of income, the opportunity to obtain tax-free growth and distribution on money they save and invest for college costs. There is now more than $35 billion invested in the 529 plans across the country. And some have predicted that total assets will balloon to some $300 billion by the end of this decade.

Given the increasingly important role that 529 plans play in enabling parents to save for their children's education, I have become concerned about certain aspects of some of these plans. For example, why are there such disparities in fees and the disclosure of those fees? Have the fees charged by these State-sponsored plans become so exorbitant that they actually outstrip the tax benefit that Congress has attempted to provide? Have the States established adequate procedures to monitor the performance and operation of the investment managers they hire to run their plans? Are they offering documents clear and concise?

These are some of the concerns that prompted me to write to SEC Chairman Bill Donaldson in February of this year. In his response to me, Chairman Donaldson said that "the current State of affairs with respect to 529 plans is complicated and likely difficult for parents to understand," end quote. He also announced the creation of the chairman's task force on college savings plans. I am pleased by the commission's energetic response, and I understand that the task force has made considerable progress, and I look forward to hearing from them in the near future.

We have assembled an all-star lineup here today. I particularly would like to welcome Diana Cantor, the chairman of the College Savings Plans Network, and Jacqueline Williams, Executive Director of the Ohio Tuition Trust Authority. I know that they have put in long hours over the past few weeks to improve the disclosure regime of 529 plans. And I look forward to their testimony and that of the rest panel.

Mr. Chairman, again we look forward to the hearing, and I yield back.

[The prepared statement of Hon. Michael G. Oxley can be found on page 40 in the appendix.]

Chairman BAKER. I thank the gentleman for his participation and his statement.

Are there any members wishing to make additional open statements at this time?

Mr. Scott.

Mr. SCOTT. Thank you very much, Mr. Chairman. This is indeed a very important hearing and has some very important ramifications for my State of Georgia. And I certainly want to thank you Mr. Chairman and also Ranking Member Kanjorski for holding this hearing today regarding State-sponsored 529 college tuition savings plans. I believe that it is very important for this committee to examine the legitimacy and disclosure fees that some 529 plans are using.

And while this hearing will focus on many of the problems that have been identified with some State savings plans, my State of Georgia has a strong record of managing its plan. Since 2002, the Georgia higher education savings plan has offered a wide variety of investment options, managed by TIAA-CREF, an industry-recognized leader in providing investment services in the education and research communities. In just 2 short years of existence, the Georgia higher education savings plan has over 42,000 participants who have invested more than $165 million to pay for college education.

Contributions to the Georgia higher education savings plan can be made for as little as $25 per beneficiary, per investment option or as little as $15 for contributions made through payroll deductions. Up to $2,000 can be deducted per beneficiary for taxpayers who meet filing status and income requirements.

Georgia's plan has made savings for college more affordable with one of the lowest fees among 529 plans across the country. Participants pay no application fee, no sales charge and no annual account maintenance fee. An annual management fee, which is deduced from fund assets, is used to cover the cost of investment management fees and expenses as well as administrative services. The annual all-inclusive fee is only 0.85 percent of assets.

While Georgia has a 529 plan that maintains low and reasonable fees, other States have not managed their plans quite as well. And I look forward to hearing from this distinguished panel of witnesses today to discuss efforts to improve the management of 529 plans.

Among the issues that I will be looking for information on are whether the 529 plan administrators exercise sufficient oversight of the intermediaries they employ to sell interest in their plans, whether the disclosures given to investors are sufficient to permit informed investment decisions, and whether greater standardization in fee disclosure to facilitate comparability is achievable and whether the fees charged by some 529 plans negate the expected tax benefits from the investment.

Thank you for coming, and this is a very distinguished panel. And I look forward to hearing your comments.

Thank you, Mr. Chairman.

Chairman BAKER. I thank the gentleman.

Are there further opening statements?

If there are no further opening statements, I would like to move at this time to our first witness, Ms. Diane Cantor, chairman of the Executive Board, College Savings Plans Network.

And I wish to commend you for your good work in this area and also, on a personal aside, seeming to be a continuing positive influence in Mr. Eric Cantor's conduct. So I welcome you here this morning.

STATEMENT OF DIANA CANTOR, CHAIRMAN, EXECUTIVE BOARD, COLLEGE SAVINGS PLANS NETWORK

Ms. CANTOR. Thank you, Mr. Chairman. Thank you Member Kanjorski and distinguished members of the committee. My name is Diana Cantor. I am the executive director of the Virginia college savings plan and chairman of the College Savings Plans Network, an affiliate of the National Association of State Treasurers that has represented State 529 college savings and prepaid tuition plans since 1991. I thank you Mr. Chairman for the opportunity to address your committee.

The cost of attending college, whether public or private, continues to rise steadily. In order to send their children to college, American families increasingly rely upon debt to meet the rising cost of a higher education. Despite the cost, the value of a higher education is undeniable.

The best answer to rising college costs is to encourage families to save in advance. The States began creating prepaid tuition and savings plans more than a decade ago to help families cope with spiraling tuition costs. The theory has worked. Give families a tax advantage, disciplined, safe way to save for college expenses, and they will use it.

There are two types of Section 529 plans, prepaid and savings. Prepaid plans are similar to a defined benefit pension plan where the family is purchasing a defined amount of future tuition years of credit. Savings trusts are more analogous to defined contribution plans. Families can save in a variety of investment options, including equity and fixed-income mutual funds, actively managed accounts, money market, and stable value funds.

Families participating in 529 plans are specifically saving for college where otherwise they may not set aside money for that purpose. The programs, through their marketing efforts, draw attention to the need to save for college early and help many families across the country take that all-important step of beginning to save.

State college savings programs have achieved phenomenal success. With the enactment of the Economic Growth and Tax Relief Reconciliation Act, the number of children participating in our programs has skyrocketed. Every State in the Nation plus the District of Columbia now has at least one Section 529 savings option designed to meet the particular circumstances and policy goals of their States. States are able to offer their participants an opportunity to invest in funds and actively managed accounts that may otherwise be unavailable to them due to high minimum investment requirements. Savings plans typically do not have age or residency requirements as is common with prepaid tuition plans, so investors are free to choose any plan across the country that best meets their needs.

Today, with assets topping $40 billion in savings plans and $10 billion in prepaid tuition plans nationally, these plans are receiving increased attention. The Securities and Exchange Commission, in response to an inquiry from Chairman Oxley, recently announced the creation of a Section 529 task force to review among other things disclosure and fee issues. Questions have been raised as to why our programs may look different from State to State.

Our feelings as State administrators are that the unique features of our plans provide their prime attraction, the ability of each State to craft a program that best suits its citizens' needs and further that State's higher education policy.

Over a year ago, the College Savings Plans Network undertook an effort to create voluntary disclosure principles. These principles were adopted in draft form just last week at our network's annual meeting. The goal of the principles is to provide a framework for disclosure so that an investor can easily understand his or her own State plan as well as compare Section 529 plans on an apples-to-apples basis. They contain recommendations on information that should be prominently stated, such as the need to consider State tax treatment and other types of benefits and the availability of other 529 programs offered by that State.

The principles also contain tables and charts which provide clear, concise and consistent descriptions of fees, expenses and investment performance. Fees will continue to vary among these plans as fees differ among all types of non-529 investment options. Consumers do not expect to pay the same fees for a completely passive large cap index fund as they do for an actively managed international equity fund. Nor do they expect to pay the same for a direct-sold investment as they would for an advisor-sold product. But the intent of our disclosure guidelines is to make comparing the same types of plans much easier.

State oversight of their 529 plans provides an additional layer of accountability and protection for participants in these plans. States, such as Ohio, Louisiana, and Wisconsin, have already reacted to the current environment by expanding investment options, adding low-cost funds, and lowering fees. As creatures of State law, Section 529 plans are subject to multiple levels of oversight that help protect the programs' participants. Each State is governed by its own administrative procedure laws, procurement laws, ethics and conflict-of-interest statutes and freedom of information or Government in the Sunshine acts.

The plans are all administered by State boards, authorities or trusts. By statute or regulation, the operating authorities are required to follow prudent personal standards in selecting and retaining funds or managers. All of the programs are subject to financial audit and reporting requirements.

Promoting greater access to higher education and encouraging savings over debt is sound public policy. The existing State college savings programs promote these goals and reduce the need for financial aid and student loans.

Mr. Chairman, these programs are working. These plans have already provided benefits to more than 400,000 students nationwide and another 6 million children are waiting to use their accounts. In closing, Mr. Chairman, Section 529 plans are flourishing, and families are using these plans in record numbers to save for their children's future.

Congress' mission in creating 529 plans is being accomplished. We, along with our partners in the financial services industry, will work together to continue to improve these plans and to serve America's families and our most important customers, America's children.

Thank you again, Mr. Chairman, Ranking Member Kanjorski, distinguished Members of the committee, for your support of State college savings programs and the millions of families across America who participate in them. We look forward to continuing to work with your committee to continue to provide the best college savings options available through Section 529 plans. Thank you.

[The prepared statement of Diana Cantor can be found on page 78 in the appendix.]

Chairman BAKER. I thank you for your statement.

For the purposes of our next introduction I would yield such time as the gentleman may consume to the gentleman from Ohio, Mr. Tiberi.

Mr. TIBERI. Thank you, Mr. Chairman.

It is a pleasure to introduce another central Ohioan, Jacqueline Williams, who is the executive director of the Ohio Tuition Trust Authority. Jackie was appointed executive director of the Ohio Tuition Trust Authority in June of 1999. She has held leadership positions in both the public and private sector. She is president of the Columbus Board of Health, serves on the Columbus Cancer Clinic Board. She earned both her master's and her bachelor's degree at Miami University in Oxford, Ohio, one of the alma maters for our chairman to the left here.

On a personal note, Mr. Chairman, I had the opportunity during my last term of the General Assembly to work with Ms. Williams, and she was respected by members on both sides of the aisle.

And it is a real pleasure to work with you and thank you for being here to offer your expert testimony, Ms. Williams.

STATEMENT OF JACQUELINE WILLIAMS, EXECUTIVE DIRECTOR, OHIO TUITION TRUST AUTHORITY

Ms. WILLIAMS. Thank you very much. Thank you for the wonderful introduction.

Mr. Chairman, Ranking Member Kanjorski, and members of the committee, this is a real pleasure to speak to you today regarding 529 plans and to share one State's history and philosophy regarding these plans.

My name is Jackie Williams, and I am the executive director of the Ohio Tuition Trust Authority and a member of the Executive Committee of the College Savings Plans Network. The Ohio Tuition Trust Authority is an independent, self-supporting State agency which is governed by an 11-member board representing business, higher education, and elected officials.

Ohio was one of the first States to offer a qualified tuition program, and in 1989, the General Assembly in Ohio created the trust authority to help with the following objectives: Make higher education more affordable and accessible to Ohio citizens, to assist State universities by providing a stable financial base, to protect Ohio citizens from rising tuition costs, to encourage savings, and to promote secondary and post-secondary academic excellence.

Since 1989, almost 25,000 students have attended college using over $232 million invested in Ohio's plan. But according to the recently completed report of Ohio's Governor's Commission on higher education and the economy, only 11 States have smaller portions of their populations who have earned baccalaureate degrees. The report states that Ohio's economic growth and prosperity is inextricably linked to increasing participation by Ohioans in higher education.

We offered initially a unit-based prepaid tuition plan called the Guaranteed Savings Fund, and our State provided a tax exemption on earnings as an incentive for families to save. In 1994, the Ohio General Assembly supported and the voters of Ohio approved a constitutional amendment to provide the State's full financial backing for that prepaid plan in the event the fund could not meet future obligations. So clearly, this was a very high priority for our State.

In 1996, when Congress established qualified State tuition programs and added Section 529 to the Internal Revenue Code, Ohio's program fell under the guidelines established for such programs. And in 1999, the tuition trust proposed legislative changes to the agency's statute to take advantage of these Federal changes. The Ohio General Assembly unanimously supported the decision to offer more diverse choices for investments and also expanded the tax incentive by providing a $2,000 State tax deduction on contributions to the program.

We undertook an extensive competitive bid process to select and hire a firm to provide investment management, marketing and administrative services. Our due diligence included on-site examinations of bidders by our staff, a review of fees and performance by our outside consultants, and oral presentations by finalists. And in 2000, we hired Putnam Investments to manage the savings program.

The firm was selected for a variety of reasons, but one of the most important things was their commitment to educate and sell options to consumers through an extensive network of financial advisers. This was a deliberate choice on the part of our board because they wanted to extend the access of these programs to the public. Our staff, while one of the larger ones in the 529 industry was never intended to grow large enough to address the more than 11 million people in the State of Ohio.

Our plan is sold through financial advisors and directly through the tuition trust. The advisor-sold component offers 17 market-based options, and those same options are available directly through the trust authority at a lower cost for Ohio residents. Over the past 4 years, we have experienced significant growth in our program. In our State alone, over $1.1 billion has been invested through CollegeAdvantage on behalf of 186,000 beneficiaries. And the average account value, despite the fact that most of these programs will allow people to save significant amounts for private or public education, graduate school et cetera, the average account value is $7,500.

However, we continue to refine and enhance our program, and in the spring of 2003, we conducted market research of Ohio citizens who had relatives under age 18 to whom they felt some obligation to help save for college. Among respondents who were saving, bank accounts were the most popular vehicle. And while 9 percent were using CollegeAdvantage to save, 28 percent were using taxable instruments. And fully half of all respondents, despite the fact that they had children or grandchildren, were not saving at all.

The other point that came out was that fully two-thirds of the people responding considered themselves to be do-it-yourself investors and wanted very clear, easy-to-understand savings options. To meet the needs uncovered through research, we took a two-step approach. And in January of this year, we issued an RFP to index fund managers for a low-cost index provider. Through a competitive selection process, we hired the Vanguard Group in March. And in May we added 15 Vanguard investment options to CollegeAdvantage.

We will soon issue an RFP to Ohio banking institutions for a 529 savings account and at least one-time deposit product. The goal would be to distribute these products through the bank's distribution channels including branch locations, on-line bank centers, call centers, workplace programs and other access points, because our job is to make sure that our citizens have full access to these programs. We offer flexible contribution methods through electronic funds transfer, payroll deduction, on-line contributions, no enrollment fee, and minimum contributions of $15. We also have made college more affordable by having some of the lowest fees in the industry, and while total expense ratios will definitely vary with the type of investment option, the lowest all-inclusive fee available through our program, is 35 basis points.

So we have done a considerable amount to standardize the information that is available over the past several months to people in our program, and we believe that we are now leading the industry in terms of some of the recent enhancements we have made to our disclosure materials. We are working to increase access to higher education in our State by offering a diverse range of investment choices, low fees, affordable minimum contributions, online access, easy contribution options, and State tax advantages. These features make Ohio's program unique and tailored to the needs of Ohio families.

While disclosure information should be standardized across the 529 industry, each State must be able to shape and define its own plan to meet the unique needs of its citizens. Our success is essential if the governor's goal of increasing participation in post-secondary education by 30 percent or 180,000 students by 2015 is to be reached. Each day, we work with families one at a time to support their aspirations to achieve a better future for their children.

Thank you again for the opportunity, Mr. Chairman. We look forward to working with you and Members of your committee. And we would be pleased to answer any questions when it is appropriate. Thank you.

[The prepared statement of Jacqueline Williams can be found on page 156 in the appendix.]

Chairman BAKER. Thank you very much.

I would like to now welcome Mr. Marc Lackritz, president of the Securities Industry Association, back to the committee.

Welcome, sir.

STATEMENT OF MARC E. LACKRITZ, PRESIDENT, SECURITIES INDUSTRY ASSOCIATION

Mr. LACKRITZ. Thank you, Mr. Chairman, and thank you for the opportunity to testify today about Section 529 plans, how important they are to financing higher education costs and how we might work together to improve them.

My name is Marc Lackritz. I am president of the Securities Industry Association. Our member firms are deeply committed, Mr. Chairman, to reviving a national culture of saving, particularly among young people. We have worked very hard to educate and encourage both students and parents to invest regularly in a product with marginal risk to help foster a renewed sense of personal responsibility. One such product, the Section 529 plans, offers some of the best benefits for savings for college.

Our members are actively involved in all phases of the management and marketing of 529 plans because these plans have easier eligibility and contribution requirements than certain other investment options, thereby making them accessible to far more families and people. The enhanced Federal tax benefit provided by Congress in the tax legislation of 2001 instantly increased the popularity of Section 529 plans: 63 percent of these accounts were open in 2001 or later, and participation in account balances will continue to rise as individuals become more aware of the tax benefits of the plan.

Indeed, if a family contributed $2,000 annually to a 529 account for 18 straight years and assuming an 8 percent rate of return, they would have saved nearly $75,000 for college, enough for most 4-year public institutions across the country. The favored tax treatment of 529 plans not only enhances returns but also helps to assure that the funds will be there when they are needed for college by discouraging withdrawal for other purposes.

Without the involvement of the States, 529 savings plans would not exist. States approve the method of distribution both in-State and nationally, and broker dealers that distribute 529 plans must work with the States to negotiate selling agreements and produce marketing and other program literature. Tax treatment of 529 plans is subject to both Federal and State law. And the Securities and Exchange Commission and the Municipal Securities Rulemaking Board oversee the broker dealers and investment advisors who distribute the plans.

Mr. Chairman, we believe there are five different ways to improve on Section 529 plans. First, make the tax-free treatment of distributions permanent. The short-term success in expanding 529 plans from enhanced Federal tax advantages enacted in 2001 could be undermined by the uncertainty that the tax incentive will not be made permanent. If Congress does not extend the provision for tax-free withdrawals on 529 plans, then, after 2010, earnings in the account will be taxed at the recipient's rate as they are withdrawn. We would urge Congress to make the tax-free treatment of distributions permanent as soon as possible to ensure certainty to participants that the tax benefit will exist when they make their withdrawals.

Secondly, create tax parity among the States. Creating tax parity among all 50 States would significantly increase participation and lower cost for investors. Currently, more than 50 percent of the

State plans have different tax rates and policies in place. Families and their financial advisors face a complex challenge to determine the value of particular State's tax benefit when placed in the proper context of other investment considerations. SIA and our member firms are actively working at the State level to achieve tax parity across the board. We have had some success, although current State fiscal constraints are hampering broader progress.

Third, we need to improve disclosure. We also believe that clear, more complete and more understandable disclosure of fee and investment-related information would help investors make relevant, consistent comparisons among different types of plans. Currently, marketing material for mutual funds purchased through a broker dealer must comply with NASD advertising rules, and since about 75 percent of 529 plans are sold through brokers, investment-related disclosure in advertising is fairly consistent across 529 plans.

However, fees are not disclosed in the uniform way in program materials with some programs including costs, such as annual maintenance fees, while others do not. We believe that all fees should be transparent and should be included in investment performance information. We have worked with the States as they develop the draft guidelines that will standardize both the kind of information disclosed as well as its location.

Similarly, we support improved disclosures of potential home-State tax benefits. Under the MSRB guidelines, broker-dealers must provide disclosure to clients of any potential home-State tax benefit. However, the location of that notice in the program description is not standard among plans. We believe this information should appear on the first page of the program description to help both investors and their financial advisors. That statement, however, should also indicate that tax treatment is only one of many features that should be weighed by investors in selecting a 529 plan.

Fourth, ensure suitability. Under our securities laws, broker-dealers must ensure that products that they sell to their clients are suitable for them. The variety of different 529 plans as well as other education savings vehicles can make choosing the right one a difficult and confusing exercise for investors. Registered representatives and financial advisors help investors make the right investment decisions by encouraging their clients to consider a variety of factors when reviewing college savings plan options.

And fifth, improve investor education. Investors continue to state that they lack the knowledge about investing and that they want the securities industry's help in educating them. We have recently updated our free guide to understanding 529 plans to include a list of questions a 529 investor should consider before investing in a particular plan. In addition, our investor education website, pathtoinvesting.org, includes information on 529 plans as well as opportunities to invest in a hypothetical account.

In conclusion, Mr. Chairman, SIA is committed to ensuring that 529 plans remain among the best possible products available to save for higher education. We have met with members of the 529 task force established by Chairman Donaldson, and we will continue our outreach efforts to promote a greater awareness and understanding of 529 plans. We look forward, Mr. Chairman, to working with you, the regulatory agencies and State officials to make permanent the Federal provision for tax-free withdrawals on 529 plans, achieve tax parity among the States, improve disclosures, and provide ongoing education on 529 plans and other appropriate investments. Together, we will expand the opportunities for all families to save for their children's education, the most important investment in our future. Thank you very much.

[The prepared statement of Marc E. Lackritz can be found on page 89 in the appendix.]

Chairman BAKER. Thank you, sir.

Our next witness is Mr. Michael A. Olivas, who holds the William B. Bates Distinguished Chair in Law and who appears today as the director of the Institute for Higher Education of Law and Governance from the University of Houston Law Center.

Welcome, sir.

STATEMENT OF MICHAEL A. OLIVAS, WILLIAM B. BATES DISTINGUISHED CHAIR IN LAW AND DIRECTOR, INSTITUTE FOR HIGHER EDUCATION LAW AND GOVERNANCE, UNIVERSITY OF HOUSTON LAW CENTER

Mr. OLIVAS. Thank you Chairman Baker, members of the committee and the subcommittee. I appreciate the opportunity to present testimony this morning and to share some of my research on prepaid plans and college savings plans which I have been studying since they began. I will spare you the details. These are available in fine bookstores everywhere and soon to be a major motion picture.

I would like to draw your attention to a number of the issues raised by a colleague, Joseph Hurley, whose annual book, the Best Way to Save for College, rates these various State plans. For example, he lists them according to eligibility or who is able to open an account, an issue that is not as easy as it seems on the surface: The time or age limitation on the beneficiary or the eventual user; age-based investment options; static investment options; the underlying investments; fees and expenses on a variety of bases; the broker distribution fees; contributions both the maximum and the minimum; account changes, such as beneficiary changes, transfers in ownership and other kinds of things like this, including the ability to transfer to a sibling or a relative; full faith and credit, whether actual or political full faith and credit; State income-tax deductibility exemptions from creditors; whether or not these are subject to involuntary transfer alienation clauses; and reciprocity with a variety of other State plans.

As students and these plans become more portable, these issues are going to continue to vex both enrollment managers, higher educators generally as well as parents and the children. Of course, these very many options reflect the maturity of investment markets and make the various plans extremely popular with parents and other investors, especially those plans that offer enhanced portability and the collateral State tax benefits as program choices.

Of course, these investors have many choices among investment funds, especially in the State savings plans. A number of States offer multiple plans. It was mentioned this morning that one State offers at least 17 at last count. As attractive as these choices are, an observer cannot help but question whether a State program really requires as many investment choices for contract purchasers, each with a different and often unclear fee structure, investment mix and track record. The marginal advantages may not be evident in any annual review while the State's supervisory role is made much more complicated by the extremely complex bid and review process, especially in States with intricate procurement and investment regulations.

This lack of transparency is the clear disadvantage held up to the mirror of enhanced investor choice. In my judgment, we may be verging on a system where there are too many choices for most investors and the system's complexity renders comparable choice shopping too complicated for most investors, particularly for those who participate because they are risk-averse in the first place and do not feel comfortable simply investing in traditional instruments, beating the markets or having bank accounts.

There is almost too much dynamism in these plans as the various States compete with other State plans to offer more plans and more complex options so as to attract more contract purchasers. A system can have too many choices and can intimidate or paralyze unsophisticated buyers especially in markets that are planned to be churning markets.

This system complexity can be a barrier to market entry for some persons. Yet another issue is that the range of investment options may have unintended consequences. Diverse plan options may encourage purchasers to place all their eggs in one basket. I have been concerned about the rise of single mutual funds as State options both with and without brokers in a number of State plans.

My concern is that people in traditional marketplaces might choose mutual funds due to their broadly based mix of stocks or bonds, in some instances, when individual contract purchaser needs may be poorly suited to such vehicles. Whenever information, such as how to best allocate and invest in State programs, is at a premium, the persons least likely to participate or prosper are the less well-educated, the very group at whom these programs are aimed, the poor, immigrants and minorities, especially linguistic minorities.

Thus, system complexity in State prepaid and saving plans programs, even in States with low barriers to entry and monthly payment options such as those in Georgia, attract and reward the most advantaged and knowledgeable participants much like the college application process itself, which so clearly serves the interests of advantaged and wealthier students. If information and investor savvy are needed for these dynamic investments, State prepaid and savings plans will widen the gap between the wealthy and the poor, majority and minority, street-smart and average persons.

Finally, I note that my earlier concerns about the viability of these programs have largely been met by the emergence of legislation and favorable tax treatment, including legal developments. After all, there are a number of us in the 1980s that were wondering how we were going to pay off the funeral of these plans before they received tax treatment favorable by this legislature.

However, as in any other public program, it is clear that the wealthy have more options, and the poor cannot afford to avail themselves of various tax vehicles or savings programs, although they value higher education for their children every bit as much as do the wealthy.

I urge you to facilitate truly comparable disclosure requirements, full and open participation data which we do not have at present, usable program investment performance and comprehensive eligibility and enrollment information.

Because of unique State conditions and political considerations, each State has fashioned its own plan or plans, and maybe, we should just rejoice in the thousand flowers that are blooming. But I fear that the program complexity has made this generous and useful universe off-putting to many parents and would-be contributors. I urge, at the very least, standardization and uniformity with regard to fee disclosures, which we do not have. And it is not clear to me that those governed can govern themselves in this regard. That is, it is not clear to me that the States are in a position to gather this information and report. I believe that this would be very troubling, and I think we have a number of categorical precedent's for this that this committee is aware of as no other.

I have attached a copy of the various State plans taken from a recent article, also available in fine book stores everywhere. I hope that this will be a useful starting point and will be useful to readers, and if I may answer any questions or elaborate upon these views, I would be certainly pleased to do so. Thank you for this opportunity to share my research and my thoughts with you.

[The prepared statement of Michael A. Olivas can be found on page 133 in the appendix.]

Chairman BAKER. Thank you very much, sir. We appreciate your attendance.

Our next witness is Mr. Daniel McNeela, senior analyst, Morningstar, Inc.

Welcome, sir.

STATEMENT OF DANIEL MCNEELA, SENIOR ANALYST, MORNINGSTAR, INC.

Mr. MCNEELA. Thank you for the opportunity to appear before this distinguished committee. My name is Dan McNeela, and I am a senior analyst with Morningstar, Inc., an independent investment research firm that provides data and analysis on mutual funds and other investments.

More than a year ago, we began to cover 529 plans which, as our research has shown, have much to offer. Now, I lead a team of four analysts that reviews all 529 plans in existence. Our analysis shows that a well-chosen 529 plan is an attractive investment vehicle. To inform their decisions, we write commentaries that detail the benefits afforded to 529 investors. Such advantages include considerable investment flexibility, tax advantages, high contribution limits, and diversification.

That said, my testimony today focuses on the shortcomings of 529 plans. Several areas are in need of substantial improvement. All too often high costs, poor disclosure and unreasonably complex structure greatly diminish their potential value. Some of our greatest concerns relate to the myriad costs investors pay to participate in a 529 plan. Investors face enrollment fees, account maintenance fees, administrative fees, management fees and, in many cases, broker fees. Some of those costs are dollar-based while others vary depending on the amount invested in the plan.

Calculating the specific fees associated with a particular investment option can be a major undertaking. Most plans are set up as funds of mutual funds whereby a single investment option represents a basket of underlying funds. To arrive at the total expenses of a single investment option, investors must first prorate the costs of the underlying funds depending on their weighting in the portfolio and add the costs of all those funds together. Any associated administrative fees and broker fees, if applicable, must be added to arrive at a total. Even at that point, dollar-based fees are left unaccounted.

That process is frustrating enough for individual investors, but most 529 plans exacerbate this problem by burying this important cost information in the back of a 100-page-long program disclosure document. At its worst, the complexity of the cost structure and the reluctance to make the information easily accessible amount to deceit on the part of 529 providers.

The simplest solution is to require plans to prominently feature cost information on websites and in their literature. Costs should be presented both at the base level, so investors can see what they are paying for, and in aggregate, to summarize the plan's expenses. In situations where costs vary depending on the chosen investment option, a total cost for each investment option should be clearly outlined. In effect, this summary expense data would serve the same purpose as that of expense ratios for mutual funds.

Finally, 529 plans should heed the call that mutual funds are hearing for better cost disclosure by providing cost estimates in dollar terms as well as percentage terms. A projection of a total cost based on a $10,000 investment would serve investors by making comparisons between competing plans much easier.

Clear disclosure of costs in both percentage terms should help alleviate the other major problem of 529 plans. In short, too many plans are prohibitively expensive. One reason plans are so expensive is that several large groups are in line to collect fees. With States, fund companies, brokers, and third-party administrators all putting their fingers in the pie, it is no wonder that investors can end up with a knuckle sandwich. Anyone who says that costs don't matter is most likely a recipient of those fees. Plan costs come out of investors' pockets on a dollar-for-dollar basis.

Although the debate between low cost index funds and more expensive actively managed options is worthwhile, overcharging for lavish advertising campaigns and bloated administrative expenses is reckless and unfair. A recent review of 529 plans turned up several with investment options whose costs approach or exceed 2 percent of assets for Class A shares. This figure does not include front-end sales costs, which can be as much as 5.75 percent of assets, or any dollar-based fees.

Collectively, these expenses significantly diminish potential gains. If long-term returns before fees average 6 percent annually, expenses could consume more than a third of investors' potential gains. The difference between paying 1 percent or 2 percent in annual asset-based fees may seem minuscule to uninformed investors, but presenting those costs in dollars and cents and projecting them over a multi-year period will shed light on this issue. In the aggregate, we can see how meaningful the potential differences become. With $47 billion currently in 529 plans, a 1 percent asset-based fee costs 529 investors $470 million annually. At a 2 percent fee level, annual costs to 529 investors rise to $940 million.

Although fees and their transparency are important issues, 529 plans also have a responsibility to disclose how fees are used. This concern focuses on administrative fees which vary greatly among plans. Tennessee's plan, for example, is cheaper than average overall because it uses low-cost index funds and lacks a broker sold option. Its cost structure is also simple because it charges a flat 95 basis points regardless of the investment option. But Tennessee's administrative costs are unreasonably high. The plan's disclosure documents do not explain why it costs nearly 50 percent more than nearly identical plans offered by Michigan and Missouri. Tennessee charges as much as 0.88 percent in administrative fees without accounting for that how that money is being used.

By comparison, Utah reports that it has been able to cover its operating costs by charging a mere 0.25 percent in administrative fees. States that offer 529 plans need to be accountable for fees. Citizens have a right to know how their money is used.

The first step towards achieving that goal is improved disclosure. We believe that States should tell investors how much money they collect and where that money ends up. Are fees paying for splashy advertising campaigns or defraying the costs of other projects? To date, States haven't felt compelled to provide answers.

In a similar vein, residents receive little information regarding how their States' selected fund company partners. States should be forthcoming about the selection process and criteria used. They should fully explain the terms of the deal, including any benefits the States will receive and how their choice serves citizens.

The final area in need of improved disclosure is the evaluation of performance. Investors currently receive information regarding the performance of the various investment options for both short-term and long-term periods, but to grasp how well their plan is performing, investors need to see the performance of relevant benchmarks alongside the plan's returns. These benchmarks should reflect the asset classes in which the investment options are invested.

Because many of the investment options include both stocks and bonds, blended benchmarks which combine returns from different asset classes are most appropriate. It is important that this comparison relates to the actual performance of investment options net of all asset-based fees. If this is done properly, plans saddled with poorly performing funds and high cost structures will have few places to hide.

As a supplement to those numbers, plans should provide investors with a written commentary explaining why the investment options did better or worse than their benchmark. This analysis, which need not be lengthy or complicated, would markedly demonstrate accountability. Thank you for your time.

[The prepared statement of Daniel McNeela can be found on page 129 in the appendix.]

Chairman BAKER. Thank you very much, sir.

Our next witness is Mr. Mercer Bullard, who appears here today as president and founder of Fund Democracy, Inc., also an assistant professor of law at the University of Mississippi.

Welcome.

STATEMENT OF MERCER E. BULLARD, PRESIDENT AND FOUNDER, FUND DEMOCRACY, INC., AND ASSISTANT PROFESSOR OF LAW, UNIVERSITY OF MISSISSIPPI SCHOOL OF LAW

Mr. BULLARD. Thank you, Chairman Baker and Members of the subcommittee. And thank you also for the opportunity to appear before you to discuss 529 State tuition savings plans. It is an honor and a privilege to appear before the subcommittee today.

I will focus my remarks on the issue of fee disclosure by 529 plans—and that is 529 savings plans, not prepaid plans—and begin with the aspects where there does not appear to be much disagreement. There seems to be little disagreement, for example, that 529 fee disclosure is inadequate. 529 plan fees are hard to find. They are hard to understand, and they are not standardized so as to permit easy comparison across different plans.

The transparent disclosure of fees is critical to the efficient operation of any market, and the 529 plan industry is no exception. Unless and until 529 plan fee disclosure is reformed, plan participants will pay higher fees than they otherwise would pay.

It would not be surprising if there were also general agreement about general minimum standards for 529 plan fee disclosure. 529 plans are in many respects similar to mutual funds, and 529 plan assets are primarily invested in mutual funds. Therefore, mutual fund rules are likely to provide at least a reference point if not a baseline for 529 plan fee disclosure.

This brings us to areas of potential disagreement. For example, as the subcommittee is very aware, there is substantial disagreement by the adequacy of mutual fund fee disclosure. The SEC has admitted that current mutual fund fee disclosure requirements are inadequate and has proposed rules to address some but not all of the most glaring deficiencies. I hope that these problems will at least be fixed for 529 plans if not for mutual funds, and I have described in my written submission the minimum standards that I believe 529 plans should be held to.

In fact, I believe that fee disclosure requirements for 529 plans should exceed those applicable to mutual funds for two primary reasons. First, Congress enacted 529 plans for a specific purpose, to promote investment in higher education, and Congress is financing this policy with foregone tax dollars. Every additional dollar spent on 529 plan fees is $1 less that can be spent on higher education. Congress has a heightened interest in promoting competition and thereby lowering 529 plan fees.

A second reason 529 plan disclosure rules must go further than mutual fund rules is that 529 plans are subject to special constraints that further impede the operation of competitive market forces and necessitate more aggressive fee disclosure requirements. These additional anticompetitive constraints arise from the exclusive sponsorship of 529 plans by governmental entities. 529 plans issue municipal securities, which generally exempt the plans and their issuers from the rules that apply to similar investment products.

This means that participants in 529 plans are deprived of the benefits not only of fee disclosure rules but also a number of other rules that, in the private sector, have the effect of promoting competition or otherwise limiting fees. For example, mutual fund sales charges are subject to set limits; 529 plan sales charges are not. Mutual fund shareholders generally have the right to have their contributions invested and redeemed immediately at the fund's per share net asset value; 529 plan participants do not have these rights. Fund share holders have the right to vote on key fee increases; 529 plan participants do not. Fund shareholders can recover excessive fees in court; 529 plan participants cannot. Each of these mutual fund rules directly or indirectly limits fund fees, but these rules do not apply to 529 plans.

Furthermore, the State sponsorship of 529 plans creates conflicts of interests that generally are not present in the private sector, and these conflicts of interest may result in higher fees. States may set fees or hire managers based on political considerations rather than the effect on participants' interests. In one case, a State treasurer purportedly used 529 plan assets to run ads about the plan that prominently featured the treasurer, who was running for reelection. States, as a group, have a monopoly over the Federal tax benefits provided by 529 plans. And each State individually has a monopoly over that State's tax benefits. These monopolies further reduce price competition and increase costs.

State sponsorship of 529 plans means that there are 50 different sets of rules, thereby increasing costs for providers which they pass on to participants in the form of higher fees. Establishing one set of rules would reduce costs.

The absence of nondisclosure rules that promote competition and limit fees, States' conflicts of interest, the State's monopoly over plan tax benefits, the added compliance costs of 50 different sets of rules all argue for more aggressive fee disclosure requirements than in other contexts.

This is not to say that, if such rules are not adopted, all 529 plans would charge excessive fees. There are States that offer low-cost plans with reasonably clear although not standardized fee disclosure such as we have heard Georgia's plan described as well as Virginia's and Ohio's in today's hearing, and they are likely to continue doing so with or without new rules.

But this is not true of all States, and tailoring fee disclosure to the Vanguards of the 529 plan industry makes no more sense in the 529 plan context than it would in the private sector.

529 plan fee disclosure must be designed with a view to the sponsors, the States, for which mutual fund-like disclosure rules will not be enough to make them sufficiently accountable to market forces and insure that 529 plans serve their congressional purpose.

Another subject about which there may be some disagreement is who should promulgate and enforce rules for 529 plan fee disclosure. I believe that the SEC has unparalleled expertise and experience in developing fee disclosure rules. It also has the objectivity and independence, as noted by Professor Olivas, which the States lack that is necessary to interpret and enforce these rules. I would recommend that Congress authorize the Commission to enforce and enforce fee disclosure rules for 529 plans.

Also I want to specifically address the idea that Chairman Baker raised about an SRO and note that we just heard, for example, Ms. Williams talk about the standardization, and it is important, but immediately caveated that with the statement that Ohio must be able to shape and define its own plan to meet its own needs. And I think that we must wonder, when we hear that statement, whether for some States, perhaps not Ohio, that is going to mean that they will want to go their own way regardless of what standard arrangements that Ms. Cantor may reach.

Another thing to think about is in the creation of this SRO you have created a brand new regulatory entity that doesn't currently exist. We already have banks and the IRS regulating IRAs. We have the Department of Labor regulating employee benefit plans. We have got the SEC regulating variable annuities. And query whether you want to have a new regulator with a whole new set of rules, one that is now answerable to possibly 50 different interpretations of those rules to administer this new securities product.

And another thing to think about is this issue will not stop with the disclosure of fees. It will go on to disclosure of performance and performance and standards, as Mr. McNeela just mentioned. It will go on to the issue of whether there should be limits on loads, as soon as some broker dealer exceeds the NASD loads on the ground as permitted under MSRB interpretations that they are providing additional services. There will be further debates about what substantive investments are made in 529 plans. What is going to happen the first time that a State decides to invest in companies in-state in order to help that State's economy? What is going to happen when the first state offers an Internet fund, the equivalent of an Internet fund in 2006 and somebody sees 40 percent of the investments that they made for their kids' education go down the tubes in 1 year as we know can happen? These are the things that are going to have to be dealt with sequentially by a new SRO. And the irony of this is of course that we have been here before. With the National Securities Markets Improvements Act it was precisely the inability of the states to standardize disclosure requirements that they were applying to mutual funds that caused Congress to enforce that standardization.

And I believe that that has been a great boon for the industry. It is simply inconsistent with the concept of Federalism that we would could expect States to get together and rigorously enforce standards that would apply to all of them or, in fact, none of you would need to be here. The States could simply do that on their own.

So as you can see, I have a bit of skepticism generally about State actors and the private sector, and particularly as Professor Olivas mentioned, having those State actors in the private sector regulate themselves.

So in conclusion, despite the inadequate state of the 529 plan fee disclosure, this product is still relatively in its infancy and regulators have a real opportunity to get it right from the start. We know how good fee disclosure promotes competition, reduces fees and creates wealth. And in this case that additional wealth creation will go to the worthy cause of higher education. I would be happy to help with the answers to any questions if you have them.

Chairman BAKER. Thank you, sir.

[The prepared statement of Mercer E. Bullard can be found on page 47 in the appendix.]

Chairman BAKER. Ms. Cantor, I would start with just the obvious, since the product is relatively new, there are still many parents learning about it and the dramatic growth we see over the past 3 years, perhaps is just a very modest indicator of what the future may hold with regard to national participation. That, in itself, would make congressional interest even more sensitive to appropriate management standards of disclosure and transparency. Given the fact that the network recently adopted a draft of principles, what would be your expectation as to a final accord being formally adopted that would be able to be reviewed by the public and Members of Congress as well? Is there a time line? Or what is your expectation?

Ms. CANTOR. Thank you for that question, Mr. Chairman. Regarding the process that we would like to continue with the guidelines that we promulgated and adopted last week, which, by the way, were a joint partnership effort between the public and the private sectors, our next step, as we promised the SEC task force, is to sit down with them under Chairman Oxley's direction to have them review with us the guidelines, get their input, work with your staff here on financial services who have a copy of the guidelines. It is a work in progress.

There are still States and their counsels who are making comments and making suggestions. We welcome all opportunities for input. We are hopeful that in the next several weeks over the summer months we will be able to work with our partners and with the regulators to provide a comprehensive set of guidelines that we look to provide to the members of Congress.

Chairman BAKER. With regard to similar efforts in other related matters, in the insurance world, we have 50-plus different regulatory structures, with varying degrees of enforcement authorities within the various States. And we have been working with the NAIC and others to try to reach some national standard to allow for more uniform sales practices and enforcement capabilities. And that has gone on for some number of years. And we are really, although having made some modest progress, we are not very close to the goal which many members of the committee would support.

And that is the reason for suggesting that if you reached accord on a model standard of disclosure, as for example, and had perhaps a product or two in response to Mr. Olivas' concerns about having too many choices for the confused average consumer, if you had a standard national product that all States would offer that could be compared A to B to C, and if the State complied with all of the model requirements which your network would adopt in consultation with the SEC, that could then lead the State to earn a nationally recognized standard of conduct, for example.

I really view that almost as the minimal sort of step that could be taken to avert where we don't want to go, and that is ultimately some Federal intervention to set a model up. I really like the idea that innovative people come up with products that meet consumer needs. In some States, there are much higher per capita income than others. Smart people are going to go wherever they can to make money for their children. And we can't keep people from investing where they think best for their own future.

So merely the fact you offer more products is not a bad thing. But having some measure of comparability so people understand what they are buying when they are not the sophisticated investor, I think, is the general concern. Because this is the roadway out for many young people to become those sophisticated investors, and we certainly want to make sure that average working families can make clear choices based on comparability. Given the fact we don't really have a firm time line, could we expect something within a year or two as to a final product? Without boxing yourself in unreasonably, how long a clock would one expect the Congress to wait while the self-regulatory process works?

Ms. CANTOR. I would be hopeful that by the end of this calendar year we would be able to have something well within—by the end of 2004 should not be an issue to present something to Congress. And again, you know, asking the support of your staff to work with us along the way would be most helpful in moving forward some ideas that would be, you know, optimal in your opinion.

The one thing that I always do want to mention, and I always use especially the example of your own plan in the State of Louisiana, where your State has crafted a program specifically for Louisiana residents that they feel, you know, best suits the citizens there, which is an amazing type of matching program into the 529 plans where certain States that have put in incredible benefits for their own citizens based upon their own needs. We have to make sure that we encompass the individuality of some of those plans into a structure that would be a model guide line.

And so that is what we are working to do. We will seek the input of every single State administrator in the country to make sure that we understand the complexities of their programs. We have been able to get the guidelines put together in a relatively short amount of time. So I am hopeful with the support of the SEC task force, and again with your staff, we will be able to move pretty quickly.

Chairman BAKER. I think the last piece of that and my time's expired, is the idea of a single product that could be offered everywhere so you could have clear concise comparability on a very limited—a very safe, an S&P index kind of not actively managed fund, so someone could pick that up and look at Mississippi or Louisiana or Texas and say, well, my State's doing pretty well or I am okay with this little extra charge because of—I think it is a little daunting when you sit down and try to go through 12, 13 plans and really figure out what that means to you 15 years hence. Particularly, when, if it is a basket of underlying mutual funds where you really don't know the managerial costs associated with that mutual fund nor how to calculate it for those 12 or 15 funds. But I appreciate that. And let me move on.

Mr. Baca, did you have questions?

Mr. BACA. Yes. Thank you very much, Mr. Chairman. And thank you panelists for being here and discussing the 529 plans. My particular question is who knows about the 529 plans. This is part of the problem that we have right now I know that there are 22 States and the District of Columbia that provide State tax deductions to residents who invest in 529s. What are the 22 States and why aren't other States participating?

Ms. CANTOR. Is that question for me, sir?

Mr. BACA. Any one of you can answer that.

Ms. CANTOR. I think the issue of who is providing a State tax advantage goes back to the creation of these plans at every State legislature, and so there are several States, as you know, around the country who don't have a State income tax structure, which is why you don't see, you know, Florida and Texas for example offering any State tax advantage. That is where you start to see some of the disparity in 529 plans which, if you go back to the beginning, are mutual fund securities. So at the base level, these are like municipal securities that the States are issuing with their partners in the financial services industry. And that is where you find some of the different State tax treatment. As far as who knows about these plans, you know, it is a huge effort on behalf of the States to work with their partners to perhaps make marketing decisions that may not be made just in the private sector.

It is a goal I know of the States of Ohio and Virginia, in particular, to reach those middle income and lower income families who get lost in the shuffle, not, you know, poor enough for financial aid, if you will, but nowhere near being able to meet the cost of higher education. We conduct marketing campaigns that maybe traditionally would not be a great marketing decision. They are questions that Ms. Williams and I face every day from our State legislators when we testify during our legislative session some of the first questions we get are how are you reaching all Virginia families and all Ohio families.

So we make extreme efforts to make sure that we are reaching all families in our States, and I know the other States around the country are doing the same in these partnerships that are truly unique. But the differences between the State tax legislations typically come from the creations of these plans and the amendments that legislatures are able to do. And as was mentioned, I think, by one of the panelists that sometimes State budget issues, today is truly the reason why you are finding, you know, hesitancies or the lack of any type of State tax additional benefit added on to these plans. I believe in the future you will see more and more of that as our economy continues to recover.

Mr. BACA. So what you are saying is that each State has to create its own plan. As we look at standardization, there are certain States that are not participating and in order for them to do that they have to develop their own plans, correct?

Ms. WILLIAMS. Well, every State——

Mr. BACA. Or approval from the State legislators.

Ms. WILLIAMS. Yes. These are statutorily based typically because they need to be sponsored by States. They can also be sponsored by higher education institutions, but they generally have been created by statute and every State now offers 529 plans. Only 22 states choose to offer a tax deduction in combination with their plan. So that is the difference. Some States choose to offer a tax deduction and others do not. And I think it is very seriously connected with what the particular goals of that State are.

In Ohio, we have a goal to significantly increase the number of people who are actually attending colleges in our State. We have traditionally been a manufacturing economy and now we have a significant need to increase the number of people who are going to attend college in our State. And our State has felt that it was important to associate tax benefits with these kinds of savings, so I think that is the variability that does occur between different States.

Mr. BACA. I see that as very important, especially as I see the State of California increasing its tuition fees. Many of these students cannot even go to a State college or university. They will be going to our community colleges, so I see the need for these kind of plans and others. But what percentage of those in the plans are Hispanics? What kind of marketing tools do we have reaching out to Hispanics? We represent 16 percent of the total population of the United States, 42 million people right now, 700 billion in purchasing power.

So when you look at having access to community and to State colleges and universities, what is currently in plan in terms of marketing? Do you have any statistics or data that shows what percentage of people participating in the plan are Hispanics, Blacks, or Native Americans?

Ms. WILLIAMS. I can try to answer that. Although we try to collect those kinds of statistics, typically that information is discretionary, as is income. So what we typically find out is that people don't generally report that kind of information to us since it is voluntary. In the case of Ohio, we have a staff of 35 people and we have five marketing reps who are—who actually work out of their homes and live in various regions of the State. And their job, despite the fact that our product is sold through financial advisors, is to market the product through public events such as baby festivals and ethnic fairs. We also send a newsletter out to every elementary school student in our entire State which they take home to their families. We——

Mr. BACA. So are you saying then that in reality, maybe we are not even targeting Hispanics since that information isn't even provided?

Ms. WILLIAMS. I don't think that is true. I know that we target every——

Mr. BACA. It is up to the plans to target Hispanics, to make them aware that this is even available for them. I would have loved to have participated in these plans. I have a child that is going to go to a university next year.

Ms. WILLIAMS. Well, I can only speak for our State, and I know that we have an extensive effort to target every single ethnic group in our entire State. We work through churches and——

Mr. BACA. But you don't have a percentage so we don't really know what percentage are actually targeted.

Ms. WILLIAMS. Unfortunately I don't have a statistic.

Mr. BACA. So then we need to make sure that as we look at the work in progress and the model that is going to be used that we develop a good marketing plan that reaches out to our communities, to make sure that they are also eligible to participate or want to participate.

Ms. CANTOR. Congressman Baca also, California for instance has a Spanish Web site that contains the information.

Mr. BACA. Yeah. But not everybody has a computer in California. That is nice.

Ms. CANTOR. Right. I do know also that several States, I know in our home State here in Virginia, we issue our materials that go to every student in the State is available in Spanish. If anyone calls our lines at the State agency, we have Spanish speaking employees who deal with the Hispanic population. We have targeted marketing campaigns every year to reach the Hispanic minority community and the African American community and the Asian community. So it is a big push on behalf of the States that contain, you know, ethnic populations that—I know it is a huge push in Texas. The commercials are in Spanish. And I think that there has been greater and greater success in reaching communities by speaking a language that everybody can understand. I know the National Association of State Treasurers has Spanish educational Web sites also available that you can access at the public libraries, and I do know about the——

Mr. BACA. But you have got to be aware that these plans exist, because if not, then they can't access them. Miguel, it seems like you wanted to say something.

Mr. OLIVAS. Well, only that I am a native Spanish speaker and let me just tell you my confusion is not ameliorated by reading these things in Spanish, nor would it be if I were a Vietnamese speaker. Let me tell you the problem is not necessarily translating these materials into Spanish or other languages. Native English speakers cannot make sense of many of these materials, let me just say. If you try, if you ever bought for your daughter a telephone plan, a portable telephone and then multiply that times 10 and try and find out how she is going to use it for 18 years, and put down a lump sum or try and invest; are approximating that kind of complexity.

And I am not certain that the answer is simply publishing it in more languages, although I think that the States, to their credit, have actually marketed these things very well. To me the question isn't that we are not marketing these things well enough. The question is how much information all users have, whether bilingual or whether native English speakers or native Spanish speakers or Hmong speakers. The question isn't whether one can go to a Web site that is bilingual.

The question, in my view, is whether or not you can make sense of that and whether or not you have confidence that the program is still going to be there. And I would have expected some convergence of these plans. Because some of these plans are actually being enacted at various States by national players who draft these plans and simply in some instances have turn keys in some of these States.

In an article I wrote on my native State of New Mexico, it is pretty clear to me that there is not much New Mexican-ness to that plan, which is done by a program that doesn't exist in New Mexico, except in this form. It is headquartered outside of New Mexico and it simply rents space in New Mexico to enable its plan to be enacted there.

[speaking Spanish.]

Chairman BAKER. Mr. Baca, I need to move on to Mr. Tiberi, if I may. We will come back with another round.

Mr. Tiberi.

Mr. TIBERI. Thank you, Mr. Chairman. I was hoping we could maybe get an Italian plan in Ohio. Ms. Williams, the Ohio plan which was established in 1989 before I went to the legislature is a fabulous plan. As a participant now, as a father, I want to compliment the leadership that you have provided. I wish that we would have had a plan sooner, so I could have taken advantage of it as a college student. In your written testimony, you mention that in Ohio, we have recently gone through an overhaul of materials, since we are talking about marketing, that is put in place to try to simplify fee disclosure. Can you describe to us what fees are disclosed and where the fees are disclosed in this marketing material.

Ms. WILLIAMS. Sure, I will be glad to, Congressman. We completely overhauled our entire offering materials and we have a one-page document now in our offering statement which shows all the over 30 options that we offer, exactly what the program fees and expenses are. It shows the fee that our agency collects in order to help administer the funds. It also shows the underlying fund fee and the total annual expense ratio. So we have laid it out on one page. We have also taken great pains to create a new document that is a risk tolerance questionnaire that we have made available to an individual who is walking through the product.

And it is a series of a few questions that help that individual to identify what kind of saver they are, what kind of risk tolerance they take. And then consequently, they can look at the list of our products and determine what products might be in their own best interest.

So this is the start of a process to be much more clear and consumer friendly, in order to enable people to be able to make the best possible decisions for their families.

Mr. TIBERI. For participants in Ohio, in addition to the tax benefits that you spoke of in your testimony, what other benefits are there for participants from an Ohio perspective?

Ms. WILLIAMS. Well, we work with Ohio employers, for example. We work with almost 2000 Ohio employers to allow people to contribute through the workplace. We actually go on-site. We market, we talk to people at their place of employment. We have no annual fee for Ohio residents for this plan. There is no enrollment fee for this program at all. We try to make this program available and accessible everywhere. We do targeted radio advertising. We do print advertising because we want every single child in our State who aspires to go to college to have some ability to save through this program. And while we know it won't cover the cost for most people, we think it is important that there are some resources available since the cost of college has at our public universities in Ohio has gone up 50 percent in 4 years.

Mr. TIBERI. From your perspective, since 1999, when you became the administrator of the Ohio program, what has been the most common complaint from participants/investors?

Ms. WILLIAMS. It varies as our program has changed. You know, we have heard complaints about fees, we have heard complaints about accessibility. The biggest complaint was we had a 1-year moratorium on new contributions to our prepaid plan, which ends the end of this year. And the biggest complaint has been that that program is no longer available. And the reason being we simply could not keep up with the costs of rising tuition at our State universities. So it was a very difficult decision for us to make.

But that has been the biggest complaint in the entire time that I have been there. But we listen very carefully to our customers. We offer an 800 number. We communicate with them by the Web. And we really take into consideration their needs and desires and try to craft our plan in order to meet those.

Mr. TIBERI. Thank you. One last question for Ms. Cantor. What do you think from where you sit nationally, of dollar cost disclosures percentage cost disclosures and how does the college savings plan work draft deal with those two issues?

Ms. CANTOR. I think those are part of the guidelines that you will see. I think they are important. It enables, you know, families to sit down at their kitchen table and understand the types of dollars that will be coming out of whatever they are earning. So those are definitely a part of what we are looking at in the tables that will be disclosed in the future, and so I am hopeful that that will aid the transparency and the disclosure across the country of what will be taking place.

Mr. TIBERI. And most administrators agree with that, from your knowledge?

Ms. CANTOR. I think that the commitment of our industry and all the stakeholders to participate in the process has been unanimous. Nobody wants to be the one plan that stands out and is covered in the financial press as the worst program because the beauty about the plans is not only do the States have the sensitivity politically and otherwise to react quickly to the concerns of our constituencies, but we are also very sensitive to the attention that is paid to this and the reputation. The last thing you want is your State legislature or your governor to ask you why you are the only State that doesn't suit a model or doesn't have a qualification status or you know a gold standard or something. So I think we are very sensitive to that. It is not probably in the terms of private competition but more of our ability as State administrators to hold up our plans as models across the country so that we make our constituents happy.

Mr. TIBERI. Thank you.

Chairman BAKER. Thank the gentleman.

Mr. Meeks.

Mr. MEEKS. Thank you, Mr. Chairman. And let me just—I will just throw out a couple of questions and just anyone can answer. Hopefully, and I apologize if they were asked already. But you know, having a 4-year old daughter myself, I am doing some of this college planning and so I want to make sure, and let me just ask, are there 529 plans whose fees are so high that they would negate the tax benefits of investing in the plan? That will be my first question.

Mr. LACKRITZ. Congressman Meeks, maybe I can address that. I know in the letter that Chairman Donaldson sent back to Chairman Oxley in response to the concerns about 529 plans, he raised the possibility that there could be fees that would be so high that they would, in fact, eliminate the tax benefit that would inure as a result of the plan. In reality, I think that is highly unlikely for a number of different reasons. But it is important from the standpoint that the fee structure—the different fees that advisors charge or that broker dealers charge when they sell these plans provide for a number of different services, levels of services that the plans provide. The key, I think, is to make sure that the disclosure is clear, that we increase competition by getting State tax parity across the board and encouraging more competition here and make sure the disclosure is fair open and let the marketplace and competition drive fees down so that they are as low as possible for everybody involved.

Mr. MEEKS. Okay. Well, and I know the plans, you know you talk about the fees, and you are shaking your head no. No, I thought you were shaking your head no.

Mr. OLIVAS. It was an inadvertent twitch.

Mr. MEEKS. Oh, okay. Since 529 plans became law in 1996, do we have affirmative evidence I would say that they have truly been effective in helping parents save money for their children's college education, or is it still too early, we don't have enough of a test.

Mr. OLIVAS. Well, there is some scholarship, and I recommend it as a cure to insomnia for the most part. Economists have begun to turn their attention to this, and I think that there is no evidence yet that there has been substantial diversion into these plans by people who would not have otherwise done so. This is the hard part to measure. Many of the people who participate in my estimation are people who already had the proclivity to do so and are seeking instead of putting money into a coupon bond or some other investment vehicle, are trying these particularly whether there used to be full faith and credit for the prepaid plans that would guarantee no matter how much the cost went up it would be covered. But that, of course, is just a small number of States.

And as was suggested earlier, as indicated earlier, Ohio and others have put those on hold. Of course, they will still pay off to the participants, but they aren't taking any newcomers. And so you had to be first there. Well, I simply ask who was always going to be first? It was going to be the most advantaged, the wealthiest and, in many cases, people who instead of putting money into other investments simply took this route. And so while I think that there is not definitive scholarship, I believe that this is intuitively obvious in the participation rates.

Mr. BULLARD. If I could add to that. To answer both your questions, it really goes to the way to think about 529 plans. If you think about them as an alternative to investing in a taxable account, then the question of whether the fees could erode the tax benefits is really a question of whether you would pay more in the 529 plan than you would otherwise pay in a taxable account.

And in my testimony, I have suggested some reasons why that might be the case. But more importantly, I think that is the way to look at it. And simply the fact that there are high cost 529 plans doesn't mean that they are destroying the tax benefit. They are simply reflecting the fact that we have high cost taxable account options. And we are also reflecting the fact that there are people who live in that marketing channel, and whether they buy the 529 plan or buy in the taxable account, they are going to pay high expenses. And that is not so much a 529 plan issue as an issue generally about the fees that people pay and decisions they make about using intermediaries for the most part.

Mr. MEEKS. So I guess the word is still out then, or the decision is still out as to whether or not—but obviously people who are lower income, whether they benefit from the these 529s because they don't have the disposable income to invest in these 529s in the first place, and then whether or not there are benefits to them, you know, as it results to the deductions in the respective States. Yes, ma'am.

Ms. CANTOR. Congressman Meeks, I would invite all the panelists and anyone else to listen in on some of our phone calls that we get back at the State agency and the visits that we have from police officers and teachers and first time students who are attending college as the first member of their generation to go to college about the family by family contacts that we have of who we are reaching and helping. And what we really like to stress, and what we have seen across our State, and I am sure is replicated across the country is the powerful message that these plans are sending to American families, that a higher education is not only worth saving for, but in many instances for families it is worth budgeting for and worth sacrificing for.

We get dozens and dozens of requests to send certificates from grandparents who are putting in $20 a month so that their grandchildren know that they have a future ahead of them to go to community college, to work as hard as they can on their grades because their parents are putting away some money every month. So although some of the focus today has been on the fee structures and disclosures and mutual fund investors, we really work with the families on a day-to-day basis and those families who may not have seen investing as something they wanted to do, and possibly having the State involved gives the family some extra security, that they can call up the State office, they can call their State legislator, they can call the Governor's Office if they have a problem if they are not getting service that they should demand and require from our programs.

So I am hopeful that you know more and moreover time, I know we are reaching them you know today. I am hopeful and our goal is in our States to continue to reach more of the population that would not necessarily be saving today. And you will find much are our marketing materials directed to that end.

Chairman BAKER. The gentleman's time has expired. Thank the gentleman.

Ms. Biggert.

Mrs. BIGGERT. Thank you Mr. Chairman. This has been a very interesting hearing. I wish that I had known about this when I had three children in college at once, but it was before the time of this, so maybe my grandchildren will benefit from this.

Mr. Lackritz, you mentioned in your written testimony something about the Coverdell Education Savings Accounts. Are those competing at all with these 529s?

Mr. LACKRITZ. Well, Congresswoman Biggert, in a way they are competitive because they are a savings vehicle for higher education. But the restrictions, the income limitations and the restriction on contributions is such that they, you know they are limited in contribution and deduction to $2,000 a year, and there are income limitations on eligibility as well so they are far more restricted and as a result participation is not nearly as wide. 529 plans really, going back to Congressman Meeks' question, 529 plans are a terrific for federalism here.

The innovation, experimentation and pioneering work of the States, coupled with the active effort at the Federal level have produced a remarkably successful plan. I mean in 3 years, the penetration rate in 529 plans has gone up to, I think it is 8 percent now over 4 million households and over $40 billion invested in these plans. I would suggest, the awareness of saving for education has increased significantly because of these plans. So all of that is to say, I think the 529 plan, the Coverdell Savings Accounts, educational savings accounts are another vehicle but they are much more restricted.

Mrs. BIGGERT. So they probably are not used as much or is that just because they—of the education. Which leads me to my next question. Could you just discuss in more detail the investor education programs? This is one of your brochures, I think that——

Mr. LACKRITZ. Well, I am glad you got it. I was going to hold it up for people in case they were interested. We have an extensive investor education Web site. It is called www.pathtoinvesting.org, and it has sort of best of class investment advice. There is no selling of products or services specifically on the site. It is designed to help people understand the basics of saving and investing for the future.

It also provides a site for individuals that are getting into the market for the first time to participate in a hypothetical investment exercise where they can take a hypothetical $100,000 and invest that and sort of see what happens before they actually risk any of their own money. In addition, we have a number of different publications. Your guide to understanding investing is our sort of flagship publication which is put out by the same people and authored by the same people as using your guide to understanding 529 plans.

Mrs. BIGGERT. What feedback have you gotten from investors about the programs or about the education program?

Mr. LACKRITZ. It is interesting. They seem to like the information we are providing and they want more. It is almost like a public good. I mean, whatever we produce, they like it and they want more. So we are continuing to put out more guides, more help in different areas for investors to help educate them as much as possible.

Mrs. BIGGERT. Do you think that the States should adopt their own investor education programs or just rely on yours?

Mr. LACKRITZ. I would defer to the States on that. I think that we have terrific material and I think given the fact that our firms are expert and have great expertise in the capital markets and in helping individual investors invest for the future I think these are terrific program materials. We would make them available to States if States wanted to use them.

Mrs. BIGGERT. Do many of the States use them or is it just——

Mr. LACKRITZ. Not yet. What we try do is to link our investor education Web site as broadly as possible and as widely as possible, and we have got a number of links to other—for example, the Treasury now has an investor education financial literacy office specifically devoted to this. We are getting linked to that. We are getting linked to the SECs investor education Web site. We get linked to other Web sites as well.

Mrs. BIGGERT. Thank you. Maybe this would be to Ms. Williams or to Ms. Cantor. Mr. McNeela proposed in his written testimony that only States that don't discriminate against out-of-State plans, in other words, States that don't penalize for withdrawals from out-of-State plans deserve to have their plans defined as a qualified tuition tax savings plan and only those plans then would presumably receive all of the Federal tax benefits. What do you think of this proposal?

Ms. CANTOR. I think we go back to the beginning as we usually do, to get a good answer. These, again, Congresswoman Biggert are municipal fund securities. They are no different from a taxation basis in general from municipal bonds that are issued by a State. If somebody lives in the Commonwealth of Virginia and owns an Illinois general obligation bond, they are going to pay Virginia taxes on the earnings of that security.

There may be some States that give an additional benefit and maybe conform to the Federal tax exemption, but I think it is the prerogative of the States. I think that the focus of our industry really needs to be on the permanency of our Federal tax exemption. I think that is the one chilling effect that we are seeing out there for families, because in the interest of full disclosure, which it seems we do on every page, we are constantly reminding our investors that our Federal tax exemption does expire unless it is extended or put into permanency by 2010. And before we blink, as we all know as parents, 2010 will be here. And so that is something that we hope to work very hard with all of you on to help that chilling effect that is going on.

We even hear some financial advisors that have national showcases to communicate saying, well, maybe you shouldn't put your money in a 529 plan because the Federal tax exemption will disappear and people think the program is going to disappear. Just to reiterate about our education initiatives, all the States have extensive, you know education initiatives. Not only do we partner internally with the State higher education authorities, the State Treasury Departments on all their financial literacy awareness activities, we also partner with the securities industry association and other member associations to offer those materials.

We have them available to us. SIA has made those books available to all the States. We bring them to the PTA meetings. We bring them to our church meetings and so we make sure that families who want general information use the best materials out there. We also are able to model a lot of our own materials on good ideas to communicate more effectively. So I am hopeful again as time goes on, this is still a new industry at some level. We may not be newborn, but we are certainly toddlers, you know, toddling around and trying to grow to the next step. We are going to do the best we can to there in a strong and a consistent way.

Mrs. BIGGERT. Thank you. Thank you, Mr. Chairman.

Chairman BAKER. Thank the gentlelady. Mr. Sherman.

Mr. SHERMAN. Yes, Mr. Chairman I am going to take up so much of the committees' time tomorrow that I am going to keep my comments to just 1 minute.

Chairman BAKER. Oh, thank you.

Mr. SHERMAN. And that is to echo what Ms. Cantor said and that is we ought to call on the Ways and Means committee to either make this a permanent program, or not. But the phony tax budgeting where they put in a program that they intend to have permanent, but then they put in the law that it is going to expire, and then they wait a couple of years then they extend it creates a circumstance where it costs the Federal Treasury every bit as much as if the program was permanent, but the effect on encouraging people, whether it is these 529s, or whether it is the research and development credit which I realize is outside this hearing, but they come up with things they want to encourage that are long term plans, then they provide a tax credit that is going to expire in a few years and then they extend it with the effect that they get all the costs and only some of the encouragement. And I will yield back.

Chairman BAKER. Do you want to yield to Mr. Baca or to yield back?

Mr. SHERMAN. Actually I will yield to Mr. Baca. I thought he would be next.

Mr. BACA. Thank you very much for yielding to me. And I want to continue with the questioning that I addressed before. And I do appreciate the fact that we are addressing this issue because I think it is very important. This administration is actually cutting back additional funding for education, especially higher ed, the PALS Program and other programs. The States are also cutting back funding for our higher education institutions, our State colleges and universities. Is there a disparity in terms of the returns between a moderate-income person who pays X amount of dollars, who buys into the 529, plan versus those with low incomes?

Mr. BULLARD. The return on the investments will be the same. It will be on a pro rata basis based on the amount of the account as I understand virtually all of the plans. But another way of looking at that question is with respect to fees and one of the interesting aspects of these plans is that when you have an asset based fee, what you really have is a structure whereby the larger accounts are in fact subsidizing the smaller accounts.

So with respect to mutual funds and other aspects of the plans where there is an asset based fee, for example, one percent of assets a $100,000 account is paying $1,000 a year. The $1,000 account is paying only $10 a year and the $100,000 account is in effect subsidizing the smaller account. So this has always been a characteristic of the mutual fund industry but is essentially a kind of progressive pricing structure.

Mr. BACA. Right. That is why Chairman Oxley, in his opening statement, was concerned with the disparity of the fees and I was just asking why. Mr. Olivas?

Mr. OLIVAS. Well, I think that he was actually talking about a different matter, and I think that was the extent to which fees erode either the corpus or the return. I do think that people who have prepaid options or who pay a small amount per month, which I encourage, and the reason that I have encouraged these plans over the years is because I do think that the psychological encouragement of people to invest in their children and their grandchildren's education is paramount, and I have been willing, in many instances, to let the wealthy be advantaged even more because I think that it pulled along smaller investors as well, and I think that that is extremely important.

But I think that your question is do poor people get back as much as wealthy people, and that is always going to depend upon their tax situation. These are structured frankly for wealthy people. Poor people don't have as much to put in and don't have as much to shelter. And they participate accordingly in higher education. I think that these are largely a refuge of the wealthy. I think that the data, no matter how they are cut and no matter how many picnics these are sold at, essentially the wealthy participate. I think that that is simply a cost—we are always going to have the poor among us. I mean, to some extent, we are always going to have that disparity.

Mr. BACA. That is why I am very much concerned with the outreach that is going on. We talked about the Internet and you mentioned earlier that even bi-lingual information doesn't increase access. So we need to continue to develop further outreach in terms of our communities. You mention, the PTA and the churches, but there are a lot of other organizations as well. Are we tapping those organizations in terms of availability of information of the 529 plans, so that people within our communities can invest?

But we want to make sure that people have access and opportunity to go on and not be denied because they can't afford to go to a State college or university. That is why I also agree with you in reference to standardization. Disclosure needs to be increased as well. And I do agree with my colleagues. So we must market to Hispanics and other groups who want to go to college.

Hopefully we come up with some form of a plan that can standardize the 529 plans and provide more of an opportunity to reach out to our communities.

Chairman BAKER. The gentleman's time has expired. And I want to get the other two gentlemen in. I am informed we are going to have a series of votes here shortly afternoon. Mr. Clay, I think you wanted to——

Mr. CLAY. Thank you Mr. Chairman. I will be brief. I am not sure which witness can answer it. But President Bush has proposed an alternative savings option, the Lifetime Savings Account. There are concerns that LSAs would be in competition with 529 college tuition plans because the LSAs could be used penalty free for uses other than education. Can LSAs be designed in a manner that could coexist with 529 plans without siphoning off their investors? We do not have enough investment dollars in this country and we need more programs to induce savings. Why make them competitive? And can this be done? And if somebody could attempt to answer.

Ms. WILLIAMS. Representative, in my view, they would be difficult to coexist. I do think that if LSAs were created that they would siphon off savings that have accrued to 529 plans. And I think specifically of States like Ohio, which have added tax benefits to these plans, and I think that it would be a critical issue, which we would have some difficulty with because if we are going to provide some kind of Federal and other State tax advantage, it needs to accrue to a higher purpose than allowing people potentially to use savings accounts potentially for higher purposes, but maybe to buy a new wardrobe or for other such purposes. So I think it would be detrimental to 529s.

Mr. CLAY. Yes, sir.

Mr. LACKRITZ. Yes, Congressman, I would just—I would respectfully differ a bit from Ms. Williams' response. We think it is really important to increase the level of savings in this country overall. And we favor any kind of measures that would help to increase overall savings. We think that the Lifetime Savings Accounts are more of a fundamental tax reform frankly than they are a specific account designed specifically for a particular purpose.

They also would not enjoy State tax benefits in the same way that 529s are, so we would favor the creation of lifetime savings accounts. I think that would be a complement in many respects to what is being provided now by the 529s.

Mr. CLAY. So you think that the two plans could coexist?

Mr. LACKRITZ. Absolutely.

Mr. CLAY. Thank you. How do we evaluate 529 plans when there is not sufficient information because of lack of disclosures to compare plans? What do you suggest we do to get the proper transparency needed for investors to make the best choice of investment plans, or do we need more enforcement? Or are sufficient resources in place already?

Ms. Williams.

Ms. WILLIAMS. I think that the voluntary disclosure principles which the college savings plans network developed is a huge and important step to take us in this direction. I think the States have a vested interest in ensuring that their State plan represents them favorably in terms of the information that is provided. It is, in no State's best interest, to provide information regarding a program that is confusing and difficult to understand.

So I think—and knowing from our perspective we are expending significant resources, time, money and attention, to talk to the public in order to make sure that we are disclosing everything that we need to legally, that we are making it very, very clear, very easy to understand, and I know from talking to my colleagues, that that is their goal as well. It is to help people make these important decisions, not to create confusion.

Mr. BULLARD. Congressman, just to—I would have to disagree. History tells us that voluntary standards will not work. These programs have been offered for more than a decade, and what Ms. Williams has to say about the States not, you know, being in their interest to provide good disclosure has been true for that entire 10, 12-year period, yet they have not provided that disclosure. Without a strong enforcement mechanism, without an experienced regulator who can independently establish those standards, I think it is simply unrealistic to believe that this program will work when we have seen this kind of approach fail in the context of State regulation year after year after year with respect to securities products.

Mr. CLAY. Thank you for your response. I yield back the balance of my time.

Chairman BAKER. I thank the gentleman. Mr. Emanuel.

Mr. EMANUEL. Thank you, Chairman Baker, and thank you for holding this hearing. As you know, college costs went up 11 percent last year and 14 percent this year alone. And the truth is the most important thing you can get in life besides the love of your parents is a college education, and none of us would be in this room if it wasn't for either one or both of those.

But the fact is, there is the deduction of college tuition that hasn't really gone up. It is 4,000. It expires in 2005 for tax deductions. The Hope Credit, which was originally for community colleges, is stuck at 1,500 with the average cost of community colleges are around $2,000, and the 529—well, community college is still on average around the country is around $2,000, and the Hope Credit needs to go up. It is the vehicle of keeping people involved in the changing economy and giving them a ticket to upward mobility.

On the issue here, in the 529, and I obviously apologize for having left and I had to go to another hearing. Some members talked about bringing uniformity, conformity and standardization to both the fee structures as well as the—some of the plans, and I want to associate myself with those words and those ideas because I think they are important to give people. I mean, just as a parent, you know, whether you are comparing mutual funds, health saving plans, insurance policies, college savings plan for your kids. I mean, there is—we all know this. There is X amount of hours in the day and you can say whatever you want. And giving people choice, but when you have all that choice, as we are now witnessing some of our seniors, who have plenty of time to look at savings plans on discount cards that, choice leads often to confusion, chaos and it is manufactured. It is not intentional.

And I do agree that if those who wanted to, the States wanted to bring that kind of access and conformity they would have done it already. The market would have demanded it. And so they need sometimes adult supervision to help bring that process about. And let me ask you one thing. On the $4,000 tuition deduction for college, 3,000 this year, next year and the next 2 years goes up to 4. According to a Harvard study, only 4 percent, only a third of the folks who are eligible take it. Two-thirds do not take the college tuition deduction. It is right on the 1040 form. It is available. It is one line. And that is about as accessible as it can be.

What is the eligibility universe for the 529 plans? And what is the world, and the percentage that take it? So what is use versus eligibility on 529s? Anybody can take a shot.

Mr. LACKRITZ. At least the numbers that I was given indicate that first of all, anybody can invest in these things. I think the good news about the 529 plans is there are no income restrictions. There are no limitations. And as a result, they are universal—it is about the closest thing to a universal program I think that there is. And the numbers I was given indicate that about 8 percent of families have taken advantage of this.

So there are over 4 million accounts, 529 accounts so far. But that is in literally the last 3 years, since the 2001 tax legislation which I think clarified it considerably and created the tax free withdrawal provision. So from the standpoint of how quickly it has increased, it has increased dramatically in only 3 years and on that growth rate it is going to continue to increase substantially.

Mr. OLIVAS. That speaks to the numerator. The denominator is that these are kids not yet in school. I mean, some of these are 6 months old and we won't be able to know until 18 years. And so the denominator is increasing exponentially as well. And so speaking about the participation rates in the numerator is only a very small part of this. 8 percent would astound me if that were somehow close to the denominator. I think that you have to understand that given all the grandparents out there and so forth, to get your arms around the universe of potential participants is simply impossible.

Mr. EMANUEL. Of the 8 percent is that—was there a big growth right after the 2001 Tax Code, and then it has tapered off, or do you see another spike coming? And is there anything more in the details of who is participating. Is it people with much younger kids, people with kids in their teens as they start to focus on this?

Ms. CANTOR. The average age of a beneficiary in these plans across the country is about 8 years old, if that gives you some sense. Also attached to some of the testimony you will see charts on the growth in these plans. One thing I also want to clarify that one of the other panelists said is that for the most part, prepaid tuition plans were the only plans that were around 10, 12 years ago. Savings plans did not really exist and start to come into creation until the beginning of the year 2000.

So if you really look at you know the ability of an industry to take hold of itself and to manage the growth that it is experiencing these are still relatively brand new plans. The savings plans have not been around for 10 years. And I would say that the States are doing a fantastic job of overseeing their plans and making sure that we move forward.

Mr. OLIVAS. These are plans that the State shut down as soon as it got too expensive to maintain them. That is not a record to emulate in the savings side.

Mr. EMANUEL. Did you want to add——

Mr. BULLARD. I agree with Professor Olivas. I mean, if the States want to stand on their record of performance, then that is the best argument for why we need SEC regulation.

Mr. EMANUEL. I have no further questions Mr. Chairman.

Chairman BAKER. Thank you Mr. Emanuel. I want to express my appreciation to each of you. As you can tell, members had to come and go, but there is significant and considerable interest in this matter and I suspect as the plans grow in size, congressional interest will only go in one direction. To that end, I am very optimistic and appreciative for the work done by the network and hope that leads us to some consensus set of standards that perhaps by early next year the committee can return to this subject and evaluate the progress made.

I would also say to our scholastic academic studious analysts from the right, represented in various fine book stores, that if there is a way to assemble data from 2001, 2002, 2003, years closed from a handful of States, with a $10,000 typical or let's go $2,000 a year for each of 3 years, make your point.

As to the lack of equality in fees, whatever concerns that you elicited this morning in your testimony to the committee, give us more substance as to past performance. Now, this is not an indication, as I realize past performance is not an indication of future earnings. But it will give us—I probably have some of those pieces of mail in my box waiting on me. But the point is, is it gives us a snapshot of where the problems may really be and that would help the committee in its evaluation of the model reforms which the network now has under consideration, and perhaps over a continued discourse in this matter we can come to some conclusion that is in everyone's best interest.

Clearly facilitating opportunity for educational college is something every American should support, and I believe they do. But making sure the system is working in a fair manner and that individual average investors are understanding what their rates of return are is something that is very, very important if that program is to maintain long term viability.

So I appreciate all of your various perspectives. We look forward to working with you in the future. Our meeting stands adjourned.

[Whereupon, at 12:07 p.m., the subcommittee was adjourned.]

A P P E N D I X

June 2, 2004

Opening Statement

Chairman Michael G. Oxley

Financial Services Committee

Subcommittee on Capital Markets, Insurance and Government Sponsored Enterprises

"Investing for the Future: 529 State Tuition Savings Plans"
June 2, 2004

Thank you, Chairman Baker, for holding such an important hearing this morning.

We all know that there are few things in life more essential than a good education. Helping parents save and invest for their children's higher education is a vital public policy initiative, particularly in this environment of runaway tuition costs.

The success of 529 tuition savings plans is good news, but it is not surprising. These programs offer all families, regardless of income, the opportunity to obtain tax-free growth and distribution on the money they save and invest for college costs.

There is now more than $35 billion invested in 529 plans across the country, and some have predicted that total assets will balloon to $300 billion by the end of this decade.

Given the increasingly important role that 529 plans play in enabling parents to save for their children's education, I have become concerned about certain aspects of some of these plans.

For example, why are there such disparities in fees and the disclosure of those fees? Have the fees charged by these state-sponsored plans become so exorbitant that they actually outstrip the tax benefits that Congress has attempted to provide? Have the states established adequate procedures to monitor the performance and operation of the investment managers they hire to run their plans? Are the offering documents clear and concise?

These are some of the concerns that prompted me to write to SEC Chairman Bill Donaldson on February 4, 2004.

In his response to me, Chairman Donaldson said that "the current state of affairs with respect to 529 plans is complicated and likely difficult for parents to understand." He also announced the creation of the "Chairman's Task Force on College Savings Plans." I am pleased by the Commission's energetic response. I understand that the task force has made considerable progress, and I look forward to hearing from it in the near future.

We have assembled an all-star lineup here today. I would particularly like to welcome Diana Cantor, the chairman of the College Savings Plans Network and Jacqueline Williams, Executive Director of the Ohio Tuition Trust Authority. I know that they have put in long hours over the past few weeks to improve the disclosure regime of 529 plans. I look forward to their testimony, and that of the rest of the panel.

I yield back.

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June 2, 2004

Opening Statement by Congressman Paul E. Gillmor
House Financial Services Committee
Subcommittee on Capital Markets, Insurance and Government Sponsored Enterprises
Hearing entitled, "Investing for the Future: 529 State Tuition Savings Plans"

Thank you, Mr. Chairman, for calling this hearing and allowing us the opportunity to discuss these important savings vehicles, 529 State Tuition Savings Plans that allow investors to contribute money eligible for future use at any accredited U.S. school. I appreciate your leadership on this issue and look forward to our discussion of the fees associated with 529 plans and their current regulatory structure.

I would like to thank all of our witnesses for joining us this morning and to give a special welcome to Jacqueline Williams, Executive Director of the Ohio Tuition Trust Authority (OTTA) and a member of the Executive Committee of the College Savings Plans Network. As I learned from Ms. Williams' prepared remarks, the State of Ohio was actually one of the first states to offer a qualified tuition program when the Ohio General Assembly created the OTTA in 1989. Thank you, Executive Director Williams, for your fine stewardship of this program and for allowing the citizens of Ohio's Fifth District greater access to affordable higher education.

Since 1989, 14,000 Ohioans have attended college using over 166 million dollars invested in Ohio's plan. In 1996, Congress created the 529 tuition savings plans and Ohio's program qualified under Section 529 of the Internal Revenue Code. Last year nationwide, total assets in 529 plans almost doubled reaching 35 billion dollars.

I support the recent action taken by the Securities and Exchange Commission (SEC), creating a task force to investigate 529 plans in response to an inquiry from Chairman Oxley. As they fulfill their mission to examine issues raised by the fee disclosure regime and sale of these 529 plans, I think they will be encouraged by the recent steps taken by Putnam Investments in their management of the Ohio plan.

On May 24th of this year, Putnam put in place voluntary initiatives that will provide investors with enhanced fee and expense information for Putnam CollegeAdvantage 529, while also reducing the plan's annual maintenance fee.

Thank you again, Mr. Chairman, for calling this important hearing and I look forward to an informative discussion.

OPENING REMARKS OF THE HONORABLE RUBEN HINOJOSA
HOUSE FINANCIAL SERVICES
CAPITAL MARKETS SUBCOMMITTEE
"SECTION 529 TUITION SAVINGS PLANS"
JUNE 2, 2004

Chairman Baker and Ranking Member Kanjorski,

Thank you for holding this hearing today on Section 529 Tuition Savings Plans.

Education is truly the key to success. The Section 529 Tuition Savings Plans enable my constituents to put aside and invest funds towards the education of their children without the fear of being taxed if they withdraw those funds for education purposes.

The 529 plans are very important, especially in light of the fact that we here in Congress and the Federal government have not been providing the funds necessary to ensure that current and future generations receive at least an adequate education, much less an excellent one. Some, if not many, are indeed being left behind.

We need to ensure that proposals to create Life Savings Accounts will not detract from the education goals of the Section 529 Plans.

Mr. Chairman, my district, the 15th district in Texas, contains the metropolitan statistical area with the lowest per capita rate in the United States. Many of my constituents fall below the poverty rate.

Forbes magazine's recent survey tells the two-faced tale of the McAllen area - - tremendous job growth coupled with the lowest rates of higher education. We face the challenge of keeping teens in school and encouraging higher education. Whatever actions we take here in Congress must be aimed towards that goal. I understand that the focus of today's hearing is on the SEC's jurisdiction and the disclosure of Section 529 Plans' fees, but we need to also look at the larger picture.

Mr. Chairman, I yield back the remainder of my time.

OPENING STATEMENT OF
RANKING DEMOCRATIC MEMBER PAUL E. KANJORSKI

SUBCOMMITTEE ON CAPITAL MARKETS, INSURANCE, AND GOVERNMENT SPONSORED ENTERPRISES

INVESTING FOR THE FUTURE: 529 STATE TUITION SAVINGS PLANS

WEDNESDAY, JUNE 2, 2004

Mr. Chairman, we take great pride in Pennsylvania of reminding others of the many wise observations of Benjamin Franklin. As I prepared for today's hearing, I was accordingly reminded of one of his more insightful reflections: "An investment in knowledge always pays the best interest." This statement is as true today as it was more than 200 years ago, in part because of Section 529 tuition savings plans.

During the last decade, the cost of attending a university has increased 40 percent while the typical household income has increased just 12 percent. Additionally, the average cost of attending a four-year university now stands at $34,000 for state institutions and at $90,000 for private colleges. Moreover, the price tag for a higher education is expected to continue to grow in the future, likely continuing to outstrip any gains in a family's earnings.

Because Democrats and Republicans alike recognize that an investment in higher education continues to produce appreciable returns for individuals and society, we have worked cooperatively in recent years to help families cover this necessary financial expense. In 1996, for example, we joined together to create 529 plans. As a result, families today can use this instrument to set aside money for higher education purposes that grows free of any federal tax.

Section 529 plans have grown greatly in popularity since their inception in the late 1990s, and they are now one of the most common ways to save for a college education. Total assets in 529 plans, which stood at $2.6 billion at the end of 2000, rose to $8.5 billion by the close of 2001. They also doubled in value in 2003, reaching $35 billion and covering more than four million accounts by the year's end. In addition, the experts at the Financial Research Corporation now predict that American families will invest $300 billion in 529 plans by 2010.

The tremendous expansion of the tuition savings plan industry has now produced some predictable growing pains. Although we created 529 plans in the federal tax code in 1996, we did not simultaneously implement a comprehensive regulatory regime to cover this financial product. As a result, some have begun to raise concerns about the need to improve the oversight of this sector of our financial system.

For the purposes of our securities laws, the states generally have oversight responsibilities for Section 529 plans. One problem that has received substantial attention in recent months with respect to 529 plans concerns the disclosures that investors currently receive about the performance of these financial products. As we will hear later this morning, many states have begun to take action on their own to protect investors, including working to develop a model disclosure regime.

National authorities in recent months have also begun to examine 529 plans, which remain subject to federal anti-fraud rules and broker-dealer sales practice requirements. Earlier this year, the Securities and Exchange Commission announced the creation of a task force to study the fee disclosure regime and sale of 529 plans. Additionally, we have learned that the National Association of Securities Dealers is now investigating whether some brokers in selling out-of-state 529 plans ultimately exposed their clients to lower investment returns and higher state taxes.

From my perspective, it is very important to study these issues and for state and federal regulators to take coordinated action to protect the families who invest in 529 plans. Greater standardization in disclosing fees and expenses will facilitate direct comparisons in performance between the various 529 plans across state lines. I am therefore pleased that the College Savings Plans Network has begun the work needed to implement a comprehensive disclosure system that will provide for greater comparability of 529 plans for investors and help to ensure that they have access to the same quality of information as mutual fund investors.

As we proceed today, I hope that we will also examine the interplay between 529 plans and a proposal by the Bush Administration to create Lifetime Savings Accounts. As currently conceived, LSAs would permit individuals to save money tax free for any purpose, including higher education. A recent study by the Senate Finance Committee determined that because LSAs would be more flexible than a 529 account, they "could compete with the tax-favored savings programs for education -- particularly among persons with limited disposable income." We should therefore explore today whether the increased flexibility of LSAs might undermine a family's well-intentioned efforts to save for a child's higher education.

In sum, Mr. Chairman, I commend you for convening today's hearing on 529 plans. We should conduct oversight of this growing segment of our financial marketplace in order to determine how we can make the present regulatory structure stronger. The observations of today's witnesses about these matters will help me in forming my opinions on these issues.

Testimony of Mercer E. Bullard

President and Founder
Fund Democracy, Inc.

and

Assistant Professor of Law
University of Mississippi School of Law

before the

Subcommittee on Capital Markets, Insurance
and Government Sponsored Enterprises

Committee on Financial Services

United States House of Representatives

on

Investing for the Future: 529 State Tuition Savings Plans

June 2, 2004

Executive Summary

It is widely recognized that fees must be transparent and accessible for retail markets to work efficiently, yet fee disclosure for 529 plans is obscure and difficult to understand. Congress should promptly authorize the Securities and Exchange Commission to adopt rules governing the disclosure of 529 plan fees. Rules for 529 plan fee disclosure, at a minimum, should be:

- Standardized, both in the way in which the fees are calculated and the terms used to describe the fees;
- Prominently disclosed relative to other information about the plan;
- Presented both as a percentage of assets and a dollar amount, and on an illustrative and individualized basis;
- Inclusive of a total expense ratio for each investment option that includes all fees incurred in connection with an investment in the plan, to include, among other things, portfolio transaction costs, distribution costs, operating costs and administrative fees, whether charged by the state, plan manager, investment manager, or other person;
- Inclusive of a pie chart that illustrates the components of the total expense ratio according to standardized categories of fees, such as investment management, administrative services, and marketing and distribution;
- Inclusive of information on fees charged by other 529 plans both in a disclosure document and in an easily accessible format on the Internet; and
- Inclusive of separate disclosure of all payments received by intermediaries for executing the transactions in plan interests, both as a dollar amount and percentage of assets, whether or not the payment is made directly by the participant.

Chairman Baker, Ranking Member Kanjorski, members of the Subcommittee, thank you for the opportunity to appear before you to discuss 529 State Tuition Savings Plans. It is an honor and a privilege to appear before the Subcommittee today.

I am the Founder and President of Fund Democracy, a nonprofit advocacy group for mutual fund shareholders, and an Assistant Professor of Law at the University of Mississippi School of Law. I founded Fund Democracy in January 2000 to provide a voice and information source for mutual fund shareholders on operational and regulatory issues that affect their fund investments. Fund Democracy has attempted to achieve this objective in a number of ways, including filing petitions for hearings, submitting comment letters on rulemaking proposals, testifying on legislation, publishing articles, lobbying the financial press, and creating and maintaining an Internet web site.

Table of Contents

I. Introduction

As this Subcommittee is aware, 529 plans have become an increasingly popular means for Americans to save for higher education. During 2002 and 2003, assets in 529 plans increased from $2.5 billion to $46 billion, a 1,840% increase.[1] Assets in 529 plans are expected to reach $85 billion by 2006.[2] These plans have enjoyed enormous appeal in part because they offer a unique combination of federal and state tax benefits, high contribution limits, matching state contributions, donor control, automatic rebalancing and, in many cases, low costs.

These plans have also been subject to criticism, however, on the ground that the high fees charged by many 529 plans have reduced the potential tax benefits of the plans.[3] Although no comprehensive study has been conducted to determine whether 529 plan fees are higher than for similar investments, a cursory review suggests that fees charged by 529 plans generally reflect fees charged by tax-deferred investments in mutual funds, with the possible exception that low-cost 529 plans may be more expensive than the lowest-cost tax-deferred accounts.[4] At the high end, 529 plan fees, albeit

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[1] See State 529 Plan Program Statistics, Investment Company Institute (reporting date: Dec. 31, 2003) (source: College Savings Plan Network) available at http://www.ici.org/issues/edu/529s_12-03.html (site last visited May 29, 2004); Margaret Clancy and Michael Sherraden, The Potential for Inclusion in 529 Savings Plans: Report on Survey of States, Center for Social Development at 4 (Dec. 2003) available at http://www.collegesavings.org/education/ResearchReport-529savingsplansurvey.pdf (site last visited May 29, 2004).

[2] The Potential for Inclusion, id. at 4.

[3] See, e.g., Austan Goolsbee, The "529" Ripoff, Slate.com (Aug. 23, 2002) ("The long-run potential of [529] plans has been seriously compromised by excessive 'management' fees that states have added to these plans.") available at http://www.slate.com/id/2070062 (site last visited May 29, 2004); Penelope Wang, The Trouble With 529 Plans, Money Magazine (Oct. 7, 2003) ("as revenue-hungry states compete for 529 assets -- more than $20 billion is stashed in these plans -- they're layering on marketing gimmicks, restrictive tax rules, and higher fees. As a result, many 529 plans are beginning to resemble high-priced insurance products rather than 401(k)s.") (quoted in Potential for Inclusion, supra note 1, at 10).

[4] A $10,000 Vanguard IRA invested in a Vanguard index fund can cost as little as 0.18% annually. This is significantly lower than the fees charged by the Nebraska and Utah 529 plans, for example, which are two plans often cited as having low fees. The fees charged by low-cost 529 plans do not appear to be higher than low-cost variable annuities, however. For example, a Vanguard variable annuity can cost about 0.60% annually.

arguably excessive, do not appear to be outside of the range charged by some mutual fund providers.[5]

Determining whether a particular fee is too high or too low, based solely on the amount of the fee, is a difficult and uncertain exercise. The best arbiter of the fairness of fees is generally the marketplace, and in the absence of evidence that the market for 529 plans is inefficient or unworkable, Congress and regulators should exercise restraint before imposing additional regulatory burdens that are designed to reduce 529 plan fees. In the case of 529 plans, however, the indirect evidence of market failure is substantial.

One of the most important indicia of efficient markets is standardized, transparent disclosure of fees. It is generally accepted that standardized, transparent fee disclosure promotes competition and reduces prices.[6] The disclosure of 529 plan fees, however, is generally incoherent and obscure, and 529 plans would likely be forced to pay lower fees if adequate fee disclosure were provided.[7] The disclosure of 529 plan fees is specifically

[5] One article cites, as an extreme example, a 529 plan in which fees consumed more than 10% of plan balances each year for two years. See Brooke A. Masters, College Savings Get Closer Study; With Little Oversight, State-Sponsored 529 Plans Vary in Expenses, Benefits, Washington Post (Apr. 14, 2004). But there are mutual funds whose expense ratios alone exceed 10% annually. According to Morningstar, Inc., for example, the Frontier Equity Fund charges annual fees of 42.36% plus a 4.50% front-end load, the Ameritor Investment Fund charges annual fees of 21.57%, APEX Mid Cap Growth Fund charges annual fees of 9.19% plus a 5.75 front-end load; the Alger Socially Responsible Fund and American Heritage Growth Fund both charge annual fees of 10.00%.

[6] See Opening Statement of Michael G. Oxley, Chairman, Subcommittee on Capital Markets, Insurance, and Government Sponsored Enterprises, Committee on Financial Services, U.S. House of Representatives (Mar. 12, 2003) (inadequate fee disclosure "precludes [investors] from 'comparison shopping,' a strong market influence that would encourage fee-based competition and would likely bring down costs) available at http://financialservices.house.gov/media/pdf/031203ox.pdf (site last visited May 31, 2004); Testimony of Paul G. Haaga, Jr., Chairman, Investment Company Institute and Executive Vice President, Capital Research and Management Company, before the Subcommittee on Capital Markets, Insurance and Government Sponsored Enterprises, Committee on Financial Services, U.S. House of Representatives at 9 (Mar. 12, 2003) ("broad availability of information about mutual fund fees and expenses has helped promote competition in the industry") available at http://financialservices.house.gov/media/pdf/031203ph.pdf (site last visited May 31, 2004).

[7] As an example of the potential competitive benefits of full disclosure, some firms may have decided to reduce their fees in response to reports that Morningstar, Inc. had publicly cited those plans as a being among the worst offered partly because of the fees that they charge. See Karen Damato, NASD Investigates College-Savings Fund Sales, Wall Street Journal (Mar. 19, 2004) (discussing Morningstar, Inc. ratings and apparently contemporaneous fee reductions in certain 529 plans).

discussed in Part II of this testimony. In addition, as discussed in Part III of this testimony, the argument for improved fee disclosure in the context of 529 plans is especially compelling because a number of special factors applicable to 529 plans may further inhibit competition and result in higher fees. It therefore is imperative that Congress takes steps to ensure that 529 plans are required to provide standardized, transparent, prominent fee disclosure.

Fee disclosure for 529 plans, at a minimum, should be:

- Standardized, both in the way in which the fees are calculated and the terms used to describe the fees;
- Prominently disclosed relative to other information about the plan;
- Presented both as a percentage of assets and a dollar amount, and on an illustrative and individualized basis;
- Inclusive of a total expense ratio for each investment option that includes all fees incurred in connection with an investment in the plan, to include, among other things, portfolio transaction costs, distribution costs, operating costs and administrative fees, whether charged by the state, plan manager, investment manager, or other person;
- Inclusive of a pie chart that illustrates the components of the total expense ratio according to standardized categories of fees, such as investment management, administrative services, and marketing and distribution;
- Inclusive of information on fees charged by other 529 plans both in a disclosure document and in an easily accessible format on the Internet; and
- Inclusive of separate disclosure of all payments received by intermediaries for executing the transactions in plan interests, both as a dollar amount and percentage of assets, whether or not the payment is made directly by the participant.

In addition, Congress should ensure that fee disclosure requirements for 529 plans are promulgated and enforced by an independent, objective government entity, as discussed in Part V.B of this testimony. The Securities and Exchange Commission ("Commission" of "SEC") has greater experience and expertise in this area than any other government entity, and it would bring greater independence and objectivity to the creation and enforcement of 529 plan fee disclosure requirements. The states, as the issuers of interests in 529 plans, lack the independence and objectivity to regulate their own plans and to enforce any rules they might devise. Congress should specifically authorize the Commission to establish comprehensive rules governing the 529 plan fee disclosure, and consider expanding this responsibility to all aspects of 529 plans operations.

Before implementing these policies, Congress should pause and first develop the analytical framework within which 529 plans should be regulated. This necessitates identifying exactly what the role of the government should be in regulating these plans. Does the fact that 529 plans are created and sold by states militate for greater or lesser regulatory oversight than in other contexts? Once the nature of the governmental interest has been established, Congress should direct the Commission to collect and analyze information on 529 plans. Finally, the development of policies for 529 plans should consider how unique structural issues relate to regulatory goals. These issues are discussed in Part IV of this testimony. Part V of this testimony sets forth specific recommendations regarding 529 plan fees.

II. Fee Disclosure in 529 Plans

The impact of the cost of investing has long been recognized. As stated by the Commission, "fund fees can have a dramatic effect on an investor's return. A 1% annual fee, for example, will reduce an ending account balance by 18% on an investment held for 20 years."[8] Nonetheless, investors do not necessarily consider fees to be a significant

[8] Shareholder Reports and Quarterly Portfolio Disclosure of Registered Management Investment Companies, Investment Company Act Release No. 25870, at Part I.B (Dec. 18, 2002) available at http://www.sec.gov/rules/proposed/ic-25870.htm (site last visited May 31, 2004); see also Opening Statement of Paul E. Kanjorski, Ranking Member, Subcommittee on Capital Markets, Insurance and Government Sponsored Enterprises, Committee on Financial Services, U.S. House of Representatives (Mar. 12, 2003) ("A recent story in *USA Today*, for example, determined that for government securities mutual funds, the group with the lowest expense ratios averaged a 41 percent gain over five years while those with the highest expense ratios grew by 34 percent during the same time frame. Small differences in annual fees will ultimately result in major differences in long-term returns.") available at http://financialservices.house.gov/media/pdf/031203ka.pdf (site last visited May 31, 2004).

factor when choosing mutual funds.[9] Consequently, "the degree to which investors understand mutual fund fees and expenses remains a significant source of concern" to regulators.[10]

The Commission has expressed similar concern regarding the impact and investors' understanding of 529 plan fees. The Commission has estimated, for example, that $10,000 invested in each of the Utah and Rhode Island 529 plans over an 18-year period, assuming the same investment performance for each plan, could leave the Utah investor with a balance that was 20.7% larger than the Rhode Island investor's balance.[11]

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[9] See Shareholder Reports, id. (citing a joint report of the Commission and the Office of the Comptroller of the Currency that "found that fewer than one in five fund investors could give any estimate of expenses for their largest mutual fund and fewer than one in six fund investors understood that higher expenses can lead to lower returns"); Testimony of Arthur Levitt, Chairman, Securities and Exchange Commission, before the before the Subcommittee on Finance and Hazardous Materials, Committee on Commerce, U.S. House of Representatives (Sep. 29, 1998) available at http://www.sec.gov/news/testimony/testarchive/1998/tsty1398.htm (site last visited on May 29, 2004) ("Our own research shows that fewer than one in five fund investors could give any estimate of expenses for their largest mutual fund and fewer than one in six fund investors understood that higher expenses can lead to lower returns. Another recent study found that 40% of fund investors surveyed incorrectly thought that a fund's annual operating expenses have no effect on the gains they earn." (footnotes omitted) (citing, respectively, Report of the Office of the Comptroller of the Currency/Securities and Exchange Commission Survey of Mutual Fund Investors (1996), and Ruth Simon, We Put Investors to the Test – and, Boy, Did They Ever Flunk, Money Magazine (Mar. 1, 1998)); Shareholder Assessment of Risk Disclosure Methods, Investment Company Institute at 11 (Spring 1996) (survey of 657 shareholders who had purchased a fund in the preceding 5 years found that only 43% cited fees and expanses, and only 27% cited the sales charge or load, as factors they considered before investing) available at http://www.ici.org/shareholders/dec/rpt_riskdiscl.pdf (site last visited May 29, 2004); compare Understanding Shareholders' Use of Information and Advisers, Investment Company Institute at 21 (Spring 1997) (survey of 1,000 recent mutual fund investors found that 76% considered annual fees, and 73% considered sales charges, before investing) available at http://www.ici.org/stats/res/rpt_undstnd_share.pdf (site last visited May 29, 2004).

[10] Levitt Testimony, id. ("The Commission is very concerned, though, that many fund investors are not paying attention to the available information about fees."); Disclosure of Mutual Fund Expense Ratios In Performance Advertising, NASD (Jan. 23, 2004) ("Congress, regulators, and investors increasingly have expressed concerns over the need for improved disclosure of fund expenses. . . . The focus on fund fees is important because fees can have a dramatic impact on an investor's return.") (proposing to require inclusion of fund expense ratios in fund performance advertisements) available at http://www.nasdr.com/pdf-text/0377ntm.pdf (site last visited May 29, 2004); Testimony of Paul F. Roye, Director, Division of Investment Management, Securities and Exchange Commission, before the Subcommittee on Capital Markets, Insurance and Government Sponsored Enterprises, Committee on Financial Services, U.S. House of Representatives at 2 – 4 (June 18, 2003) ("the degree to which investors understand mutual fund fees and expenses remains a significant source of concern").

[11] See Memorandum from Annette L. Nazareth, Director, Division of Market Regulation, Securities and Exchange Commission, to William H. Donaldson, Chairman, Securities and Exchange Commission at A-3

Chairman Donaldson recently expressed his "concern regarding the ability of parents to understand the operation of [529] plans and the economic implications that high fees may have on families as they save for their children's higher education."[12]

Chairman Donaldson has good reason to be particularly concerned about the ability of investors to make informed decisions about 529 plans. Unlike mutual funds, which provide a useful comparison to 529 plans because their structure and fees closely resemble those of 529 plans, such plans generally are not subject to the federal securities laws. Interests in 529 plans are municipal securities that are exempt from registration under the federal securities laws, and the states that issue these securities are exempt for registration under the federal securities laws as brokers and investment advisers. States are subject to the anti-fraud provisions of the federal securities laws, and it is possible that a failure to disclose fees could be actionable as a violation of those provisions, but this risk is unlikely to provide a sufficient incentive for states to adequately reform the disclosure of 529 plan fees.

One result of the exemption enjoyed by 529 plans is that they are not subject to fee disclosure requirements that apply to similar investment products. In some cases, 529 plan fees are relatively clear, but in many cases 529 plan fees are difficult to find and understand. After a preliminary review, the Commission concluded that:

> "the wide variations in disclosure among the various state 529 tuition savings plans we reviewed, as well as the absence of significance securities law protections, makes it difficult for investors to fully understand the options that are available to them with respect to these tax-advantaged college savings plans."[13]

(Mar. 2, 2004) ("Nazareth Memorandum") at http://financialservices.house.gov/media/pdf/3-16-04%20529%20lttr%20part%20two_001.pdf (site last visited May 30, 2004).

[12] Letter from William H. Donaldson, Chairman, Securities and Exchange Commission to the Honorable Michael G. Oxley, Chairman, Subcommittee on Capital Markets, Insurance and Government Sponsored Enterprises, Committee on Financial Services, U.S. House of Representatives (Mar. 12, 2004) ("Donaldson Letter") available at http://financialservices.house.gov/media/pdf/3-16-04%20529%20lttr%20part%20two_001.pdf (site last visited May 30, 2004).

[13] Nazareth Memorandum at A-2, supra note 11; see also Donaldson Letter, supra note 12, ("the current state of affairs with respect to 529 plans is complicated and likely difficult for parents to understand.").

If anything, the Commission's preliminary conclusion understates the inadequacy of fee disclosure for many 529 plans. Fee disclosure for 529 plans is often obtuse and buried in long disclosure documents.[14] The information typically presents a multiplicity of fees that do not follow standardized terminology and frustrate comparison across different plans. These fees include, among others, program fees, annual fees, enrollment fees, administration fees, investment fees, transfer fees, service fees, and sales charges; they may be charged at the opening of the account, on a periodic basis, or upon the closing of the account; and they may be presented as a percentage of assets, a one-time, flat payment, or a series of payments that depend on a variety of account characteristics, such as the residency of the participant and the value of the account. The complexity and nonstandardized nature of 529 plan fees make it unlikely that an investor who is not already financially sophisticated about fees will be able to make an informed investment decision regarding 529 plans.

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[14] For example, the Program Description for Maine's NextGen College Investing Plan is 88 pages, fees are not discussed until page 43, and the discussion of fees is extremely difficult to understand. The Program Description is available at: https://www.enroll529.com/pdf/NEXTGEN_100792RR.pdf (site last visited May 27, 2004). Similarly, the Plan Description for Texas's Tomorrow's College Investment Plan is 31 pages and fees are not discussed until page 18 (although the discussion of fees is relatively clear). The Plan Description is available at http://www.enterprise529.com/downloads/529PLANDES_CA5_04.pdf (site last visited May 30, 2004). The Plan Disclosure Document for Alaska's Manulife College Savings Plan is 61 pages, fees are not discussed until page 45, and the discussion of fees is difficult to understand. The Plan Disclosure Document is available at http://www.manulifecollegesavings.com/files/common/pdf/DisclosureDoc.pdf (site last visited May 30, 2004). These examples, as with other examples in this testimony that are derived from actual 529 plans, are not based on a comprehensive review of all 529 plans.

It should also be noted that some 529 plans provide accessible, clear (albeit nonstandardized) fee disclosure. For example, the main page of the web site for the Delaware College Investment Plan provides a table of "Fast Facts," including the following statement regarding the Plan's expenses:

> "Annual maintenance fee of $30 is waived for accounts with automatic bank transfer, direct deposit, or balance over $25,000. Expenses of underlying investments are approximately 0.65% to 0.81% (portfolio weighted average). Annual asset-based program management fee is approximately 0.3%."

The Fast Facts are available at http://www.doe.state.de.us/high-ed/DCIPfacts.htm (site last visited May 28, 2004).

Disclosure rules that apply to mutual funds provide a good illustration of how 529 plan fee disclosure could be improved. Mutual funds must include, near the front of the prospectus, standardized information about expenses in an easy-to-read fee table, as well as the estimated dollar amount of expenses on a $10,000 account over 1-, 3-, 5- and 10-year periods. This disclosure enables investors to easily compare mutual fund fees and thereby promotes competition and reduces costs.[15] Although mutual funds that are used as investment vehicles in 529 plans are subject to these disclosure requirements, and plan participants therefore can access that information, the states are not required to provide mutual fund disclosure documents to plan participants.

Even mutual fund disclosure is inadequate in several respects, however, as has been recognized by the Commission in recent rulemaking initiatives[16] and widely discussed in Congress over the last year, beginning with this Subcommittee's hearings in March 2003.[17] For example, the mutual fund expense ratio does not include portfolio transaction costs, which can be a fund's (and a 529 plan's) single largest expense.[18]

[15] See Haaga Testimony, supra note 6.

[16] See, e.g., Confirmation Requirements and Point of Sale Disclosure Requirements for Transactions in Certain Mutual Funds and Other Securities, and Other Confirmation Requirement Amendments, and Amendments to the Registration Form for Mutual Funds, Investment Company Act Rel. No. 26341 (Jan. 29, 2004) (proposing point-of-sale and confirmation disclosure for mutual funds) available at http://www.sec.gov/rules/proposed/33-8358.htm (site last visited May 31, 2004); Request for Comments on Measures to Improve Disclosure of Mutual Fund Transaction Costs, Investment Company Act Rel. No. 26313 (Dec. 19, 2003) (requesting comment on ways to improve disclosure of mutual fund portfolio transaction costs) available at http://www.sec.gov/rules/concept/33-8349.htm (site last visited May 31, 2004).

[17] See Mutual Fund Industry Practices and their Effect on Individual Investors, Hearing before the Subcommittee on Capital Markets, Insurance and Government Sponsored Enterprises, Committee on Financial Services, U.S. House of Representatives (Mar. 12, 2003) available at http://financialservices.house.gov/hearings.asp?formmode=detail&hearing=187 (site last visited May 31, 2004) and Hearing on H.R. 2420, the Mutual Funds Integrity and Fee Transparency Act of 2003, Hearing before the Subcommittee on Capital Markets, Insurance and Government Sponsored Enterprises, Committee on Financial Services, U.S. House of Representatives (June 18, 2003) available at http://financialservices.house.gov/hearings.asp?formmode=detail&hearing=233 (site last visited May 31, 2004).

[18] See Opening Statement of Congressman Paul E. Gillmor, before the Subcommittee on Capital Markets, Insurance, and Government Sponsored Enterprises, Committee on Financial Services, U.S. House of Representatives (Mar. 12, 2003) (fund portfolio transaction costs "can be very significant and even exceed the amount of the fund's expense ratio; yet, these costs are not clearly presented to consumers") available at http://financialservices.house.gov/media/pdf/031203gi.pdf (site last visited May 31, 2004); Testimony of Mercer Bullard, President and Founder, Fund Democracy, Inc. and Assistant Professor of Law, University

Furthermore, funds are not required to inform shareholders about the dollar amount of their individual fees[19] or provide them with comparative information about fees charged by other funds.[20]

III. The Special Importance of Fee Disclosure in the 529 Plan Context

The lack of transparent, prominent, standardized disclosure of 529 plan fees is exacerbated by factors in the 529 plan context that make fee disclosure even more important. In effect, certain governmental entities have been granted an exclusive monopoly to sell a particular tax-deferred investment product in competition with private providers of other tax-deferred investment products. This intrusion of the government into the private sector may distort many functions of the financial services markets, including the setting of fees.

For example, investors may lower their guard when evaluating 529 plans on the assumption that a public-minded governmental entity would sell only a high-quality, low-cost investment product. In fact, states' interests may not be aligned with plan participants' interests with respect to negotiating fees and choosing investment options, and investors' trust in states' motivations and interests may be misplaced.[21]

States may have incentives to offer plans that charge high fees. States may charge high fees as a means of increasing their general revenues,[22] or charge higher fees to out-

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of Mississippi School of Law, before the Banking, Housing, and Urban Affairs Committee, U.S. Senate at 11 – 15 (March 23, 2004) available at http://banking.senate.gov/_files/bullard.pdf (site last visited May 31, 2004).

[19] Id. at 15 – 16.

[20] Id. at 16.

[21] See Closer Study, supra note 5 ("Regulators and industry experts warn that investors should not assume that the government-sponsored nature of these plans means they have consumer interests at heart").

[22] See Restrictions Lessen Benefits of State College Savings Plans, USA Today (Dec. 1, 2003) (states may seek to add new accounts "because they can keep a portion of the investment fees"); Avrum D. Lank, Tax Break is Just One Factor in Choosing a 529 Plan, The Milwaukee Journal Sentinel (Dec. 14, 2003) ("'To

of-state residents as a way to subsidize services provided to in-state participants.[23] Political considerations also may influence the selection of money managers and cause states to be less diligent when negotiating fees. For example, states may favor in-state money managers[24] or managers that have contributed to the election campaigns of state officials.[25] State officials may even use 529 plan assets for self-promotion.[26]

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the extent that [states] can keep assets in their state [plan], they want to do that because fees accrue to the state as well,'" quoting Shannon Zimmerman, college savings plan analysis for Morningstar, Inc.).

[23] See Closer Study, supra note 5 ("state officials acknowledge that they want to attract out-of-state participants and may even charge them more to cut costs for their own residents"); see, e.g., Texas Plan Description, supra note 14 (waiving annual account fee for accounts with Texas owners or beneficiaries); Rhode Island Plan Description, supra note 33 at 11 (same for Rhode Island owners).

[24] For example, the Maryland College Investment Plan is managed by Baltimore-based T. Rowe Price, and Wisconsin's EdVest College Savings Program is managed by Menomonee Falls-based Strong Capital Management, Inc. See Restrictions Lessen Benefits, supra note 22 ("Massachusetts, Maryland, Pennsylvania and Wisconsin have rewarded politically powerful companies based in their states with exclusive contracts to manage" the state's 529 plan); see also Avrum D. Lank, State Seeks New Options for EdVest (Nov. 22, 2003) ("I want to find some way to keep the mutual fund business strong in Wisconsin, I don't want the (Strong) company to be decimated. I want to make certain that whatever liability there is that we don't kill the company." (quoting Wisconsin state treasure Jack C. Voight)); Elliot Blair Smith, Fund Scandal Worries Tuition Plan Investors, USA Today (Nov. 19, 2003) (describing campaign contributions by Richard Strong to Wisconsin politician indirectly responsible for choosing Strong to manage the state's 529 plan).

[25] Such pay-to-play practices have been well-documented. See, e.g., Mercer Bullard, Pay-to-Play in America, TheStreet.com (Apr. 26 - 30, 2001) available at http://www.thestreet.com/funds/mercerbullard/1406251.html (site last visited May 29, 2004). In 1999, the Commission proposed generally to prohibit money managers from accepting compensation from a public client if the money manager had contributed to the campaign of any official who controlled the allocation of management contracts for the client. See Political Contributions by Certain Investment Advisers, Investment Advisers Act Rel. No. 1812 (Aug. 4, 1999) available at http://www.sec.gov/rules/proposed/ia-1812.htm#foot4 (site last visited May 29, 2004). In 1994, the Commission approved a parallel pay-to-play rule that applies to municipal securities underwriting. In the Matter of Self-Regulatory Organizations; Order Approving Proposed Rule Change by the Municipal Securities Rulemaking Board Relating to Political Contributions and Prohibitions on Municipal Securities Business and Notice of Filing and Order Approving on an Accelerated Basis Amendment No. 1 Relating to the Effective Date and Contribution Date of the Proposed Rule, Securities Exchange Act Release No. 33868 (Apr. 7, 1994). It appears that this rule applies to sales of interests in 529 plans only when the seller is acting as an underwriter. See 529 – Frequently Asked Questions, NASD, available at http://www.nasd.com/Investor/Choices/College/529_faqs.asp (site last visited May 31, 2004); 529 Savings Plan Workshop, NASD at 16 – 18 (Apr. 3, 2002) (available at http://www.nasdr.com/pdf-text/phone_wkshp_0402.pdf (site last visited May 31, 2004).

[26] See College Savings Get Closer Study, supra note 5 (state treasurer used millions of dollars of 529 plan assets to pay for commercials about the plan that prominently featured the treasurer, who was running for reelection).

Participants in 529 plans typically do not receive any state tax deduction for contributions to out-of-state plans,[27] which may create incentives to pay higher fees. Investors may opt for a higher-cost, in-state plan specifically in order to receive the tax benefits of the in-state plan,[28] or may miss out on the in-state tax benefit offered by a low-cost in-state plan because brokers recommend out-of-state plans that pay higher compensation to the broker.[29] This has the effect of reducing price competition among 529 plans because in-state plans can exploit their monopoly on in-state tax benefits to offset their higher fees. This is essentially a kind of bundling, not dissimilar to a private company that has a government-granted monopoly over one product (state tax deductions) to help it sell another, possibly inferior product (the 529 plan).[30] Congress should consider mandating that any state tax deductions for 529 plan contributions or distributions be reciprocal across all qualified 529 plans.

The rules governing 529 plans can limit price competition by making it more costly and burdensome for plan participants to transfer their 529 plan interests, thereby reducing price competition and further elevating the importance of fee disclosure. For

[27] The 529 plans for 24 states and the District of Columbia permit residents to deduct some or all of their contributions to their state's 529 plan from their state tax return. See Tax Break, supra at note 22. A Wisconsin state representative has introduced a bill that would permit residents to deduct some or all of their contributions to any state's 529 plan from their Wisconsin tax return. See Tax Break, id. Some states treat, or are considering treating, all 529 plan distributions equally for state law purposes. See, e.g., 529 College Investing Programs in Maine Now Treated Equally, Finance Authority of Maine (June 23, 2003) (state law treating distributions equally for all 529 plans) link available at http://www.ici.org/issues/edu/arc-leg/03_maine_529_tax.html (site last visited May 29, 2004); Letter from Matthew Fink, President, Investment Company Institute, to Illinois State Representatives Michael J. Madigan and Barbara Flynn Currie (Apr. 24, 2003) available at http://www.ici.org/statements/cmltr/03_maine-illinois_529_com2.html#TopOfPage (site last visited May 29, 2004) (discussing Illinois' considering similar provision for equal treatment of distributions by all 529 plans).

[28] See Tax Break, supra note 22 ("Zimmerman and others are concerned that the various state tax breaks stop some people from making the proper choice of plan").

[29] See NASD Investigates College-Savings Fund Sales, supra note 7 ("'overwhelming majority'" of plans sold by six securities firms investigated by the NASD were out-of-state, quoting Mary Schapiro, Vice Chairman, NASD); Closer Study, supra note 5 (citing anecdotal evidence that Washington, D.C. "investors are being steered into out-of-state plans that offer neither low fees nor a state tax break").

[30] See Closer Study, id. ("'One of the most significant things (the tax breaks) do is to make it necessary for anyone considering a 529 plan to consider their home state plan first,' [said Zimmerman] 'It sweetens the deal.'").

example, mutual fund shareholders have the right to receive their pro rata share of the fund's net assets within seven days of a redemption request.[31] In contrast, there is no limit on the amount of time that a state can hold a participant's assets pending a transfer[32] or on the amount of fees charged on the transfer.[33] Accordingly, it is that much more important that investors be informed about 529 plan fees before choosing a plan, because it may be difficult or costly to change that decision.

Further, participants in 529 plans have limited control over fees. Mutual funds can raise advisory and 12b-1 fees only with shareholder approval, whereas states generally can raise fees at will without notice to participants,[34] thereby making it more important that investors understand the fees charged before making an investment decision. When a mutual fund that is a 529 plan investment option seeks to raise its fees, the state has the right to vote on the fee increase, but, as noted above, it may not have the same interests to negotiate low fees as plan participants have. In some cases, states have locked themselves into long-term arrangements that may make it difficult for them to change managers or reduce fees.[35]

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[31] As a practical matter, broker regulations and certain SEC staff positions effectively require that sales of fund shares settle in no more than three days. Funds can charge redemption fees, but the SEC staff limits these fees to 2% of the redemption amount and the fee must be paid to the fund.

[32] In addition, mutual funds typically must accept purchases the same business day they are received, whereas there are no limits on states' ability to hold 529 plan contributions pending investment in the plan. For example, the Virginia Education Savings Trust holds participants' contributions for up to 30 days before investing them in the plan. See College Savings Get Closer Study, supra note 5; Nazareth Memorandum, supra note 11, at A-4 (in effect, the "delay in investment [is] an interest-free loan from investors" to the state).

[33] For example, Rhode Island imposes $50 fee on transfers to another state's 529 plan. Rhode Island Program Description at 12 (Oct. 27, 2003) link available at http://www.collegeboundfund.com/ (site last visited May 31, 2004).

[34] The Plan Disclosure Document for the Alaska's Manulife College Savings Plan provides that the Trust, "in its sole discretion, will establish or change Fees as it determines to be appropriate. Such Fees may include a program fee, a sales load, an annual Account fee, fees associated with SFAs and other fees and charges to support the purposes and administration of the Trust." Plan Disclosure Document, supra note 14, at 45 – 46. In contrast, Texas state law prohibits the Board from collecting administrative fees in excess of the costs of administering the 529 plan. See Plan Description, supra note 14.

[35] See Nazareth Memorandum, supra note 11, at n. 25 (citing examples of limitations on states' ability to fire 529 plan managers). Whereas Oregon and Utah terminated Strong Capital Management from their 529 plans because of the CEO's wrongful conduct, Wisconsin's plan was bound by an exclusive contract with Strong until 2006. See Avrum D. Lank, EdVest Overseers Add Options to Strong Funds, Milwaukee

Finally, federal law gives mutual fund shareholders legal recourse against a fund's directors and manager with respect to excessive fees charged by the manager,[36] which may provide some restraint on fees. Participants in 529 plans, however, have no such rights absent a violation of the antifraud rules under the federal securities laws. Although participants have political recourse against state officials, it is uncertain whether this provides an effective restraint on fund fees.

Restrictions on 529 plan investment options, participants' limited control over fees and fee increases, the costs and burdens of transferring from one plan to another, states' monopoly on state tax benefits, limited legal recourse against plan sponsors, and the divergence of state and participant interests are some of the special factors that make it especially critical that 529 plan fees be fully disclosed in an understandable, standardized, accessible format.

In addition, permitting states to offer a financial product has effectively added 50 new regulators for tax-deferred mutual fund wrappers, which are subject to too many different regulators and sets of rules as it is.[37] The Commission is responsible for fee disclosure for variable annuities, the Department of Labor is responsible for fee disclosure for employee benefit plans, and banking regulators and the Internal Revenue Service are responsible for fee disclosure for IRAs. Multiple disclosure regimes confuse investors and increase the costs of offering investment products, as each provider must tailor its program to the particular state's requirements. The Subcommittee should take

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Journal Sentinel (Dec. 4, 2003). Oregon's contract included an "at-will" provision. See Kathleen Gallagher, Oregon Ousts Strong from College Fund, Milwaukee Journal Sentinel (Nov. 14, 2003).

[36] The Commission also has the authority to sue a fund's directors and manager with respect to fees paid to the manager, but it has never exercised that authority, and that authority therefore cannot be considered to restrain mutual fund fees to any degree. For examples of excessive mutual fund fees, see supra note 5.

[37] A substantial percentage of mutual fund assets are invested through these tax deferred wrappers. At the end of 2003, about one-third of mutual fund assets (about $2.7 trillion) were held in retirement plans, primarily in 401(k) accounts and IRAs. See Mutual Fund Fact Book, Investment Company Institute at 86 (May 2004) available at http://www.ici.org/stats/mf/2004_factbook.pdf (site last visited May 31, 2004).

this opportunity to explore ways of rationalizing fee disclosure and other regulatory aspects of various tax-deferred mutual fund wrappers.[38]

Additional regulation of 529 plans probably can mitigate many of the disadvantages of state-sponsored investment products, but Congress should also consider reforms that might more directly address fee disclosure and other problems. The need for additional 529 plan regulation is due, in part, to the fact that they are exempt from the federal securities laws. The municipal exemption under which 529 plans operate was not intended for the offering of retail financial services, and Congress should consider amending the exemption to exclude 529 plans or permitting private firms to offer 529 plans outside of state sponsorship.[39]

IV. Guidelines for the Regulation of 529 Plan Fees

The inadequacy of 529 plan fee disclosure necessitates prompt Congressional or agency action to ensure that investors in 529 plans can make fully informed investment decisions. Before choosing a particular course of action, however, it is important to (1) establish guidelines regarding the nature of the government's interest in 529 plan fees, and (2) collect and analyze information about fees that are currently charged by 529 plans.

[38] This problem extends beyond tax-deferred investment pools to all types of investment pools, including bank collective investment trusts, funds of funds, folios, mini-accounts, exchange-traded funds, separate accounts, hedge funds, etc., and will worsen as the proliferation of similar investment vehicles subject to different regulations increases the opportunity for and transaction costs of regulatory arbitrage.

[39] As suggested by Professor Goolsbee: "The federal government will forgo billions of dollars in tax revenue to subsidize 529s. The goal of this subsidy was to encourage education, not to have the federal government provide a windfall to states and financial firms in the form of high fees. An easy way to fix the 529 problem would be to bestow the benefits of the 529s on other savings plans. Congress could raise the limit on contributions to Coverdell/Education IRAs or allow penalty-free withdrawals from 401(k) accounts for educational expenses. In these other accounts, people can choose any investment from any provider, without paying extra management fees. It would cost the federal government the same amount as the current 529 system, but the benefits would go to the parents, not the providers." "529" Ripoff, supra note 3.

A. The Governmental Interest in 529 Plans

The most important step in developing a framework for 529 plan regulation is to identify the nature of the government's interest in these plans. The government's interest in 529 plans reflects, to a large extent, its interests in financial services and products generally. The government interest in brokerage services, investment advice, mutual funds and other financial services and products is generally based on four principles: (1) promoting the operation of free markets unfettered by government interference, (2) mandating full disclosure to facilitate informed decisionmaking and the efficient allocation of capital, (3) protecting investors against fraud, and (4) imposing targeted, substantive regulation.

These government interests are generally applicable to all financial services and products, with some tailoring in individual circumstances. For example, the regulation of securities issuers has generally focused on the first three principles of free markets, full disclosure, and investor protection, with limited substantive regulation. The regulation of brokers and investment advisers has generally entailed a representative mix of all four principles. Mutual fund regulation is characterized by more extensive substantive regulation in many areas, including, in a number of respects, the level and disclosure of fees.[40] Congress has regulated mutual funds more intrusively than in other areas primarily because mutual funds involve the discretionary control over a liquid pool of cash and securities where the potential for abuse is greater than in other securities-related contexts.

The structure of 529 plans is similar to that of mutual funds, and, not coincidentally, states generally have opted for mutual funds as the underlying investment vehicles for plan assets. The regulation of the level and disclosure of 529 plan fees, however, falls well below the standards applicable to mutual funds.[41] Assuming that the

[40] See supra, discussion at pages 11 - 12 (regulation of disclosure of mutual fund fees) and infra, discussion at page 29 (regulation of level of mutual fund fees).

[41] Id.

governmental interest in 529 plans parallels its interest in mutual funds, Congress should take steps to subject 529 plans to the same level of regulation, and not only with respect to the level and disclosure of fees, but also with respect to governance, affiliated transactions, leverage, and other areas in which mutual funds have been successfully regulated for decades.

But one might argue that the governmental interest in 529 plans is actually quite different. On the one hand, Congress authorized 529 plans to promote a specific "investment objective," that is, to increase or facilitate investment in higher education. Congress therefore may have a greater regulatory interest in ensuring that 529 plans achieve that investment objective. This special government interest is implicit, for example, in Chairman Oxley's question to Chairman Donaldson regarding whether 529 plan fees could outstrip the tax benefits of the plan.[42]

In the context of fees, for example, this perspective might argue for more intrusive regulation of the level and disclosure of 529 plan fees for the purpose of maximizing the additional funds available for higher education.[43] Another way of looking at this question would be to consider Congress as having an interest in obtaining the greatest possible return on its investment, its investment being the amount of foregone tax revenues, and accordingly a greater interest in 529 plans' achieving the best possible performance at the lowest possible cost.

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[42] See Letter from Michael G. Oxley, Chairman, Committee on Financial Services, U.S. House of Representatives, to William H. Donaldson, Chairman, Securities and Exchange Commission at 2 (Feb. 4, 2004) available at http://financialservices.house.gov/media/pdf/3-16-04%20529%20lttr%20part%20two_001.pdf (site last visited May 30, 2004).

[43] This holds for many characteristics of 529 plans. For example, Congress could reasonably decide that the purpose of 529 plans would not be served if a participant could bet his entire investment on a single stock, and accordingly require that 529 plan assets be invested exclusively in diversified pools. This issue echoes the recent debate regarding a proposal by Senator Corzine and others to limit the percentage of an employee's account in a tax-deferred employee benefit plan that may be allocated to his employer's stock. See Ellen Schultz, Should Pension Law Do More to Protect Retirement Savings? Wall Street Journal (Jan. 14, 2002) (proposal by Senators Corzine and Boxer to limit employer's stock to 20% of employee's retirement plan).

On the other hand, 529 plans already are, in a sense, the most intrusively regulated financial product offered in America. The structure and operation of 529 plans are set by their state sponsors. Congress could take the view that the role of the states supports a reduced regulatory role on the assumption that the states generally will set or negotiate fees that are lower than for similar investment products. There is evidence, however, that a number of states offer 529 plans with extremely high expenses, which suggests that some states may provide less effective mechanisms for efficient pricing than the mutual fund marketplace.

The purpose of the foregoing discussion is to frame ways of thinking about the regulation of 529 plan fees and encourage Congress and regulators to resolve the issue of the governmental interest in 529 plans before developing new 529 plan regulations.

The following discussion is based on my view that Congress does have a greater regulatory interest in 529 plan fees than it has in mutual fund fees. In this case, if one also assumes that the regulation of mutual fund fees has generally been successful,[44] then the regulation of 529 plan fees needs a substantial overhaul. At a minimum, Congress should authorize and direct the Commission to establish standardized formats for the prominent disclosure of 529 plan fees, as discussed further in Part V of this testimony, that are comparable or superior to the fee disclosure provided by mutual funds.

Indeed, Congress should consider regulation of 529 plan fees that exceeds similar rules for mutual funds. Congress should exercise greater caution here, however, for we lack the historical experience that 16 years of standardized mutual fund fee disclosure has provided. Congress should be particularly careful about addressing concerns that are truly 529 plan concerns, as opposed to concerns that simply reflect problems with the securities products generally.

[44] There is strong, indirect evidence that mutual fund fee disclosure has been fairly successful (although it could be substantially improved). Over the last decade or so, mutual fund investors generally have migrated toward lower cost fund complexes, thereby suggesting that cost is a factor they consider when making investment decisions.

For example, it may be unprofitable to evaluate the need for regulation based on whether there is a causal relationship between the amount of fees charged by a 529 plan and the amount of additional funds made available for higher education as a result of the plan's tax benefits. It may seem intuitively obvious that, because every dollar that a participant spends on fees is one less dollar that he could spend his child's education, fees directly reduce, and can exceed, the tax benefits provided by 529 plans. But this tradeoff between fees and tax benefits may be nonexistent if the participant would otherwise have invested in a taxable mutual fund that had similar expenses.

In response to Chairman Oxley's question about whether fees could outstrip the tax benefit provided by 529 plans, for example, the Commission showed that an investment in a high-cost, load 529 plan that invests in a actively managed fund would leave the participant with a much smaller end-of-period balance than if he had invested in no-load, low-cost index fund in a taxable account.[45] This is not, as the Commission concedes, an "'apples-to-apples' comparison," however, because the participant who buys an actively managed option in a high-cost, load 529 plan probably would not otherwise invest in a low-cost, no-load, index mutual fund in a taxable account, but in a high-cost, load, actively managed mutual fund in a taxable account. Fees charged by high-cost 529 plans, based on a cursory review, simply do not bear out the argument made by some that they exceed what an investor might otherwise pay outside of the plan.[46] While excessive 529 plan fees clearly raise policy concerns, they are not truly ***529 plan*** concerns.

A more relevant question may be whether a 529 plan, after taking into account any additional services it provides (e.g., asset allocation), is more expensive than a

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[45] Nazareth Memorandum, supra note 11, at A-13. This assumes that the investment option for the model 529 plan used by the Commission, which has annual fees of 2.0%, is an actively managed fund.

[46] Professor Goolsbee uses the example of a 529 plan option that imposes annual fees equal to 1.83% and a 5.75% front-end load (or, without the front-end load, annual fees of 2.54%) to support the statement that "[t]hese fees are unbelievably high, vastly more than you would pay for a normal investment." See "529" Ripoff, supra note 3. In fact, even higher fees are charged by mutual funds outside of 529 plans. See, e.g., supra note 5.

similar tax-deferred account.[47] If the answer is "no," then arguably 100% of the tax benefit that Congress intended to bestow on 529 plan participants has been preserved, even where the plan's expenses are very high. In the absence of evidence that participants in 529 plans routinely incur higher expenses than they would otherwise incur in similar non-529 plan accounts,[48] it is unlikely that 529 plans' tax benefits are reduced or eliminated by fees in any meaningful sense.[49]

B. Current 529 Plans Fees and Fee Disclosure

Once the nature of the governmental interest in 529 plans has been identified, information about 529 plan fees should be collected and analyzed. Legislators and regulators will not be able to formulate effective fee disclosure policies and procedures without a thorough understanding of the amount and kinds of fees charged by 529 plans. I recommend that this Subcommittee task the Commission with collecting and analyzing

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[47] It is also possible that participants in 529 plans might not otherwise invest those assets at all. This might be particularly likely where the interests in the plan have been sold by an intermediary who has convinced the participant that the tax benefits are worth foregoing the benefits of immediate consumption. Even in this case, however, it is difficult to show that fees directly reduce the tax benefits realized from 529 plans. And in any case, it is likely that most 529 plan assets would have been invested in taxable (or other nontaxable) accounts if 529 plans had not been available.

[48] One reason that fees may be increased is that participants may pay commissions and other distribution fees to intermediaries. Anecdotal evidence suggests, however, that the use of intermediaries in the 529 plan context is no higher than in other contexts. See Nazareth Memorandum, supra note 11 (broker-sold 529 plans account for approximately 75% of all sales of interests in 529 plans) (citing J. Kim, Assets in 529 Plans Jumped 83% to $35B in 2003, Dow Jones Newswire (Feb. 4, 2004) (quoting Whitney Dow, director of education-savings research at Financial Research Corporation)); Mutual Fund Fact Book, supra note 37, at 48 (87% of new sales of mutual fund shares were made through third parties in 2003).

[49] It should be noted that this analysis implicitly rejects the oft-stated view that sales charges are a dead weight expense that by their very nature are excessive. See, e.g., Penelope Wang, The Trouble with 529 Plans: More and More States Are Messing Up a Good Thing with Fees, Commissions and Bum Funds, Money (Oct. 7, 2003). This position confuses what we might like to be true about investors with what we might like to be true about 529 plans. It makes sense to wish that all 529 plans were no-load only in the sense that we might wish that all investors were sufficiently self-directed and informed so as not to need (or have to pay for) investment advice. If one assumes that some investors do need advice, however, then we should wish that all states provided 529 plans that could be used by such investors. The argument that intermediaries should simply recommend no-load 529 plans is a contradiction of terms, for an intermediary is, by definition, a person who is in the business of providing investor services ***for compensation***. In a world in which intermediaries recommended no-load investments, intermediaries would not exist. Thus, the criticism of 529 plans for imposing distribution fees is not so much a criticism of 529 plans as it is of the situation of investors who decide to invest through intermediaries or the practice of tying intermediaries' compensation the product being sold. See Bullard Testimony, supra note 18, at 22.

information regarding 529 plan fees. The Commission has the greatest expertise in this area, and Chairman Donaldson's Task Force on College Savings Plans already has a head start on this work. In the past, the Commission has not been as effective as it should have been in anticipating broad developments in the financial services industry. The Task Force should help remedy this problem by developing not just the empirical basis for further evaluation (and, as appropriate, regulation) of 529 plans, but also an analysis of the role of 529 plans and similar products in the financial services marketplace within the framework of the governmental interests such plans are intended to serve.

Toward this end, I recommend that the Subcommittee provide specific guidance to the Commission regarding the scope of the work of the Task Force to ensure that it does not merely collect data, but also places that data in its broader policy context and defines core principles on the basis of which it believes products such as 529 plans should be regulated – even where those products are outside of the SEC's jurisdiction. The Commission often has a tendency to limit its role to that of an interpreter of what the law is and to avoid its equally important role in proposing answers to the hard questions of what the law should be. The Commission's unparalleled expertise and background necessitates that it become more engaged in the process of developing the foundational principles according to which markets should be regulated. The Subcommittee should encourage Chairman Donaldson to steer the Commission's new focus on risk assessment in this direction.

More specifically, the Task Force should not confine its role to identifying and categorizing 529 plan fees and describing the quality and scope of the disclosure of those fees. The Task Force should also consider how 529 plan fees and fee disclosure compare to fees charged by comparable investment vehicles, including mutual funds, Individual Retirement Accounts ("IRAs"), 401(k) plans, variable annuities, and similar investment vehicles. The Commission has expended substantial resources analyzing mutual fund disclosure, for example, but few resources analyzing the actual disclosure provided to end-users of mutual funds where the mutual funds are sold in a tax-deferred wrapper that may or may not be within the SEC's jurisdiction.[50] The Task Force should also consider how the structure of 529 plans affects their operation and fees. The next part of this testimony discusses a number of ways in which the structure of 529 plans raises particular concerns, and the debate about how to regulate 529 plans would benefit from the SEC's analysis of those concerns. Finally, and perhaps most importantly, the Task Force should specifically articulate the general government policy or policies that the Commission and the Task Force understand the regulation of 529 plans should serve.

V. Recommendations for Reform

With respect to the issue of 529 plan fee disclosure, there appears to be widespread agreement that current standards are inadequate, and that 529 plans should be subject to uniform standards for fee disclosure. As noted above, the Commission already has proposed point-of-sale and confirmation disclosure requirements for 529 plans.[51] Even the College Savings Plan Network, an affiliate of the National Association of State Treasurers, reportedly has recognized the need for such standards and plans to promulgate them in the near future.[52] This leaves the questions of what form such standards should take and who should develop and enforce them?

A. Uniform Standards for 529 Plan Fee Disclosure

Fee disclosure rules for 529 plans should follow certain basic principles. Fees should be prominently disclosed to reflect their importance, and be easy to compare across different plans. This necessitates standardization and disclosure of fees charged by competitors. Fees should be provided as a percentage of assets and in dollars. The

[50] For example, in a 1992 study, the SEC staff published an extensive analysis of mutual fund regulatory issues that cut across a variety of investment products, some of which were outside of the SEC's jurisdiction. Protecting Investors: A Half Century of Investment Company Regulation, Division of Investment Management, Securities and Exchange Commission (May 1992).

[51] See supra note 16.

[52] See Ann Perry, Popular College Savings Plans Face Overhaul, TheStreet.com (May 28, 2004) available at http://www.thestreet.com/_tscs/funds/annperry/10162887.html (site last visited May 29, 2004).

former approach permits comparability[53] and prevents high-percentage fees to be hidden in the form of apparently low fixed charges.[54] The latter approach conveys a more tangible sense of the actual cost of the services provided.[55] Fees should be divided into categories, in order that investors may evaluate the uses to which their payments are being put. Finally, 529 plans should provide separate disclosure of the fees received by intermediaries in connection with the purchase and sell of plan interests in order to direct participants' attention to intermediaries' conflicts of interest.

Based on these principles, uniform standards for 529 plan fee disclosure should meet the following minimum standards. Fee disclosure for 529 plans, at a minimum, should be:

- Standardized, both in the way in which the fees are calculated and the terms used to describe the fees;
- Prominently disclosed relative to other information about the plan;
- Presented both as a percentage of assets and a dollar amount, and on an illustrative and individualized basis;
- Inclusive of a total expense ratio for each investment option that includes all fees incurred in connection with an investment in the plan, to include, among other things, portfolio transaction costs, distribution costs, operating costs and administrative fees, whether charged by the state, plan manager, investment manager, or other person;
- Inclusive of a pie chart that illustrates the components of the total expense ratio according to standardized categories of fees, such as investment management, administrative services, and marketing and distribution;

[53] See Opening Statement of Chairman Oxley, supra note 6 (affirming importance of investors' being able to engage in "comparison shopping").

[54] For example, the Maryland College Investment Plan charges a one-time $90 enrollment fee and a $30 account fee, which for a minimum account of $250 would equal 48% of assets in the first year and 12% each year thereafter, not including other expenses. Disclosure Statement at 5 & 13 – 14 (November 2003) link available at http://www.collegesavingsmd.org/GT2gettingstarted.cfm (site last visited May 30, 2004).

[55] See Opening Statement of Congressman Gillmor, supra note 18 ("Disclosure of expenses as a percentage of assets allows for better comparison among funds but it does not effectively communicate real costs.)

- Inclusive of information on fees charged by other 529 plans both in a disclosure document and in an easily accessible format on the Internet; and

- Inclusive of separate disclosure of all payments received by intermediaries for executing the transactions in plan interests, both as a dollar amount and percentage of assets, whether or not the payment is made directly by the participant.

B. Responsibility for Promulgating and Enforcing 529 Plan Fee Disclosure

Congress should assign exclusive responsibility for the regulation of 529 plan fee disclosure to the Commission. The Commission has more experience and expertise regulating fee disclosure than any other governmental entity, and it has more objectivity and independence than the states. Although the states should play a central role in developing uniform fee disclosure standards, they should not have final decisionmaking authority over the form and content of such disclosure. Nor should states be left to enforce such standards themselves.

The states will not provide the objectivity and independence necessary to develop uniform disclosure standards. For example, the brokerage industry already has expressed its unconditional opposition to the SEC's proposal to require delivery of point-of-sale and confirmation fee disclosure, and it is likely to oppose any similar disclosure standards promulgated by the states.[56] This same industry acts as a partner with the states in the offering of 529 plans. It is unrealistic to believe that, in view of their partnership with the brokerage industry, the states will be as independent and objective as an entity that had no such relationship.

The states' objectivity and independence will also be compromised by the fact that their interests are not necessarily always aligned with the interests of all 529 plan

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[56] See Letter from George R. Kramer, Vice President and Acting General Counsel, Securities Industry Association to Jonathan G. Katz, Secretary, Securities and Exchange Commission (Apr. 12, 2004) (rejecting SEC proposal to require delivery of point-of-sale document and opposing proposal for disclosure of actual dollar amount of commission on confirmation) available at http://www.sec.gov/rules/proposed/s70604/sia041204.pdf (site last visited May 30, 2004).

participants.[57] States have incentives to benefit elected officials, state institutions and non-participant state residents to the detriment of plan participants, and to benefit in-state plan participants to the detriment of out-of-state plan participants. The states, as public actors in the private sector, have a conflict of interest that will inevitably color their judgment regarding fee disclosure and other aspects of 529 plan operations.

Regulation of 529 plans by the states has an additional disadvantage of requiring agreement by 50 different entities,[58] and probably a large percentage of their financial services partners. There is also the risk that one or more states may refuse to cooperate, thereby undermining the important goal of uniformity, and there is no clear enforcement mechanism to address this potential problem. In contrast, the Commission has one, five-member decisionmaking authority that can more efficiently develop rules, issue them for public comment, and move to final adoption in a timely manner, and the Commission can enforce these standards against the states independent of political considerations.[59] To illustrate the limitations of allowing states to regulate their own plans, the states have only recently suggested that they may propose standards for uniform 529 plan fee disclosure, no specific proposal has been made, and even that step has been taken only under the threat of imminent Congressional or regulatory action. The Commission already has taken the initiative in proposing point-of-sale and confirmation disclosure requirements for 529 plans. Interjecting the states into this process risks the

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[57] See supra discussion at pages 13 - 16.

[58] The states were unable to resolve similar problems with state-by-state regulation of mutual fund disclosures, thereby prompting Congress to enact the National Securities Markets Improvements Act of 1996, which effectively assigned exclusive authority over the substantive regulation of mutual funds to the Commission.

[59] The Commission has brought numerous enforcement actions against public officials in connection with municipal underwritings. See, e.g., SEC v. Larry K. O'Dell, Civ. Action No. 98-948-CIV-ORL-18A (M.D. Fla.); Litigation Release No. 15858 (August 24, 1998) (settled final order); SEC v. Louis Bethune, Charles L. Howard and John Jackson, Litigation Release No. 15271 (February 28, 1997) (settled final order); SEC v. Louis Bethune, Charles L. Howard and John Jackson, Litigation Release No. 15024 (August 26, 1996) (settled final order); SEC v. Robert L. Citron and Matthew R. Raabe, Litigation Release No. 14913 (May 17, 1996) (settled final orders); SEC v. Robert L. Citron and Matthew R. Raabe, Civ. Action No. SACV 96-74 GLT (C.D. Cal.), Litigation Release No. 14792 (January 24, 1996) (complaint); SEC v. Louis Bethune, Charles L. Howard and John Jackson, Civ. Action No. CV:95-B2509 (N.D. Ala.), Litigation Release No. 14675 (October 2, 1995) (complaint).

promulgation of conflicting standards and ongoing tension between the states and the Commission.

Although agencies other than the Commission have exercised responsibility for developing fee disclosure requirements for products similar to 529 plans, none has comparable experience and expertise, or a comparable record of success, as the Commission. The Commission currently has responsibility for fee disclosure for mutual funds, which are the predominant investment vehicle in which 529 plan assets are invested, and for variable annuities, which, along with certain employee benefit plans, are the investment products that are most similar to 529 plans. In addition, the Commission already has proposed fee disclosure rules that would address a broad range of 529 plan fee disclosure issues. The SEC's proposed point-of-sale disclosure proposal, with certain key improvements,[60] provides a good starting point for developing a 529 plan disclosure document. Indeed, if Congress grants the Commission jurisdiction over 529 plan fee disclosure, it should consider doing so for other tax-deferred mutual fund wrappers as well.[61]

C. Limits on 529 Plan Fees

The Subcommittee also should consider imposing limits on 529 plan fees. Those who might reject this proposal out of hand -- as contrary to the widespread (and wise) view that the government generally should not set fees -- should hold judgment and consider certain factors that militate for considering limits on fees in the 529 plan context.

[60] See Letter from Mercer Bullard, Founder and President, Fund Democracy, Inc. and Assistant Professor of Law, University of Mississippi School of Law, Barbara Roper, Director of Investor Protection, Consumer Federation of America, Kenneth McEldowney, Executive Director, Consumer Action, and Sally Greenberg, Senior Counsel, Consumers Union to Jonathan G. Katz, Secretary, Securities and Exchange Commission (Apr. 21, 2004) (recommending, among other things, that point-of sale document be provided a meaningful amount of time before the investment decision is made and include all investment-related costs).

[61] See Protecting Investors, supra note 50, at 151 (recommending that Congress repeal securities law exemption for employee benefit plans in part because "plan participants receive far less information about the investment objectives and policies, performance, investment managers, fees, and expenses of their investment options than do investors who directly purchase securities issued by [mutual funds].")

First, the very concept of a 529 plan depends on the setting of fees by the government because the states set or negotiate all 529 plan fees. The government's role in setting fees is already firmly established in the context of 529 plans.

Second, many do not appreciate that the government already sets fees for investment services and products in a number of contexts. For example, the NASD imposes absolute limits on sales charges on sales of mutual funds and on 12b-1 fees that can be charged by those funds.[62] The Commission effectively prohibits funds from charging redemption fees in excess of 2%. Section 22(d) of the Investment Company Act requires that fund shares be sold only at the price set forth in the prospectus, which effectively fixes the sales charge for any particular fund.

In addition, as discussed above, Congress created 529 plans to achieve a specific social goal: to promote investment in higher education. Congress should consider a more intrusive regulatory approach when an investment product is intended to serve a particular social goal, especially when this purpose is funded by taxpayers in the form of foregone tax revenues. As discussed above, it therefore would be appropriate for Congress to consider limiting 529 plan fees to help achieve this purpose.

There are at least three areas where Congress should consider specific limits on 529 plan fees, as discussed immediately below.

> Limits on Distribution Fees. As noted above, the NASD currently limits sales charges and 12b-1 fees. Some 529 plans, within NASD limits,

[62] It appears that these limits may effectively apply to intermediaries selling interests in 529 plans, as the Municipal Securities Rulemaking Board takes the position that sales charges on sales of 529 plan interests that exceed NASD limits on mutual fund sales charges presumptively do not meet the fair and reasonable standard under MSRB rule G-30(b). Rule G-30(b) prohibits dealers from selling municipal securities to a customer for a commission or service charge in excess of a fair and reasonable amount. See Interpretive Notice On Commissions and Other Charges, Advertisements and Official Statements Relating To Municipal Fund Securities, MSRB (Dec. 19, 2001) available at http://www.msrb.org/msrb1/archive/MFSDecNotice.htm#_ftnref1 (site last visited May 31, 2004); Workshop, supra note 25, at 28 – 29.

impose front-end sales loads in excess of 5%. This payment reduces an initial $10,000 contribution by $500 or more, thereby substantially reducing the participant's short-term performance.[63] In the 529 plan context, where the investment period as a practical matter is limited to 18 years and is often substantially shorter (depending on the age of the child), participants may have less time over which to spread the impact of a front-end load.

Furthermore, the larger the commission and/or 12b-1 fee, the greater the distortion of the intermediaries' and participants' incentives may be. The greater the distribution payment, the greater the intermediary's incentive to seek a plan with a higher payout and not to recommend a plan that might be better suited for the participant, particularly when the participant's plan offers a state tax deduction only for the in-state plan. The greater the distribution payments, the less freedom the participant has to sell the investment. Locking participants into 529 plans reduces competition and increases costs.

Congress should consider imposing lower limits on 529 plans, such as a 3.00% limit on commissions and a 0.50% limit on 12b-1 and other asset-based distribution fees, that would apply to intermediaries and states alike.

Limits on Purchase and Transfer Fees. For similar reasons, Congress should consider limiting fees charged by 529 plans in connection with initial purchases and transfers. These fees can inhibit competition by making it prohibitively costly for a participant to change plans. For

[63] For example, participants in Arizona's Waddell & Reed InvestEd 529 Plan who buy Class A shares pay a 5.75% front-end load. A $10,000 investment in Class A shares of the highest cost investment option in the Texas Tomorrow's College Investment Plan would incur 7.05% in expenses the first year. See Plan Description, supra note 14, at 18. The expenses include a 4.75% front-end sales charge, a $30 annual account fee, a 0.20% plan manager administrative fee, a 0.25% marketing fee, and up to a 1.75% fee for the underlying investment option. Fees on the investment options range from 0.00% to 1.75%. After May 1, 2005, the plan manager may charge a state administrative fee of 0.10%, thereby increasing the first year's fees to 7.15%.

example, if a plan raises its fees, participants should be able to reject the increase by voting with their feet without having to incur a material fee for doing so. Limits on such fees should be based on the actual administrative cost of process the purchase or sale.

Mandatory Low-Cost Option. Congress should also consider requiring states that sell 529 plans to offer at least one low-cost option, the fees of which do not exceed a certain amount. For example, Congress could require that each state offer at least one option the annual, total cost of which does not exceed 0.60% of a participant's account in any year. As long as the maximum fee does not exceed the cost of readily available programs, this should not distort the marketplace, while ensuring that every in-state resident has the ability to take advantage of the tax benefits that Congress intended 529 plans to provide without having to pay high fees to enjoy any in-state tax deduction.

Testimony of Diana F. Cantor before the House Committee on Financial Services, Subcommittee on Capital Markets, Insurance and Government Sponsored Enterprises

June 2, 2004
10:00 a.m.

Introduction

Mr. Chairman, Ranking Member Kanjorski, and Members of the Committee, my name is Diana Cantor. I am the Executive Director of the Virginia College Savings Plan and Chair of the College Savings Plans Network ("CSPN"). CSPN, an affiliate of the National Association of State Treasurers, has represented the interests of state-operated Section 529 college savings and prepaid tuition plans since 1991. The primary mission of the Network is to encourage families to save for college. To accomplish its mission, the College Savings Plans Network acts as a clearinghouse for sharing information among programs and is involved in federal activities and legislation affecting state programs. CSPN welcomes the opportunity to assist in making Section 529 programs more user-friendly and accessible for consumers.

The cost of attending college, whether public or private, continues to rise steadily. In order to send their children to college, American families increasingly rely upon debt to meet the rising cost of a higher education. According to the College Board's *Trends in College Pricing 2003*, average annual tuition and fees at a public four-year college in current dollars has increased from $617 to $4,694 since 1976, an increase of 761 percent. Also according to College Board data, the share of household income required to cover average college costs for middle-income families reached 19 percent in 2003-04, and 71 percent for low-income families.

Despite the cost, the value of a college education is undeniable, and is something all American families wish for their children. In monetary terms, median annual earnings for year-round, full-time workers with bachelor's degrees are about 60 percent higher than earnings for those with only a high school diploma. This income gap, over a lifetime, exceeds $1,000,000. As the College Board concludes, "While the cost of college may be imposing to many families, the cost associated with **not** going to college is likely to be much greater." [1]

Families have increasingly turned to debt to finance college costs. The 2002 National Student Loan Survey indicates that since 1997, the growth in average debt for undergraduates attending public institutions is 57 percent, for an average debt amount of $18,900 for graduating students. Even more troublesome is the reliance on credit card debt to finance higher education costs, with an average credit card debt of $3,400 among graduates who report using this means of financing college costs.[2]

Section 529 State College Savings Plans Promote Savings

The best answer to rising college costs is to encourage families to save in advance. The low savings rate in the United States is well documented. The success of the 529 Plans clearly indicates that when tax incentives are provided in a savings vehicle, families are encouraged to save for a specific purpose—their children's college education.

The states began creating prepaid tuition and savings trust plans more than a decade ago to help families cope with spiraling tuition costs. The theory has worked -- give families a tax-advantaged, disciplined, safe way to save for college expenses, and they will use it.

In 1996, there was uncertainty over the federal tax treatment of these new, innovative programs. The states asked Congress to step in and confirm that, as state instrumentalities, these savings plans could not be taxed by the federal government. Thus Section 529 of the Internal Revenue Code was born, and the states' college savings plans became known as Section 529 plans.

There are two types of Section 529 plans—prepaid and savings. Prepaid plans are similar to a defined benefit pension plan, where the family is purchasing a defined amount of tuition—either years or credits. Savings trusts are more analogous to defined contribution plans. Families can save in a variety of investment options, including equity and fixed income mutual funds, actively managed accounts, money market and stable value funds. The plans encourage early college savings and

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[1] Data from The College Board *Trends in College Pricing 2003.*

promote future access to higher education. Families participating in the programs save specifically for college where otherwise they may not set aside money for this purpose. The programs, through their marketing efforts, draw attention to the need to save for college and help many families take that first, all-important step of beginning to save.

It is not uncommon to open a magazine or newspaper on an almost daily basis and find an article about the phenomenal growth in these plans. The unparalleled tax advantages in Section 529 plans have fueled this growth. They include tax-free growth, current tax-free distributions for college expenses and, in some states, a state tax deduction for contributions. These plans are meeting a need that perhaps no one knew was so compelling--the opportunity to save for an expense that dwarfs virtually any other cost a family will need to prepare for--a college education for their children.

State college savings programs have achieved tremendous success. With the enactment of the Economic Growth and Tax Relief Reconciliation Act, the number of children participating in the programs has skyrocketed. Every state in the nation, plus the District of Columbia, now has at least one Section 529 savings option designed to meet the particular circumstances and policy goals of their states.

Many states offer age-based portfolios that automatically shift to a more conservative investment mix as the beneficiary approaches college age. States are also able to offer their participants an opportunity to invest in funds that may otherwise be unavailable to them due to high minimum investment requirements. Consumers also benefit from investment strategy decisions and manager selections made by state investment advisory commissions and other professionals who are charged with choosing investment funds and managers for the plans. Savings plans typically do not have age or residency requirements, as is common with prepaid tuition plans, so participants are free to choose the plan that best meets their needs.

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[2] Data from *College on Credit: How Borrowers Perceive Their Education Debt. Results of the 2002 National Loan Survey*, by Dr. Sandy Baum and Marie O'Malley, February 6, 2003.

Response to Questions Raised

With assets topping $50 billion nationally, these plans represent a significant pool of assets that have received increasing attention. The Securities and Exchange Commission, in response to an inquiry from Chairman Oxley, recently announced the creation of a Section 529 task force to review, among other things, disclosure and fee issues. Questions have been raised as to why our programs may look different from state to state. Our feeling, as state administrators, is that the unique features of our plans provide their prime attraction—the ability of each state to craft a program that best suits its citizens' needs and furthers that state's higher education policy.

In reaction to the recent emphasis on disclosure and transparency, the College Savings Plans Network has undertaken an effort to create voluntary disclosure principles. These principles were adopted in draft form last week at the Network's annual meeting. The goal of the principles is to provide a framework for disclosure so that an investor can easily understand his or her own state plan as well as compare Section 529 plans on an apples-to-apples basis. The principles establish a framework for disclosure, including general matters such as how frequently offering materials are to be updated. More specifically, the principles specify information that should be prominently stated, such as the lack of any state guarantee, the need to consider state tax treatment and other benefits, and the availability of other state 529 programs. The principles also provide tables and charts to provide clear, concise and consistent descriptions of fees, expenses and investment performance.

Fees will continue to vary among these plans, as fees differ among all types of investment options. Consumers do not expect to pay the same fees for a completely passive large-cap index fund as they do for an actively managed international equity fund. Nor do they expect to pay the same for a direct-sold investment as they do for a broker-sold product. But the intent of the disclosure guidelines is to make comparing the same types of plans easier.

Another initiative of the Network is to continue improving its website so that consumers will be able to access primary information about all Section 529 plans directly without having to go to each state's website. The goal is to provide a clearinghouse where a consumer can compare fees, investment options and basic offering materials in a convenient, accessible, independent format that is not associated with any one state or plan.

State Oversight

In the post-Enron environment, and in the wake of the recent mutual fund scandals, state oversight of their 529 plans provides an additional layer of accountability and protection for participants in these plans. In fact, as reported in the *Wall Street Journal* on April 15th of this year, states have already reacted to the current environment by expanding investment options, adding low-cost funds, and lowering fees. For example, Ohio, Louisiana and Wisconsin have recently added index funds to their plans. Oregon also terminated a manager after reports of potential wrongdoing surfaced. Several other states have lowered fees and are continuing to add additional managers to their investment options.

As creatures of state law, Section 529 plans are subject to multiple levels of oversight that help protect the programs' participants. Each state is governed by its own administrative procedure laws, procurement laws, ethics and conflict of interest statutes, and freedom of information or government in the sunshine acts. The plans are administered by state boards, authorities, or trusts. Executive committees or trustees, subject to specific qualification requirements, are responsible for the overall direction of the programs. State oversight boards are generally comprised of officials from the state legislature, executive branch, higher education authority, or from financial institutions and the public.

By statute or regulation, the operating authorities are required to follow prudent person standards in selecting and retaining funds or managers. All of the programs are subject to financial audit and reporting requirements. Audits may be conducted internally, by legislative oversight committees, or by external auditors. Audit reports generally are required to be distributed to the state legislature, the governor and other executive branch officials, and are available to the public.

Conclusion

Promoting greater access to higher education and encouraging savings over debt is sound public policy. The existing state college savings programs promote these goals and reduce the need for financial aid and student loans. These programs enable and encourage more young Americans to go to college and secure higher paying positions, providing a better-educated workforce for our nation. Mr. Chairman, these programs are working.

Let us not lose sight of the benefits these plans have already provided to the more than 400,000 students nationwide who have used these accounts to pay for college. Another 6 million children are waiting to use their accounts when they go to college. The states created these unique college savings programs long before Section 529 was first codified in 1996 in an effort to help their residents save for their children's education and to create a workforce prepared for the future. Section 529 Plans continue to provide families nationwide with innovative, low cost and high quality investment opportunities to save for college.

In closing, Mr. Chairman, Section 529 plans are flourishing and families are using these plans in record numbers to save for their children's future. Congress' mission in creating 529 plans is being accomplished. We, along with our partners in the financial services industry, will work together to continue to improve these plans and to serve America's families—and our most important customers—America's children.

The powerful message these plans send to our children—that a higher education is not only worth saving for but worth budgeting for and sacrificing for—is one they will carry with them throughout their lives.

Thank you again, Mr. Chairman, Ranking Member Kanjorski, and Members of the Committee, for your support of the state college savings programs and the millions of families across America who participate in them and have the security of knowing they are taking concrete steps to prepare for the future. We look forward to working with you and your Committee to continue to provide the best college savings options available. I would be pleased to answer any questions.

College Savings Plans Network

Program Statistics

Reporting date: March 31, 2004

State or other territory	Value of Actual Funds	Total Number of Accounts	Total Distributions	Beneficiaries / Accounts with Distributions	Date of Inception
Alabama Prepaid	$530,000,000	69,570	$158,046,327	15,169	1990
Alabama Savings	$203,286,920	26,987	$2,658,166	...	June-02
Alaska	$1,124,831,384	131,172	$50,765,097	...	1991
Arizona	$210,738,119	37,833	$1,816,556	1,964	June-99
Arkansas	$143,263,476	12,884	...	...	Dec-99
California	$1,074,345,926	172,709	$17,143,131	1,735	Oct-99
Colorado Prepaid	$41,300,000	14,497	$59,690,296	1,002	Sept-97
Colorado Savings	$1,452,846,169	196,268	$94,790,529	...	Sept-97
Connecticut	$449,017,627	46,569	$16,182,082	1,037	Dec-97
Delaware	$186,000,000	18,750	$11,100,000	1,473	July-98
Florida Prepaid	$4,266,748,136	973,690	$553,954,186	119,657	1988
Florida Savings	$31,585,479	12,989	$274,284	171	Fall 2002
Georgia	$158,736,019	41,711	$826,831	177	Apr-02
Hawaii	$18,619,267	2,241	$686,373	78	Apr-02
Idaho	$44,535,237	10,667	$7,325,040	5,932	Mar-01
Illinois Savings	$987,728,125	100,580	$70,809,788	...	Mar-00
Illinois Prepaid	$425,766,573	40,732	$6,614,283	1,057	Oct-98
Indiana	$231,536,600	43,996	$13,649,645	3,186	1997
Iowa	$779,816,842	88,071	$26,075,654	3,042	Sept-98
Kansas	$666,754,786	69,781	$31,929,566	3,929	July-00
Kentucky Prepaid	$61,449,000	7,044	0	0	Oct-01
Kentucky Savings	$50,334,056	13,635	$4,119,469	688	1990
Louisiana	$43,738,277	14,519	$2,463,313	559	July-97
Maine	$2,377,982,907	138,780	$261,038,372	16,951	Aug-99
Maryland Prepaid	$233,700,587	23,548	$6,151,222	1,298	Apr-98
Maryland Savings	$518,678,273	76,534	$20,076,110	2,413	Dec-01
Massachusetts Prepaid	$98,000,000	35,888	$22,000,000	6,000	1995
Massachusetts Savings	$1,270,000,000	97,250	$66,000,000	5,806	Mar-99
Michigan Prepaid	$961,497,771	74,885	$461,674,500	12,800	1988
Michigan Savings	$659,958,870	139,034	$16,741,692	1,927	2001
Minnesota	$221,031,468	45,923	$3,991,717	400	Sept-01
Mississippi Prepaid	$135,544,403	19,355	$11,161,177	1,818	1997
Mississippi Savings	$29,806,619	6,211	$2,056,266	174	Mar-01
Missouri	$507,374,345	85,291	$30,252,723	3,022	Nov-99
Montana	$106,300,000	6,858	$4,430,175	1,000	1998
Nebraska	$712,093,630	94,029	$5,442,828	3,009	Jan-01
Nevada Prepaid	$61,898,611	10,330	$401,482	271	Oct-98
Nevada Savings	$714,203,583	113,824	$6,221,538	...	Oct-01
New Hampshire	$3,110,000,000	308,613	...	...	July-98
New Jersey	$406,745,945	62,680	...	...	Aug-98

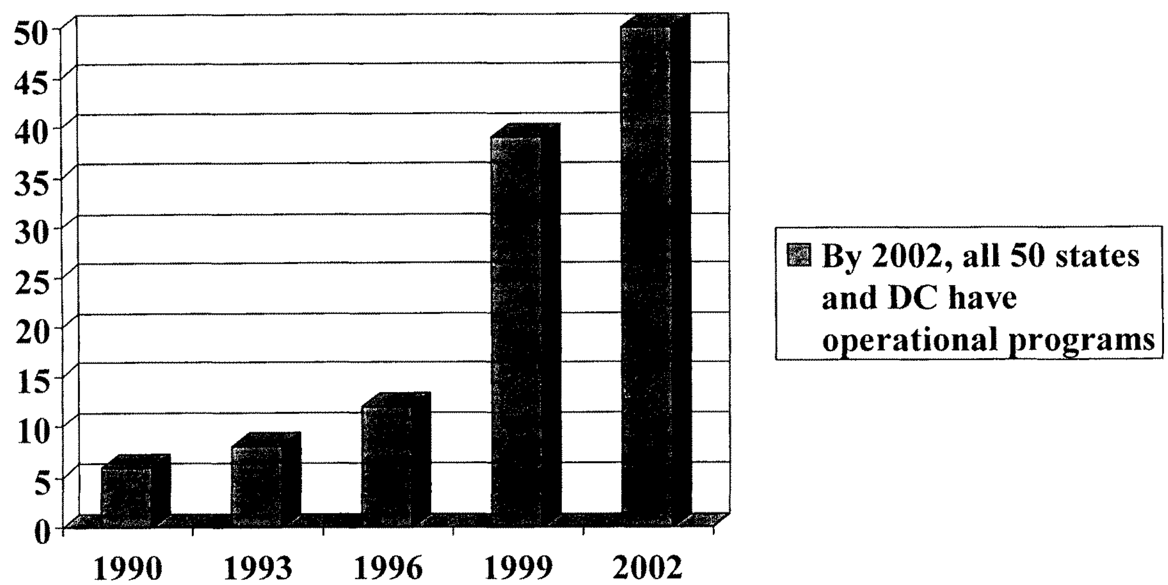
College Savings Plans Network

Program Statistics

Reporting date: March 31, 2004

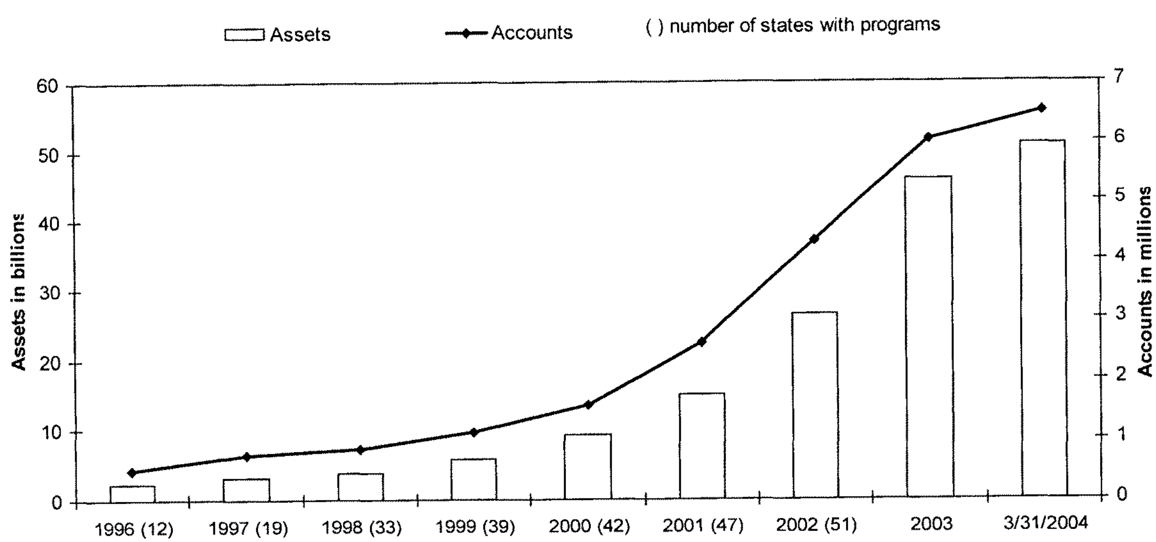
State or other territory	Value of Actual Funds	Total Number of Accounts	Total Distributions	Beneficiaries / Accounts with Distributions	Date of Inception
New Mexico Prepaid	$384,548	110	$27,848	7	Sept-00
New Mexico Savings	$812,731,871	114,328	$20,365,697	4,622	Sept-00
New York	$2,623,099,434	291,174	$203,758,398	21,256	Sept-98
North Carolina	$145,303,266	17,301	$5,460,964	1,847	June-98
North Dakota	$196,344,128	17,996	$14,370,444	1,702	Sept-01
Ohio Guaranteed Fund	$859,650,334	131,185	$177,840,887	26,181	1989
Ohio Variable Funds	$2,979,605,819	506,411	$429,376,962	44,857	2000
Oklahoma	$82,766,382	27,335	$2,629,751	605	Apr-00
Oregon	$285,834,406	49,727	$13,706,189	...	Jan-01
PA Guaranteed Savings Plan	$835,000,000	108,616	$93,600,000	23,059	1993
Pennsylvania Investment Plan	$122,000,000	12,820	$1,170,000	207	July-02
Rhode Island	$4,562,271,268	421,799	$306,522,987	15,824	Sept-98
South Carolina Prepaid	$84,200,617	6,506	$1,662,425	250	Sept-98
South Carolina Savings	$287,003,571	28,241	$635,097	214	Mar-02
South Dakota	$201,924,059	20,652	$2,066,286	230	May-02
Tennessee Prepaid	$48,233,036	8,248	$4,326,293	793	1997
Tennessee Savings	$17,266,095	3,353	$281,865	46	2000
Texas Prepaid	$1,299,964,261	158,434	$105,572,085	15,606	1996
Texas Savings	$68,564,934	10,426	$928,631	197	Sept-02
Utah	$674,318,912	43,550	$7,080,735	718	1996
Vermont	$30,362,275	3,927	$606,133	79	Dec-99
Virginia Prepaid	$786,819,990	67,907	$21,513,736	6,987	1996
Virginia Savings	$6,776,560,621	694,075	...	...	Dec-99
Washington	$373,265,023	44,230	$7,522,369	1,465	1998
West Virginia Prepaid	$82,300,063	9,737	$3,652,334	202	Oct-98
West Virginia Savings	$323,562,309	42,272	$4,686,697	2,618	Feb-02
Wisconsin	$1,166,722,871	178,081	$137,813,537	...	1997
Wyoming	$18,707,447	1,839	...	...	May-00
District of Columbia	$25,931,255	3,645	$726,852	154	Nov-02
Total:	$51,078,493,825	6,509,853	$3,616,465,620	387,471	

Development of 529 plans by states



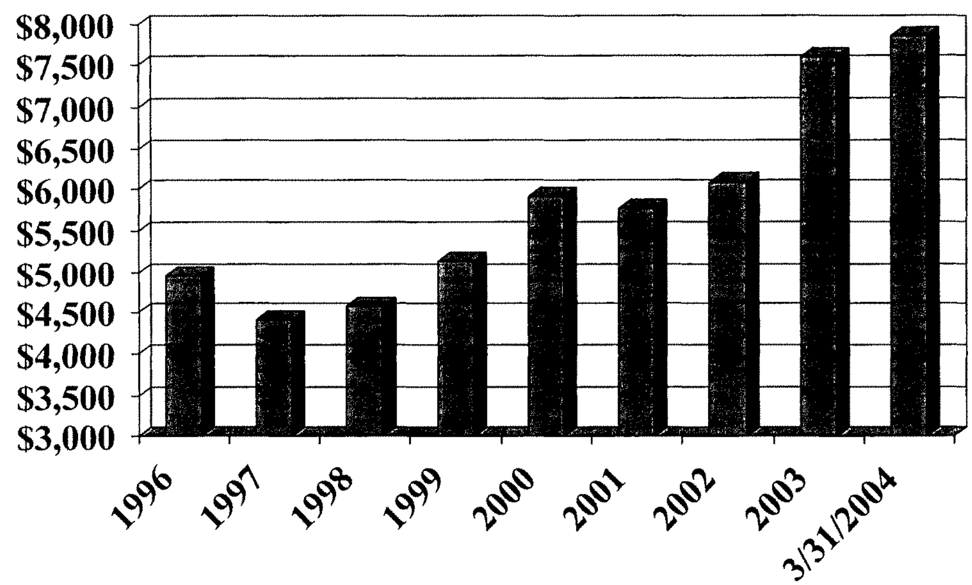
Growth In 529 Plans Nationally

(Year end data except where indicated)



Section 529 plan
Average Account Size

(Year end data except where indicated)



STATEMENT OF

MARC E. LACKRITZ
PRESIDENT
SECURITIES INDUSTRY ASSOCIATION

before the

HOUSE FINANCIAL SERVICES COMMITTEE
SUBCOMMITTEE ON CAPITAL MARKETS, INSURANCE AND GOVERNMENT SPONSORED ENTERPRISES

"Investing for the Future: 529 State Tuition Savings Plans"

Chairman Baker, Ranking Member Kanjorski and members of the subcommittee, I am Marc E. Lackritz, President of the Securities Industry Association.[1] We commend you for holding this hearing on the importance of 529 state tuition savings plans in helping American families save for post-secondary education.

As financial intermediaries and providers of investment advice, our member-firms are deeply committed to reviving a national culture of saving, particularly among the nation's youth. We have worked hard to educate and encourage both students and parents to invest regularly in a product with marginal risk to help foster a renewed sense of personal responsibility. One such product – Section 529 education plans – offers some of the best benefits for saving for college. Our members are actively involved in all phases of the management and marketing of 529 plans because these plans have easier

[1] The Securities Industry Association, established in 1972 through the merger of the Association of Stock Exchange Firms and the Investment Banker's Association, brings together the shared interests of nearly 600 securities firms to accomplish common goals. SIA member-firms (including investment banks, broker-dealers, and mutual fund companies) are active in all U.S. and foreign markets and in all phases of corporate and public finance. According to the Bureau of Labor Statistics, the U.S. securities industry employs 780,000 individuals. Industry personnel manage the accounts of nearly 93-million investors directly and indirectly through corporate, thrift and pension plans. In 2003, the industry generated an estimated $209 billion in domestic revenue and $278 billion in global revenues. (More information about SIA is available on its home page: www.sia.com).

eligibility and contribution requirements than certain other investment options, making them accessible to far more families and people.[2]

American families need help to meet the daunting challenge of financing ever-increasing post-secondary education costs. According to the College Board, in the 10-year period ending 2003-04, average tuition costs rose 47 percent at public institutions and 42 percent at private institutions.[3] The cost of four years of college in 2003 was nearly $43,000 for tuition, fees, room and board at a public college and more than $107,000 at private schools. As costs increase, parents and their children increasingly have relied on loans to finance education. In the 2000-01 academic year, loans comprised about 58 percent of all student aid.

History, Growth, and Regulation of 529 Plans

In recognition of the important policy goal of helping American families cope with the growing burden of college costs, many states pioneered the creation of dedicated tuition plans in the 1980s. The plans permitted residents to contribute to a trust to lock-in costs of future tuition payments. The federal taxation of the contributions and earnings, however, was uncertain during the early years of the plans' existence. To address that uncertainty, Congress approved an amendment to the tax code (Section 529 of the Internal Revenue Code) in 1996 to exempt state programs from federal income taxes on the earnings until the funds were distributed. In addition, the statute addressed the gift tax treatment of the funds. Congress amended Section 529 again in 1997 to include room

[2] Coverdell education savings accounts (ESAs), for example, are limited by the amount of earned income and are restricted to a $2,000 annual contribution. Uniform Gift to Minors Act (UGMA) and Uniform Transfer to Minors Act (UTMA) accounts enjoy federal tax advantages, but have potential drawbacks, depending on financial circumstances and goals.
[3] The College Board is a national, nonprofit membership association of more than 4,300 schools, colleges, universities and other educational organizations. Trends in College Pricing 2003, p. 5.

and board expenses and additional relief in the area of gift and estate taxes. The most significant, beneficial change to Section 529 plans, however, came in 2001 when Congress authorized the tax-free treatment of distributions used for educational purposes as part of the *Economic Growth and Tax Relief Reconciliation Act of 2001* (EGTRRA).

The enhanced federal tax benefit instantly increased the popularity of Section 529 plans. More than $40 billion is now invested in 529 programs,[4] nearly 13 times more than the approximately $3.1 billion invested in 2000 (the year prior to enactment of EGTRRA).[5] The average 529-account balance is now about $8,200,[6] and between 7-8 percent of families with children under 18 own a 529 savings plan.[7] Research shows that 63 percent of accounts were opened in 2001 or later,[8] indicating that participation and account balances will undoubtedly continue to rise as individuals become more aware of the tax benefits of the plan. Indeed, if a family contributed $2,000 annually to a 529 account for 18 years (assuming an 8 percent rate of return) the family would have saved nearly $75,000 for college – an amount that would meet the requirements of most four-year public institutions across the country.[9] Under the same scenario, a taxable mutual fund investor who pays capital gains taxes at a marginal rate of 15 percent would have accumulated only $66,706, or 12.3 percent less than the 529 plan investor.[10] The favored tax treatment of 529 plans not only enhances returns, but also helps assure the funds will

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[4] Financial Research Corporation, Quarterly Update, April 2004.
[5] Cerulli Associates, Presentation by Luis Fleites, SIA 529 Plans Conference, January 23, 2003.
[6] Financial Research Corporation, Quarterly Update, April 2004.
[7] Cerulli Associates Presentation and Profile of Households Saving for College; Investment Company Institute Research Series, Fall 2003, p. 43.
[8] Profile of Households Saving for College, Investment Company Institute Research Series, Fall 2003, p. 43.
[9] Calculator provided by www.smartmoney.com/college/investing/index.cfm7.story=529calc: The 529 College-Savings Plan Estimator, May 19, 2004.
[10] www.smartmoney.com.

be there when needed for college by making it less attractive to withdraw them for other purposes.

Each individual state elects to establish or sponsor a 529 program. Without the state's involvement, 529 savings plans would not exist. States either manage the plan on their own, or select an outside manager, usually a brokerage firm, mutual fund company, or insurance company. States approve selection of investment options, administration issues, and fees. States usually approve the methods of distribution both in-state and nationally, and broker-dealers that distribute 529 plans must also coordinate with the states to negotiate selling agreements and produce marketing and other program literature. Tax treatment of 529 plans is subject to both federal and state law, and the Securities and Exchange Commission (SEC) and the Municipal Securities Rulemaking Board (MSRB) oversee the broker-dealers and investment advisers who distribute the plans.

The MSRB has released extensive guidance on the sale of 529 plans, including the requirement to disclose the potential of a home-state tax benefit, suitability requirements, and advertising of 529 plans. MSRB rules applicable to 529 plans include the following:

- Registration and qualification (Rules A-12, A-14, G-2, and G-3);
- Advertising (Rule G-21);
- Recommendations and suitability determinations on the purchase or sale of 529 plans and disclosure of state tax implications (MSRB Rules G-17 and G-19);
- Prices and commissions (MSRB Rule G-30);

- Providing new customers with a copy of the official statement (MSRB Rule G-32);
- Political contributions (MSRB Rules G-37 and G-38) from municipal security dealer firms must be tracked and disclosed.

Improving 529 Plans

Make the Tax-Free Treatment of Distributions Permanent

The short-term success in expanding 529 plans resulting from enhanced federal tax advantages could be undermined by remaining uncertainties or barriers to investing in 529 plans. Probably the greatest inhibitor to investing in 529 plans is the uncertainty that the tax incentive will be renewed after it sunsets on December 31, 2010. If Congress does not extend the policy of tax-free withdrawals on 529 plans, then beginning after December 31, 2010, earnings in the account will be taxed at the recipient's rate as they are withdrawn.[11] Clearly, families with children close to entering post-secondary institutions do not find 529 plans as attractive as saving in taxable accounts or Coverdell Education Savings Accounts. Congress should make the tax-free treatment of distributions permanent as soon as possible to ensure that participants can invest in 529 plans with complete certainty that the tax incentive will exist when they make their withdrawals.

Create Tax Parity Among States

Creating tax parity among all 50 states would significantly increase participation and lower costs for investors. Currently, more than 50 percent of the state plans have different tax rates and policies in place. Twenty-four states provide an up-front deduction for contributions into the home-state plan. Five states do not conform to the federal tax

[11] In most cases a higher rate than if invested in a taxable account subject to the capital gains tax rate.

exemption for distributions and tax distributions from other state plans, even when used for educational expenses. Seven states require residents to add back to their state taxable income previous deductions on contributions if they choose to roll over their 529 accounts to another state. (A map showing the different tax treatment of these investments by state is attached as Appendix I). At the very least, families and their financial advisers face a stiff challenge to determine the value of a particular state's tax benefit when placed in the proper context of other investment considerations.

In addition, disparate tax treatment has hurt the potential for employers to provide their employees with a workplace 529-plan option. An employer with a national presence may find it difficult to select a small number of state plans for its employees because of the concern that employees in some states will not be able to take advantage of a home-state plan. The employer-based model has worked well in expanding the reach of retirement plans, and so greater encouragement of this model for 529 accounts could substantially increase education savings.

SIA and our member-firms are actively working at the state level to achieve tax parity across the board. We have had some success, although current state fiscal constraints are hampering broader progress. We will continue to aggressively advocate tax parity, and would welcome any help or support from the subcommittee in this area, because we believe a level playing field for 529 plan investors would increase consumer choice, create additional competition, and lower costs.

Improve Disclosure

We also believe that clearer, more complete, and more understandable disclosure of fee- and investment-related information would help investors make relevant, consistent comparisons among different types of plans. Currently, marketing material for investment-related disclosure of mutual funds purchased through a broker-dealer must comply with the NASD advertising rules. The SEC has noted that about 75 percent of 529 plans are sold through brokers, and so generally, investment-related disclosure in broker advertising is consistent across 529 plans.[12] Currently, other fees that have an impact on overall performance, such as annual maintenance fees, are not required to be part of investment-related disclosures in offering materials. We believe that all fees should be transparent and should be included in investment performance information. A gap that could be filled is a more standardized location for information about fees. SIA has worked with the states as they developed the draft disclosure guidelines that will standardize the type of information as well as its location for investors.

Similarly, we support improved disclosures of potential home-state tax benefits. Regulators and state-plan sponsors have recently questioned why investors would forego a tax deduction for investing in their home-state plan in favor of an out-of-state plan.[13] Under the MSRB guidelines, broker-dealers must provide disclosures to clients of any potential home-state tax benefit. Brokers may rely on the 529-program description as long as it discloses that a home-state tax benefit may exist. However, the location of the notice in the description is not standard among plans. We believe a statement on the first page of the program description would help investors and financial advisers give proper consideration to the state tax implications. That statement, however, should indicate that investors should take into account that tax treatment is only one of many features that

[12] See letter from Chairman William H. Donaldson, Securities & Exchange Commission, to Chairman Michael. G. Oxley, House Financial Services Committee, March 12, 2004.
[13] An Investment Company Institute survey recently found that only 20 percent of investors had purchased an out-of-state plan, while 80 percent of households owned an in-state plan.

should be weighed in selecting a 529 plan. Moreover, we support a requirement that 529 program applications include an acknowledgement that the investor understands there may be state-tax implications. Since program managers, not the advisers, develop the application forms, this acknowledgement should be in standardized language to accommodate plans that are sold nationally.

Ensure Suitability

The securities laws mandate that broker-dealers ensure that products they sell to their clients are "suitable" for them. The variety of different 529 plans as well as other education savings vehicles can make choosing the right one a difficult and confusing exercise for investors. Registered representatives and financial advisers help investors make the right investment decisions by encouraging their clients to consider the following factors, among others, when reviewing college savings plan options:

- 529 as an alternative. Do any of the other tax-advantaged vehicles make sense for the investor?
- Evaluate investment options. Are the options age-based, static, or individual portfolios? How has the investment or investment manager performed in comparison to peers? What is the length of contract with the program manager? What is the minimum contribution? Is there a state guarantee? Other principal protection options? How do the potential options compliment the investor's overall investment goals and time horizon?
- Compare fees and expenses. Do fees vary whether or not the investor is a state resident? How do fees impact the overall performance? What other expenses may not be included in the management fees?

- Restrictions. Residency requirements? Can non-owners contribute to the account? Is there a state-income tax deduction? Is the value of the state tax benefit outweighed by other factors?[14] How are rollovers to another state treated if the investor takes advantage of an in-state deduction? Are there other benefits such as state financial aid considerations? Distribution options? Does the plan specify a date at which withdrawals must begin?

Focus on Investor Education

Investors continue to state that they lack knowledge about investing and that they want the securities industry's help in educating them.[15] As a result, SIA recently has strengthened our investor education programs. We have published new investor education brochures available in print or online to supplement our flagship primer – *Your Guide to Understanding Investing*, an easy-to-read handbook that covers the basics of investing. We recently updated our *Guide to Understanding 529 Plans* to include a list of questions a 529 investor should consider before investing in a particular plan. The brochure is available free of charge to the public. In addition, our highly rated investor education website, www.pathtoinvesting.org, includes information on 529 plans, as well as opportunities to invest a hypothetical account.

Many other companies have developed search tools to assist do-it-yourself investors as well as advisers in comparing the advantages and disadvantages of the various 529 plan offerings.[16]

[14] Depending on the amount of the up-front deduction and the state-income tax rate, the value could be as low as $99 in Rhode Island (joint tax return with top marginal rate of 9.9 percent and limited to $1,000 per tax return) or $1,000 for Mississippi (joint tax return with a top marginal rate of 5 percent limited to $20,000 per tax return).
[15] Annual SIA Investor Survey, November 2003, p. 51.
[16] Some of the offerings include Search529 and Savingforcollege.com – products that are similar to those offered to plan sponsors and advisers who market 401(k) plans.

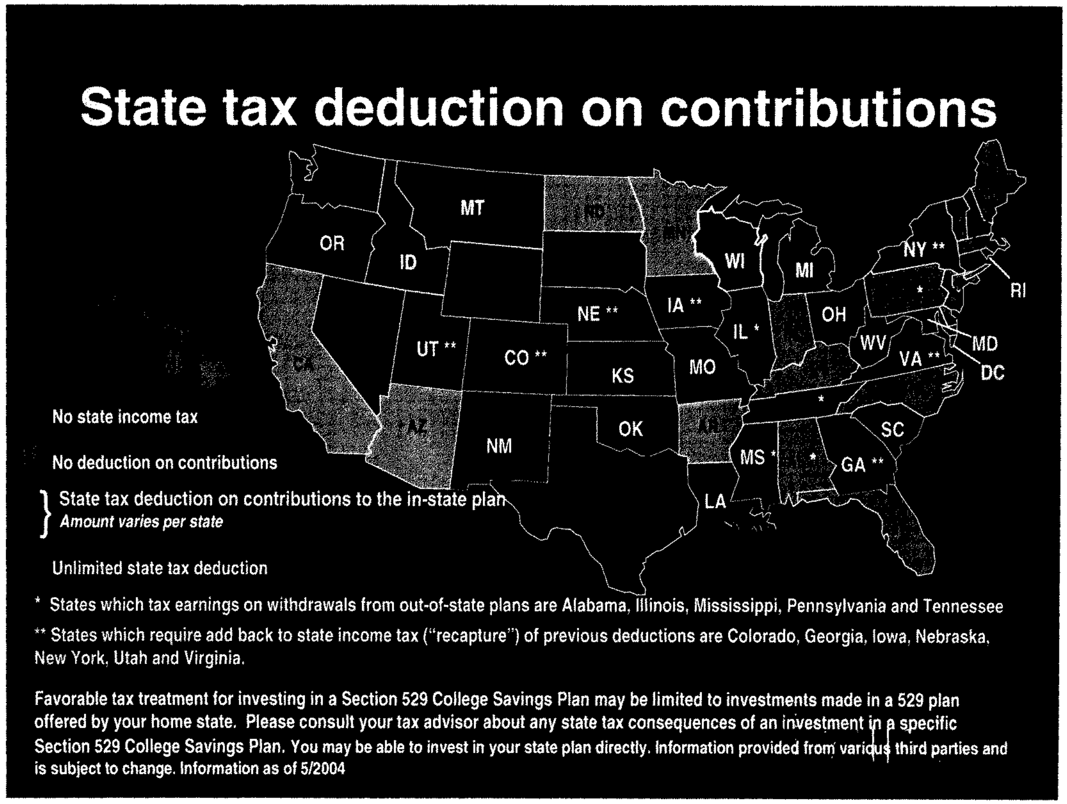
Conclusion

SIA is committed to ensuring that 529 plans remain among the best possible products available for people who need to save for higher education. We have met with members of the 529-task force established by SEC Chairman Donaldson, and we will continue our outreach efforts to promote a greater awareness and understanding of 529 plans. We look forward to working with you, the regulatory agencies, and state officials to make permanent the federal policy of tax-free withdrawals on 529 plans, achieve tax parity among states, improve disclosures, and provide ongoing education on 529 plans and other appropriate investment vehicles. Together we will expand the opportunities for all families to save for their children's educations – the most important investment in our future.

Thank you.

Appendix

Note: On May 18, 2004, the Governor of Tennessee signed into law legislation providing for back-end tax parity. Thus, Tennessee will no longer tax the withdrawals of out-of-state plans.


State tax deduction on contributions
MT
OR
ID
UT **
CO **
NM
NE **
KS
OK
IA **
MO
IL *
WI
MI
OH
WV
VA **
NY **
*
RI
MD
DC
SC
GA **
*
MS *
LA
No state income tax
No deduction on contributions
State tax deduction on contributions to the in-state plan
Amount varies per state
Unlimited state tax deduction
* States which tax earnings on withdrawals from out-of-state plans are Alabama, Illinois, Mississippi, Pennsylvania and Tennessee
** States which require add back to state income tax ("recapture") of previous deductions are Colorado, Georgia, Iowa, Nebraska, New York, Utah and Virginia.
Favorable tax treatment for investing in a Section 529 College Savings Plan may be limited to investments made in a 529 plan offered by your home state. Please consult your tax advisor about any state tax consequences of an investment in a specific Section 529 College Savings Plan. You may be able to invest in your state plan directly. Information provided from various third parties and is subject to change. Information as of 5/2004

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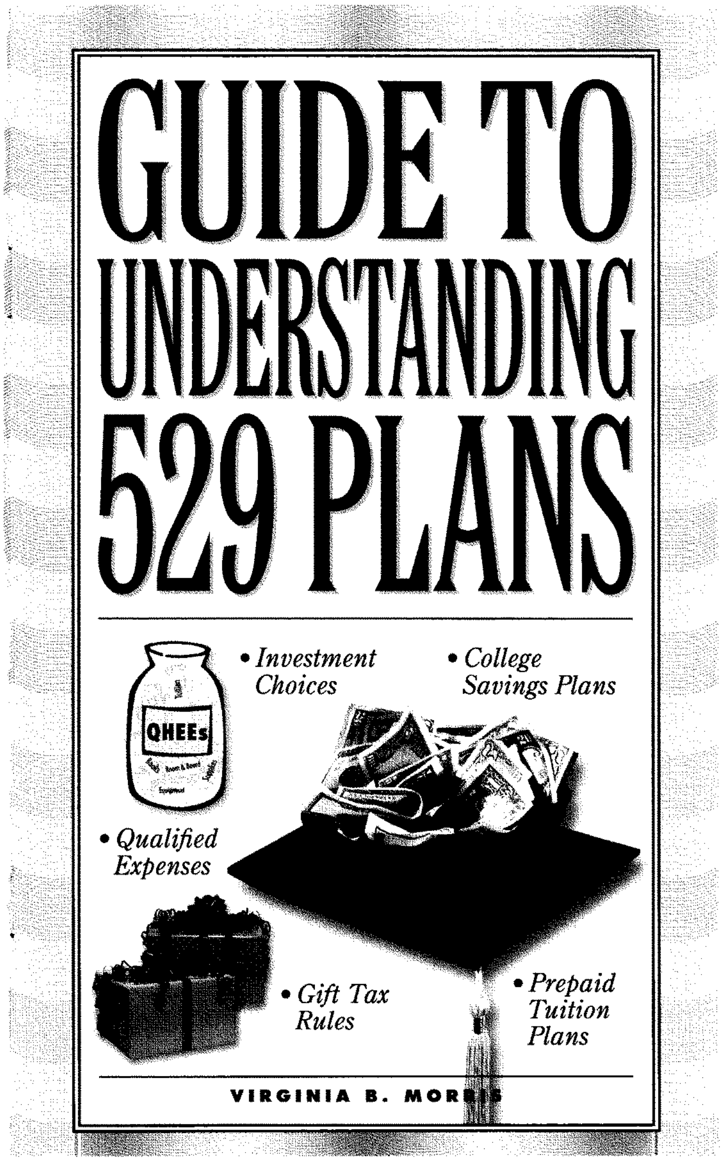

Securities Industry Association

Dear Investor:

Rising tuition costs have greatly increased the challenge of saving for a child's college education. Fortunately, help is available in the form of the Section 529 education savings plan.

Section 529 plans allow investors to save for education costs, while the earnings accumulate on a tax-deferred basis. All earnings are free from federal income tax if used to pay for qualifying education expenses. The plans are available in all 50 states.

Although based on a very straightforward concept, the variety of different types of 529 plans available can make choosing the right one a sometimes difficult and confusing exercise. That is why the Securities Industry Association has made *Guide to Understanding 529 Plans* available.

This guide provides a step-by-step explanation of how 529 plans work, and questions you should ask to find the plan that best suits your needs. *Guide to Understanding 529 Plans* will help you and your investment professional find the plan that's right for you.

Richard E. Thornburgh
Chairman
Securities Industry Association

Securities Industry Association
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GUIDE TO UNDERSTANDING 529 PLANS

CONTENTS

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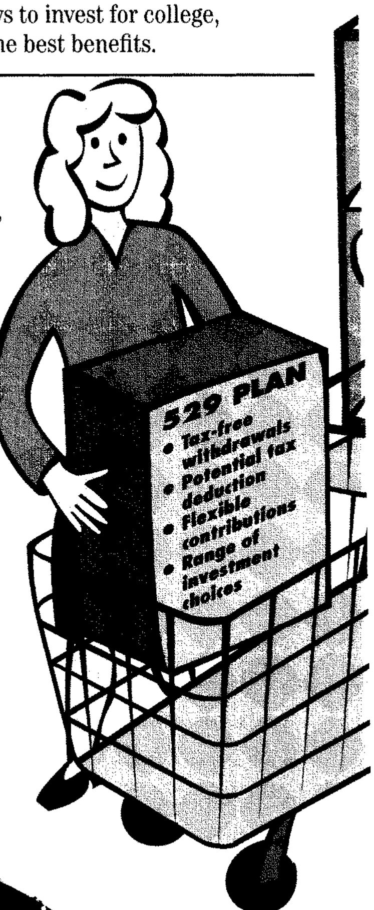
Investing for College

There are many different ways to invest for college, but 529 plans offer some of the best benefits.



As an investment, a college education is nearly guaranteed to be successful. According to the College Board and the US Census Bureau, people with a bachelor's degree earn over 80% more on average than those with only a high school diploma. And, over the course of a lifetime, the earning potential of someone with a college degree exceeds that of someone with just a high school degree by over $1 million. That means two things:

- The high cost of paying for college is more than likely to pay off in the long term
- It could be more costly for your child not to go to college

Unfortunately, though, that doesn't reduce the expense of college bills. The only way to make the cost more manageable is to start saving as far in advance as possible. With some **529 plans**, for example, you can start saving before your child is born by naming yourself as the beneficiary, and then transferring the account to your child when he or she is born.

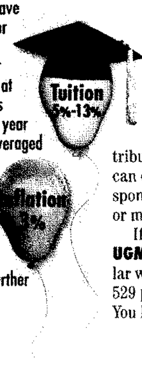
WHY CHOOSE A 529 PLAN?

No one way of investing for college works for everyone, but some investment plans have easier eligibility and contribution requirements, making them accessible to a broader range of people. That's the case with 529 college savings plans. Unlike contributing to a **Coverdell education savings account (ESA)**, you aren't limited by the amount of income you earn, and you aren't restricted to a $2,000 annual contribution. In fact, with a 529 plan, you can contribute up to the limit set by the sponsoring state. That's usually $100,000 or more.

If you're comparing a 529 plan to an **UGMA** or **UTMA** account—another popular way to invest for college—you'll find 529 plans have another major advantage: You keep control of the money in the

BEATING INFLATION

There's a good reason why you have to invest—rather than save—for college: The cost of a college education consistently rises faster than the rate of inflation. Tuition at most colleges and universities has increased from 5% to 13% every year since 1980, while inflation has averaged around 3%. That means that money saved in a regular savings account or money market account, which currently earns between 1.5% and 3% interest, will lose value over the long term, lagging further and further behind the cost of education.



account. Assets held in an UGMA or UTMA account belong to the beneficiary once he or she reaches age 18, 21, or 25, depending on the state where you live.

And, compared to regular taxable investment accounts, 529 plans look especially good. Although you contribute after-tax dollars, any earnings in your plan grow tax deferred and may be withdrawn free of federal income tax for qualified higher education expenses. In some cases, state income tax may apply.

But there's a lot more to know about 529 plans. To get the most from a plan, you'll have to choose the one that you believe will work best for you from among the many 529 plans available. And you have to follow the rules.

BECOME TAX SAVVY

One way to evaluate the variety of investment accounts you can open for college is to consider how taxable accounts, such as UGMAs and UTMAs, differ from 529 plans and ESAs. In the latter accounts, the tax that would normally be due on your earnings each year is deferred until you withdraw money from the account. Then, if you use the money you withdraw to pay for qualified education expenses, you can avoid paying tax altogether.

	Taxable account (taxed at student's rate)	Tax-free account, such as a 529 plan
Amount invested	**$40,000**	**$40,000**
Annual 8% earnings	**$ 3,200**	**$ 3,200**
Tax (10%)	**$ 320**	**0**
Reinvestment	**$42,880**	**$43,200**
After 10 years	**$80,169**	**$86,357**

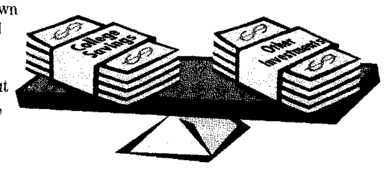
This example is a hypothetical illustration and is not based on the return of any specific plan.

BALANCE YOUR GOALS

Whether or not you decide to use a 529 plan to save for college, there's one thing nearly all experts recommend: Keep your college savings separate from your other investments. That will make it easier for you to track the performance of your savings, and you'll be less tempted to tap into the money for everyday expenses.

But remember the same goes for your other long-term goals, particularly when it comes to retirement savings. It may seem like a good idea to use money you've set aside for retirement to fund your college account, since college has a firm deadline and retirement can be delayed. But, in most cases, it's not worth taking an early withdrawal from your retirement account:

- There's a chance your child will get a scholarship or grant, but no one else is going to fund your retirement
- If you withdraw early, you'll lose the tax advantages that may be part of your retirement plan, and you may have to pay a penalty as well



What Is a 529 Plan?

For your 529 plan to make the grade, you've got to master the basics.

A 529 plan is a state-sponsored investment program designed to ease the burden of paying for college by providing a tax break. By opening a 529 plan, you can contribute money—in regular installments or in lump sums—to an investment account set up for a specific beneficiary. The beneficiary can be anyone—a child, grandchild, cousin, or friend.

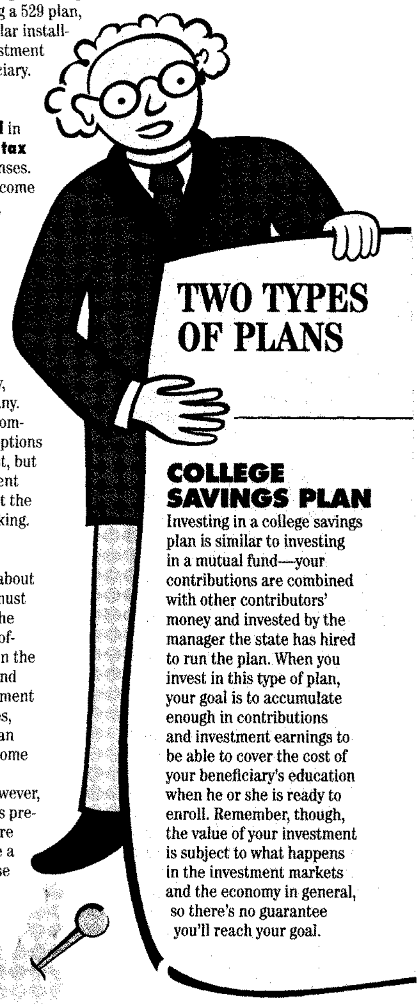
Your money grows **tax deferred** in the 529 plan and can be withdrawn **tax free** for qualified educational expenses. That means you'll owe no federal income tax, and in some cases, no state tax, on withdrawals as long as you use the money to pay the beneficiary's college bills, including tuition, books, and some room and board. Graduate, professional, and technical school expenses also qualify.

Although individual states sponsor 529 savings plans, each plan is managed by a mutual fund company, brokerage firm, or insurance company. The state works together with the company to determine the investment options that will be offered in the plan. Most, but not all, offer three or more investment tracks for you to choose from, to suit the level of risk you feel comfortable taking.

IN AND OUT OF STATE

One of the questions you may have about opening a 529 plan is whether you must live in the state offering the plan. The answer is no. Most states allow out-of-state residents to open an account in the college savings plan they sponsor. And since each plan has different investment options, contribution levels, and fees, you may find that another state's plan suits you better than the one your home state offers.

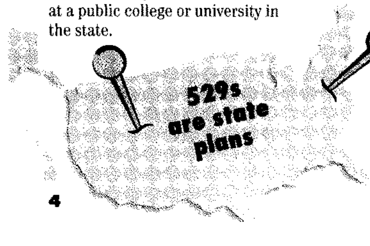
Where you live often matters, however, if you want to participate in a state's prepaid tuition plan. Many states require that either you or the beneficiary be a resident to buy tuition credits for use at a public college or university in the state.



TWO TYPES OF PLANS

COLLEGE SAVINGS PLAN

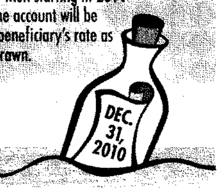
Investing in a college savings plan is similar to investing in a mutual fund—your contributions are combined with other contributors' money and invested by the manager the state has hired to run the plan. When you invest in this type of plan, your goal is to accumulate enough in contributions and investment earnings to be able to cover the cost of your beneficiary's education when he or she is ready to enroll. Remember, though, the value of your investment is subject to what happens in the investment markets and the economy in general, so there's no guarantee you'll reach your goal.

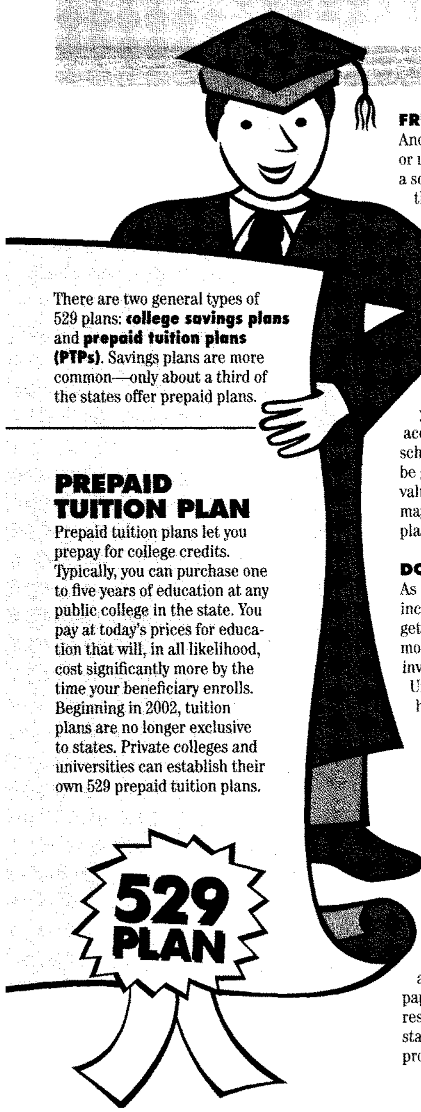


UNDERSTANDING 529 PLANS

INTO THE SUNSET

As the saying goes, good things don't last forever. One thing to keep in mind is that the current tax incentives are scheduled to **sunset**, or end, on December 31, 2010. By that time, Congress will choose whether or not to extend the policy of tax-free withdrawals on 529 plans. If they decide not to, then starting in 2011 earnings in the account will be taxed at the beneficiary's rate as they're withdrawn.





There are two general types of 529 plans: **college savings plans** and **prepaid tuition plans (PTPs)**. Savings plans are more common—only about a third of the states offer prepaid plans.

PREPAID TUITION PLAN

Prepaid tuition plans let you prepay for college credits. Typically, you can purchase one to five years of education at any public college in the state. You pay at today's prices for education that will, in all likelihood, cost significantly more by the time your beneficiary enrolls. Beginning in 2002, tuition plans are no longer exclusive to states. Private colleges and universities can establish their own 529 prepaid tuition plans.

FREEDOM OF CHOICE

Another common question is whether or not your beneficiary must attend a school in the state that sponsors the plan you've chosen. Again, the answer is no. The money you've accumulated in your 529 savings plan can be used at any accredited US college or university, as well as at more than 700 international schools. And, if you've prepaid for credits at a state school through a PTP, you can transfer the value of your account to another state or private school where your beneficiary will be going. But be aware that the full value doesn't always transfer—so you may have to add more than you had planned to cover the full cost.

DO YOUR HOMEWORK

As the popularity of 529 plans increases, the plans themselves are getting more sophisticated. You have more plans to choose from and more investment options within each plan. Under current legislation you also have more control—you can switch investment tracks or roll over your assets from one state's plan to another plan once every 12 months. Being able to improve the performance of your plan is a major advantage, but it means you have a greater responsibility to track your investment.

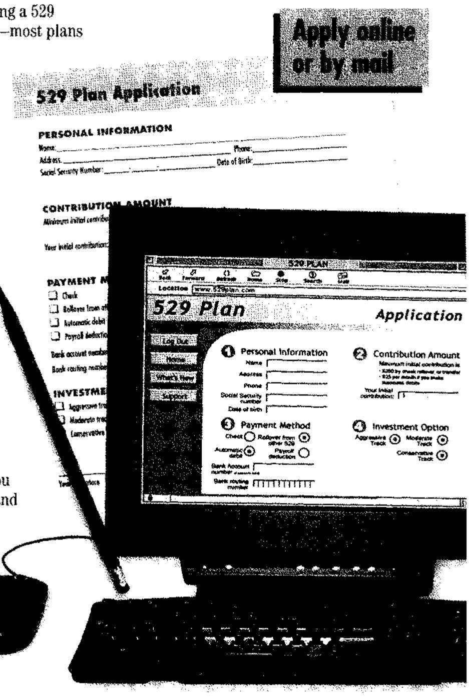
It's critical to examine your plan at least once a year and make sure you know about any changes in the rules. Talking to a knowledgeable financial adviser, reading articles in newspapers and magazines, and doing research on the Web can help you stay on top of your 529 plan and the progress you're making.

Opening a 529 Account

Simple requirements and minimal paperwork mean you won't have to pull an all-nighter to open a 529 plan.

The actual process of opening a 529 account couldn't be easier—most plans simply ask you to complete a brief application and make at least the minimum contribution to open the account. Some plans don't even require any actual paperwork—you can enroll online when you visit the state's 529 plan Web site.

But the simplicity of opening an account doesn't mean you should jump into a 529 blindly. To find the plan that works best for you, you should research the investment options available and the fees involved in several different plans, weighing the advantages and the drawbacks of each one. For example, enrolling in your state's program might let you take a state tax deduction and reduce the amount you pay in management fees, but an out-of-state plan might provide more extensive investment options.



FILLING OUT THE APPLICATION

In addition to those states that offer direct online enrollment, many states let you download their application from the Internet, which you can print, fill out, and send in. For plans that don't offer these options, you can get an application by contacting the investment company or brokerage firm who manages the plan.

All applications ask you to provide some standard personal information. Generally, you'll have to specify:

☑ Name, address, Social Security number, and date of birth for you, your beneficiary, and your successor, who would become the owner of the account upon your death

☑ Amount of initial contribution and schedule for future contributions, if you intend to contribute regularly by month, quarter, or year

☑ Method of payment for initial and future contributions, which, depending on the plan, might include check, money order, automatic debit from bank account, payroll deduction, or rollover from a Coverdell education savings account (ESA), US savings bond, UTMA/UGMA, or other 529 plan

☑ Investment option, which determines how your money will be allocated in the account

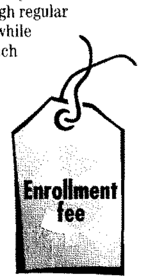
THE COMPANY PLAN

It may be even easier to open an account if your employer offers 529 contributions as a payroll deduction. Before establishing this benefit, the employer decides which state's 529 plan to offer employees. Keep in mind that just because your employer has chosen a plan doesn't necessarily mean it's the best one for you. You should decide on your own whether the investment options, fees, and possible state tax deductions fit with your needs. If you feel you'd be better off with another plan, you're free to enroll on your own.

You should note that unlike 401(k) contributions, which are made with pretax money, contributions to a 529 are made with **after-tax** money. That means making the contribution won't lower the amount on which your income tax is based.

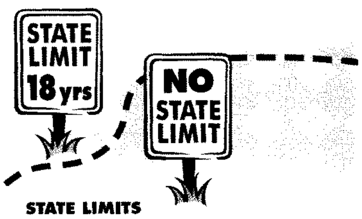
AT LEAST...AT MOST

The investment company managing the state's 529 plan usually determines the **minimum contribution** that participants must make to open an account. The amount varies from state to state—some request as little as $25 (or $15 if you contribute through regular payroll deductions) while others request as much as $1,000. You may also have to pay a one-time **enrollment fee** when you open the account, which typically falls between $10 and $90. Fortunately, many states waive the enrollment fee altogether.



The maximum amount you can put away in a 529 plan also differs from state to state. Some savings plans let you contribute up to $269,000 over the life of the account. But some prepaid tuition plans set the maximum lump-sum contribution as low as $10,000, and others fall somewhere in between.

If $269,000 sounds like a lot to you—it's probably more than tuition alone is likely to cost 18 years from now—remember that money in your 529 account can also be used for books, fees, some room and board, and graduate, professional, or technical school expenses. If you consider the cost of four years at college and then five years of medical school, for example, $269,000 might seem low. Congress establishes what it considers a reasonable contribution limit to prevent people from taking advantage of 529 plans as tax-free shelters.



STATE LIMITS

As you research different 529 plans, you may encounter a few additional restrictions on opening an account. The two most frequent limitations concern the age of the beneficiary and the date that you can open the account.

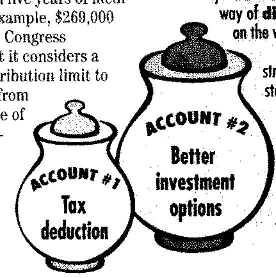
Some states require the beneficiary to be under 18 when you open the account. Others set limits according to the beneficiary's school year—you might not be able to open an account if he or she is above grade 9, 10, or 11. But a large number of states impose no age restrictions at all.

Although most plans let you open a new account at any time during the year, a few plans limit enrollment to a two- or three-month period. It's a good idea to ask in advance to avoid missing the window and having to postpone opening your account.

MULTIPLE ACCOUNTS

There are no restrictions on contributing to more than one 529 plan for a single beneficiary. The only stipulation is that accounts you open outside the state where you live must allow nonresident participants. If you have enough available income, dividing your assets among different plans can be one way of **diversifying** your college savings on the whole.

That can be a particularly effective strategy if your home state offers a state tax deduction on 529 plans. In that case, you might put part of your money into your state's plan to get the tax deduction, and the remainder of your money into a different state's plan to take advantage of investment options that appeal to you more.



Investment Options

Understanding your 529 plan's investment options—and choosing the right one for you—can help you reach your goal.

Evaluating the investment options a plan offers can be the most challenging part of choosing a 529 plan. But having options is a good thing—it means you have more choice in selecting investments that you're comfortable with. That wasn't always the case. When 529 plans were introduced, you had little say in how your money was allocated, and you couldn't change your allocation once you made it.

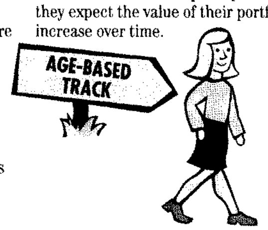
Fortunately, many states now offer three or more different investment tracks for you to choose from, usually based on the level of risk you are willing to take. You may also have a choice between **age-based tracks**, in which the plan manager adjusts the allocation of your investment from aggressive to conservative as your beneficiary nears college age, or **fixed tracks**, in which the allocation stays the same over time.

Recent federal legislation has increased the control you have over your investment. Now you can switch plans once every 12 months if you become unhappy with your plan's performance, without having to change the beneficiary of the account. The IRS has also made it easier to switch the investment track once you've started a plan. In 2001, they notified 529 programs that they could allow participants to change their investment option once a year or if the beneficiary was changed. While that's not a requirement, experts believe that more and more programs will include this provision as a way of attracting participants.

YOUR INVESTING STYLE

You'll have to know your **investing style**, or the amount of risk you feel comfortable taking, to decide which investment track is best for you. There are three general types of investing styles: **conservative**, **moderate**, and **aggressive**.

Conservative investors aim to keep what they have—they avoid risk in order to preserve their **principal**. Moderate investors seek to increase the value of their portfolio by including some risk, but want to avoid suffering major losses from facing too much risk. Aggressive investors strive for growth and high returns by having a high-risk portfolio. Usually, they invest for the long term, so they're willing to ride out potential downturns in the market or loss of some principal because they expect the value of their portfolio to increase over time.



AGE-BASED TRACKS

With many age-based tracks, you'll have to make two different assessments to find the investment option that's right for you. First, you'll have to decide which investing style you want—conservative, moderate, or aggressive. Then, you'll have to calculate the number of years before your beneficiary plans to attend college (current age subtracted from 18) and choose a portfolio that corresponds to that number.

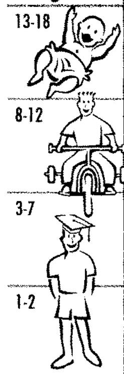
Typically, plans provide a chart that shows how these two key pieces of information are used to determine the allocation of your money across different **asset classes**. Remember, with age-based tracks, the fund manager automatically reallocates your account toward more conservative investments as your beneficiary gets closer to college age.

FIXED TRACKS

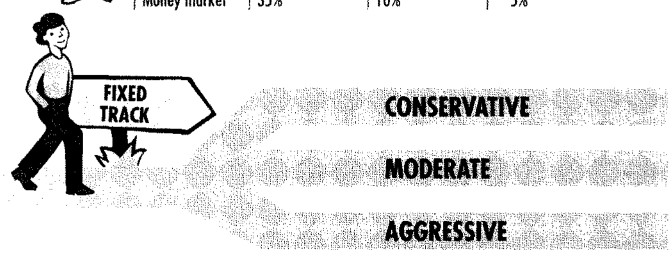
If you choose to invest in a fixed track that your 529 plan offers, your portfolio's risk level doesn't change over time. Fixed tracks tend to be either very aggressive, such as 100% equity funds, or very conservative, such as guaranteed funds, but a few fall in the middle. Common fixed tracks include:

- 100% equity, or stock and stock mutual funds
- 100% fixed-income, 100% bond, or 100% short-term yield
- Stable value, which blends money market and bond funds
- Guaranteed, which promises principal plus a minimum interest rate, such as 3%

SAMPLE AGE-BASED 529 PLAN



Years before college		Conservative track	Moderate track	Aggressive track
13-18	Stock	45%	75%	100%
	Bond	45%	20%	0%
	Money market	10%	5%	0%
8-12	Stock	40%	65%	80%
	Bond	45%	30%	20%
	Money market	15%	5%	0%
3-7	Stock	35%	35%	60%
	Bond	45%	55%	40%
	Money market	20%	10%	0%
1-2	Stock	30%	20%	35%
	Bond	35%	70%	60%
	Money market	35%	10%	5%



STYLE SCENARIOS

Investment styles reflect an overall investment attitude, but for most people, they're also linked to a time schedule.

- **Aggressive:** You open an account for your daughter when she is born, expecting to invest for her college education over the next 18 years. You're willing to let the value of your investment rise and fall in the short term, because you know you won't be withdrawing from the account for a long time.
- **Moderate:** You receive an inheritance and decide to open a 529 account for your 10-year-old nephew. You don't want to lose any of your initial lump sum contribution, but you'd like to see the money grow as much as possible before he goes to school.
- **Conservative:** You plan on going back to graduate school some time in the next five years, so you open a 529 account for yourself with money you've saved. You want to be sure the money you've contributed will be there when you're ready to use it, so you don't want to risk a market downturn.

INVESTMENT RISK

Most states don't insure your investment in a college savings plan against losses or guarantee you'll have the money you need when your beneficiary is ready to enroll. In the rare plan where there is insurance, the state attaches a moral obligation clause to its age-based savings accounts. If the value of your account when you are ready to withdraw is less than the total you put in, the state will replace the amount you lost, so that at least your full contribution is available for withdrawal.

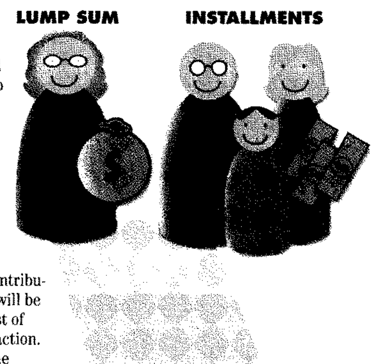
In contrast, many state-sponsored prepaid tuition plans (PTPs) are guaranteed, meaning the tuition credits you purchase will cover the equivalent cost of tuition at an eligible public college or university.

PAST PERFORMANCE

Some experts warn that it's hard to evaluate the investment potential of 529 plans because the plans don't have much of a track record. But while investment potential is an important consideration in choosing a plan, past performance is never a guarantee of future return.

Making Contributions

Putting money in a 529 plan is easy, but you need a strategy to get the most of your contributions.



Almost anyone can open a 529 account, but to take full advantage of the plan, you need a **contribution strategy** for what, where, and when you invest. A strategy will help ensure that the money you put into the 529 will cover a substantial part of the education costs you or your beneficiary will face. And you need a strategy to minimize taxes and avoid penalties and fees.

The best strategy for a young couple on a budget probably isn't the best strategy for a grandparent with significant assets. But these contributors—and other participants too—will be in a better position to make the most of what 529s offer by having a plan of action.

Remember, though, that your time frame, or the number of years before your beneficiary goes to college, determines only one part of your strategy. The rest depends on the terms of the 529 plan you choose. Each plan sets different contribution limits—both maximum and minimum—and different criteria for how and when you make your contributions. Your strategy has to take all these factors into account.

Contribution Limits

CASHING IN

All 529 plans have one critical requirement when it comes to funding your account: They can accept only cash contributions. That doesn't mean you need to send in bills and coins. You can make:

- **Payments by money order, credit card, or check**
- **Electronic contributions through automatic withdrawals from a bank or money market account**

It does mean if some or all of the money you want to invest is tied up in other investments, you'll have to **liquidate**, or sell off, those assets in order to deposit cash. If you liquidate an investment, you run the risk of triggering a **capital gains tax**. That happens when you sell an asset at a higher price than you paid to buy it. The tax is figured on your profit.

Although your contribution strategy may be to avoid as much tax as possible, you may find that paying some capital gains tax now, and having the money to make a lump-sum contribution to a 529 plan, is a good tax strategy as well. For example, if your money is invested in a taxable account, you may calculate that over the long term, the tax-deferred and tax-free advantages of your 529 plan will offset the capital gains tax you might pay when you make the transfer. Before you make a decision like this, talk to a knowledgeable tax adviser about what would work best for you.

LUMP SUM vs. INSTALLMENTS

There's no clear-cut answer to which way it's smarter to contribute to a 529—lump sum or installment. Each option offers advantages and drawbacks.

One advantage of lump-sum contributions is that your account starts with a larger base, which means the potential for faster growth over a long period of time though no growth is guaranteed. But remember that if you contribute more than $11,000 a year per beneficiary—or $55,000 once in five years—you may owe gift tax.

And, depending on your plan, making a large one-year contribution could limit the state tax deduction you may be eligible for. Often, those deductions are capped at

UNDERSTANDING 529 PLANS

WHO CONTRIBUTES, AND HOW?

There's a way for people in every economic bracket and of all different ages to contribute to 529 plans. Here are some examples:

You've recently retired and now you're interested in reducing your estate to avoid estate tax. So you make a lump-sum contribution to your grandchild's 529 account with money from the sale of your home.

You and your husband have a 2-year-old daughter. You're on a tight budget so you've decided to make automatic contributions from your checking account. That way you know you'll make at least the minimum contribution each month.

You have a son who is just starting high school. You've had an investment account designated for his college expenses for a number of years. You transfer the money into a 529 account because you want to take advantage of tax-free withdrawals.

$10,000 or less annually—so if you make contributions in smaller installments over several years, you might be able to deduct more than if you make a lump-sum contribution in one year.

Other advantages of installment contributions, in addition to being more affordable, are that you don't risk making a major contribution just before a market downturn, and you won't be vulnerable to the gift tax. But the drawback is that it may be harder to accumulate the assets you need to meet the expenses you're hoping to cover.

AUTO-SAVE

One way to minimize the effort and maximize the regularity of contributing to a 529 plan is by making automatic contributions. Many plans offer two ways of doing this—through monthly debits from your bank account or with payroll deductions. The catch is that you can take payroll deductions only if your employer includes a 529 plan with other eligible deductions, such as 401(k) contributions and health insurance, in your employee benefit package.

If you're unsure about having money automatically deducted, you might consider these positive aspects:

- You won't forget to add money or be tempted to spend it on something else
- Since you know how much you'll be contributing each month, you can factor college savings into your regular budget
- Most plans allow smaller minimum contributions if you contribute automatically, so you put less strain on your overall resources—but you'll contribute less to your account

EARNING STUDENT MILES

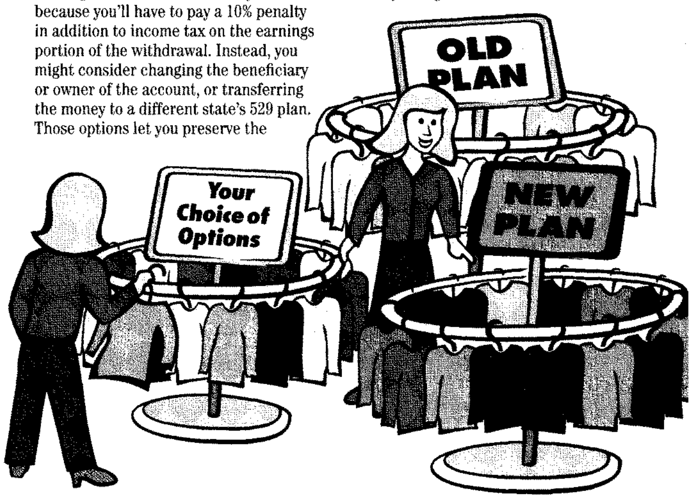
Two companies—Upromise and BabyMint—have responded to the popularity of 529 plans by sponsoring rewards programs similar to frequent flier programs. When you become a member and shop at a participating retailer, use a particular credit card, or make some major purchases, a percentage of your purchase is rebated as reward points. Then, the points are converted into cash and deposited in your 529 plan.

The amounts you earn are modest, so using these programs doesn't substitute for direct contributions to your account. But it's a good way to build your savings while you shop for everyday items, such as groceries or gas.

Managing Your Account

When things change, your 529 account needs to keep up.

The terms of your 529 plan aren't set in stone. If your original goals for the account change, you can adjust the plan to meet your new needs. Of course, there are limits. If possible, you want to avoid simply cashing out the account entirely. That's because you'll have to pay a 10% penalty in addition to income tax on the earnings portion of the withdrawal. Instead, you might consider changing the beneficiary or owner of the account, or transferring the money to a different state's 529 plan. Those options let you preserve the tax-free—and penalty-free—status of your investment. In fact, the longer your 529 account is open, the more likely it is that you'll want to make adjustments. The process for making these changes is fairly straightforward.



Changing the Investments

Although it's not required by federal law, your plan may let you change the investment track you've chosen once a year with an existing account, or when you change the beneficiary. Many plans let you transfer either a specific dollar amount or the entire account. Generally, plans will ask you to complete a form indicating the track you are withdrawing from and the track you are moving to.

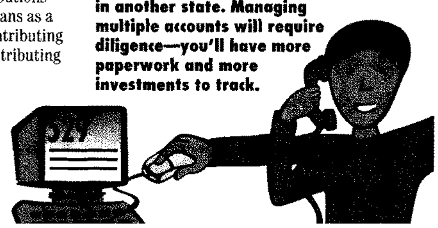
If your plan doesn't provide the flexibility of transferring among investment tracks, you can adjust your investment in other ways. With any plan, you always have the option of stopping contributions to one track and starting contributions to another. The same goes for plans as a whole—you can always stop contributing to one state's plan and start contributing to another, instead of transferring assets.

Transferring to a New Plan

You can move your assets from one state's 529 plan to another any time you want, provided you change the beneficiary of the account. Remember, the new beneficiary has to be a member of the same family as the original beneficiary.

You can also change plans while keeping the same beneficiary, provided you don't transfer more than once every 12 months. Usually, you'll have to complete and sign a transfer of account form for the plan you're leaving, and then fill out a new application for the plan you're joining.

Rather than transfer to a new plan, you could open a second plan in another state. Managing multiple accounts will require diligence—you'll have more paperwork and more investments to track.



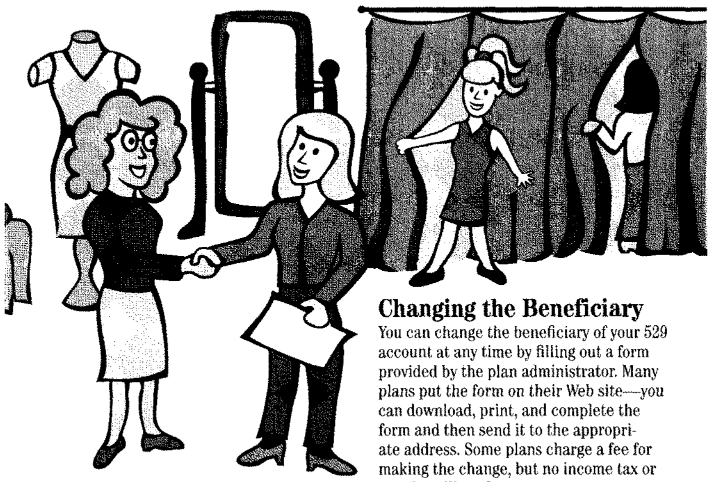
ROUTINE MAINTENANCE

Many 529 plans charge an annual maintenance fee while your account is open. But several plans waive the fee if you keep a minimum balance in the account, if you choose to make automatic contributions, or if you're a state resident. Typically, maintenance fees range from $10 to $50.

You may also have to pay an annual management fee, which is figured as a percentage of the value of your account. Several plans charge a management fee in lieu of enrollment or maintenance fees. Management fees usually fall between 0.30% and 1.30% of the value of the account.

WHEN THE MANAGER STOPS MANAGING

The manager of your plan, which is the mutual fund company or brokerage firm the state has hired, may not be the manager for the life of your account. These companies and firms have signed contracts with the states that may last anywhere from 2 to 15 years. When the contract expires, the state can hire a new company to manage the plan. If that happens, there may be big changes in the investment options, fees, and terms of your account. At that point, you'll have to decide if you want to keep your money in the account or transfer to a different state's plan.



Changing the Owner

Most plans let you transfer your account to a new owner if you provide written consent, and the new owner completes an application. Some plans, however, allow a change in ownership only in the case of death or disability of the current owner. If the original account owner dies, the account becomes the property of the successor, provided one was named on the application. To designate or change the successor, you fill out a form provided by the plan administrator.

Changing the Beneficiary

You can change the beneficiary of your 529 account at any time by filling out a form provided by the plan administrator. Many plans put the form on their Web site—you can download, print, and complete the form and then send it to the appropriate address. Some plans charge a fee for making the change, but no income tax or penalty will apply.

The catch is, you can't choose just anyone as the new beneficiary. You must name someone who is a member of the same family as the original beneficiary.

WHO IS A MEMBER OF THE FAMILY?

When you change beneficiaries of your 529 account, you must choose someone who is a member of the same family as the original beneficiary. The new beneficiary can be:

- Son or daughter, grandson or granddaughter, stepson or stepdaughter
- Brother or sister, stepbrother or stepsister, half-brother or half-sister
- Father or mother, stepfather or stepmother
- Niece or nephew
- Aunt or uncle
- First cousin
- Spouse
- In-law

Making Withdrawals

When it comes to withdrawing from your account, knowing what to pay for can pay off.

When your beneficiary is ready for college or graduate school, you're ready to use the money in your 529. You control how much of the total value you withdraw at any one time, and the way the money is used. If you play your cards right, no federal income tax—and in more than half the states, no state income tax—will be due on your withdrawal.

Since the contributions you made to your 529 have already been taxed, the portion of any withdrawal that's a return of principal is already free of federal tax. And if the earnings you withdraw pay **qualified higher education expenses (QHEEs)**, which include the beneficiary's tuition, fees, books, school supplies and equipment, room and board, as well as any special needs, no taxes are due either.

It's only if you use the money to pay nonqualified educational expenses or for some other reason that taxes will be due. And remember, you can't use withdrawals from two different tax-free accounts to cover the exact same expense.

QUALIFIED WITHDRAWALS

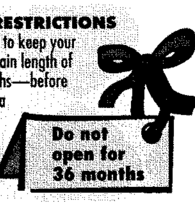
Your plan will provide an annual statement that reports your contributions and earnings, and, in years when you've withdrawn, the amount you took out of the plan.

When you complete your tax return, you match your QHEEs against your withdrawals. If they're equal—or if the QHEEs exceed your withdrawals—all of your earnings, and thus your entire withdrawal, are tax free. But if your withdrawals are higher, you'll have to calculate the percentage of earnings on which taxes are due.

If you have multiple accounts for the same beneficiary within the same plan, you'll have to combine your withdrawals from those accounts before you can match them against your QHEEs. The same is true if you have accounts in multiple plans.

As of 2002, you—and not your program provider—are responsible for accounting for your QHEEs when you file your federal income tax return. Some programs may require proof of qualified expenses when you withdraw, but it's up to you to provide evidence of your QHEEs if you are audited. For this reason, it's a good idea to keep a complete record of your transactions for at least six years after the money has been spent.

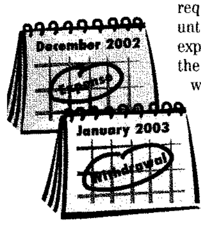
WITHDRAWAL RESTRICTIONS
Some states require you to keep your 529 account open a certain length of time—such as 36 months—before you're eligible to make a withdrawal of any kind. That may be something you want to consider in choosing a plan.



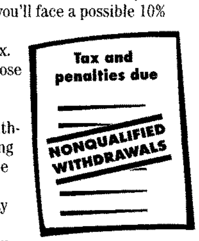
PAYING THE BILLS
You can usually arrange to have your 529 plan pay a qualified expense directly, or you may request reimbursement for expenses you pay yourself.

It's a good idea to keep close track of timing if you use the reimbursement method. You must submit your request for the cash within the same calendar year as you make the payment, not the same academic year.

For example, if you pay spring tuition in late December, but your reimbursement request isn't processed until January, the expenses count in the first year and the withdrawals in the second. If you don't have enough additional QHEEs to offset your withdrawals in the second year, you risk owing tax on what the government considers nonqualified withdrawals.



NONQUALIFIED WITHDRAWALS
If you use money from your 529 account for nonqualified expenses, federal income tax—and state income tax in most states—will be due on the amount you withdraw, and you'll face a possible 10% federal penalty on top of the tax. States may impose an additional 10% penalty for nonqualified withdrawals, bringing the potential fee as high as 20%. The penalty may be waived if there are extenuating circumstances, such as the death or disability of the beneficiary, or if he or she receives a scholarship, veterans' educational assistance, or other nontaxable education payment that isn't a gift or inheritance.



In addition, if you have deducted some of your contributions on your state tax returns, the state may want to recover the amount you saved in tax. So you may have to report part of your withdrawal as additional income to compensate for those deductions.

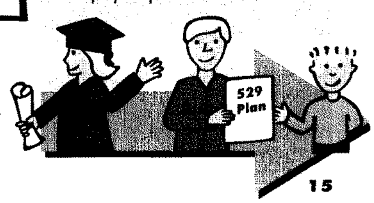
In other words, with a nonqualified withdrawal, you may end up paying income taxes, additional taxes to compensate for previous deductions, and a possible 20% penalty. Those consequences are designed to be severe enough to make you think twice about misusing the account.

FOOTING THE TAX BILL
If you take a nonqualified withdrawal, the earnings will be taxed either to you or your beneficiary, depending on the way the withdrawal is made. If your 529 plan makes a direct payment to an educational institution, your beneficiary is considered the recipient and pays taxes at his or her regular tax rate, which may be lower than your rate.

If you take a cash withdrawal from your account, the earnings may be taxable to you even if the money has been spent on the student's behalf. But some plans may allow you to direct your withdrawal to your beneficiary who pays tax at a lower rate.

The bottom line is that before making any nonqualified withdrawal, it's a good idea to understand your plan's policies and your state's tax laws so you can assess the potential damage beforehand.

HELPFUL HINT
If there's money left over in your account after your beneficiary finishes college, rather than withdraw the money for non-education—and therefore, nonqualified—expenses, you might consider changing the beneficiary of the account to a younger child or relative. Or, if you think your beneficiary might go to graduate school at some point in the future, you might just choose to keep the money in the account for the time being. Either way, you'll avoid paying the taxes and penalties that accompany nonqualified withdrawals.



Tax and Legal Issues

529 accounts offer a wide range of tax advantages—but only if you follow the rules.

The federal income tax benefits your 529 plan can provide are easy to see—your account grows tax deferred and your qualified withdrawals are tax free. But if you look a little closer, you'll discover other benefits as well. For example, there are ways to use 529 contributions to avoid paying gift and estate taxes. And depending on where you live, you may be able to save on your state taxes, too.

STATE PREROGATIVE

States can assign their own tax incentives to the 529 plans they offer. Many states have chosen to follow in the footsteps of the federal government, exempting qualified withdrawals from **state income tax**. For the majority of states that offer an exemption, you have to be a resident investing in the state's plan to make tax-free withdrawals. But a few states, such as Arizona and New Jersey, will exempt earnings on other states' 529 plans as long as you withdraw for qualified expenses.

Other states let you deduct contributions to their 529 plan from your state income tax. Some states, such as Colorado, let you deduct your entire contribution, while others let you deduct up to a limit—typically, somewhere between $1,000 and $10,000 each year. If there's a limit on how much you can deduct, you might spread out your contributions to stay under the limit over several years rather than contributing more than the limit in any one year.

There's one caveat you should remember when it comes to state tax deductions—many states reserve the right to recapture the amount deducted if you withdraw money for nonqualified expenses. That means you'll owe tax on the prior contributions you made and the earnings, if any, that you realized.

GIFT AND ESTATE TAX STRATEGIES

You can reduce your estate, without forfeiting control of your money, by contributing to a 529 savings plan. By allowing the account owner to retain control, 529 plans hold a unique advantage over other types of estate-reducing investments, such as UGMA and UTMA custodial accounts. Those types of accounts will let you move money out of your estate, but you'll have to transfer control of the money to the beneficiary of the account.

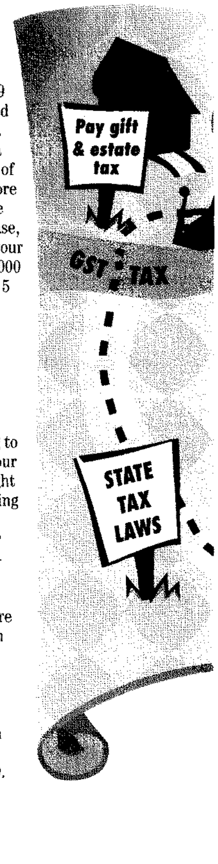
With 529 plans, you also have the advantage of making a large, lump-sum contribution—up to $55,000 in a single year (which counts as an annual $11,000 gift over five years)—without triggering a **gift tax**. And, fortunately, the amount by which you can reduce your estate can be even higher. The limit varies depending on the specific 529 plan you're using. Most plans set the maximum contribution limit—and therefore the maximum estate reduction—between $200,000 and $260,000.

There is one condition, however, that causes your 529 assets to be included in your gross estate. That's if you make a 5-year contribution of $55,000 but die before the beginning of the fifth year. In that case, the amount left in your contribution—$11,000 for each year of the 5 you weren't alive—will be included in your estate.

SKIPPING GENERATIONS

If you're a grandparent contributing to a 529 account for your grandchild, you might worry about triggering a **generation-skipping transfer (GST)** tax. That happens when you give a substantial gift to someone who is more than one generation apart from you. To avoid the tax, you need to stay below the lifetime federal limit—$1 million in 2002, increasing to $3.5 million by 2009.

In regard to 529 plans, the amount

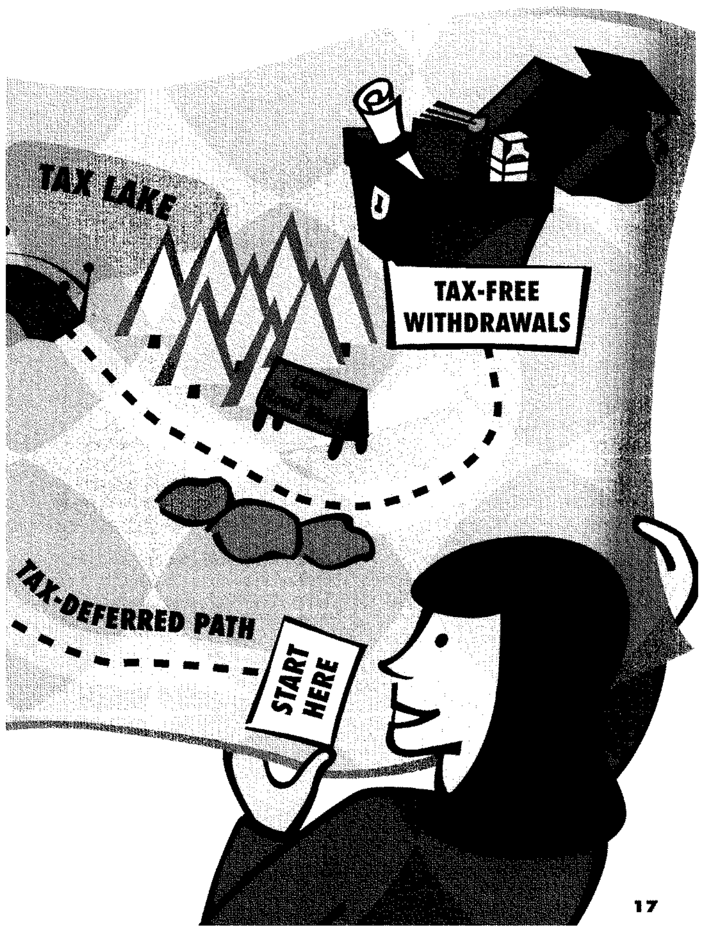


A TAXING RESPONSIBILITY
You don't have to own a 529 account to be responsible for the tax consequences of making a contribution. If you make a gift into an account for a beneficiary—such as for a grandchild whose parents own the account—you're the one responsible for the taxes that may apply to your gift.

covered by the gift tax exclusion—$11,000 annually—is also excluded from GST tax. If you want to contribute over the gift tax limit, you can employ your lifetime limit to shelter the contribution. But you'll probably want to talk to a tax adviser first, since tax strategies frequently get complicated.

LEGAL COMPLICATIONS
Even though you own your 529 account, there are situations in which you may not be legally entitled to retain control. For example, applying for **Medicaid** may put you in this position. State Medicaid agencies require that 529 accounts be used to pay for medical and long-term care expenses before you can start receiving Medicaid payments.

You may also have to surrender control of your 529 assets if you are facing claims from creditors or if you go bankrupt. Some states offer protection from creditors or bankruptcy as part of their 529 plans, but many do not provide any security against these circumstances.

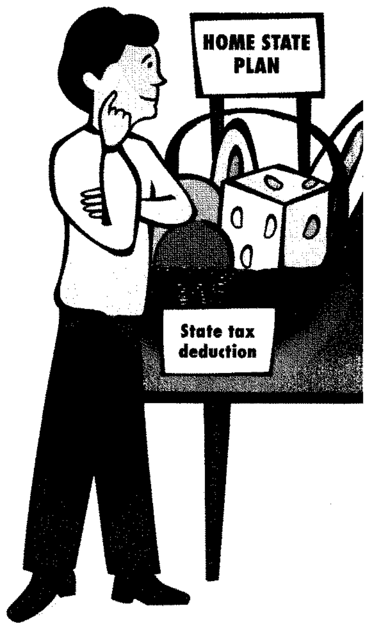


Choosing the Right Plan

Finding the 529 that's right for you is easier once you narrow the field.

While no single 529 plan may be perfect for your needs, a number of different plans may fill the bill. One approach to choosing a plan is to identify the features that are most important to you, such as fixed investment tracks or a large contribution cap, and then narrow your choices to a few plans that meet your criteria.

There are enormous resources available on the Internet to help you with this process. One place to start is at www.collegesavings.org, a site sponsored by the College Savings Plan Network, an affiliate of the National Association of State Treasurers. Among other things, the site provides links to a Web site for each state, where you'll find a summary of its plans. Another resource is www.savingforcollege.com, which provides information on plan expenses, investment options, and recent plan performance.



GET A TUTOR

If you're not sure if you're asking the right questions, or if you'd like a professional perspective, you may want to work with a financial adviser. You may already have an adviser who can help you with your search, or who'll recommend a colleague who specializes in college planning. If you've never worked with an adviser, you may want to ask friends or family for suggestions or get a reference from your lawyer or accountant.

A knowledgeable adviser can help you analyze investment options and compare fee structures, and may alert you to any overly restrictive provisions in a plan you're considering. In most cases, if you prepare a list of questions before your meeting, you'll end up with more useful information than if you're not sure what you want to find out.

Some advisers work on a fee-only basis, but don't sell 529 plans. Others may sell one or more state's plan, earning a commission when you buy. Either type can provide the help you need, but if you ask upfront about the way the adviser is paid, you can be alert to advice that seems too narrowly focused.

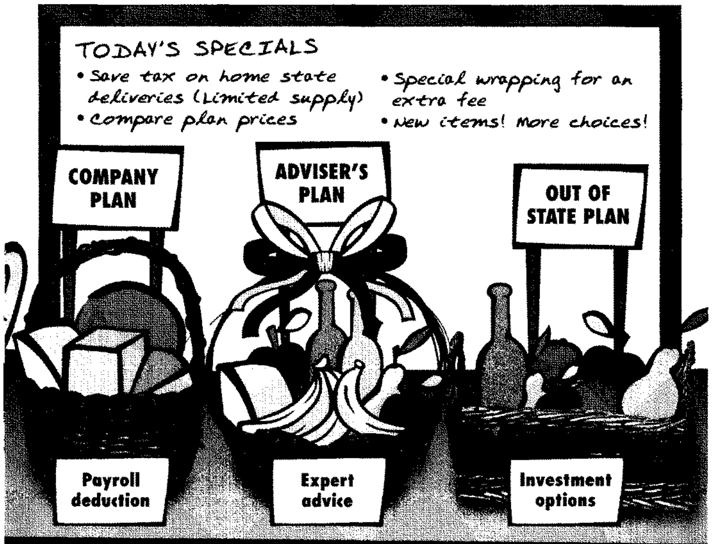
CHECK OUT THE PLAN

If you're considering a 529 account, it's important to take a close look at investment choices first, since they're the critical issue. Check to see that the plan has the option you want—whether it's an age-based or fixed track—and evaluate the mutual funds or other investments the manager offers. Then weigh:

Beneficiary rules. If you're interested in opening a 529 to pay your own higher education expenses, you'll need a plan that allows the owner and the beneficiary to be the same person. Some plans cap the age your beneficiary can be when you open the account. Others may limit the number of years you can keep your

THE ESCAPE CLAUSE

If, down the road, you're not happy with the plan you're in, you can open another one or transfer your assets. So don't let concerns about making the right choice keep you from making a decision.



account open. You can eliminate any plan that's too restrictive for your needs.

Fees and expenses. The cost of opening and maintaining a 529 plan varies significantly from state to state, and sometimes among different plans that a single state offers. Plans sold through advisers usually carry sales charges that in some cases are as high as 5.75% of your contribution plus annual management and fund expenses. The total cost of other plans is less than 1% of the account value—sometimes much less. Since expenses affect return, they're something you should consider carefully.

Investment returns. While past performance can't predict future returns, many experts suggest looking at a plan's investment returns over a multiyear period to get a sense of how it has been managed. However, some plans are too new to have a long history.

Contributor limits. You may also want to check to see if the plans you're considering allow people other than the owner to contribute to the account.

HOME GROWN PLANS

Start by looking at the plan or plans your own state offers. Often, the extra benefits available to residents make it the best choice. Tax-free earnings and a state tax deduction for contributions may be especially attractive if your state income taxes are high to begin with.

But remember, withdrawals are tax free only if you use them to cover qualified expenses. The same goes for the tax deduction. Many states that allow deductions will try to recapture, or take back, the amount you deducted if you use the money for nonqualified expenses.

Some states also offer benefits that aren't tax-related. If you meet the requirements, a few states will match part of your contributions. Some will even disregard 529 balances when they determine your beneficiary's eligibility for state-funded financial aid.

However, your state's plan may be less appealing if the investment options are limited or the fees are high.

JOIN A WORK PLAN

Find out if there's a plan available through your job. Recently, employers have started adding payroll deductions for 529s to their employee benefits packages, along with 401(k) contributions and health insurance. It's quick and convenient—and a smart way to contribute if the plan meets your criteria.

However, you can't assume that your employer will offer the plan that's best for you. For example, if the plan isn't sponsored by your state, you may miss out on a tax deduction on your contributions or an income tax exemption on withdrawals. Here, too, you want to look at the investment options and the fees.

Other Ways to Save

529s are one way to save for college, but they aren't the only way.

When you're facing expenses as large as college and graduate school tuitions, you want to consider all your savings options. Contributing to one type of plan doesn't prevent you from using another. For example, you may be interested in funding different investment accounts on your own. Or, you may be orchestrating contributions from a number of different people, seeking the right plan for each one.

EDUCATION SAVINGS ACCOUNTS

A **Coverdell education savings account (ESA)** offers the benefit of tax-free withdrawals to pay qualified education expenses, much as a 529 plan does. You can contribute up to $2,000 each year to an account set up for a specific beneficiary—but that cap applies to all contributions from all donors for the year. That means an account opened the year a child is born could accumulate up to $36,000 in contributions plus any earnings by the year he or she started college at 18.

Perhaps the most distinctive difference between an ESA and a 529 plan is that earnings in an ESA may be used to pay qualified expenses for students in grades K through 12 as well as those in college and graduate school. That includes expenses at public, private, boarding, vocational, and parochial schools. The covered expenses may range from tuition and books to uniforms, transportation, and Internet service costs.

ESAs: PROS AND CONS

ESAs, which replaced education IRAs in 2002, have some strong points:

- Contributions can be invested any way the account owner wishes
- Any earnings accumulate tax deferred, and assets that have increased in value can be sold and the money reinvested without incurring capital gains tax
- Earnings are tax free at withdrawal if they're used to pay qualified expenses, which include elementary and secondary school costs in addition to higher education costs
- The beneficiary can be changed as frequently as once a year to any other person who is a member of the same family

But there are also some potential drawbacks to ESAs:

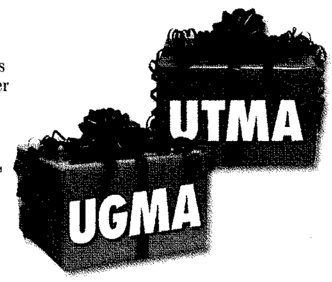
- A beneficiary must be younger than 18 when the account is established
- The money must be spent on qualified education expenses before the beneficiary turns 30
- There are income limits restricting people's eligibility to contribute, currently capped at $110,000 for single tax payers and $220,000 for married people filing a joint return
- The total amount of money all contributors can put into a beneficiary's account is capped at $2,000 a year
- The list of qualified expenses is shorter than with 529 plans

UGMAs AND UTMAs

You may want to establish an account in a child's name, contributing investments that can be used to pay for college, under either the **Uniform Gifts to Minors Act (UGMA)** or the **Uniform Transfers to Minors Act (UTMA)**. Since a minor can't own assets in his or her own name, you or someone you designate serves as custodian of the account until the child reaches majority and legally assumes ownership.

One advantage of an UGMA or UTMA account is that any income that investments in the account produce, and any capital gains realized by selling investments for more than you paid for them, are taxed at the child's rate once he or she turns 14. That rate is usually lower than the rate you'd pay on the same income. But those earnings are taxed, not tax free as they are in an ESA or 529 plan.

On the other hand, there are no limits on the way you can invest the assets in an UGMA or UTMA account, no income cap on who can contribute, and no contribution cap on the amount you can add to the account. However, if you contribute more than $11,000 in any one year—$22,000 if you're married and file a joint return—the excess over that amount may be subject to gift tax.



IT'S THE KID'S MONEY

One reason you may shy away from an UGMA or UTMA account, in addition to the tax advantages of the other college savings plans, is that the child for whom you set up the account can assume control of the account at the age of majority—18 or 21 for UGMA accounts, and 21 or 25 for UTMAs depending on the state—and spend the assets any way he or she likes. While you would hope that your goals and the goals of your beneficiary would be similar, especially when it comes to paying for college, your wishes could be ignored.

TAXABLE INVESTING

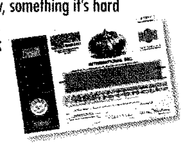
Of course, you can always save for college by opening a taxable account, and earmarking those funds to meet that goal. You might consider just one child as the ultimate beneficiary of each account—an approach many financial advisers suggest—or you may simply do all your investing for education in one account.

The advantage of taxable accounts is that there are no limits on your contributions or on the way your money is invested, and there's no legal obligation to use the money in any particular way.

The chief drawback is that all the earnings your investments produce and any capital gains you realize are taxable. But you do have the option of transferring any assets that have increased in value to your college-age child before selling them, so that the gain would be taxed at the child's presumably lower rate.

US SAVINGS BONDS

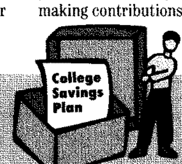
While you can buy **US savings bonds** for any reason, you may qualify for a tax break if you use the money you get from redeeming your bonds to pay your child's qualified education expenses. The catch is that your adjusted gross income must be less than the limit set by Congress in the year you withdraw, something it's hard to predict ahead of time. But it might pay to check out the rules for buying qualifying bonds. You'll still collect interest even if it's not tax free.



Comparing Alternatives

You can get an idea of which college investment is right for you by sneaking a peek at each plan's syllabus.

When you're comparing the pros and cons of different ways to invest for college, it helps if you can see—across the board—how the plans may meet your most essential criteria. The chart below illustrates how the options stack up in three vital areas: opening an account, paying taxes, and changing parts of your account after you've started making contributions.

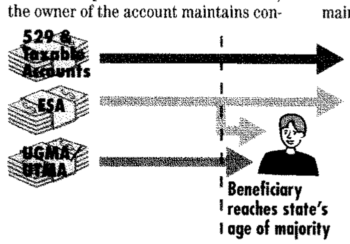


	OPENING AN ACCOUNT			PAYING TAXES
	Contribution limits	**Income restrictions on eligibility**	**Uses for account**	**Tax status of earnings**
529 Plans	Depending on the plan, up to $269,000	None	For full tax benefits, money must pay for qualified higher education expenses	Tax deferred
Coverdell ESAs	A total of $2,000 from all contributors, for each beneficiary	Once adjusted gross income (AGI) reaches $95,000 (or $190,000 for joint), right to contribute begins to phase out	For full tax benefits, money must pay for qualified education expenses, covering K-12, as well as higher education	Tax deferred
UGMA/ UTMA	Unlimited	None	Any expenses that benefit the child	Taxed
Taxable Accounts	Unlimited	None	No limits on uses	Taxed

KEEPING IT UNDER CONTROL

You might also want to consider who controls the account when you're comparing college savings plans.

With 529 plans and taxable accounts, the owner of the account maintains control as long as the account is open. If you open an ESA, you can transfer control to the beneficiary of the account when he or she reaches the age of majority, either 18 or 21 depending on the state, or you can maintain control.

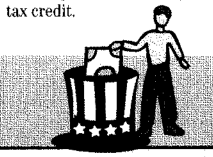


UGMA/UTMA accounts are the major exception. The custodian—often, but not always, the person who opened the account—manages the account for the beneficiary until he or she reaches the age of majority. At that time the beneficiary can take control and use the money any way he or she wants.

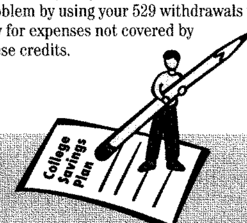
UNDERSTANDING 529 PLANS

EXTRA CREDIT
Based on your family income, you may be able to claim a Hope scholarship or Lifetime Learning credit on your tax return for qualified education expenses. But if you claim the credits while you're taking withdrawals from a 529, you'll have to plan carefully. Your 529 withdrawals will lose their qualified status, and be subject to tax and penalty, if you use them for the same expenses for which you claim the tax credit.

You'll have to weigh the tax savings available from the credit—a maximum of $1,500 for Hope and $2,000 for Lifetime Learning starting in 2003—against the tax and penalty. In rare instances, making a nonqualified withdrawal might still be worthwhile, but you can often avoid the problem by using your 529 withdrawals to pay for expenses not covered by these credits.



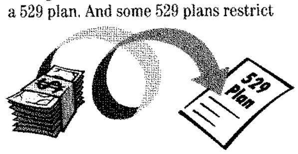
MAKING CHANGES



Tax on withdrawals	Changing beneficiary	Changing investments	Ability to reclaim money
Withdrawals for qualified expenses free from federal, and sometimes state, income taxes. For nonqualified withdrawals, earnings taxed as income, plus a possible penalty	Can change beneficiary to another member of the same family	Allowed, once every 12 months, with most plans	Yes, but withdrawal will be subject to income tax and penalty
Withdrawals for qualified expenses free from federal, and sometimes state, income taxes. For nonqualified withdrawals, earnings taxed as income, plus a possible penalty	Can change beneficiary, in most cases, to another member of the same family, as long as new beneficiary is under 30	Allowed at any time	No, the money must be used for the benefit of the child
First $750 of income and capital gains is tax free; next $750 is taxed at the child's rate; the rest is taxed at your rate. Once the child turns 14, income is taxed at the child's rate	Not permitted	Allowed at any time, but gains might be taxed	No, the money must be used for the benefit of the child
Earnings taxed as capital gains or ordinary income, at your rate	Not applicable	Allowed at any time, but gains might be taxed	Not applicable

ROLLING INTO A 529
You can roll over investment accounts into a 529 plan with only a few stipulations. Transfers must be in cash, which means you'll have to liquidate, or sell off, any assets in other investments before making the transfer. You may trigger a capital gains tax if you sell an asset at a higher price than you paid to buy it.

Some banks or brokerage firms restrict rolling over an UGMA/UTMA account into a 529 plan. And some 529 plans restrict funding an account with money from an UGMA/UTMA account. That's partially due to complications in ownership. You should check with the plans you're considering and with the financial institutions holding the UGMA or UTMA involved before making this type of transfer.



NOT THE BEST CHOICE
You can withdraw money from your **individual retirement account (IRA)** without penalty to pay college costs. But you owe tax on the withdrawal, and you take a big bite out of your own financial future. Think of it as a last resort, not a clever plan.

SIA 529 Checklist

A checklist of questions you should ask before investing in a 529 plan.

What type of investment options are available?

Determine if the Section 529 plan offers a variety of investment options that are conservative, moderate, and aggressive. Typical investment options include age-based portfolios and/or portfolios with conservative, moderate, and aggressive asset allocations. Some states also offer individual mutual fund options.

How does the performance of the investments in the plan compare to similar investments available in the marketplace?

Evaluate the performance of the investment managers for the particular investments you are considering. A good way to compare performance is to look at how the investment compared to the market index for that type of investment.

What are the fees for the investment I am considering?

Generally, the types of fees charged in Section 529 plans include: enrollment fees, annual maintenance fees, management fees, and underlying fund expenses. Some plans consolidate these fees into one charge. Section 529 plans also may include sales charges, either when the investment is first made (a front-end load) or when money is withdrawn from the plan (back-end load). Fees will be listed in a document called the Program Description.

Does the state where I reside offer any special tax advantages if I invest in my home-state plan?

More than 20 states offer a deduction from state income taxes for contributions to the home state 529 plan. Some states offer other special benefits for participating in your home state plan. Be sure to consult with a tax adviser to determine if there are any special restrictions on claiming the benefits or potential penalties if the investment is later transferred to another state.

What if my designated beneficiary decides not to continue his/her education? Can I change beneficiaries?

Beneficiaries may be changed as long as they are within the same family. However, states may have established their own rules for when accounts must be distributed so your flexibility to change the beneficiary may be somewhat limited.

What is the penalty if I withdraw money and it is not used to cover educational expenses?

Any distributions that are not a qualified educational expense will be taxed at the income rate of the recipient plus a 10% excise tax. There may also be state income taxes and penalties.

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Morningstar Testimony to the Subcommittee on Capital Markets, Insurance, and Government Sponsored Enterprises

Subject: 529 College Savings Plans

Hearing Date: June 2, 2004

Thank you for the opportunity to appear before this distinguished Committee. My name is Dan McNeela. I am a senior analyst with Morningstar Inc., an independent investment research firm that provides data and analysis on mutual funds and other investments. More than 150,000 individual investors and 80,000 financial planners subscribe to our services. In addition, our investment Web site, Morningstar.com, has more than two million registered users.

More than a year ago, we began to cover 529 savings plans, which, as our research has shown, have much to offer. I now lead a team of four analysts that reviews all 529 plans in existence. Our analysis shows that a well-chosen 529 plan is an attractive investment vehicle. To inform their investment decisions, we write commentaries that detail the benefits afforded to 529 investors. Such advantages include considerable investment flexibility, tax advantages, high contribution limits, and diversification.

Today's hearing is important because 529 savings plans are increasingly becoming a valuable tool for parents saving for their children's education. Our most recent figures show that investors have assets totaling more than $47 billion in 529 savings plans. Studies show that after retirement savings, putting money away for college is often parents' top financial goal.

That said, my testimony focuses on the shortcomings of 529 plans. Several areas need substantial improvement. All too often, high costs, poor disclosure, and an unreasonably complex structure greatly diminish their potential value.

Complex Cost Structure

Some of our greatest concerns relate to the myriad costs investors pay to participate in a 529 plan. Investors face enrollment fees, account-maintenance fees, administrative fees, management fees, and in many cases broker fees. Some of those costs are dollar-based, while others vary depending on the amount invested in the plan.

Calculating the specific fees associated with a particular investment option can be a major undertaking. Most plans are set up as funds of mutual funds, whereby a single investment option represents a basket of underlying funds. To arrive at the total expenses of a single investment option, investors first must prorate the costs of the underlying funds depending on their weighting in the portfolio and add the costs of all those funds together. Any associated administrative fees and broker fees, if applicable, must be added to arrive at a total. Even at that point, dollar-based fees are left unaccounted.

That process is frustrating enough for investors, but most 529 plans exacerbate this problem by burying this important cost information in the back of a 100-page program-disclosure document. At its worst, the complexity of the cost structure and the reluctance to make the information easily accessible amount to deceit on the part of 529 providers.

The simplest solution is to require plans to prominently feature cost information on their Web sites and in their literature. Costs should be presented both at the base level, so investors can see what they're paying for; and in aggregate, to summarize a plan's expenses. In situations where costs vary depending on the chosen investment option, total costs for each investment option should be clearly outlined. In effect, this summary expense data would serve the same purpose as that of expense ratios for mutual funds.

Finally, 529 plans should heed the calls that mutual funds are hearing for better cost disclosure by providing cost estimates in dollar terms as well as percentage terms. A projection of total costs based on a $10,000 investment would serve investors by making comparisons between competing plans much easier.

Exorbitant Fees

Clear disclosure of costs in both percentage terms and in dollar terms should help alleviate the other major problem of 529 plans. In short, too many 529 plans are prohibitively expensive. One reason plans are so expensive is that several groups are in line to collect fees. With states, fund companies, brokers, and third-party administrators all putting their fingers in the pie, it's no wonder that investors can end up with a knuckle sandwich.

Anyone who says that costs don't matter is most likely a recipient of those fees. Plan costs come out of investors' pockets on a dollar-for-dollar basis. Although the debate between low-cost index funds and more-expensive actively managed options is worthwhile, overcharging for lavish advertising campaigns and bloated administrative expenses is reckless and unfair.

Our recent review of 529 plans turned up several plans with investment options whose costs approach or exceed 2% of assets for class A shares. This figure does not include front-end sales costs, which can be as much as 5.75% of assets or any dollar-based fees. Collectively, these expenses significantly diminish potential gains. If long-term returns before fees average 6% annually, expenses could consume more than a third of an investor's potential gains.

The difference between paying 1% or 2% in annual asset-based fees may seem minuscule to uninformed investors, but presenting those costs in dollars and cents, and projecting them over a multiyear period, will shed light on this issue. In the aggregate, we can see how meaningful the potential differences become. With $47 billion in 529 plans, a 1% asset-based fee costs 529 investors $470 million annually. At a 2% fee level, annual costs to 529 investors rise to $940 million.

How Fees Are Used

Although fees and their transparency are important issues, 529 plans also have the responsibility to disclose how fees are used. This concern focuses on administrative fees, which vary greatly among plans. Tennessee's plan, for example, is cheaper than average because it uses low-cost index funds and lacks a broker-sold option. Its cost structure is also simple, because it charges a flat 0.95% regardless of the investment option. But Tennessee's administrative costs are unreasonably high. The plan's disclosure documents do not explain why it costs nearly 50% more than nearly identical plans offered by Michigan and Missouri. Tennessee charges as much as 0.88% in administrative fees, without accounting for how that money is being used. By comparison, Utah reports that it has been able to cover its operating costs by charging a mere 0.25% in administrative fees.

States that offer 529 plans need to be accountable for fees. Citizens have a right to know how their money is used. The first step toward achieving that goal is improved disclosure. We believe that states should tell investors how much money they collect and where that money ends up. Are fees paying for splashy advertising campaigns or defraying the costs of other projects? To date, states haven't felt compelled to provide answers.

Selection of Investment Manager

In a similar vein, residents receive little information regarding how their states selected fund company partners. States should be forthcoming about the selection process and the criteria used. They should fully explain the terms of the deal, including any benefits the states will receive and how their choice serves citizens.

Evaluating Performance

The final area in need of improved disclosure is evaluation of performance. Investors currently receive information regarding the performance of the various investment options for both short-term and long-term periods. But to grasp how well their plan is performing, investors need to see the performance of relevant benchmarks alongside the plan's returns. These benchmarks should reflect the asset classes in which the investment options are invested. Because many of the investment options include both stocks and bonds, blended benchmarks-which combine returns from different asset classes--are most appropriate. It is important that this comparison relates to the actual performance of the investment options net of all asset-based fees. If this is done properly, plans saddled with poorly performing funds and high cost structures will have few places to hide.

As a supplement to those numbers, plans should provide investors with a written commentary explaining why the investment options did better or worse than their benchmarks. This analysis, which need not be lengthy or complicated, would markedly demonstrate accountability.

Spark Competition

One problem plaguing citizens in many states is an uneven playing field. Twenty-six states offer a deduction on contributions, but typically that benefit is not bestowed on those who invest in an out-of-state plan. Seven states that grant tax-free withdrawals for citizens who opt for the home-state plan withhold that benefit from those who choose an out-of-state plan. In Illinois and Mississippi, residents who choose an out-of-state plan give up both benefits.

The end result is that citizens in many states become captive to their home-state plan. Their decision is based on weighing the advantages of a mediocre in-state plan with state-tax benefits versus those of a superior plan that foregoes in-state benefits. Often the choice is not determined by which is the best plan. Without having to compete head-to-head with other plans, states can raise fees and craft a plan that favors state interests over citizens'.

Wisconsin residents are acutely aware of this problem. Not only were they saddled with above-average costs and a subpar investment manager in Strong Capital Management, but then the market-timing scandal tainted Wisconsin-based Strong. Wisconsin's citizens are stuck with hoping for improvement or with leaving the Wisconsin EdVest College Savings Program, which means giving up state-tax deductions.

To address this issue, we suggest that federal legislators consider changing the definition of a qualified tuition-savings plan to include only plans from states that don't discriminate against out-of-state plans. Individual states are reluctant to act unilaterally based on fears that competing plans will raid their plan without providing equal opportunity. A federal law requiring equal treatment would put those fears to rest, but more importantly it would allow investors freedom to select the best plans in the market.

Make Sunset Provisions Permanent

The Economic Growth and Tax Relief Act of 2001 boosted 529 plans significantly by making qualified withdrawals from 529 savings plans free from federal taxes. The hitch is that the federal tax exemption is set to expire in 2010. Although we recognize the need for fiscal restraint, this uncertainty is troubling for 529 investors. Saving for college is a long-range goal, and investors need to know that promised tax benefits will be there when the tuition bills come due. Each year the tax exemption is not extended, investors become less certain that the benefits will remain. We encourage you to secure the federal tax exemption on qualified withdrawals as soon as possible.

Testimony Before the

U.S. House of Representatives,

Subcommittee on Capitol Markets, Insurance, and Government

Sponsored Enterprises

of the Committee on Financial Services

June 2, 2004

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Chairman Baker, Representative Hinojosa, and members of the Subcommittee: I am Michael A. Olivas, Professor of Law at the University of Houston Law Center, where I direct the Institute for Higher Education Law and Governance, the country's only university research center devoted to the study of college law and finance issues. Thank you for the opportunity to present testimony this morning and to share research on prepaid plans and college savings plans, which I have been studying since they began. In a series of books and articles, I have been tracking these plans before and since they were accorded 529 status, and I am a true believer in the efficacy of these plans and the need for parents and family members to contribute to their children's college education expenses. Because I have outlined my views elsewhere on the overall issues of equity and other public policy dimensions of these plans,[1] I will concentrate this morning upon the consumer information/transparency/complexity issues—concerns that this subcommittee, its parent committee, and other public officials and citizens have expressed about related financial instruments, such as mutual funds, annuities, and complex commercial transactions.[2]

The Problem of System Complexity

A good way to appreciate the complexity of 529 plans is to consider traditional retirement plans or 401K programs, and then make them more complicated. Virtually no state operates its prepaid or savings plans the same way as does another state. For example, Joseph H. Hurley, whose annual book, *The Best Way to Save for College*,[3] rates state plans, records the following criteria for each:

* Eligibility, or who can open an account
* Time or age limitations on beneficiary or on use of account assets
* Age-based investment options
* Static investment options
* Underlying investments
* Fees and expenses (annual/enrollment/withdrawal)
* Broker distribution
* Contributions (maximum/minimum)
* Account changes (beneficiary changes, transfer ownership, successor owners, rollover/transfer assets, investment options)
* Full Faith and Credit

* State income tax deductibility

* Exemptions from creditors

* Subject to involuntary transfer or alienation

* Reciprocity with other state plans

In addition, there are many other complicated features, such as whether programs involve a state's private colleges (Texas); whether a state plan's withdrawal provisions conform to federal law (California, Arkansas); where there is a cancellation penalty (Illinois); whether a beneficiary can move from the state and maintain residency status (Texas); whether payroll deductions are permitted (Idaho); whether tuition alone is covered, or tuition and college fees (Virginia); whether receipt of a scholarship provides special refund provisions (Texas); whether there are special provisions for death, military service, disability, state financial aid eligibility, and a myriad of other conditions.

Of course, these many options reflect the maturity of investment markets and make the various plans extremely popular with parents and other investors, especially those plans that offer enhanced portability and tax benefits as program choices. Additionally, investors have many choices among investment funds, especially in state savings plans: Alaska offers eight age-based options and four static portfolios, while Tennessee and Vermont offer eleven age-based funds, all managed by TIAA-CREF. Texas maintains thirteen fund options. Each state also maintains at least one major diversified investment portfolio for its base funds. California even offers a "social investment" portfolio, one that invests only in stocks considered socially and environmentally progressive, such as not including alcohol or tobacco interests.

As attractive as these choices are, an observer cannot help but question whether a state program really requires thirteen or more investment choices for contract purchasers, each with a different fee structure, investment mix, and track record. The marginal advantages may not be evident in any annual review, while the state's supervisory role is made more complicated by the extremely complex bid and review process, especially in states with intricate procurement and investment regulations. This lack of transparency is the clear disadvantage, held up to the mirror of enhanced investor choice. In my judgment, there are likely too many choices for most investors, the system's complexity rendering comparable choice shopping too complicated for most investors, particularly for those who participate because they are risk-averse and do not feel comfortable simply investing in traditional instruments and beating the markets. I have a law degree and a PhD, have studied these state programs since their early versions, have written two books on the subject, own contracts in five states, and still cannot compare the plans across various states. There is almost too much dynamism in the plans, as states vie with other to offer more plans and more complex options so as to attract more contract purchasers. A system can have too many choices, and can intimidate or paralyze unsophisticated buyers, especially in such churning markets.

This system complexity can become a barrier to market entry for some. The early state prepaid programs did not pose this issue, as purchasers simply bought into a contract that either performed well or did not, and in states with guaranteed state FF&C, the investment results literally made no difference to the purchasers (save for their concern about overall program efficacy, as in the Wyoming case).[4] Consumers of state savings and trust plans, however, invest both for the substantial state and federal tax advantages, and for enhancing their investment returns. The lack of transparency is another result of system complexity and too many choices.

Yet another issue is that the range of investment options may have unintended consequences. Diverse plan options may encourage purchasers to place all their eggs in one basket. I have been concerned about the rise of single mutual funds as state options, both with and without brokers, in several state plans, such as those in Utah, Texas, and Nebraska. My concern is that many people in traditional marketplaces might choose mutual funds due to their broadly-based mix of stocks (or bonds, in some instances), when individual contract purchaser needs may be poorly suited for such vehicles. For example, a mutual fund will likely track the performance of the Dow-Jones or Standard & Poor markets, when an investor with a teenaged or middle school child will need to better today's disappointing market performance. Use of a single mutual fund, which might be right for retirement planning, may not be a well balanced choice for some college going plans: college attendance will likely come soon after high school, whereas retirement age is subject to many features and can be postponed in real life. Joseph Hurley made this point dramatically in an October, 2002 editorial to his service subscribers to the Savings College Plan Network,[5] when he noted a similar concern in his Utah Educational Savings Plan, a single 100% equity mutual fund option, offered by the private Vanguard Institutional Index Fund. While he notes that he is, in principle, for "greater investment choice," he is also concerned that such options will lead parents to place all their CSP eggs in one basket, rather than diversifying across several options, especially age-based ones that shift their investment mix as the beneficiary approaches college age. No doubt, he was also influenced by the mutual fund's poor performance in 2001-2002, when it lost over 30%, but his overall point is a good one, a situation exacerbated by system complexity.

Whenever information, such as how to best allocate and invest in state programs, is at a premium, the persons least likely to participate or prosper are the less-well educated, the poor, immigrants, and minorities. Thus, system complexity in state prepaid and savings programs -- even in states with low barriers to entry and monthly payment options -- attract and reward the most advantaged and knowledgeable participants, much like the college application process itself, which so clearly serves the interests of advantaged and wealthier students. If information and investor savvy are needed for these dynamic investments, state prepaid and savings will widen the gap between wealthy and poor, majority and minority, street-smart and average persons.[6]

Finally, although the focus of this Subcommittee is on a more specific topic, I must point out that a number of issues remain to be resolved or addressed by the state or by Congress. These include:

- interaction of state and federal taxation of the plans, including the 1997 Tax payer Relief Act College provisions and those of the Economic Growth and Tax Relief Reconciliation Act of 2001;
- effect of other federal programs upon financial aid (Hope, Lifetime Learning Credits, etc.);

- how to count applicable funds (such as Medicaid's "countable resources" or the "self help" provisions that can be gamed by families with access to sophisticated legal and accounting expertise;
- the differential treatment of income and assets in Expected Family Contribution (EFC) terms;
- the sunset provision of December 31, 2010 Sword of Damocles hanging over the heads of QTP participants.

Finally, I note that my earlier concerns about the viability of these programs have largely been met by the emergence of legislation and favorable tax treatment, including legal developments. However, as in any other public program, it is clear that the wealthy have more options and the poor cannot afford to avail themselves of the various tax vehicles or savings programs – although they value higher education for their children every bit as much as do the wealthy.

I urge you to facilitate truly comparable disclosure requirements, full and open participation data, usable program investment performance, and comprehensive eligibility and enrollment information. Because of unique state conditions and political considerations, each state has fashioned its own plan (or plans), and maybe we should just rejoice in the thousand flowers blooming. But I fear that the program complexity has made this generous and useful universe off-putting to many parents and would-be contributors.

I have attached a copy of the various state plans, taken from a recent article. I hope this starting point will be useful to readers. If I may answer any questions or elaborate upon my views, I would be pleased to do so. Thank you for this opportunity to share my research and thoughts with you.

References

1. See, e.g., Michael A. Olivas, ed. Prepaid Tuition Plans: Promise and Problems (NY: College Bound, 1993); Barbara F. Jennings and Michael A. Olivas, Prepaying and Saving for College, Opportunites and Issues (DC: College Board, 2000).

2. There is a virtual library of such pieces: A sampling includes: Leonard Wiener, "Taxing Choices for Investors," U.S. News & World Report, May 3, 2004, p. 50; Kim Clark, "Vanguard Gets an Earful," U.S. News & World Report, May 3, 2004, 48; Jeff D. Opdyke, College Savings 101: *How We Chose,* Wall Street Journal Feb. 22, 2003, 2; Mark Schwanhausser, *Puzzling Tax Credits for College are Worth Study*, Philadelphia Inquirer, Mar. 24, 2003, C1; Hilary Appleman, *College Savings Plans: You'll Need a Scorecard*, N.Y. Times, Feb. 16, 2003, § 3, 16.

3. Joseph Hurley, The Best Way to Save for College, A Complete Guide to 529 Plans (Pittsford, NY: Savingforcollege.com Publications, 2003).

4. Wyoming, one of the earlier prepaid plans, closed in 1995, less than a decade after its 1986 start.

5. Joseph Hurley, *Whither Individual Funds*?, 529 E-ditorial (Oct. 17, 2002), at www.savingforcollege.com (last visited May 31, 2003). See also http://www.tia-crefinstitute.org/Data/statistics/tf_latest.htm (last visited May 20, 2004).

6. For a review of how these plans afftect household savings and individual investor preferences, see Jennifer Ma, Mark Warshawsky, John Ameriks, and Julia Blohm, An Economic Approach To Setting the Contribution Limits in Qualified State-sponsored Tuition Savings Plans (Houston: IHELG Monograph 00-09, 2000) and Julia L. Coronado and Susan H. McIntosh, The Impact of Qualified Tuition Savings Programs on Household Saving (Houston: IHELG Monograph 00-10, 2000). These studies were published by my Institute with support from the Ford Foundation and Andrew W. Mellon Foundation, although neither funding source endorses the publications.

Tables adapted from Michael A. Olivas, *State College Savings and Prepaid Tuition Plans: A Reappraisal and Review*, 32 J. L. & EDUC. 474 (2003)

Table of State 529 Plans

State Prepaid/ Start Administrative Website

Savings Date Agency

Alabama Prepaid Affordable College Tuition (PACT)	P	1990	Alabama State Treasurer	www.treasury.state.al.us
Alabama Higher Education 529 Fund	S	2002	Alabama State Treasurer	www.treasury.state.al.us
Alaska University of Alaska College Savings Plan	S	2001	University of Alaska & the Alaska Trust	www.uacollegesavings.com
T. Rowe Price College Savings Plan	S	2001	University of Alaska and the Alaska Trust	www.troweprice.com/collegesavings
Manulife College Savings	S	2001	University of Alaska and the Alaska Trust	www.manulifecollegesavings.com
Arizona Arizona Family College Savings Program (CSB)	S	1999	The Arizona Commission for Postsecondary Education	http://arizona.collegesavings.com
Arizona Family College Savings Program (SMR)	S	1999	The Arizona Commission for Postsecondary Education	www.smrinvest.com

Waddell & Reed InvestEd Plan	S	2001	The Arizona Commission for Postsecondary Education	www.waddell.com
Arkansas GIFT College Investing Plan	S	1999	Arkansas Tax Deferred Tuition Savings Program Investment Committee & Executive Director of the Arkansas Teacher Retirement System	www.thegiftplan.com
California Golden State Scholar Share College Savings Trust	S	1999	ScholarShare Investment Board	www.scholarshare.com
Colorado CollegeInvest-Prepaid Tuition Fund	P	1997	Colorado Student Obligation Bond Authority and State Treasurer	www.collegeinvest.org
CollegeInvest – Scholars Choice College Savings Plan	S	1999	Colorado Student Obligation Bond Authority and State Treasurer	www.collegeinvest.org (Colorado Residents); www.scholars-choice.com (national)
Connecticut The Connecticut Higher Education Trust Program	S	1999	The Connecticut State Treasurer	www.aboutchet.com
Delaware Delaware College Investment Plan	S	1998	Delaware College Investment Board	www.fidelity.com/delaware

Florida Florida Prepaid College Program	P	1987	Florida Prepaid College Board	www.floridaprepaidcollege.com
Florida College Investment Program	S	2002	Florida Prepaid College Program Board	www.floridaprepaidcollege.com
Georgia Georgia Higher Education Savings Plan	S	2002	Georgia Office of the Treasury and Fiscal Services and Georgia Higher Education Savings Plan	www.gacollegesavings.com
Hawaii Hawaii College Savings Program Tuition Edge	S	2002	The Hawaii Department of Budget and Finance	www.state.hi.us/budget/college/college.htm
Idaho Idaho College Savings Program (IDeal)	S	2001	Idaho College Savings Program Board	www.idsaves.org
Illinois College Illinois!	P	1998	Illinois Student Assistance Commission	www.collegeillinois.com
Bright Start College Savings Program	S	2000	Office of the State Treasurer	www.brightstartsavings.com
Indiana College Choice 529 Investment Plan	S	1997	Indiana Education Savings Authority chaired by the State Treasurer	www.collegechoiceplan.com

Iowa College Savings Iowa	S	1998	State Treasurer	www.collegesavingsiowa.com
Kansas Learning Quest Education Savings Program	S	2000	Kansas State Treasurer	www.learningquestsavings.com
Kentucky Kentucky Education Savings Plan Trust	S	1990	Kentucky Higher Education Assistance Authority	www.kentuckytrust.org
Kentucky's Affordable Prepaid Tuition (KAPT)	P	2001	KAPT Board of Directors & the Office of the State Treasurer	www.getkapt.com
Louisiana Student Tuition Assistance and Revenue Trust (START) Savings Program	S	1997	Louisiana Office of Student Financial Assistance, Louisiana Tuition Trust Authority, and State Treasurer	www.osfa.state.la.us/start.htm
Maine NextGen College Investing Plan	S	1999	Finance Authority of Maine and State Treasurer	www.nextgenplan.com
Maryland Maryland College Investment Plan	S	2001	Maryland Higher Education Investment Board	www.collegesavingsmd.org

Maryland Prepaid College Trust	P	1998	Maryland Higher Education Investment Board	www.collegesavingsmd.org
Massachusetts U.Fund College Investing Plan	S	1999	Massachusetts Educational Financing Authority	www.fidelity.com/ufund
U.Plan	P	1995	Massachusetts Educational Financing Authority	www.mefa.org
Michigan Michigan Education Trust	P	1988	MET Board of Directors and Department of Treasury	www.michigan.gov/treasury
Michigan Education Savings Program	S	2000	Michigan Department of Treasury	www.misaves.com
Minnesota Minnesota College Savings Plan	S	2001	Minnesota State Board of Investment and Minnesota Higher Education Services Office	www.mnsaves.org
Mississippi Mississippi Prepaid Affordable College Tuition (MPACT) Program	P	1997	Mississippi Treasury Dep't	http://www.treasury.state.ms.us/mpact.htm

Mississippi Affordable College Savings (MACS) Program	S	2001	Mississippi Treasury Dep't	www.collegesavingsms.com
Missouri Missouri Saving for Tuition (MO$T) Program	S	1999	Missouri Higher Education Savings Program Board, chaired by State Treasurer	www.missourimost.org
Montana Montana Family Education Savings Program	S	1998	The Montana Board of Regents of Higher Education	http://montana.collegesavings.com
Nebraska College Savings Plan of Nebraska	S	2001	State Treasurer and Nebraska Investment Council	www.PlanForCollegeNow.com
AIM College Savings Plan	S	2001	State Treasurer and Nebraska Investment Council	www.aiminvestments.com
Nevada Nevada Prepaid Tuition Program	P	1998	Bd of Trustees of the College Savings Plan of Nevada and the State Treasurer's Office	http://nevadatreasurer.com/prepaid
America's College Savings Plan	S	2001	Bd of Trustees of the College Savings Plan of Nevada chaired by state treasurer	www.americas529plan.com

American Skandia College Savings Program	S	2002	Bd of Trustees of the College Savings Plan of Nevada chaired by state treasurer	www.americanskandia.com
New Hampshire UNIQUE College Investing Plan	S	1998	State Treasurer	www.fidelity.com/unique
The Advisor College Investing Plan	S	2001	State Treasurer	www.advisorxpress.com
New Jersey New Jersey Better Educational Savings Trust (NJBEST)	S	1998	Higher Education Student Assistance Authority & the New Jersey Dep't of the Treasury, Division of Investment	www.hesaa.org/students/njbest
New Mexico The Education Plan's Prepaid tuition Program	P	2000	The Education Trust Board of New Mexico	www.tepnm.com
The Education Plan's College Savings Program	S	2000	The Education Trust Board of New Mexico	www.theeducationplan.com

CollegeSense	S	2001	The Education Trust Board of New Mexico	www.collegesense.com
Scholar'sEdge	S	2001	Education Trust Board of New Mexico	www.scholarsedge529.com
New York New York's College Savings Program	S	1998	Office of the State Comptroller and NYS Higher Education Services Corporation	www.nysaves.org
North Carolina North Carolina's National College Savings Program	S	1998	North Carolina State Education Assistance Authority	www.cfnc.org/savings
Seligman College Horizon Funds	S	2001	North Carolina State Education Assistance Authority	www.seligman529.com
North Dakota College Save	S	2001	Bank of North Dakota	www.collegesave4u.com
Ohio CollegeAdvantage Savings Plan	S	1989	Ohio Tuition Trust Authority	www.collegeadvantage.com

Putnam CollegeAdvantage Savings Plan	S	2000	Ohio Tuition Trust Authority	www.putnaminvestments.com
Oklahoma Oklahoma College Savings Plan	S	2000	Board of Trustees, Chaired by State Treasurer	www.ok4saving.org
Oregon Oregon College Savings Plan	S	2001	Oregon Qualified Tuition Savings Board, chaired by State Treasurer	www.oregoncollegesavings.com
Pennsylvania Tuition Account Guaranteed Savings Program (TAP)	S	1993	Pennsylvania State Treasury	www.patap.org
Rhode Island CollegeBoundfund	S	1998	Rhode Island Higher Education Assistance Authority and the State Investment Commission	www.collegeboundfund.com
South Carolina South Carolina Tuition Prepayment Program (SCTPP)	P	1998	State Treasurer	www.scgrad.org
FUTUREScholar 529 College Savings Plan	S	2002	Office of State Treasurer	www.futurescholar.com

South Dakota CollegeAccess	S	2002	South Dakota Investment Council	www.collegeaccess529.com
Tennessee Tennessee's BEST Prepaid College Tuition Plan	P	1997	Treasury Department and 9 member Board chaired by State Treasurer	www.treasury.state.tn.us/best.htm
Tennessee's BEST Savings Plan	S	2000	Tennessee's Baccalaureate Education System Trust & State Treasurer	www.tnbest.org
Texas Texas Tomorrow Fund	P	1996	State Comptroller's Office and the Texas Prepaid Higher Education Tuition Board	www.texastomorrowfunds.org
Tomorrow's College Investment Plan	S	2002	Texas Prepaid Higher Education Tuition Board	www.enterprise529.com
Utah Utah Educational Savings Plan Trust (UESP)	S	1997	Utah Higher Education Assistance Authority and State Treasurer	www.uesp.org

Vermont Vermont Higher Education Investment Plan	S	1999	Vermont Student Assistance Corp.	www.vsac.org
Virginia Virginia Prepaid Education Program	P	1996	Virginia College Savings Plan Board and its Executive Director	www.virginia529.com
Virginia Education Savings Trust (VEST)	S	1999	Virginia College Savings Plan Board and its Executive Director	www.virginia529.com
CollegeAmerica	S	2002	Virginia College Savings Plan Board and its Executive Director	www.americanfunds.com
Washington Guaranteed Education Tuition (GET)	P	1998	Washington State Higher Education Coordinating Board	www.get.wa.gov
West Virginia West Virginia Prepaid College Plan	P	1998	State Treasurer's Office under the authority of the West Virginia College Prepaid Tuition and Savings Program Board of Trustees	www.wvtreasury.com

SMART 529	S	2002	State Treasurer's Office	www.wvtreasury.com
Wisconsin EdVest College Savings Program	S	1997	Wisconsin College Savings Program Board and the Office of the State Treasurer	www.edvest.com
Tomorrow's Scholar	S	2001	Wisconsin College Savings Program Board and the Office of the State Treasurer	www.tomorrowsscholar.com
Wyoming College Achievement Plan	S	2000	State Treasurer	www.collegeachievementplan.com

Written Testimony of

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Before the

Committee on Financial Services
Subcommittee on Capital Markets, Insurance, and
Government Sponsored Enterprises

June 2, 2004

"Investing for the Future: 529 State Tuition Savings Plans"

Mr. Chairman and Members of the Committee, thank you for the opportunity to speak with you about 529 plans, and to share one state's history and philosophy regarding these plans. My name is Jacqueline Williams. I am the Executive Director of the Ohio Tuition Trust Authority and a member of the Executive Committee of the College Savings Plans Network.

The Ohio Tuition Trust Authority is a self-supporting state agency, governed by an 11-member Board of Directors. Ohio's Governor appoints six members representing business and higher education; the Speaker of the House and the Senate President each appoints one member from the respective legislative body from each political party and the Chancellor of the Ohio Board of Regents (or his designee) is an ex-officio voting member.

Ohio was one of the first states to offer a qualified tuition program when the Ohio General Assembly created the Trust in 1989. The legislative intent of the agency was to help make higher education affordable and accessible to Ohio citizens; to assist state universities by providing a stable financial base; to protect Ohio citizens from rising tuition costs; to encourage savings; and to promote elementary, secondary and post-secondary academic excellence. Since 1989, almost 25,000 students have attended college using over $232 million invested in Ohio's plan.

According to the recently completed report of the Governor's Commission on Higher Education and the Economy "only 11 states have a smaller portion of their populations who have earned baccalaureate degrees." The report concludes that Ohio's economic growth and prosperity are inextricably linked to increasing participation by Ohioans in higher education.

The Tuition Trust's mission is to offer affordable, innovative and tax-advantaged college investment products to help families save for college. Initially, the Tuition Trust offered Ohioans a unit-based prepaid tuition program. The Guaranteed Savings Fund was designed to help families keep pace with rising tuition costs at the state's public universities. The state provided an income tax exemption on earnings as an incentive for families to save. In 1994, the Ohio General Assembly supported a constitutional amendment to provide the state's full faith and credit backing to the Fund. In November 1994, Ohio voters supported the constitutional amendment putting the state's full financial support behind the program if the Fund could not meet future obligations.

In 1996, Congress established "qualified state tuition programs" adding section 529 to the IRC. Ohio's program fell under guidelines established for "Sec. 529 plans." The 1996 law paved the way for more states to begin their own college savings programs and broadened the tax incentives and savings options that could be offered.

In 1999, the Tuition Trust proposed legislative changes to the agency's statute to take advantage of federal changes to offer tax-advantaged, market-based choices. The Ohio General Assembly supported the Tuition Trust's decision to offer investment choice for Ohioans and unanimously approved the legislative changes. The General Assembly also expanded the tax incentive by providing a $2,000 state tax deduction on contributions to the Tuition Trust's college savings program.

The Tuition Trust undertook an extensive, competitive bid process to select and hire a firm to provide investment management, marketing and administrative services for the new investment options. The due diligence included on site examinations of bidders by staff, a review of fees by outside consultants and oral presentations by finalists. In 2000, the Tuition Trust hired Putnam Investments to manage the savings program. The firm was selected for their strong performance, commitment to customer service and ability to educate and sell the options to consumers through an extensive network of financial advisors.

The OTTA Board deliberately chose to offer the product through investment professionals to expand program access. In October 2000, the Tuition Trust launched the CollegeAdvantage 529 Savings Plan, which incorporated the Guaranteed Savings Fund and new market-based investments.

CollegeAdvantage is sold through financial advisors and directly through the Tuition Trust. The advisor-sold component offers 17 market-based options managed by Putnam and sold nationwide through financial advisors. The advisor-sold program is overseen by the Tuition Trust but marketed and administered by Putnam. The direct-sold program is overseen, marketed and administered by the Tuition Trust and offers the same investment options at a lower cost to Ohio residents.

Over the last four years, CollegeAdvantage has experienced significant growth. Through March, over $1.1 billion has been invested in Ohio through CollegeAdvantage on behalf of 186,000 beneficiaries. The average account value is $7,500.

While CollegeAdvantage has been successful in Ohio and across the country, the Tuition Trust continues to refine Ohio's 529 plans to meet the diverse needs of families saving for college. In the spring of 2003 the Tuition Trust commissioned a telephone survey of Ohioans with relatives under 18 to whom they felt some obligation to help with college. Among respondents who were saving, bank accounts were the most popular vehicle. While 9% were using CollegeAdvantage to save, 28% were using taxable investments. Fully half of all respondents were not saving for college.

Many respondents indicated they preferred a savings vehicle, with FDIC backing. Research also indicated that two-thirds of potential investors considered themselves to be "do-it-yourself" investors and would not seek the advice of financial advisors.

To meet the needs uncovered through research, the Tuition Trust took a two-step approach to broaden program appeal. In January 2004, the Tuition Trust issued an RFP to index fund managers for low-cost index options that would appeal to "do-it yourself" investors. Through a competitive selection process the Tuition Trust hired the Vanguard Group in March 2004 and in May, the Tuition Trust added 15 Vanguard index options to CollegeAdvantage.

The Tuition Trust will soon issue an RFP to Ohio banking institutions for a 529 savings account and at least one time deposit product insured by the FDIC. The goal is to introduce these products within the next year. The bank products would be available through a variety of the bank's distribution channels including branch locations, online bank centers, call centers, workplace programs, and other access points. With the addition of these products, the Tuition Trust will offer a well-rounded, diversified product line-up with appeal to Ohioans across all levels of income and investment experience.

In addition to offering broad investment choices, the Tuition Trust also encourages families to save for college by offering flexible contribution methods such as electronic fund transfers (EFT), payroll deduction, online contributions and low minimums contribution of $15.

The Tuition Trust also helps make saving for college affordable with some of the lowest fees in the industry through our direct-sold program. While total expense ratios vary by investment option, they can be as low as .35%.

The disclosure and reporting of fees and investment performance has been a critical priority for the Tuition Trust. Recently we completed an overhaul of all offering materials to simplify fee disclosure. These enhancements are setting a new industry standard for disclosure and full transparency. The Tuition Trust and CSPN support standardizing critical information such as total expenses, investment performance and establishing best practices for disclosing significant legal information.

Ohio's 529 plan is working to increase access to higher education in Ohio by offering a diverse range of investment choices, low fees, affordable minimum contributions, online access, easy contribution options and state tax advantages. These features make Ohio's program unique and tailored to the needs of Ohio families. While disclosure information should be standardized across the 529 industry, each state must be able to shape and define its own plan to meet the unique needs of its citizens.

Our mission is essential if Ohio is to achieve the Governor's goal of increasing participation in postsecondary education by 30% (or 180,000 students) by 2015. Every day we work with families one at a time to support their aspirations to achieve a better future for their children.

Thank you again, Mr. Chairman and Committee Members for your efforts to learn more about Ohio's plan and 529 plans across the country. We look forward to working with you and your Committee. I would be pleased to answer any questions.