Developments in Prepaid Tuition Plans (PTP) and 529 College Savings Plans (CSP) since 2003

Michael A. Olivas, University of Houston Law Center

In some respects, the recent story of 529 plans has resembled Dickens' ***A Tale of Two Cities***: "It was the best of times, it was the worst of times…." While the U.S. economy has had peaks and valleys, nearly every state has contributed less of its resources to public higher education appropriations, and as a result, tuition costs have increased to record levels, even outstripping inflation and cost indices. These pincer movements have clearly been the worst of times for 529's. The resultant rising tuition has made it impossible for states with 529 prepaid tuition plans to gauge pricing for those plans or to meet targets for guaranteeing plan terms. As a result, states have closed programs entirely, as in Wyoming, or closed plans to new participants, put plans on hold, or suspended operations until the plans can be restructured; for example, in Summer, 2006, Wyoming (which earlier had closed its 529 Prepaid plan) also closed its 529 savings plan, called the College Achievement

Plan, and coordinated with the Colorado CollegeInvest program for those who chose to keep their contracts. Eight of the nineteen states with prepaid plans (of either the guaranteed or unit variety) are either closed or not open in 2007, and more are sure to restructure. Even those states that have full faith and credit guarantees have had to reorganize their plans, as in Texas, which has suspended the operations of its popular Texas Tomorrow Fund until the predicted $3 billion actuarial shortfall can be dealt with. Maryland accountants have predicted at least a $70 million actuarial shortfall, and other state will be found to have similar deficits. In some states, such as Illinois and Texas, these public funds and their kissing-cousins, public lotteries, have even been seriously discussed as candidates for sale and privatizing. Several states have tightened up criteria, added "fees," reduced coverage for expenses, or "decoupled" tuition and the payout, in the hope of making the programs more sound.

In addition, fraud and poor management have reared their head in this market, as in criminal charges brought against the head of the

otherwise-successful Utah 529 plan, where the state not only lost money due to imbezzlement by the program's director, but had to pay a Securities and Exchange Commission (SEC) fine due to poor institutional oversight. Indeed, the industry has imposed new self-governing rules and policies to fend off greater regulation by the federal government, and Congressional hearings were held, where there were calls for such increased oversight. In 2004, the SEC found widely-divergent investment policies and results among the plans it studied. On November 15, 2006, the SEC imposed sanctions and issued a cease-and-desist order against 1st Global Capital Corp. for 529 sales practices and supervisory failures; it found that 1st Global violated MSRB rules in its sales of 529 plans to clients from 2001 through 2004 by its agents selling C-class units when A-class units would have produced better returns over the expected time period of investment. In 2006, the Municipal Securities Rulemaking Board MSRB) amended advertising and supervision rules to align with those of SEC and NASD. Even an international prepaid plan, based in the Philippines, became known when

its assets disappeared and left thousands of contract-purchasers without recourse.

Litigation has arisen in several settings, as in the SEC case against the Utah thefts and in the 1st Global Capital Corp. matter. In Kentucky, the state's Attorney General sued to prevent the state Legislature from allocating surplus state funds to the State's Kentucky Affordable Prepaid Tuition program (KAPT), which in 2007 is not accepting new participants. In state court in Illinois, litigation has arisen concerning the issue of state tax deductions for non-residents who purchase the plan for resident beneficiaries; in response, the State revamped its program in August, 2007 (H.B. 376), which removed the state tax on qualified distributions to an Illinois taxpayer from a non-Illinois 529 plan.

However, as in ***Tale of Two Cities***, these have also simultaneously been the best of times for 529 plans, especially with developments at the federal level. The Deficit Reduction Act of 2006 wrote important changes in parental assets determinations for federal financial aid

purposes. In the Tax Increase Prevention and Reconciliation Act, a technical loophole (in the “Kiddie Tax”) reconstituted how money set aside in college-savings plans is to be counted in determining a dependent student's eligibility for need-based financial aid if the account is in the student's name. Prior to this change, contributions made to college-savings plans, even under a student's name, would act to shrink a student's financial-aid award. Most importantly, the sword of Damocles was removed from the head of 529 programs when President George Bush signed into law the Pension Protection Act of 2006, which removed the plans’ original sunset provisions, which would have ended their life in 2010. As a result, the financial services industry has moved much more aggressively into the market, extending the reach and the scope of the 529 savings plans. In 2007 Congressional hearings, the Bush Administration proposed to make all 529-plan contributions tax deductible on federal income tax (by adding to the existing “saver’s credit” provisions). While not yet enacted, there is no doubt that the 529 savings plans are faring better at the federal level than they are at the

state operational level, especially in those states where both types of 529 plans co-exist in a single agency or department.

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