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Developments in 529 Prepaid Tuition Plans
(PTP) and College Savings Plans (CSP) Since 2003
Presentation: September, 2010,
Center for Social Security Studies (CSSS) of
Wuhan University, Wuhan, PRC

**IHELG Monograph** 

10-05

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

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Michael A. Olivas, University of Houston Law Center

Introduction:

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 its 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 529s. 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 the unit variety) are either closed or did not open by 2007, several are suspended, and more are sure to restructure. Even those states that have full faith and credit guaranties have had to reorganize their plans, as in Texas, which has suspended the operations of its popular Texas Tomorrow Fund (a prepaid plan) until the predicted \$3 billion actuarial shortfall can be dealt with. Maryland accountants have predicted at least a \$70 million actuarial shortfall, and other states 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. One issue that observers will be watching carefully in the prepaid/college tuition area is whether some states might decide to "privatize" these assets in order to gain a short-term, lump-sum buyout or lease by private investors, as has happened with some public transportation authority programs. Such actions are very troubling public policies, and raise many complex policy issues.

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 embezzlement by the director of the program, 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, at which where there were calls for 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 1<sup>st</sup> Global Capital Corp. for sales practices relating to 529s and for supervisory failures. Even an international prepaid plan, based in the Philippines, gained notoriety when its assets disappeared and left thousands of Filipino contract-purchasers without recourse, in a nation where there are no such things as student loans or work-study programs.

Litigation has arisen in several settings, as in the SEC case against the Utah thefts and in the 1<sup>st</sup> 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 stopped 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 2005 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, beginning in 2006, 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 W. 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 scope of the 529 savings plans.

State	Programs	Prepaid/ Savings	Start Date	Administrative Agency	
Alabama	Prepaid Affordable College Tuition (PACT)	Р	1990	Alabama State Treasurer	www.treasury.
Alabama	Alabama Higher Education 529 Fund	S	2002	Alabama State Treasurer	www.treasury.
Alaska	University of Alaska College Savings Plan	S	2001	University of Alaska and the Alaska Trust	www.uacollege
Alaska	T. Rowe Price College Savings Plan	S	2001	University of Alaska and the Alaska Trust	www.trowepric
Alaska	Manulife College Savings	S	2001	University of Alaska and the Alaska Trust	www.manulife
Arizona	Arizona Family College Savings Program (CSB)	S	1999	The Arizona Commission for Postsecondary Education	http://arizona.c

Arizona	Arizona Family College Savings Program (SMR)	S		1999	The Arizona Commission for Postsecondary Education		www.smrinves
Arizona	Waddell & Reed InvestEd Plan	S		2001	The Arizona Commission for Postsecondary Education		www.waddell.o
Arkansas	GIFT College Investing Plan	S		1999	Arkansas Tax Deferred Tuition Savings Program Investment Committee & Executive Director of the Arkansas Teacher Retirement System		www.thegiftpla
California	Golden State Scholar Share College Savings Trust	S		1999	ScholarShare Investment Board		www.scholarsh
Colorado	CollegeInvest-Prepaid Tuition Fund	P		1997	Colorado Studen State Treasurer	t Obligation Bond Authority and	www.collegein
Colorado	CollegeInvest – Scholars Choice College Savings Plan	S		1999	Colorado Student Obligation Bond Authority and State Treasurer		www.collegen www.scholars-
Connecticut	The Connecticut Higher Education Trust Program	S		1999	The Connecticut	State Treasurer	www.aboutche
Delaware	Delaware College Investment Plan	S		1998	Delaware Colleg	e Investment Board	www.fidelity.c
Florida	Florida Prepaid College Program	P		1987	Florida Prepaid College Board		www.floridapr
Florida	Florida College Investment Program	S		2002	Florida Prepaid College Program Board		www.floridapr
Georgia	Georgia Higher Education Savings Plan	S		2002	Georgia Office of the Treasury and Fiscal Services and Georgia Higher Education Savings Plan		www.gacollege
Hawaii	Hawaii College Savings Program Tuition Edge	S		2002	The Hawaii Department of Budget and Finance		www.state.hi.u
Idaho	Idaho College Savings Program (IDeal)	S		2001	Idaho College Savings Program Board		www.idsaves.c
Illinois	College Illinois!	P		1998	Illinois Student A	Assistance Commission	www.collegeill
Illinois	Bright Start College	S		2000	Office of the State Treasurer		www.brightsta
	Savings Program						
Indiana	College Choice 529	S		1997	Indiana Education Savings Authority chaired by the		www.collegecl
Iowa	Investment Plan College Savings	S		1998	State Treasurer State Treasurer		www.collegesa
10 wa	Conege bavings	5		1770	State Treasurer		www.conegesc
Kansas	Learning Quest Education Savings Program	S		2000	Kansas State Treasurer		www.learningo
Kentucky	Kentucky Education Savings Plan Trust	S		1990	Kentucky Higher	r Education Assistance Authority	www.kentucky
Kentucky	Kentucky's Affordable Prepaid	P	2001	Directo	Board of ors & the Office	www.getkapt.com	
Louisiana	Tuition (KAPT) Student Tuition Assistance and Revenue Trust (START) Savings Program	S	1997	of the State Treasurer Louisiana Office of Student Financial Assistance, Louisiana Tuition Trust Authority, and State			
Maine	NextGen College Investing Plan	S	1999	Finance Maine	Treasurer Finance Authority of www.nextgenplan.com Maine and State Treasurer		

Maryland	Maryland College Investment Plan	S	2001	Maryland Higher Education Investment Board	www.collegesavingsmd.org
Maryland	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
Massachusetts	U.Plan	P	1995	Massachusetts Educational Financing Authority	www.mefa.org.
Michigan	Michigan Education Trust	P	1988	MET Board of Directors and Department of Treasurer	www.michigan.gov/treasury
Michigan	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 Department	www.treasury.state.ms.us/
Mississippi	Mississippi Affordable College Savings (MACS) Program	S	2001	Mississippi Treasury Department	www.collegesavings.ms.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
Nebraska	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
Nevada	America's College Savings Plan	S	2001`	Bd of Trustees of the College Savings Plan of Nevada chaired by state treasurer	www.americas529plan.com
Nevada	American Skandia College Savings	S	2002	Bd of Trustees of the College Savings Plan	www.americanskandia.com

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	Program			of Nevada chaired by	
NT.	LINIOUE C. II.	C	1000	state treasurer	C 1.1'4
New	UNIQUE College	S	1998	State Treasurer	www.fidelity.com/unique
Hampshire	Investing Plan	C	2001	Ct. t. Thursday	. 1
New	The Advisor College	S	2001	State Treasurer	www.advisorxpress.com
Hampshire	Investing Plan	C	1000	Higher Education	
New Jersey	New Jersey Better	S	1998	Higher Education	www.hesaa.org/students/njbest
	Educational Savings			Student Assistance	
	Trust (NJBEST)			Authority & the New	
				Jersey Dep't of the	
				Treasury, Division of	
N N .		ъ	2000	Investment	
New Mexico	The Education Plan's	P	2000	The Education Trust	www.tepnm.com
	Prepaid Tuition			Board of New Mexico	
	Program	~	• • • •		
New Mexico	The Education Plan's	S	2000	The Education Trust	www.theeducationplan.com
	College Savings			Board of New Mexico	
	Program				
	G 11 G	~	2004		**
New Mexico	CollegeSense	S	2001	The Education Trust	www.collegesense.com
	~ <del>.</del>	~	2001	Board of New Mexico	
New Mexico	Scholar's Edge	S	2001	Education Trust Board	www.scholarsedge529.com
NY NY 1	N W 11 G 11	a	1000	of New Mexico	
New York	New York's College	S	1998	Office of the State	www.nysaves.org
	Savings Program			Comptroller and NYS	
				High Education	
XX 4	V 1 G 11 1	~	1000	Services Corporation	
North	North Carolina's	S	1998	North Carolina State	www.cfnc.org/savings
Carolina	National College			Education Assistance	
XX4	Savings Program	~	2001	Authority	
North	Seligman College	S	2001	North Carolina State	www.seligman529.com
Carolina	Horizon Funds			Education Assistance	
N 4 D 1	C 11 C	a	2001	Authority	11 4
North Dakota	College Save	S	2001	Bank of North Dakota	www.collegesave4u.com
Ohio	Collogo Adventage	C	1000	Ohio Tuition Trust	www.acllagardvantaga.com
Ohio	CollegeAdvantage	S	1989		www.collegeadvantage.com
Ohio	Savings Plan Putnam	S	2000	Authority Ohio Tuition Trust	
Ollio		S	2000		www.putnaminvestments.com
	CollegeAdvantage			Authority	
Oklahoma	Savings Plan Oklahoma College	S	2000	Board of Trustees,	www.ok/soving.org
Oktanonia	Savings Plan	S	2000	Chaired by State	www.ok4saving.org
	Savings I lan			Treasurer	
Oregon	Oregon College	S	2001	Oregon Qualified	www.oregoncollegesavings.com
Olegon	Savings Plan	S	2001	Tuition Savings Board,	www.oregoneonegesavnigs.com
	Savings I lan			chaired by State	
				Treasurer	
Pennsylvania	Tuition Account	S	1993	Pennsylvania State	www.patap.org
1 Cillisyivailla	Guaranteed Savings	S	1773	Treasury	www.patap.org
	Program (TAP)			i i casui y	
Rhode Island	CollegeBound Fund	S	1998	Rhone Island Higher	www.collegeboundfund.com
Miode Island	Conegebound Fund	S	1770	Education Assistance	www.conegeoodiidiuid.com
				Authority and the State	
				Investment	
				Commission	
South	South Carolina	P	1998	State Treasurer	www.scgrad.org
Journ	South Carollia		1770	State Housuldi	"" " "" " " " " " " " " " " " " " " "

Carolina	Tuition Prepayment Program (SCTPP) FUTUREScholar 529	C	2002	Office of State	www.futurosahalar.com
South Carolina	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	Tennessee's BEST Savings Plan	S	2000	Tennessee's Baccalaureate Education System Trust and 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
Texas	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 Corporation	www.vsac.org
Virginia	Virginia Prepaid Education Program	P	1996	Virginia College Savings Plan Board and its Executive Director	www.virginia529.com
Virginia	Virginia Education Savings Trust (VEST)	S	1999	Virginia College Savings Plan Board and its Executive Director	www.virginia529.com
Virginia	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
West Virginia Wisconsin	SMART 529 EdVest College Savings Program	S S	2002 1997	Treasurer's Office Wisconsin College Savings Program Board and the Office of the State Treasurer	www.wvtreasury.com www.edvest.com

Wisconsin	Tomorrow's Scholar	S	2001	Wisconsin College	www.tomorrowsscholar.com
				Savings Program	
				Board and the Office	
				of the State Treasurer	
Wyoming	College Achievement Plan	S	2000	State Treasurer	www.collegeachievementplan.com

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#### A. Developments in individual states:

In a certain (and sad) sense, the developments in the individual states show the institutionalization of 529 plans: widespread acceptance, news about their shortfalls, commercial exploitation, and even scandals all show the extent to which the plans have been accepted into the financial system. Financial scandals with elected and appointed officials surfaced and involved 529 plans in Utah, Nevada, and New Mexico. Utah settled with SEC investigators after an investment fraud scandal, and the lieutenant governor of Nevada was accused of being implicated in problems with that state's program, ones that arose when he had been state treasurer, with responsibility for the 529 plans. The charges were later dropped, and he is a candidate for governor in Fall, 2010. In other states, investigations have followed the major losses that occurred to state funds during the financial crises of 2008 to the present.

Every Spring, a widely-read Morningstar rating study ranks the various state plans, which draws attention to the overall performance of the programs, and which causes several states to try and shore up their weak plans, such as Ohio, New Mexico, Alabama, and Texas have done in recent years. Texas even allowed worried investor-parents to pull out of their contracts, and more than 7,000 did so, further plunging the 529 program into a weakened state. Improved performance of the stock markets and improved financial investments have partially improved the situation for many of the plans, but full restoration will be long in coming, and public confidence in the programs has waned. These complex investments are not always understood by purchasers, and they are genuinely complicated. In 2009, as one example, Ohio's portfolio had both the best-performing (OTTA) and an option among the worst-performing for the year (the broker-sold Putnam CollegeAdvantage@ funds).

Several states have sued individual funds, charging fraud, mismanagement, bribery, and other theories to account for the poor performance of investments. One such multi-state action was undertaken by Oregon and other states against Oppenheimer, while in New Mexico (one of

the co-plaintiffs in the Oregon suit), the 529 program was the defendant against a group of parent-contract holders. Other states have brought actions, where the defendant investment brokers settled, as in Alabama, where J.P. Morgan settled charges.

The Best 529 College-Savings Plans (2009)

8 8	` /
Best 529 College-Savings Plans	
Ohio CollegeAdvantage	Ohio Tuition Trust
	Authority
Indiana CollegeChoice 529 Direct	Upromise
Savings Plan	Investments
Utah Educational Savings Plan Trust	UESP Trust
Virginia Education Savings Trust	Virginia College
	Savings Plan Board
Virginia CollegeAmerica 529 Savings	
Plan*	American Funds
*Broker-sold	
(Morningstar, 2009)	

The Worst 529 College-Savings Plans (2009)

Worst 529 College-Savings Plans	
Nebraska State Farm College	
Savings Plan*	OppenheimerFunds
New Jersey Best 529 College	
Savings Plan	Franklin Templeton
Montana Pacific Life Funds 529	
College Savings Plan	Pacific Life Funds
Ohio Putnam CollegeAdvantage*	Putnam
Nebraska AIM College Savings	Invesco Aim Capital
Plan*	Management

(Morningstar, 2009)

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challenged, as Ohio's fundamental challenge to the way that ratings agencies operated. Investors, including public fund managers, have gone to court to recover billions of dollars from worthless or low-grade bonds on which the rating agencies had conferred their highest grades; in July, 2009, the country's largest pension fund (the California Public Employees Retirement System) filed a lawsuit in California state courts, claiming that "wildly inaccurate ratings" caused nearly \$1 billion in losses. In November, 2009, Ohio sued Moody's Investors Service, Standard & Poor's and Fitch, claiming that the rating services (which account for analyzing and rating over three quarters of the U.S. credit market) had cost state retirement and pension funds almost one half billion dollars by approving high-risk Wall Street securities that were improperly rated by flawed or collusive methodologies and models.

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#### C. General finance and bonds

The unfortunate developments in 529 plan bond and credit markets since the mid-2005 period were writ large in even larger sums in the general finance and bond markets, of which the 529 plans are essentially a subset for states. The massive losses in these investments have not yet been recovered in the sluggish world economy, and a number of irregularities, mistakes, and sheer incompetence surfaced to tank a number of these huge funds. Moreover, these funds include many other public infrastructure projects such as airports, public authorities, highway trust funds, and other extremely large public investments that have proven to be tempting sources of bonding capacity, investment leverage, construction projects, pension funds, and debt

financing for the wide array of public expenditures, vastly overshadowing the college and 529 sectors. In this vast universe of funds, Chicago's Midway Airport has been privatized, toll roads and highways have been sold to private, foreign investors, and lotteries have been proposed as auction assets—all in an attempt to balance books in jurisdictions that may have constitutional obligations to present annual "balanced budgets" or to shore up historically-underfunded investment funds such as those responsible for schools, colleges, and pension funds.

Even small losses or sluggish gains in these funds ripple through the economy, as many of them depend upon growth to fund other leveraged components, such as highway or transportation bonds tied to garage/toll/ticket/sales revenues. Virtually every municipality depends upon tax receipts, as do schools and other public enterprises. The declining economy produces less revenue, and the high unemployment equates to less spending and taxes paid; even the revenue-sharing provisions of federal stimulus money in 2009-2010 cannot make up for the deficits. In one extreme example, San Carlos, a small city in California, disbanded its police services and subcontracted them to the nearby San Mateo County Sheriff office in September, 2010, after evaluating its declining sales tax revenues and city tax base.

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#### D. General higher education finance, including 529 plans

As dismal as the situation has been for municipalities and states, at least their revenue sources are large and diversified, and there are some means at the disposal of elected officials to tax and fund programs and services. Colleges, especially public institutions are more limited in their capacity to adapt in difficult financial times. At the income level, there are only a few ways in which they can increase revenue, which in turn depend upon the ability of students to pay tuition, often discounted by institutional aid and scholarships, the ability of states to fund general appropriations, which are often the most-discretionary component of states' budgeting practices, and auxiliary funds or investment income, which are dependent upon the size of the institutional endowment and market returns on investments. On the expenditure side of the ledger, expenses are often fixed in advance of students appearing each fall for class, in faculty and staff personnel

costs, and in the need for growing infrastructure costs for facilities, utilities, and other program needs. Higher education finances are often premised upon impossible business practices, and governmental models of support essentially follow the students, necessitating enrollment growth in a competitive market, one where proprietary schools with contingent faculty, rental facilities and thin infrastructures have increased their market share and can peddle their wares more cheaply and effectively than traditional collegiate institutions in the college casbah.

The increased college costs and sluggish baccalaureate job markets have resulted in more students working while in college, spreading their collegiate careers over more years, with growing reliance upon loans that must be repaid at the time of their employment, if they can secure work in a difficult job market. Of course, this makes college completion and loan repayment much more difficult, even with contingent-loan repayment options available to some graduates. Additional developments include the reduced ability of parents to invest in savings programs in a stagnant economy, where unemployment is at high levels. Even previously-available mechanisms such as taking out second home mortgages to finance children's college educations have been squeezed out by tightened lending practices and reduced or declining home values. Inevitably, excesses in such funding mechanisms have been constrained, and the resulting squeeze has occurred at a time when the perfect storm of declining family resources and rising college costs intersect.

In a perfect world, parents will invest small sums along the 18 year trajectory of their children's college preparation, and the full resources would be ripe when they are needed. This system no longer works in practice for most parents, who instead face unemployment, declining home values, increased costs of living, and higher education costs that outstrip inflation---with concomitant declining subsidies for college attendance, increased reliance upon the tax code for much familial support, but which is only available to the wealthier stratum of society, who earn enough money for tax relief to be a genuine resource. The financial slowdown of the recent half dozen years has taken a substantial toll upon this most discretionary sector of the United States economy, and the signs are all pointing against recovery in the near future. Ironically, at a time when US dominance in this sector is likely at its apex, participation rates have eroded at the time other competitor countries have begun to invest substantially in their higher education sectors, both for economic and political ambitions.

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