



COLLEGE SAVINGS ACCOUNTS 101

An educated and skilled workforce is critical to Texas' economic vitality and competitiveness. However, Texas' low educational attainment poses tremendous challenges for the future. Rising tuition and limited financial aid also present Texas families and students with considerable barriers in paying for college and postsecondary training. Without substantial intervention, this trend is likely to continue, leaving many students locked out of higher education and a brighter future. 529 College Savings Plans offer important tools for increasing educational levels by improving K-12 student achievement, minimizing dropouts, supporting our lagging financial aid system, and reducing dependence on expensive student loans. To date, however, the Texas plans have yet to reach their full potential. As with most savings and investment vehicles, low-income families may face barriers to participation because they have a limited ability to save for the future. Texas can overcome these barriers by developing policies that help families save for their children's education, such as matching their contributions to a 529 plan. Increasing participation in these college savings plans should be a vital component of statewide efforts to increase college enrollment and completion. This policy page introduces college savings plans, how they operate, and why a matched savings policy can move Texas forward.

Overview of 529 College Savings Plans

Section 529 college plans are tax-exempt college savings vehicles with relatively high contribution limits and low impact on need-based financial aid eligibility. There are two distinct types of 529 plans: prepaid tuition and college savings plans. Prepaid tuition plans enable accountholders to purchase tuition units at current prices, while college savings plans—the more commonly used plan—are similar in many ways to retirement plans, such as 401(k) and IRAs. Withdrawals for qualified educational expenses are tax free. Traditionally, the owner of the 529 account would be a parent or guardian, while the account beneficiary would be a child who is a prospective student in higher education.

Each state offers at least one 529 plan, and all state-sponsored 529 savings plans are open to everyone, regardless of state residency. States have the flexibility to design various features of their respective plans. The plans are typically administered by an investment management firm. To encourage plan contributions, most states offer a state income tax deduction for qualified contributions.¹

Additionally, several states offer matching grants and enrollment bonuses to eligible residents.

Because Texas is among the nine states without a state income tax, Texas must take full advantage of these other incentives in order to boost participation in its 529 plans. (Currently, 41 states have a state income tax. Of these states, 33 offer a state income-tax deduction for in-state plan contributions. Four—Arizona, Kansas, Maine, and Pennsylvania—provide for state tax parity, where contributions to any state plan are eligible for the state's income tax deduction.)

User fees and financial performance also play a major role in influencing decisions about 529 plans. Nationwide, participation in 529 plans is growing rapidly. In 2007, investors held more than \$100 billion in these plans, up from \$2.6 billion in 2000. Many financial analysts predict 529 plan assets to double in the next five years.

The Texas Experience with 529 Plans

The Texas Tomorrow Fund

From 1996-2003, the Texas Guaranteed Tuition Plan, also known as the Texas Tomorrow Fund, enabled more than 150,000 accountholders to pre-purchase all or a portion of undergraduate tuition at then-current rates. Largely due to tuition deregulation and unsound actuarial projections, the plan closed to new enrollees in 2003. However, Texas is obliged to honor its full commitment to those individuals who remain enrolled in the Texas Tomorrow Fund.

During the 2007 legislative session, the Texas Legislature enacted HB 3900, which established the Texas Tomorrow Fund II (TTF II), a new prepaid tuition plan. The new law allows enrollees to purchase tuition units among three price tiers at current prices. The TTF II is expected to open to new enrollees by September 2008.

Texas Save & Match Program

HB 3900 also created the *Texas Save & Match* Program as a means to increase participation in the prepaid tuition plan by lower-income families. Texas is the first state to include a matching program for its prepaid tuition plan.

Among other features, the *Save & Match* provisions require the Prepaid Tuition Board (Board), an arm of the Comptroller's office, to:

- Develop a tuition unit matching program for beneficiaries who reside in households with earnings below the state's median family income; and
- Promote enrollment in the Texas Tomorrow Fund II among low- and moderate-income families to help meet the targets established in *Closing the Gaps*, Texas' master plan for increasing educational attainment.

HB 3900 also requires the Board to coordinate outreach and marketing efforts with the Health & Human Services Commission (HHSC), the Texas Workforce Commission (TWC), and the Texas Higher Education Coordinating Board (THECB) and align these marketing and outreach efforts with Earned Income Tax Credit (EITC) outreach.

This year, the Comptroller will design the features of the Texas Save & Match program.

The Texas College Savings Plan

For the past several years, Texas' 529 savings plan—formerly known as Tomorrow's College Investment Plan—was one of the nation's poorest performing plans, with high fees and low financial returns. Administered by Enterprise Capital Management, the Texas plan had only 22,000 accountholders and approximately \$240 million in total assets. By comparison, Virginia's 529 plan is more than 10 times larger with nearly \$28 billion in assets. As a result of this lackluster performance, the Texas Comptroller changed fund managers and launched an initiative to revamp Texas' 529 savings plan.

In November 2007, the Comptroller inked a new contract with Oppenheimer Funds Inc. (OFI) to administer the newly entitled Texas College Savings Plan. OFI also operates college savings plans for Illinois, New Mexico, and Oregon. To boost plan enrollment and assets, OFI plans a statewide marketing campaign.

Both OFI and the Comptroller recognize the need to offer incentives to encourage more Texans to enroll in the savings plan. The contract includes a provision that requires Oppenheimer to "establish a scholarship fund from fees paid to Contractor by plan participants," once total plan assets reach \$500 million. The Comptroller would be charged with setting the criteria for scholarship recipients. The contract language is flexible enough to allow Oppenheimer to develop a mechanism for matching the savings of some accountholders, similar to the *Save & Match* provisions in the Texas Tomorrow Fund II.

Why Texas Would Benefit from a Matched Savings Plan

To boost college savings among low-income families, several states have enacted matching grant programs as part of their 529 plans. Some of these programs include enrollment bonuses for eligible state residents, and are funded through a range of sources, including private donations, state appropriations, and redirected plan fees.

STATE 529 MATCHING GRANTS

State	Eligibility	Funding
Arkansas	Adjusted Gross Income less than \$60k	\$250,000 (2 years of pilot funding)
Colorado	Income up to 200% of federal poverty level	Subject to annual appropriation
Kansas	Income below 200% of federal poverty level	Three-year pilot limited to about 1,000 accounts a year
Louisiana	All state residents (Sliding match scale based on income)	Subject to appropriations
Maine	Family adjusted gross income of \$75,000 or less	User fees charged to national accountholders ⁱⁱ
Michigan	Adjusted gross income of \$80,000 or less	Annual state appropriation (tobacco settlement)
Minnesota	Adjusted gross income of \$80,000 or less	Annual appropriation
North Dakota	Adjusted gross income of \$40,000 or less	User fees
Rhode Island	Adjusted gross income at or below state median income	User fees
Utah	Income up to 200% of federal poverty level	State appropriation (pilot funding for 150 families)

Source: Center for Social Development, *State 529 Matching Grant Program Summary*, 2008.

Another common incentive used by states to encourage 529 enrollment and contributions is the state income tax deduction. Over three-quarters of eligible states offer a state income tax deduction for qualified accountholders. As noted, with no state income tax, Texas lacks the primary incentive for savings plan enrollment and contributions, especially for Texans with modest incomes. Also, some states exempt 529 savings when determining eligibility for state financial aid.

Texas has had success with a matched savings program targeted for modest-income residents. Individual Development Accounts (IDAs) are special matched savings accounts. Each dollar a participant saves is matched by public and/or private sources. The program's ultimate goal is to help families purchase an asset, such as attending post-secondary school, buying a home, or expanding or starting a business. From 2000-2006, more than 2,000 participants used their IDAs to purchase an asset. These Texans saved over \$3.6 million, which was matched by over \$6.4 million. These pooled resources leveraged over \$57 million in assets. Without a savings match, it is

unlikely that any of these Texans would have saved or purchased assets.

Texas can achieve similar success by developing robust savings incentives for the Texas College Savings Plan and the Texas Tomorrow Fund II. A matched college savings plan would benefit all Texans. Enabling a wider range of Texans to afford college would increase the skills of our workforce and boost our economic competitiveness.

Upcoming Event

To get involved in the college savings campaign, please take part in the RAISE Texas Action Summit, RAISE Texas Action Summit: Moving Texans Toward Financial Success, on April 29-30. Registration information is still available at <http://dallasfed.org/news/ca/2008/08raise.cfm>.

More information on the four major campaigns—Matched Savings Accounts; Community Tax Centers and EITC; Alternative Small Dollar Consumer Loan Products; and Home Mortgage Foreclosure Prevention—is available online at <http://www.covenantcapital.org/html/publicpolicy/activities.html>.

The Benefits of College Savings Accounts

- **Federal Tax Benefits:** Earnings in 529 plans grow tax deferred, and qualified withdrawals are exempt from the federal income tax.
- **College-Going Culture:** Preliminary research indicates that college savings accounts instill inevitability about college attendance that helps students navigate the K-12 educational system.
- **Community Piggy Bank:** 529 plans allow an unlimited number of account contributors for the same beneficiary, enabling households to seek help from family members and friends in investing in their children's educational future.
- **Flexibility:** 529 funds can be used at any U.S.-accredited postsecondary educational institution offering credit toward a bachelor's degree, an associate degree, a graduate-level degree or professional degree, or another recognized postsecondary credential, including technical and trade courses. They can also be used for a wide range of higher education expenses, including tuition, mandatory fees, books, supplies, and equipment.

Resources

Texas

Texas Tomorrow Funds:

<http://www.texas tomorrowfunds.org/>

Texas College Savings Plan:

<https://www.texascollegesavings.com/>

Comptroller:

<http://www.window.state.tx.us/news2007/071119-collegeplan.html>

National

CFED SEED Initiative:

<http://www.cfed.org/focus.m?parentid=31&siteid=288&id=288>

Center Social Development:

http://gwbweb.wustl.edu/csd/SEED/seed_researchpapers.htm

New America Foundation:

http://www.newamerica.net/programs/asset_building#

¹ In December 2007, the late philanthropist Harold Alfond, through the Eponymous Foundation, created the Harold Alfond College Challenge. The challenge provides a \$500 scholarship gift to be invested in a NextGen College Investing Plan account for each newborn Maine resident. Visit <http://www.famemaine.com/NextGen/maineResidentBenefits/overview.asp> for more information on Maine's NextGen plan—considered a national model—and the College Challenge.

To learn more, sign up for e-mails, or make a donation, go to www.cppp.org.

The Center for Public Policy Priorities is a nonpartisan, nonprofit research organization committed to improving public policies to better the economic and social conditions of low- and moderate-income Texans.