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]

<u>Section 529 State College Savings Plans Promote Savings</u>

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 15^{th} 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

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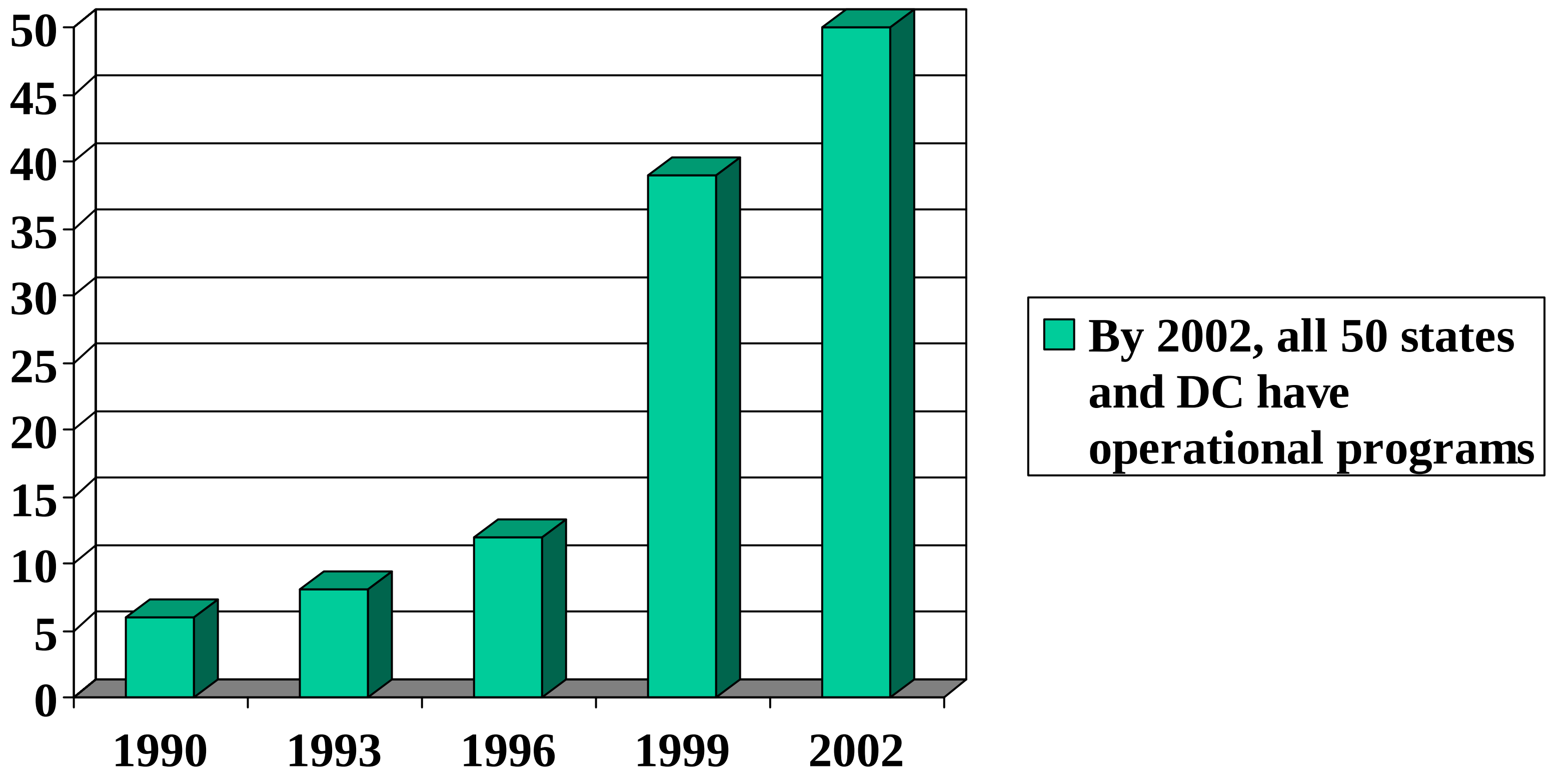
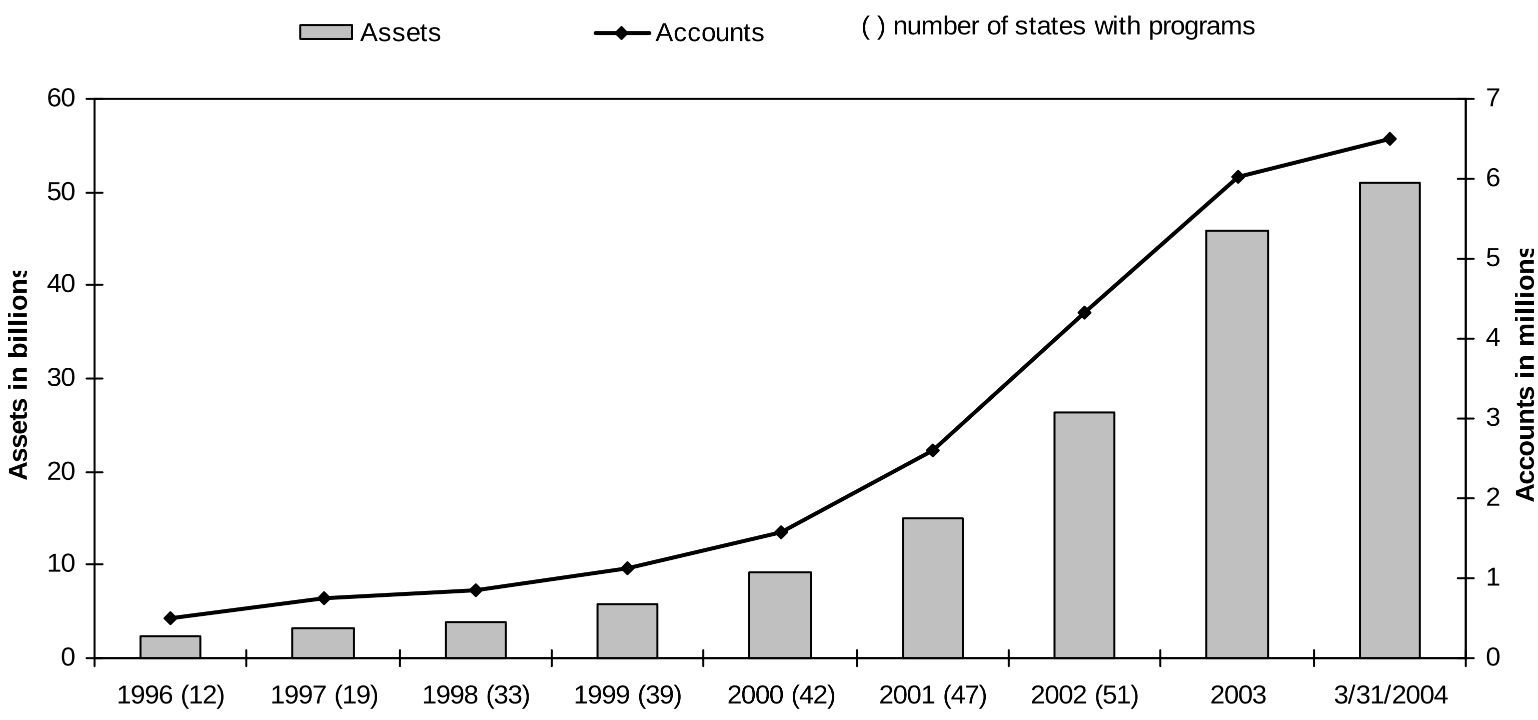
State or other territory	Value of Actual Funds	Total Number of Accounts	Total Distributions	Beneficiaries / Accounts with Distributions	Date of Inception
New Mexico Prepaid	$384,548	110	$27,848	7	Sept-00
New Mexico Savings	$812,731,871	114,328	$20,365,697	4,622	Sept-00
New York	$2,623,099,434	291,174	$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)