College Savings Nation 2018: Trends and Opportunities

April 2018

Overview

As the Municipal Advisor to more than fifteen public administrators of 529 Plans today, AKF Consulting Group is pleased to report on the college savings market available to American families in 2018. Over 2017, college savings plan assets grew to more than $294 billion across 12.2 million accounts, representing a 16.9 percent increase over 2016 assets.[1] Growth should continue in 2018, particularly with college savings plans expanding to cover K-12 tuition costs, as described below.

College savings plans offered directly to the public ("Direct Plans") drove the growth in assets and accounts as opposed to plans offered only through financial advisors ("Advisor Plans"). We attribute the success of Direct Plans to the low cost investment options, the increased awareness of the burdens of student loans, and more visible marketing nationwide. We also note that registered investment advisors ("RIAs") may be playing a more significant role than in the past.

We also note that the 529 market now has its first robo advisor plan — offered by Wealthfront through Nevada — with an all-ETF line-up, low asset-based fees, and no investment advisory fees for small accounts held by Nevada residents. Other new plans are carving their niche by adding asset classes such as real estate and Treasury inflation protected securities in their investment line-ups.

The most dominant "disrupter" in the 529 industry is the recent change to Section 529, which now allows families to make qualified withdrawals for public, private and religious K-12 tuition expenses. Policy makers' reactions across the nation have been mixed and, as a result, in some States individuals must decide whether the K-12 withdrawals they make are actually qualified for purposes of the State in which they pay taxes. We are actively tracking how States are adjusting to this major change to Section 529.

Finally, the 529 Industry has several unique opportunities for future growth. We continue to believe that 529 plans offered through the workplace would be market game changers. Additionally, 529 Advisor Plans are adapting to technology enhancements and to share class adjustments, which present further opportunities to create market growth.

Method

Data for this AKF Market Report was aggregated through a review of disclosure documents for 89 college savings plans.

[1] Asset and account data from College Savings Plans Network with clarification from certain States

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Findings and Observations

Since our 2016 College Savings Market Report, the number of available savings plans has decreased from 90 to 89. As shown in the following chart, Direct Plans continue to outnumber Advisor Plans by a factor of two to one:

Data as of		October 2014			April 2016			April 2018		
Plan Type		Direct	Advisor	Direct and Advisor	Direct	Advisor	Direct and Advisor	Direct	Advisor	Direct and Advisor
Savings	Open Plans	60	31	1	59	30	1	59	30	0
Savings	Investment Options	723	675	8	733	656	8	769	668	0
Open Prepaid Plans		13			12			12[2]		

Changes in the number of Plans since April 2016 reflect the following:

- Nevada Wealthfront Advisor Plan, the first robo advisor plan offered nationwide, launched in October 2016
- District of Columbia collapsed its Advisor Plan into the Direct Plan after a March 2017 change in Program Manager
- Virginia CollegeWealth Plan assets rolled into the Invest529 FDIC-insured accounts as of April 2017
- Illinois Bright Start Advisor was merged into Bright Directions following a Program Manager change in July 2017

Most new investment options result from these Plan changes in Nevada, District of Columbia and Illinois, as well as from the relaunched Rhode Island Plans under Ascensus and Invesco, and the revamped Michigan Advisor Plan under Nuveen.

Direct Plans: Expanded Market Share

Over the last several years we have seen Direct Plans growing at a faster rate than Advisor Plans. While the following data from the College Savings Plans Network ("CSPN") only distinguishes Direct and Advisor Plans as of 2009, we believe the difference would be more pronounced had the data extended further back. The charts below show the breakdown of Direct versus Advisor Plan assets and accounts, with the cross-over representing the year in which Direct Plans exceeded Advisor Plans in market share.

[2] Includes: Alaska, Florida, Maryland, Massachusetts, Michigan, Mississippi, Nevada, Pennsylvania, Texas, Virginia, Washington and Private College 529. Enrollment in the Illinois Plan is temporarily suspended

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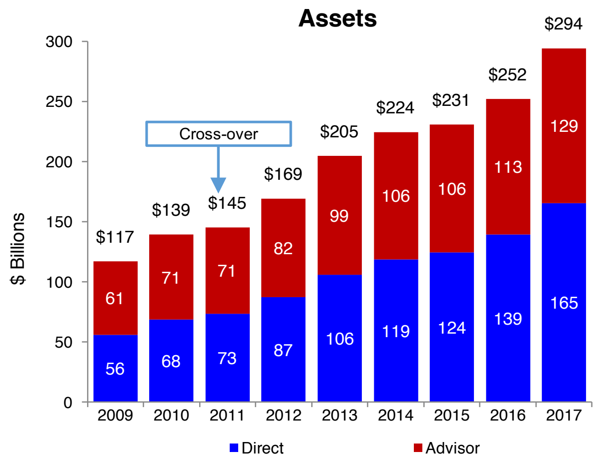
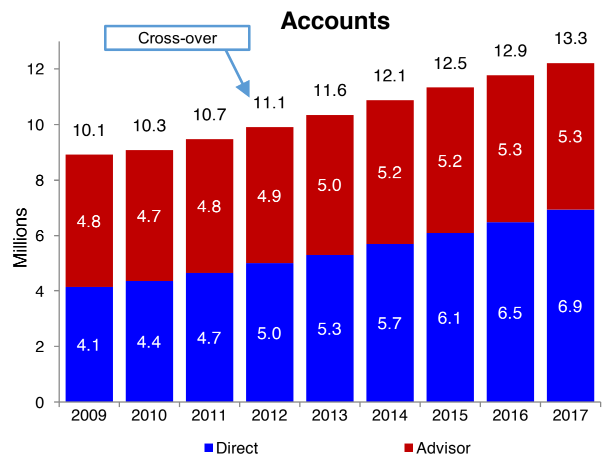
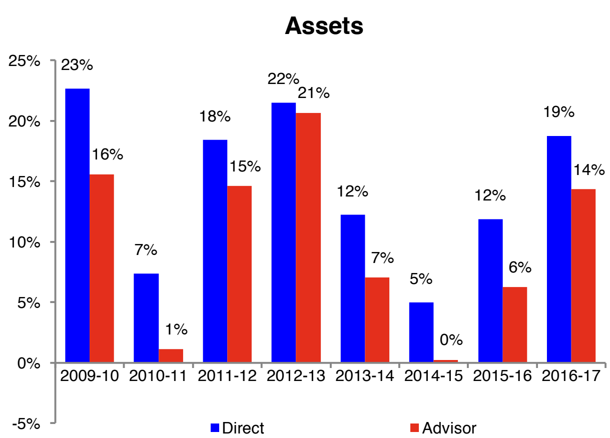
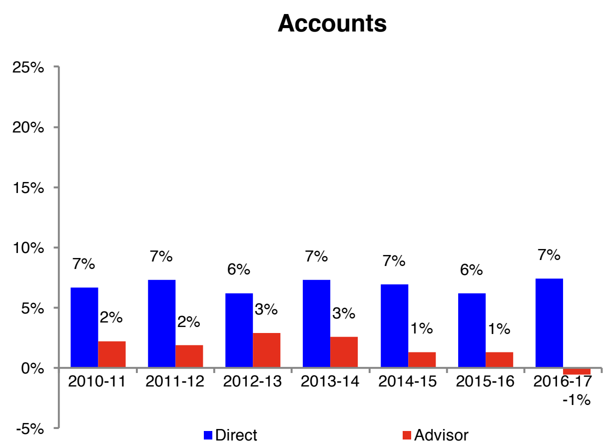




The following charts show the comparative growth between Direct and Advisor Plans, confirming that overall market growth is driven by investors in Direct Plans:





We attribute the change in market share to (i) lower cost, high quality investment options in Direct Plans, (ii) increased awareness of the burdens of student loan debt, and (iii) increased visibility of Direct Plan marketing across target audiences. For many investors choosing a 529 plan, the lower cost of passive management in a Direct Plan outweighs the benefits of active management in a more expensive Advisor Plan. As described in the next section, we also surmise that RIAs are contributing to the growth in Direct Plans.

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RIAs: An Important Distribution Channel for College Savings

RIAs have long been a proponent of 529 plans as part of an individual's planning strategy. Given the fee-based compensation model applicable to their distribution channel, we believe that RIAs likely seek highly-rated, low cost Direct Plans for their clients. Although eleven Advisor Plans currently offer a share class dedicated to RIAs, we believe low costs and quality investment choices have led RIAs to recommend Direct Plans for their clients. And, as a first, in May 2017 North Dakota added an RIA share class to its Direct Plan.

It is also interesting to note that States and Program Managers are increasingly aware of the importance of Direct Plans to RIAs. We see this in the presence of web portals dedicated to financial professionals across Direct Plans offered by Colorado, Maryland, Nevada, and Utah, among others, making it easier for RIAs to be current on and involved in account activity.

New Assets Classes and Investment Vehicles Introduced

In exploring the investment options offered in the Plans that are relatively new since our last Market Report, we discovered the following changes to asset classes and underlying investments:

State Plan	ETFs	TIPS	Real Estate	Emerging Market Equity	International Bond	New Unique Individual Options	New to Plan
District of Columbia *Direct*	Added to age-based and individual	Added to age-based	Added to age-based	Added to age-based and individual	Added to age-based and individual	DFA U.S. Sustainability and International Sustainability Funds	6
Illinois *Direct*	--	Added to age-based, static and individual	Added to age-based, static and individual	Added to age-based, static and individual	Continues to offer in static Added to age-based and individual	--	3
Michigan *Advisor*	--	Added to age-based, static and individual	Continues to offer in age-based and static	Continues to offer in age-based, static and individual	Added to individual	TIAA-CREF Social Choice Equity and Social Choice Bond Funds	3
Nevada *Wealthfront Advisor*	Added to age-based	Added to age-based	Added to age-based	Added to age-based	Added to age-based	--	5
Rhode Island *Direct*	Added to age-based	Continues to offer in age-based and individual	Added to age-based	Continues to offer in age-based, static and individual	Continues to offer in age-based and individual	Invesco Equally-Weighted S&P 500 and Global Sustainability Funds	3
Rhode Island *Advisor*	Added to age-based, static and individual	Continues to offer in age-based and individual	Added to age-based	Continues to offer in age-based and static	Continues to offer in age-based, static and individual	Invesco Floating Rate, Equally-Weighted S&P 500, Global Sustainability Funds, and PowerShares Emerging Market Low Volatility Funds	3

Source: Program disclosure documents as of April 1, 2018

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In sum, each of the Plans above introduced at least three new vehicles or assets. Four out of six Plans added ETFs and Real Estate. In addition, the District of Columbia, Michigan and Rhode Island have included unique individual options, which we believe will attract do-it-yourself investors (in the case of the District's Direct Plan) and a wide range of financial professionals generally (in Michigan and Rhode Island). The expansion of underlying investments demonstrates the continued importance of diversified investment options to 529 investors.

K-12 Expansion of 529

The Tax Cuts and Jobs Act of 2017 amended Section 529 of the Internal Revenue Code of 1986, as amended, to expand "qualified higher education expenses" to include "expenses for tuition in connection with enrollment or attendance at an elementary or secondary public, private or religious school." While the federal tax law treatment is unequivocal, the treatment for state tax law purposes depends upon each State's authorizing legislation. The following summary chart shows the disparity in tax treatment:[3]

Allow K-12 Withdrawals		**State Legislation Pending**	**Other Decision Pending or Treatment Unclear**
Alaska	North Dakota	Arizona	Alabama
Arkansas	New Hampshire	Iowa	Colorado
Delaware	Nevada	Louisiana	Connecticut
Florida	Ohio	Maine	District of Columbia
Georgia	Oklahoma	New York	Illinois
Idaho	Oregon		Michigan
Indiana	Pennsylvania		Minnesota
Kansas	Rhode Island		Montana
Maryland	South Carolina		Nebraska
Massachusetts[4]	Utah		New Mexico
Mississippi	Virginia		Vermont
Missouri	West Virginia		
	Wisconsin		

Source: Plan websites, program disclosure documents and State legislation as of April 18, 2018

In most cases, we believe the uncertainty on particular State tax treatment relates to concerns about the potential impact on general fund revenues. To that end, if allowing K-12 withdrawals causes more accounts to be opened in the first place, then the cost of a state tax benefit for contributions — whether a deduction or a credit — will increase. And, in some cases, there is concern that this could lead to an abuse of the tax benefit offered (e.g., contributions made before year end with withdrawals soon thereafter in the next calendar year). An additional complication is that the definition of "eligible educational institutions" in Section 529 has not been amended to refer to elementary and secondary schools. Thus, there may be some question as to whether a tuition expense would in fact be qualified.

As a general matter, we expect most States to allow K-12 tuition expenses to be treated as qualified withdrawals ultimately. We also expect to see additional federal legislation introduced to expand K-12 to home schooling costs, as this was part of the bill approved by the Senate in December. In the meantime, where the treatment is uncertain, it will be up to the individual taxpayer to decide how to characterize the use of funds withdrawn from a 529 account.

[3] Chart only captures 35 tax-advantaged States plus Alaska, Delaware, Florida, Maine, Nevada and New Hampshire
[4] Earnings will be free from tax but treatment of previously taken deductions is unclear

Growth Opportunities for College Savings

Robo Advisors for Millennials

Although the college savings industry is relatively mature, there are emerging distribution opportunities in the advisor realm. Nevada's Wealthfront 529 Plan may represent an up-and-coming means by which individuals save for college. The robo advisory platform, new to the 529 marketplace in 2016, has become known as an advisor preference for the millennial population. These investors often prefer this low cost, set-it-and-forget-it alternative. In fact, to date, 70% of the account owners in this Plan are under age 40.[5] Total asset-based fees run between 42 basis points and 46 basis points and Nevada residents with less than $25,000 in the Plan pay no investment advisory fee. Given these low costs and the algorithmic advice, we see the appeal of and potential for additional robo advisor 529 plans in other States.

Plans through the Workplace

Although not generally offered as a workplace benefit, an employer-offered 529 represents a potential distribution channel for all Plans. As a behavioral matter, individuals take advantage of retirement, health care and insurance options when provided through a payroll mechanism. To this end, we believe individuals would save for college more readily if given a similar payroll option. We also note that a federal tax benefit for employers would generate the biggest boost for 529 plans at the workplace and we are hopeful that Congress will enact legislation to accomplish this. In the meantime, we have seen some State employer initiatives, including tax credits offered for employer 529 contributions in Illinois, Nevada, and Wisconsin.

In terms of encouraging financial professionals to promote 529 plans to employers, at least five Advisor Plans, including Illinois, New Hampshire, South Carolina, Virginia and West Virginia, have a dedicated employer share class. We also note the concerted employer promotion efforts by Direct Plan Program Managers, as well as private company commitments to fund their employee's 529 accounts, including notably American Century, the Kansas Program Manager. Finally, we expect to see more activity in this space as firms like Gradifi promote the workplace opportunity.

Technology Enhancements through Administrative Platforms

In the past, the administrative requirements associated with 529 accounts seem to have limited the appeal of 529 Plans to financial advisors in traditional broker-dealer firms. The rise of omnibus recordkeeping may spur activity in the advisor community as these platforms reduce the paperwork burden for financial advisors, making it easier for advisors to select Plans and enroll individuals. We see the trend continuing, as shown by the seven broker-dealers that currently offer or expect to offer an omnibus platform in conjunction with the following 529 Program Managers:

Broker-Dealer	Program Managers
Ameriprise	**Columbia** / Fidelity / **Hancock** / **Legg Mason**
Edward Jones	**American Funds** / **Blackrock** / Franklin Templeton Hartford / **Hancock** / MFS

[5] Data provided by Wealthfront as of April 28, 2017

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Broker-Dealer	Program Managers
Merrill Lynch	**American Funds** / **BlackRock** / **Columbia** **Legg Mason** / Merrill Lynch *Expected additions in 2018: Invesco / J.P. Morgan / Voya*
Morgan Stanley	**American Funds** / **Legg Mason** / Union Bank (IL)
Pershing	**American Funds** / **Hancock** / Voya (IA and WI)
Raymond James	**American Funds** / Franklin Templeton / *Expected addition in 2018:* ***Hancock***
Wells Fargo	**American Funds** / **Hancock**

Source: Strategic Insight as of April 2, 2018

The advantage of an omnibus platform is that financial advisors can enroll individuals directly in 529 Plans (just as they do with other financial products), eliminating the need to complete a separate application for those Plans that are not part of financial advisor's platform. In addition, the omnibus platform enables financial advisors to "household" 529 accounts into their clients' overall financial position, providing more comprehensive financial planning opportunities for financial advisors. While there are costs associated with "going omnibus," we believe that most Advisor Plan Program Managers recognize the benefits of doing so and that the trend towards omnibus will continue.

Share Class Differentiation

Advisor Plans generally offer A and C share classes. Investors expecting a long-term holding period usually choose the A share class, which offers a low annual servicing fee of 0.25% but a front-end sales load of as much as 5.25%, which is paid from the investor's contribution. C share classes typically attract investors with a shorter investment horizon who would rather pay higher annual servicing fees (typically 1.00% on assets) versus an upfront load.[6] Without a front-end sales load, 100% of the contribution is invested with a C share class. Whether an investor is better off choosing the A or C share class at the start depends on the number of years the investment is expected to stay in the 529 account.

With the fiduciary rule as a backdrop, broker-dealer compliance reviews have discovered that many C share class investments last longer than expected, causing these investors to pay higher fees than A share class investors. To eliminate the disparity in the college savings market, several Program Managers have introduced the Convertible C share class, which automatically converts a C share class to an A share class after a specified number of years. The number of years varies by Advisor Plan and is determined in a way that establishes A and C share class annual servicing fees and sales loads on an equitable basis. Convertible C shares ensure that a C share class investor who ultimately invests for a longer period than initially expected is not penalized for not initially choosing the A share class. The chart on the top of the next page shows the increased presence of Convertible C shares:

[6] If sold within the first year, C share class investors typically are subject to a back-end sales load of 1.00%

Advisor Plan	Launched	Conversion to A Shares
Kansas	August 1, 2018	After 7 Years
Alaska	July 2, 2018	After 7 Years
Nevada (Putnam)	May 18, 2018	After 7 Years
New Mexico	February 26, 2018	After 5 Years
Indiana	December 1, 2017	After 7 Years
Virginia	December 1, 2017	After 10 Years
Maine	September 18, 2017	After 5 Years
New York	September 18. 2017	After 7 Years
Connecticut	September 15, 2017	After 4 Years
Michigan	September 11, 2017	After 6 Years
Nebraska	August 27, 2017	After 5 Years
New Hampshire	June 8, 2017	After 5 Years
West Virginia	April 3, 2017	After 4 Years
South Carolina	July 1, 2016	After 5 Years
Iowa	Prior to 2014	After 6 Years
Wisconsin	Prior to 2014	After 6 Years

Source: Program disclosure documents and State contacts as of April 18, 2018

As Advisor Plans continue to see increased market share competition from Direct Plans, we would expect more Plans to launch Convertible C shares.

Find Out More

For more information, please contact:

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About AKF Consulting Group

The AKF Consulting Group is the leading Municipal Advisor to State administrators of 529 and ABLE Plans, counting 37 governmental entities across 33 States as current or past clients. Specifically, AKF Consulting assists in structuring and advising upon all Plan aspects, including governance, administration, investment options, marketing and performance evaluations. AKF Consulting also now serves as the Program Consultant to the California Secure Choice Retirement Savings Investment Board in connection with its expected 2019 launch of the California Secure Choice Retirement Program, bringing our client count to 38 governmental entities. For more information, please visit www.akfconsulting.com.