AKF CONSULTING

AKF Market Report

College Savings Nation 2020: States Fostering Growth in Challenging Times

June 2020

Overview

This AKF 529 Market Report provides an update on the trends and developments we have observed over the last year and opportunities for States to foster growth in the 529 market. With more than $346 billion in assets under management spread across approximately 13.3 million accounts nationwide,[1] the ninety 529 savings plans available today ("529 Plans") continue to help American families save for and realize the dream of higher education. And, despite current savings challenges and uncertainties about the forms of higher education in the future, we are optimistic that this market will continue to attract investors and expand in the future.

Observations demonstrating recent trends and developments:

- 529 Plans offered directly to investors ("Direct Plans") continue to attract more accounts and assets than those offered through financial professionals ("Advisor Plans"). This decade-long trend suggests that the States' marketing programs have effectively increased awareness by their target market of investors and by registered investment advisors ("RIAs") who find Direct Plans appealing for their advisory clients.
- The past year saw more changes to investment options across Direct Plans than Advisor Plans, including streamlined investor choices; the introduction of "socially aware" investment options; several new asset classes as individual options; and revamped investment line-ups that include multiple static options.
- Seeking to reduce market timing risk, both Direct and Advisor Plans continue to shift to progressive glidepaths either by *converting totally* from stepped age-based glidepaths or by *increasing* the number of age-bands to smooth the glidepath itself.

Enhancements indicating opportunities to foster growth:

- By expanding 529 qualified expenses to include apprenticeships and certain student loan repayments, the 2019 SECURE Act has created additional opportunities for 529 applicability, in line with the changing face of "higher education" as students find alternative paths to successful careers in the changing US economy.
- States, and *not* the federal government, are leading the way for employer incentives, which may be bolstered by technology developments that will resonate with employers across multiple states.
- More States also are implementing incentive programs to appeal to wide demographic ranges of families. Child Savings Accounts ("CSAs") offer new opportunities for often untapped and underserved families.

Methodology

Data for this AKF 529 Market Report was aggregated through a review of the Program Disclosure Statements for 90 Savings Plans as of May 11, 2020. Child Savings Accounts data is sourced to Prosperity Now as of March 5, 2020.

[1] Source: College Savings Plan Network ("CSPN") as of December 31, 2019

Findings and Observations

Nationally, the number of available 529 Plans has remained constant since the 2018 launch of the Washington Dream Ahead Savings Plan.[2] During this time, the number of investment options in Direct Plans peaked in 2019 while the number of options in Advisor Plans has continued to decrease each year since 2018.

		April 2018		April 2019		April 2020	
Plan Type		Direct	Advisor	Direct	Advisor	Direct	Advisor
Savings	Available Plans	59	30	60	30	60	30
	Investment Options	769	668	795	662	773	643
Open Prepaid Plans[3]		12		12		11	

Key changes across Direct Plans reflect (i) a new Program Manager in New Mexico, which resulted in streamlined investment choices; (ii) new "socially aware" static investment choices in Nebraska; (iii) new individual options in Tennessee comprised of diversifying asset classes, including emerging market equity, real estate, high yield bond and international bond classes;[4] and (iv) multiple static options in a revamped investment line-up in Florida. Our first observation in this Report discusses the increasing dominance of Direct Plans.

Observation 1: Direct Plans Expand Market Share

As of December 31, 2019, the 529 Savings Plans nationwide had $346.2 billion in assets under management across 13.3 million accounts. This represents overall asset growth of 19.9% and overall account growth of 3.6% since December 31, 2018.[5] When we break down the drivers of this growth, it is clear that Direct Plans are the force behind the increases as shown by the following chart:

	Total Growth	Direct Plans Growth	Advisor Plans Growth
Assets	19.9%	22.4%	16.5%
Accounts	3.6%	6.6%	-0.6%

The chart on the next page shows that over the past decade, the Direct Plan market has surpassed the Advisor Plan market in terms of overall accounts and assets under management. As already noted in our 2018 and 2019 College Savings Market Reports, we believe this shift can be attributed to increased visibility through Direct Plan marketing efforts, an appetite for well designed, low cost passive investments, and sales by registered investment advisors ("RIAs"). In fact, we believe that RIAs are actively promoting high quality, low cost Direct Plans since they are typically paid on retainer and not by the products sold.

[2] We note that as this Market Report is being released, North Carolina has partnered with Morgan Stanley to launch the Morgan Stanley National Advisory 529 Plan, which appears to be the first Advisor Plan that will be offered solely with the "best interest" standard established by Regulation BI rather than a suitability standard that would otherwise apply to commissioned sales.
[3] Includes: Alaska, Florida, Maryland, Massachusetts, Michigan, Mississippi, Nevada, Pennsylvania, Texas, Virginia, Washington and Private College 529. Enrollment in the Illinois Plan has been suspended since 2018. Virginia's Prepaid 529 Plan closed to new enrollment as of May 1, 2019; a new Virginia Prepaid 529 Plan is expected to be offered in February 2021.
[4] Reflects the removal of DFA, replacement of certain Vanguard funds and the addition of Double Line Capital as a new investment manager.
[5] See the AKF Market Report, College Savings Nation 2019: Searching for Enhancements

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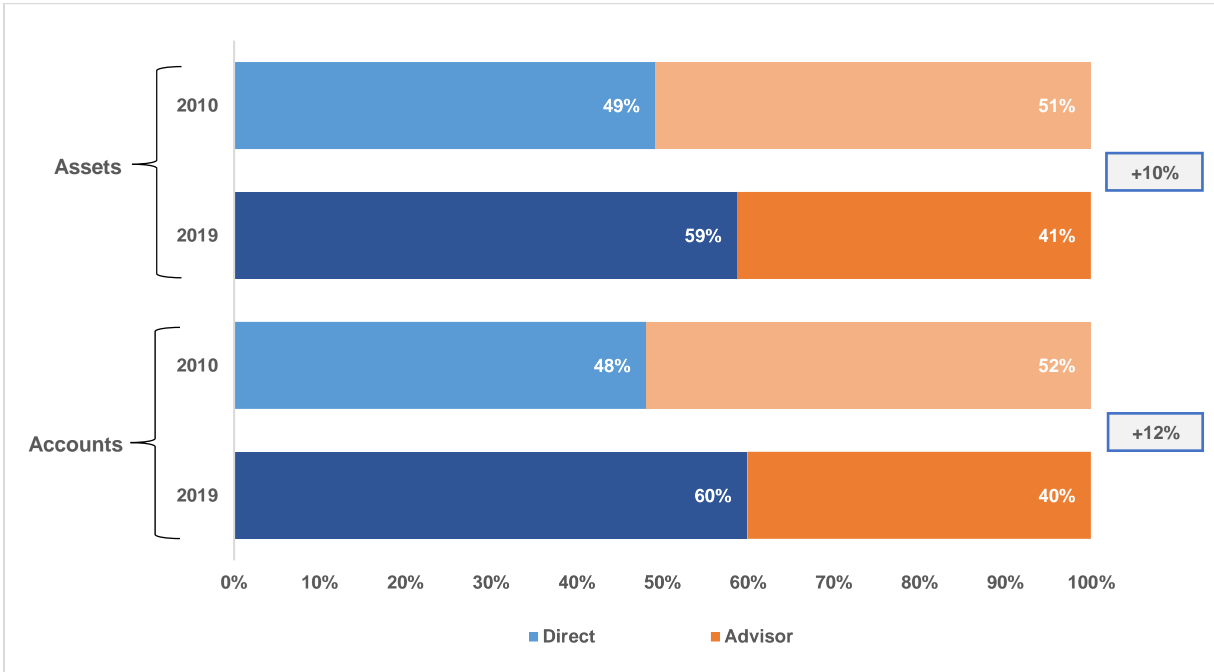
Direct Plans Dominate a Decade of 529 Growth



With respect to marketing, we note that in March 2019, the College Savings Plan Network launched a national awareness campaign in conjunction with Fred Rogers Productions, the not-for-profit organization affiliated with and dedicated to the learning spirit of "America's favorite neighbor." While metrics are not available, industry observers speculate that including 529 information before or after certain children's TV programs (most notably Daniel Tiger's Neighborhood) has enhanced the industry's visibility to young families.

Given the success of 529 marketing and the increased evidence of RIA usage, States with high-quality Direct Plans should consider enhancing their existing marketing campaigns to specifically target RIAs. A well-rounded client experience for RIAs can also include a dedicated RIA portal on the State's website and even dedicated phone representatives for these financial professionals.

The last decade's trend toward Direct Plans does not diminish the importance of Advisor Plans in the overall financial planning of many families. The challenge for Advisor Plans, however, will be to attract new account owners with young beneficiaries in order to replace maturing accounts. These account owner targets could be young parents or grandparents – the key point is to continue to open new accounts for younger children so that Advisors benefit from more years of account growth during the accumulation stage.

Overall, Direct and Advisor Plans alike must respond to changing investor demands and implement plan enhancements to continue to offer a strong value proposition. One such enhancement is the trend toward smoother glidepaths across Direct and Advisor Plans, which we discuss in the next section of this Market Report.

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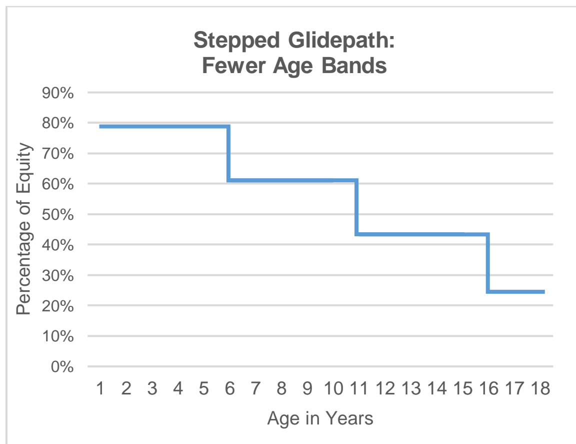
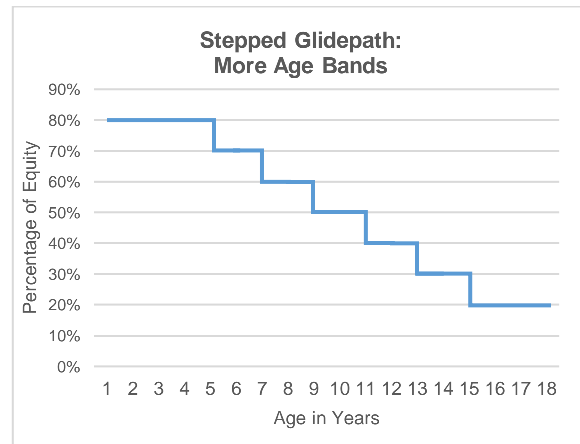
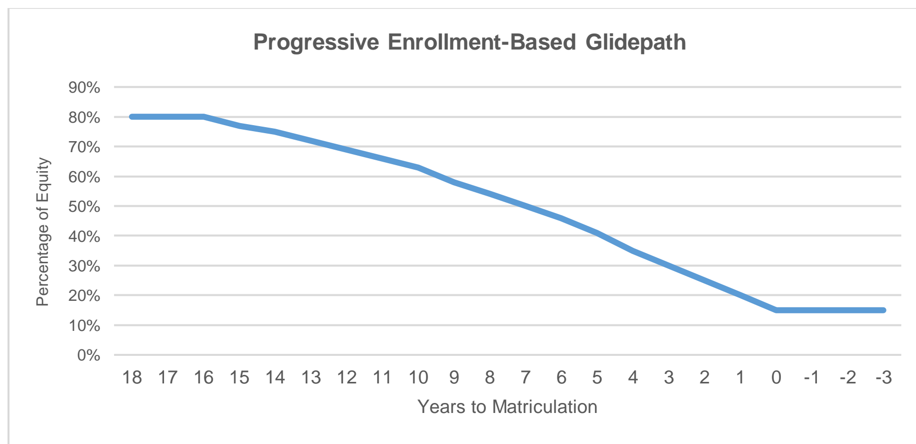
Observation 2: Progressive Glidepaths Lead Structural Enhancements

Most 529 Plans have historically used stepped or fixed age-bands in glidepath construction, reducing *larger* equity allocations at *set points* in time. In comparison, the retirement industry's target date funds have used truly progressive glide paths, which evolve over time and reduce a *small* percentage of equity exposures *each year.*

The illustrations below highlight these differences. Note that the progressive path counts time downward to zero years to matriculation while the more traditional stepped path counts up to the student's age at matriculation. The progressive, or years-to-enrollment, structure allows the account owner to flexibly self-determine *when* the assets will be used.







Our 2019 Market Report identified the move to enrollment-based portfolios as a key enhancement for the future. Enrollment-based investment options would allow an account owner to choose a structured investment option based upon *when* a beneficiary would be expected to need funding and *without regard* to the beneficiary's age. In this way, enrollment-based options could accommodate potential K-12 withdrawals or a non-traditional entry point for higher education. Enrollment-based options typically incorporate a progressive glidepath rather than the stepped glidepaths associated with age-based options.

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In the last year, several 529 Direct and Advisor Plans implemented changes to their glidepath designs either by converting existing age-based options to enrollment-based options that use progressive glidepaths, or by increasing the number of age-bands to smooth the glidepath. The following chart summarizes the changes:

Recent Enhancements to Glidepath Design	
Enrollment-Based Options: Progressive Glidepath (Investment Advisor)	**Age-Based Options: Expansion of Age-bands (Number of Age-bands)**
TFI **California** **Georgia** **Michigan *Direct and Advisor*** **Minnesota** **Oklahoma *Direct*** **Wisconsin *Direct*** **Ascensus/Principal** **New Mexico *Direct*** **New Mexico *Advisor***	**Florida (5 to 16)** **Tennessee (5 to 10)** **West Virginia Select (7 to 9)**

Regarding changes in portfolio structures, the Plans in “Enrollment-Based Options” above replaced existing Age-Based Portfolios entirely. The shifts in California, Georgia, Michigan, Minnesota, Oklahoma and Wisconsin follow the firm-wide initiative of TIAA-CREF Tuition Financing Inc. (“TFI”) to implement a progressive glidepath; the shifts in the New Mexico Plans reflect the change in Program Manager. On the other hand, the Plans in “Age-Based Options” increased the number of steps, achieving less abrupt reductions of equities. For example, with sixteen different age-bands, the Florida Plan has just 0%-7% equity declines across the age-bands.

These changes achieve one common benefit - the reduction of market timing risk by smoothing the glidepath. As a result, smoother glidepaths – whether accomplished through a truly progressive or an expanded stepped design -- are particularly useful in near-college ages when portfolios would be most sensitive to big market swings. The recent market declines in early 2020 clearly illustrate this. In fact, Morningstar Inc. found that first quarter losses averaged as much as 19% for portfolios of children age 4 and under, while portfolios for students 17 - 18, who will probably be heading to college shortly, fell less than 5%, on average. In comparison, the MSCI ACWI Index, a global stock index, fell a little over 21% during the same time.[6]

Converting from a stepped, age-based structure to a truly progressive structure will present operational considerations and challenges. We believe that is why some Plans opt to increase the number of age-bands: a sufficient number of equity step-downs can approximate the smooth equity allocation decline seen in a progressive glidepath. For State Administrators and investment advisors seeking to reduce market risk through smoother glidepaths, this confirms that it is possible to do so without undertaking a wide-scale, operational conversion.

[6] See New York Times, Stock Market Turmoil Took Toll on 529 College Accounts, and Morningstar’s 2020 529 College Savings Plan Landscape.

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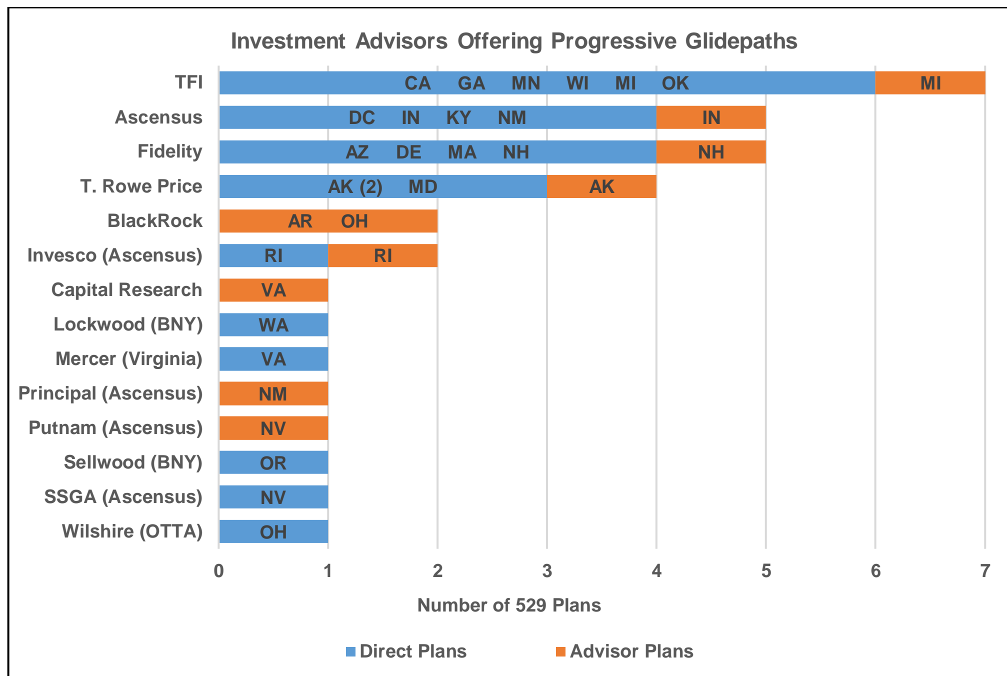
With this background, we note that today thirty-three Direct and Advisor Plans, accounting for 30% of all 529 Savings Plans, offer progressive glidepaths. The following chart shows the fourteen investment advisors that have implemented progressive glidepaths along with the number of Direct and Advisor Plans:



In closing on this observation, we note that Morningstar Inc., the leading independent rating agency for mutual funds and 529 Plans, has expressed a strong preference for progressive glidepaths over the traditional age-based glidepath design. In fact, in its most recent Annual 529 Landscape Report, Morningstar reiterated its view that smoother glidepaths will “lead to better outcomes” for investors.[7]

In many ways, Morningstar has played a significant role in raising the focus on glidepath design. Beginning in 2015, it explained that in evaluating the investment design process, it would prefer glidepath design by investment advisors with retirement expertise who use a continuously smooth glidepath, mimicking the target date structure used in retirement plans.[8]

Observation 3: Federal Laws Redefine Qualified Higher Education Expenses

Since January 2018, the definition of qualified higher education expenses has expanded to include limited K-12 tuition expenses, fees associated with certain apprenticeship programs, and certain student loan repayments. Our 2019 Market Report included information on the K-12 tuition expansion resulting from the 2017 Tax Cuts and Jobs Act; this 2020 Market Report provides a brief update on K-12 as well as relevant information regarding the expansion provided by the 2019 SECURE Act covering apprenticeships and student loan repayments.

[7] Morningstar Annual 2020 529 College Savings Plan Landscape
[8] Best Practices for College Savings Plans

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K-12 State Tax Treatment Update

Today, thirty-eight States and the District of Columbia allow K-12 tuition withdrawals to be treated as a qualified 529 expense at the state level. Since our 2019 Market Report, Illinois is the only State that has clarified its treatment of K-12 withdrawals and now allows K-12 expenses.[9] We include in this count five States that do not offer particular benefits for 529 investments as well as the eight States that do not have a state income tax. Importantly, eleven States have expressly not conformed to federal law. The following chart summarizes this information:

Status of K-12 State Tax Treatment			
	K-12 Withdrawals Are Qualified		Not Qualified[10]
State Tax Benefits Offered (35)	Alabama Arizona Arkansas Connecticut District of Columbia Georgia Idaho Illinois[9] Indiana Iowa Kansas Louisiana Maryland	Massachusetts[11] Mississippi Missouri North Dakota Ohio Oklahoma Pennsylvania Rhode Island South Carolina Utah Virginia West Virginia Wisconsin	Colorado Michigan Minnesota Montana Nebraska New Mexico New York Oregon Vermont
No State Tax Benefits Offered (7)	Delaware Kentucky	Maine New Jersey North Carolina	California Hawaii
No State Income Tax (8)	Alaska Florida New Hampshire Nevada	South Dakota Tennessee Texas Washington	--
Total (50) [12]	38 States and DC		11 States

SECURE Act Expands 529 Qualified Expenses

The December 2019 SECURE Act provides that certain student loan payments and the cost of apprenticeship programs are qualified 529 Plan expenses at the federal level. For student loan payments, repayment of principal and/or interest on qualified education loans has, in the aggregate, a lifetime limit of $10,000 per beneficiary. Importantly, funds in a beneficiary's account may be used to repay a sibling's student loans as well (subject to the same aggregate $10,000 lifetime limit). Allowable apprenticeship expenses include fees, books, supplies and equipment required for participation in an apprenticeship program registered with and certified by the Secretary of Labor under Section 1 of the National Apprenticeship Act.

The SECURE Act changes may present some operational challenges for 529 Plans, including how to process student loan repayments on behalf of siblings and where applicable tax reporting is done. At

[9] Illinois leaves open the possibility that while earnings will be free from state tax, previously taken tax deductions could be subject to recapture
[10] Express non-conformance or other indication that State will not approve tax-free withdrawals for K-12
[11] Earnings will be free from tax but treatment of previously taken deductions is unclear
[12] Chart does not include Wyoming because it does not offer a 529 Plan

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this time, we are not aware of any 529 Plans issuing repayment checks to student loan companies or to siblings of a beneficiary. We also note that the certification requirement with respect to apprenticeships is likely to place the burden on the account owner. Compliance details are still being worked out at the industry level. Most Plans appear to have issued disclosure on both matters or at least made information available on websites, but many also are continuing to determine how best to comply with the expansion.

On a final note, we applaud the expansion of qualified expenses to include apprenticeships as we believe this is in line with the changing face of higher education. As the cost of a traditional, four-year higher education has increased and continues to be challenging in the current environment, we believe that more students will find alternative paths to successful careers.

The avenues for brighter futures for today's students are likely to be broader, with more options beyond a four-year college experience. Apprenticeships are just the first indication of expanding options of 529 plans. This expansion, and more to come, will mirror a changing economic environment and may present new growth opportunities for the 529 market. States should be ready for them.

Observation 4: Program Manager Shifts and Consolidation

Since our April 2018 Market Report, we have seen a number of changes in the program management landscape. We believe this represents a shift in key players and an industry consolidation of the remaining managers, as shown in the following chart:

Recent and Announced Program Management Changes			
Effective Date	**Plan**	**Distribution**	**Program Manager or Investment Advisor Change**
February 2019	**Kentucky**	Direct	Ascensus replaced TFI
July 2019	**Nevada (USAA)**	Direct	Victory Capital assumed the role of Investment Advisor and Distributor in connection with its acquisition of USAA Asset Management Company
October 2019	**Colorado (College Invest Stable Value Plus)**	Direct	Nationwide replaced Brighthouse (MetLife)
December 2019	**New Mexico**	Direct	Ascensus replaced Oppenheimer
		Advisor	Ascensus and Principal replaced Oppenheimer
December 2020 (expected)	**Nebraska (NEST)**	Direct	Union Bank designated to replace First National Bank of Omaha
		Advisor	
	Nebraska (TD Ameritrade)	Direct	
	Nebraska (State Farm)	Advisor	

The key takeaways from the changes in the chart above are shifts in the industry's main players and a consolidation among the remaining ones. In terms of shifts, longstanding Program Managers Oppenheimer and First National Bank of Omaha pulled back from the 529 business, while changes in Kentucky and Nebraska further consolidate the position of Ascensus and Union Bank as Program Managers.

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Overall, this slightly narrows the pool of private sector Program Managers pursuing new 529 business, which may give States fewer choices when considering new procurements.

Enhancements for the Future

As the 529 industry matures, fine-tuned state regulations, specialized investment offerings, and demographic expansions of the market are complementing the more structural trends we have already noted in this Market Report. In terms of future growth, no arena or distribution channel holds more promise than the workplace.

Enhancement 1: State Tax Incentives and Technology Advancements for the Workplace

The inclusion of 529 Plans as a workplace benefit will encourage savings by employers and employees. Funding any kind of savings plan through automatic payroll deductions is considered a highly effective way to increase savings because it simplifies the process and forces discipline on the saver. Clearly, a *federal* tax incentive would present the most significant opportunity for growth. College savings associations including the College Savings Plans Network and the College Savings Foundation have repeatedly supported federal legislation to create employer incentives. The following chart details legislation pending today:

Federal Legislation for 529 Employer Tax Benefits	
Bill	**Tax Benefit**
S.220	Allows employer 529 plan contributions to be excluded from employee’s gross income
S.2347	Excludes employer contributions to student loan repayment from income, up to $10,000 per year
S.1428	Allows employer-sponsored retirement plans to make matching contributions for an employee's student loan payments. Payments are made as if the loan payments were salary reduction contributions to the retirement plan
H.R.655	Allows a tax credit for employers that provide student loan repayment assistance for employees. The tax credit is 10% of the amount that an employer pays

Unfortunately, we are not optimistic about the prospects for these proposed bills, at least not in light of current legislative pressures at the federal level. However, we note that several *States* have taken the initiative to offer State tax benefits for corporate 529 contributions. The chart on the next page lists all States that currently offer State tax incentives to employers.

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	State	State Maximum Annual 529 Employer Tax Benefits	Sunset
Deduction	Arkansas[13]	$500 per employee	None
	Utah	$2,040 per beneficiary	None
Credit	Colorado[14]	$500 per employee Based upon 20% of employer contributions	1/1/2022
	Idaho[15]	$500 per employee Based upon 20% of employer contributions Five-year carry-forward	None
	Illinois[16]	$500 per employee Based upon 25% of employer contributions	12/30/2020
	Nebraska[17]	Effective January 1, 2022: $2,000 per employee Based upon 25% of employer contributions Program may award up to $250,000 in total incentives per year Matching contributions may not be used for K-12 contributions	None
	Nevada[18]	$500 per employee Based upon 25% of employer contributions Five-year carry-forward	None
	Wisconsin[19]	$820 per employee (adjusted annually for inflation) Based upon 25% of employer contributions	None

While eight States taking initiative to create tax incentives for employers does not rise to an overwhelming trend, we are hopeful that other States will take note and follow suit. Just as States offering the earliest prepaid tuition plans in 1988 or so began the efforts that culminated in Section 529, we believe that as more States take action to support workplace incentives, Congress may eventually create a federal benefit as well. Even if it does not, States have shown that they can and will lead the charge for their citizens' benefit. **If there is one new 529 solution we recommend States consider, it is tax incentives for employers. Eight of your sister States have already begun.**

On a related note to workplace enhancements, certain technology advancements present important strategic partnership opportunities for employers and 529 Plans. Examples include companies with offerings available in the ADP Marketplace, including the opportunity for employers to match student loan repayments in addition to processing contributions to 529 and ABLE accounts.

For the 529 industry, this presents a significant opportunity because enabling contributions to any 529 Plan removes barriers for multi-jurisdictional employers. We look forward to additional enhancements in the industry as other technology companies create offerings for participants in 529 Plans.

[13] Source: Arkansas Act 884 (Regular Session 2017)
[14] Source: Colorado HB18-1217 (2018)
[15] Source: Idaho HB 550 (2020)
[16] Source: Illinois Bright Start Program Disclosure Statement (December 31, 2019)
[17] Source: Nebraska LB610 (2019)
[18] Source: Nevada SB412 (2015)
[19] Source: 2017 Wisconsin Act 197

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Other Considerations for Growth

In the past year, we have seen other enhancements gain traction in the 529 industry, but none as important as State tax incentives for employers. However, we would be remiss if we did not include them in this Market Report.

Consideration 1: Funding Child Savings Accounts to Close the Gap

Child Savings Accounts ("CSAs") are long-term savings accounts typically established by public entities and non-profit organizations to encourage low- and moderate-income families to save for and eventually enroll in a postsecondary education. Research has shown that the likelihood of college enrollment and graduation levels increase even when very small amounts are held in CSAs. Largely accomplished through the power of expectations and identity effects, i.e. when children experience reinforcement of the expectation of college graduation, their drive towards academic achievement is increased and they begin to act in ways consistent with their 'college-bound' identity. In turn, this leads to more savings, further strengthening expectations and achievement. Some CSAs offer incentives such as seed deposits and/or matching funds made by the sponsoring organization to encourage participation.

The following chart provides an overview of key CSA features:

Key Features of CSA Programs	
Sponsoring Organization	Government Agency / Charitable Foundations / Other Entity
Eligibility	Universal (e.g., offered to all children within a defined group such as newborns or children in kindergarten) Progressive (e.g., by income level)
Account Type Funded	529 Plan / Coverdell ESA / Bank Savings Account
Account Opening	Voluntary Opt-In / Automatic
Ownership of Account	Program Sponsor / Individual

CSAs associated with 529 Plans are increasingly visible today with at least 53 programs tying the Child Savings Account to a 529 Plan account. The map on the next page shows the presence of 529-based CSAs by funding type.

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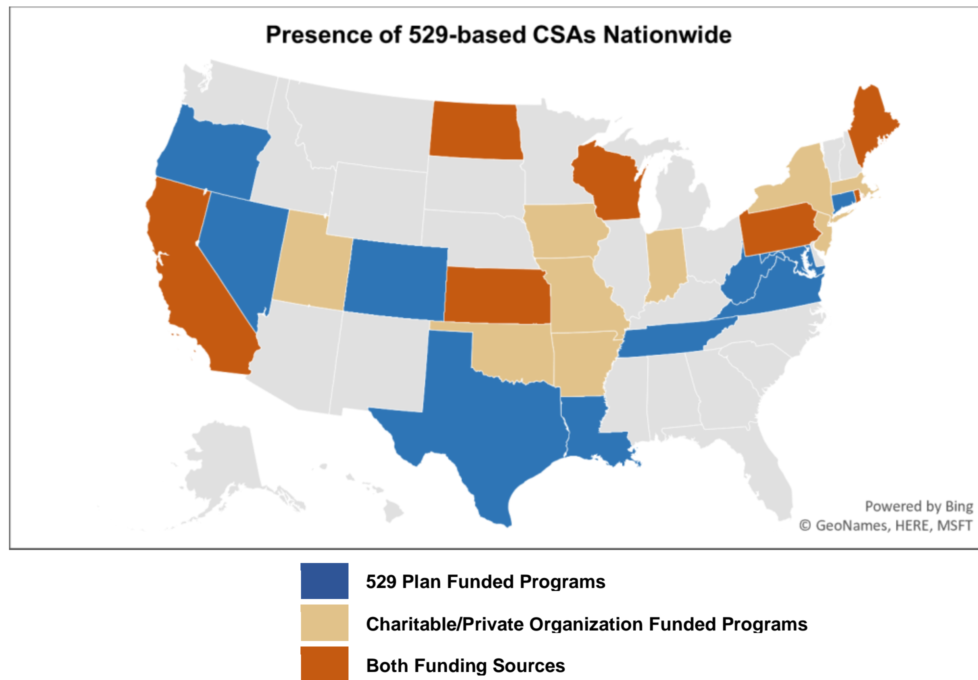

In the past year, Pennsylvania launched the first 529-funded CSA program, universally providing $100 for each newborn child. Four States are expected to launch similar universal CSAs as a result of legislation passed in 2019. Additionally, four more states introduced CSA legislation in 2020 to either establish or determine the feasibility of offering a CSA.

The following chart summarizes information on upcoming or pending CSA legislation:

Recent CSA Legislation	
Program Bills Passed in 2019	**New Bills Introduced in 2020**
California[20] **Colorado** **Illinois** **Nebraska**	**Massachusetts – Program Bill** **Missouri – Program Bill** **New York – Study Bill** **Washington – Study Bill**

CSAs offer new opportunities for growth in an untapped and underserved part of the education savings market. By providing initial funding, organizations believe families will be encouraged to take positive steps toward saving for their children's future, thus potentially expanding the 529 Plan market.

[20] $25 million appropriation to California Student Aid Commission to give grants to new and existing local CSA programs

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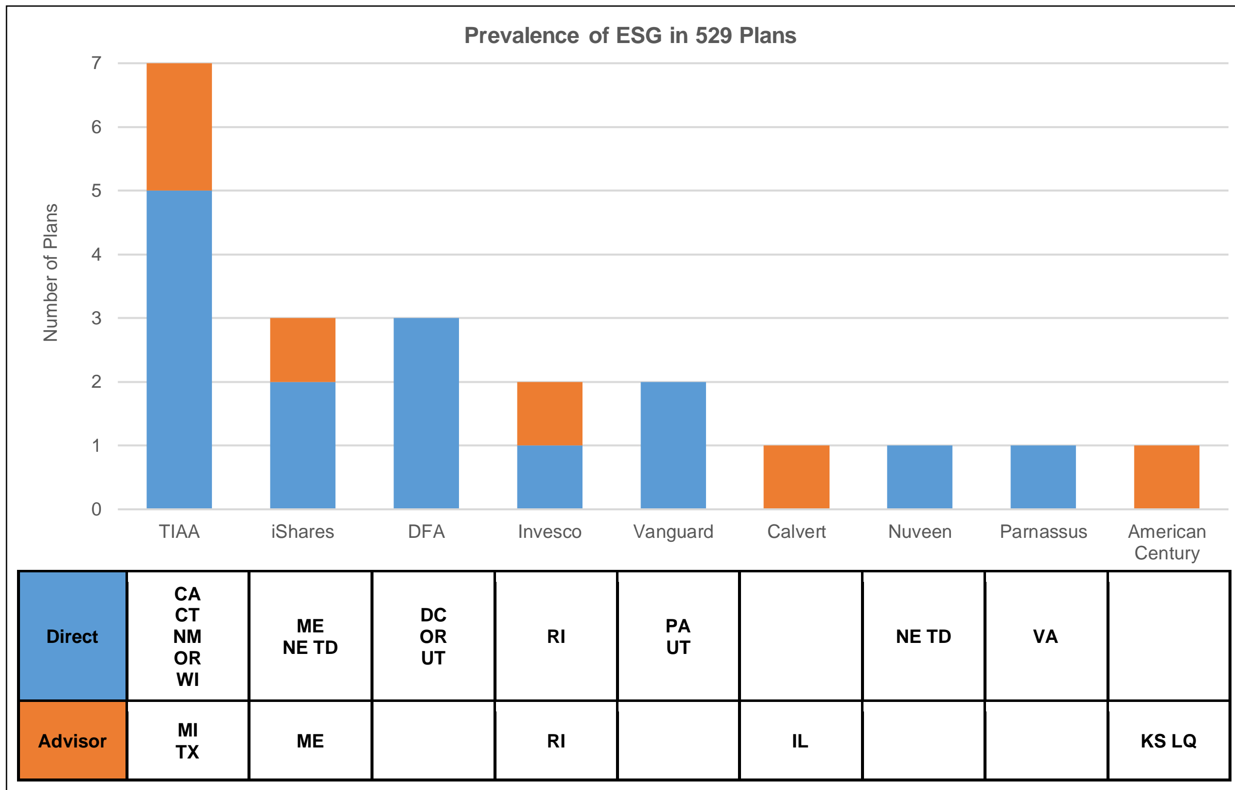
Consideration 2: ESG Adoption Accelerates in Financial Markets, but Not 529…Yet

The inclusion of environmental, social and governance ("ESG") criteria in investment decisions as a way for investors to put their money where their values are has gained increased traction. ESG criteria are also used as a risk management tool by indicating the risk of investing in companies whose corporate practices signal the likelihood of increased risk factors and lower enterprise value. Interest and demand continue to grow across both retail and institutional marketplaces as individual investors, institutions and public funds are conscious about the impact or consequences of their investment decisions and use ESG criteria to reflect personal and corporate values.

Notwithstanding, while ESG has gained attention, actual adoption has been relatively slow in the 529 industry. As demand for ESG investment solutions increases in the 529 industry and State sponsors find ESG compelling from a cost and performance standpoint, we believe ESG investing presents opportunities for investment design enhancements in the future.

According to our research of 529 Plans, ESG investment visibility has increased and the topic is being brought up more frequently in industry discussions. Eighteen Direct and Advisor Plans offer at least one ESG fund within their investment lineup, mostly included as individual options but also as part of asset allocation options.[21] The following chart shows ESG fund managers and the number of Direct and Advisor Plans that include them. Section 529 Plans today include seventeen different ESG funds from nine different investment managers. Often the investment manager is affiliated with the Plan Manager. Fund fees vary widely (0.12% to 0.95%) based on strategy and management style.



	TIAA	iShares	DFA	Invesco	Vanguard	Calvert	Nuveen	Parnassus	American Century
Direct	CA CT NM OR WI	ME NE TD	DC OR UT	RI	PA UT		NE TD	VA	
Advisor	MI TX	ME		RI		IL			KS LQ

[21] ESG options in Utah's my529 are only available in the Customized Age-Based and Customized Static Options

Find Out More

In the last year, the 529 Plan market has seen many changes at both the structural and operational levels and on the margins with program enhancements. Both types of changes have provided opportunities for States to lead the charge to improve and expand their 529 offerings to help families save for higher education. We would be delighted to discuss our findings in more detail with you. For more information, please contact:

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