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AKF Market Report

Saving for College with a Safety Net:

Low Risk Investment Options – Renewed Interest for 529 Plan Administrators

A State-by-State Analysis of Advisor and Direct Plan Options

May 2009

Overview

Some silver linings are starting to emerge from the market turmoil of 2008 and 2009. In the 529 college savings market, the bittersweet bonus of the recession is this: investors need to feel comfortable about continuing to save for college and many plans offer investment options that will deliver that comfort. For investors and advisors, it's just a matter of doing the legwork to find those plans. For state administrators, it's time to make sure that your plan is among those that continue to attract otherwise gun-shy investors. State plan administrators need to identify those short term or otherwise conservative investment options that will appeal to all investors and provide a place to park precious financial resources until a sense of stability prevails once again.

The following AKF Market Report surveys the state 529 plan marketplace to assess the various options in advisor and direct-sold programs. It finds a wide range of investment options that state administrators and plan managers should be marketing now in order to reassure the public that saving for college is important and doesn't have to be overly risky.

Method

Data for this AKF Market Report were aggregated through a review of offering documents for more than eighty 529 plans as of February 28, 2009.

Findings and Observations

Total Number of Plans and Options

There are a total of 87 different 529 college savings plans currently available to investors. Among those, 52 are available directly to individual investors, 29 are available through financial advisors and 6 are available to both individual investors and through advisors.

While the bulk of the available investment options are actually static blend options or individual mutual fund portfolios, an increasing number of 529 plans offer short-term options including money market funds and short term cash funds, guaranteed investments (including, for example, GICs and funding agreements from insurance companies) and Treasury inflation-protected options. More recently 529 plans have launched bank-type products that offer FDIC insurance to 529 investors.

The following table offers a detailed breakdown of the broad options available in the current market:

	Age-Based Portfolios	Static Blend Portfolios	Individual Fund Portfolios	Short Term Options	Guaranteed Options	TIPS Options	Bank Options
Advisor	36	100	326	16	6	6	0
Advisor & Direct	18	17	51	3	2	0	0
Direct	101	209	139	31	13	7	11
Total	**155**	**326**	**516**	**50**	**21**	**13**	**11**

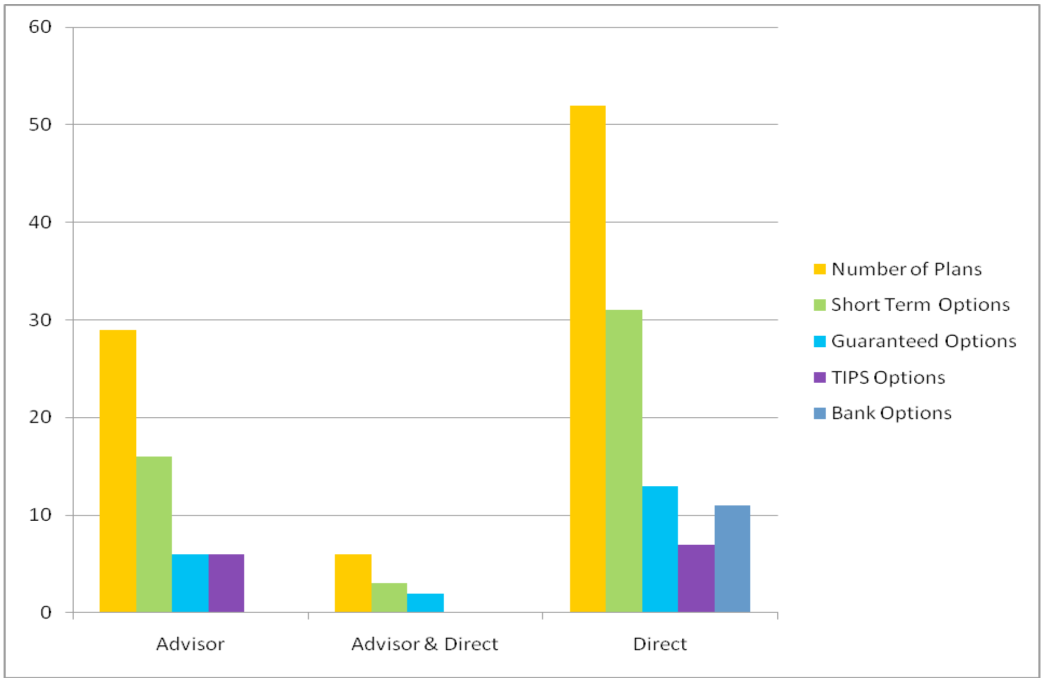
It is interesting to note that individual mutual fund options dominate the choices in the advisor sold market (including the six advisor-sold and direct-sold plans that are identical). We believe this reflects the view that, by and large, advisors are comfortable crafting an appropriate asset allocation for their clients and, in fact, that they prefer doing this to taking a pre-determined asset allocation that might not be perfectly suitable for their individual clients. Additionally, some would suggest that this is exactly what advisors should be paid to do with the college savings product – to tailor the investments to their client's needs rather than merely taking an off-the-shelf solution and charging a load or other sales fees for it.

Not surprisingly, it would follow that in the direct-sold market, the easiest, most comfortable route for investors operating without the benefit of financial advice would be to choose pre-set asset allocation options such as age-based or static blend portfolios. The only caution on this is the recent experience of investors who trusted that an age-based allocation would offer an age-appropriate risk-return tradeoff, only to find out that the asset allocation was indeed far more aggressive in the older age portfolios than an investor would have assumed. The lesson? An investor in the direct-sold market cannot take for granted that a standard solution will work for everyone. Even if the age-based answer seems easiest to understand, the investor must still read the fine print to find out exactly how the investments will change over time and then decide whether that's comfortable given his or her appetite for risk.

Short Term and Conservative Focus

Given recent market performance, it seems that the most appealing investment options in the 529 marketplace over the last several months have been those that appeared to offer some security or comfort to investors who can't quite forget the pain of 2008 market losses. These options include the low risk realm of money market funds, cash reserve funds, Treasury inflation-protected and FDIC-backed investment options. These options typically insulate investors from market volatility, while still providing a tax friendly shelter for college savings.

The chart on the top of the following page shows the breakdown of short-term, low-risk or guaranteed options currently available:



Just as it is not surprising to find the most opportunities for customization in advisor-sold plans, it is not surprising that short-term, guaranteed and bank options have proliferated in the direct-sold market. This would suggest that state administrators of direct-sold plans understand that not every investor is comfortable with market risk and that a wide range of investment options is critical to encouraging every kind of investor possible to save for college.

Bank Options

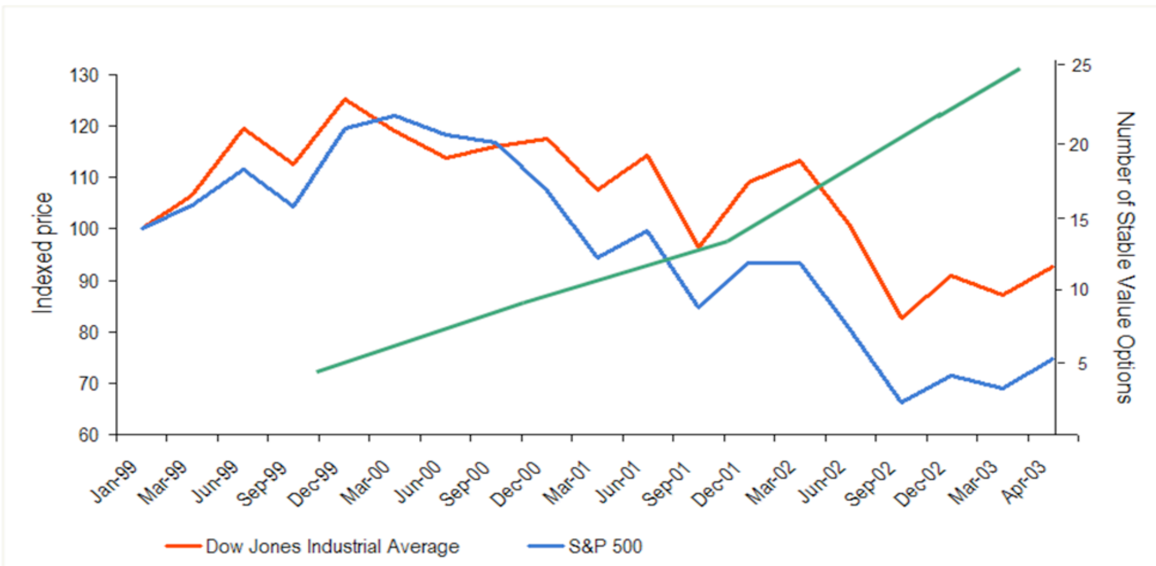
As we saw in the charts above, bank products – meaning those products that include a bank-savings vehicle (such as a certificate of deposit or a savings account) – are found in just a handful of plans. In fact, only six plans – Arizona, Montana, Ohio, Utah, Virginia and Wisconsin – offer bank products of any kind, and none of them offer these products through advisor share classes. Of the eleven bank products offered, all but two offer the investor the benefit of FDIC insurance – the Wisconsin plan provides the benefit of FDIC or NCUA insurance to the plan but not to the individual investor.

Still, these bank options are important tools for any state plan because they serve two critical purposes. First, they offer the assurance of a federal guarantee up to applicable limits, which surely provides comfort to still skittish investors, and second, they appeal to investors who might not otherwise choose to save in investments with market risk.

For state administrators without bank products in the investment line-up, 2009 is the opportune time to address consumer demand for conservative investments and to find a way to integrate insured bank options into the plan offering.

Guaranteed Products

The college savings market first saw interest in guaranteed products in the early 2000s – just as the market was experiencing the dot-com meltdown in growth stocks. The following chart specifically shows the growth in the number of stable value or GIC options offered in the earliest days of 529.



The interesting point about these guaranteed options is that as the market has dropped overall, stable value funds have come under scrutiny, particularly in the retirement space. These options are designed to preserve capital and generate smooth, positive returns. And, in 2008, stable value funds on average returned 4.7% compared to a 33.8% decrease in the Dow Jones Industrial Average.

However, in the recent months, the "crediting rate" on these instruments, which is essentially the yield investors receive, has decreased because of lower returns on underlying bond holdings along with an increased allocation to cash. Additionally, banks and insurance companies are reported to be more reluctant to provide wrap contracts to smooth out returns, leaving some stable value providers unsure of how to hedge their bets on these investments. While the stable value experience is far deeper in retirement plans than in 529s, this still suggests that 529 administrators with stable value options should use this time to assess the strength of the providers included in each plan. This is not an alarm sounding but it is a note of caution for the plans that include the stable value options or other guaranteed options that are dependent upon a pool of underlying fixed income instruments.

Conclusion

Restoring Confidence

Investor confidence is the holy grail of the college savings industry. Just as the number of aggressive equity options proliferated during the market's boom times, the number of short-term low risk options available is growing or at least drawing new attention to address investor concerns about risk exposure. Our research demonstrates that plan administrators are beginning to realize that those who continue to flourish will be those who are doing the legwork now to build the kinds of low risk plan options that can give consumers peace of mind.

Trends in the college savings market will continue to be monitored and reported in future installments of the AKF Market Report.

Find out more

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About the AKF Consulting Group

The AKF Consulting Group is the leading strategic advisor in the 529 College Savings market, currently counting 25 state governments as clients. AKF Consulting provides strategic advice to entities involved in the Section 529 College Savings Market. Specifically, the firm assists in structuring all aspects of Section 529 savings and prepaid programs, including investments, administration and marketing. AKF Consulting also advises on program enhancements such as scholarships and matching grant programs, affinity programs and other loyalty builders. For more information, please visit www.akfconsulting.com.