

In the Press

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States, Companies to Scramble for More of 529 Space

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By: Hannah Glover

Competition on the 529 playground is about to get fierce.

With the federal tax break on state-sponsored college savings plans now permanent, parents and grandparents saving to educate the next generation can look forward to more competition among states and fund companies this back-to-school season. And that could mean more investment options, lower fees, increased advertising efforts and greater tax incentives.

In 2001, Congress passed a law allowing for tax-free growth and withdrawal for 529 plans. But those provisions were set to expire in 2010. Industry monitors say that the closer that date grew, the slower inflows became.

"A lot of parents were scared off," said Arbab Hassan, a business analyst with 401kid, an investment advisory firm in New York that focuses on education planning. As a result, the products that experts projected would shoot to the head of the class and amass \$350 billion by

2010, have, to date, collected only \$80 billion, or roughly 22% of that goal.

Such lackluster performance caused Wyoming, for one, to drop out this year and send its 1,400 participants to neighboring state Colorado, which has a more robust, better-performing plan of its own. Other states, such as Tennessee, have been considering similar options.

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Experts blame a combination of parents unwilling to invest in a product with an uncertain future, a dearth of marketing and a lack of public understanding

for dampening the industry's growth. All that changed with the Pension Reform Act, a bundle that includes the provision making 529s' tax-exempt federal tax status permanent.

"This [law] will help unlock that and let programs get back to focusing on growth," said David Pearlman, chairman of the College Savings Foundation of Washington.

The key growth will be education. "Either people have heard of the plan, but don't know any of the details surrounding it, or they know it's out there, but they don't have any idea of how to get started," said Michael Bischoff a certified financial planner with Webb Financial Group in Bloomington, Minn.

For a long time, the industry had relied on planners like Bischoff to spread the word. Now, pending guidelines from the Municipal Securities Rule-making Board might help broaden the audience. In the past, states were required in ads

to include disclaimers about rates, costs and interstate competition. The New York-based board agreed the legalese muddled the message and will now allow firms to refer investors to a toll-free number or website instead.

Education also means teaching people the strategy behind saving for college, which is different than the rainy-day mentality of retirement, said Doug Chitenden, vice president for education savings at TIAA-CREF in New York.

"Step one is educating investors about that objective," he said.

Step two might be educating investors about how to compare state plans. Chicago-based fund rater Morningstar ranks plans annually based on performance, selection and fees. Most states also offer home-turf incentives, such as state tax breaks, which often confuse investors, as the benefits are sometimes offset by expenses, or even performance.

Bischoff said he often finds

himself referring in-state clients to Nebraska, where TD Ameritrade offers good managers, low costs and a decent investment selection. Such interstate shopping is what helps states like Nebraska attract significant dollars to their plans. Nebraska has only 428,250 children below college age, but holds \$1.72 billion in assets in its TD Ameritrade plan.

Meanwhile, Pennsylvania, a state with 2.8 million residents under 18, had only 26,600 participants and \$315 million in its investment plan as of March, according to data from the College Savings Plan Network of Lexington, Ky.

But the Keystone State's plan is in the midst of a turnaround that might lay the foundation for a new era of 529 competition. Pennsylvania announced that it will offer state residents tax breaks no matter where in the union they choose to invest, or where students may attend school. Maine and Illinois announced plans to allow tax parity in 2007. Pennsylvania State Treasurer Robert P. Casey, Jr.

also increased income tax deduction levels to \$12,000 for individuals or \$24,000 for joint filers for each 529 plan to which they contribute.

In order to make its own plan more attractive, Pennsylvania nixed annual and enrollment fees for its pre-paid plan and, after years of mediocre returns, cut ties early with Philadelphia-based Delaware Investments in favor of signing a contract with a new provider.

That might be the most important improvement any plan can make, Hassan said.

New York, California and Ohio have also recently shuffled providers, causing competition on price, selection and add-ons among fund companies scrambling to expand their market share in this soon-to-take-off space.

Karen Walsh, a spokeswoman for the Pennsylvania Treasurer's Office says that's the best scenario for everyone.

"Competition is always good. It makes you become better," she said.