Testimony of

New Hampshire State Treasurer Michael Ablowich

regarding

Section 529 College Savings Plans

before the

United States Senate Committee on Governmental Affairs

Subcommittee on Financial Management, the Budget, and International Security

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Mr. Chairman and Members of the Committee, my name is Mike Ablowich. I am the Treasurer of the State of New Hampshire, trustee of the UNIQUE College Investing Plan, the Fidelity Advisor 529 Plan, both of which are sponsored by our state. I am also a member of New Hampshire's College Tuition Savings Plan Advisory Commission, and a member of the College Savings Plans Network (CSPN), which is an affiliate of the National Association of State Treasurers. CSPN coordinates states' college savings efforts by harnessing the collective resources of the states to improve industry practices and develop self-regulating policies.

It is my sincere pleasure to be here today to speak with you about 529 college savings plans, the State of New Hampshire's perspective and philosophy regarding these plans, and how states are making them successful.

The states have been working with Congress for over a decade to increase access to college by helping families overcome one of the greatest barriers to college – the ever-increasing cost of sending a child to college. This successful partnership culminated in the enactment of the tax exemption for qualified distributions from the plans in the Economic Growth and Tax Relief

Reconciliation Act of 2001. Since 2001, these plans have grown tremendously, and we appreciate Congress' vision and leadership in enhancing the ability of the states to build the college savings plans, which in turn makes higher education more affordable and accessible to families. You should know that our shared vision is being realized every day as 529 plans in all 50 states continue to help families achieve the dream of a college education. Families in record numbers are putting their hard-earned dollars in 529 plans, and that commitment is paying off. More than 400,000 students nationwide already have used their 529 resources to pay for college, and nearly seven million more are waiting to use their accounts when they go to college.

New Hampshire's story is no different.

We began offering 529 plans in 1998, and since then, residents in New Hampshire and other states have responded to 529 plans with excitement and enthusiasm. More than $3.3 billion has been invested in our two programs combined. That high level of response is even more amazing when you consider that we started these plans a couple years before one of the most challenging financial markets in history. Investors clearly understand the need for higher education and the need to save early and regularly in a tax advantaged account. Of course, while periodic investing strategies do not guarantee a profit or protect against a loss in a declining market, investing in a federal income tax-free vehicle, like a 529 plan may be one of the simplest and best ways for families to start saving for college.

Our 529 program is built on the foundation of putting the investors and beneficiaries first. We make every program decision with the interests of our investors placed first. And while we maintain outstanding relationships with our private-sector partners, our first priority is always to our investors, the plan participants. That is why New Hampshire currently has two 529 college savings plans to choose from. Each offering investors a different method of deciding on which investment options are best for them. We sponsor the UNIQUE College Investing Plan which is sold directly to investors and the Fidelity Advisor 529 Plan which is marketed to investors through intermediaries like financial planners. Both plans give investors a wide range of 529 college savings options to satisfy their college savings goals. Our retail UNIQUE Plan is designed with smaller investors in mind. For these investors they can get started with as little as $50 with $50 monthly contributions, or for a one-time contribution of $1,000. It is our goal to offer solid investment choices to attract a wide range of investors with varying risk tolerances and investment philosophies.

We believe our approach is working, with over 332,000 accounts opened since we opened and new investors joining daily.

The Public Policy Behind 529

The states long recognized the need to foster saving for college, which is economically more sound than borrowing, both for families and for institutions of higher education. Beginning in the late 1980s, the states established tuition savings programs to encourage families to save for college, leading the way in meeting the needs of families to save for college by developing innovative plans to reach families of every income level and in every community. The mission of the state college savings plans, whose existence predates the passage of Section 529 of the

Internal Revenue Code, has always been to increase access to higher education by offering families a simple, safe, affordable and dedicated way to save for college tuition. In 1996, Congress recognized the need to develop supportive federal policies to encourage and empower more Americans to save for college. Today, 529 plans are shining examples of how good public policy can enhance the futures of many Americans. My passion and my interest in the 529 program is the same as yours — to foster a savings ethic and help all families save for a college education.

So what is the challenge that families face to send their children to college? The frequent headline in newspapers across the country says it all: "Cost of college rising again." While families continue to take advantage of the 529 plans, they see the cost of college rising steadily every year. Families are doing financial back-flips to meet this rising cost. Many are forced to rely heavily on debt to meet their needs. 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.

Despite the rising cost, the value of a college education is enormous. To give you an example, median annual earnings for full-time workers with bachelor's degrees are about 60 percent higher than earnings for those with only a high school diploma. Over a lifetime, this gap exceeds one million dollars in earning potential. Further, more and more jobs require technical training and post high-school education.

That is why Congress and the states long have recognized the need to foster a college savings ethic. Today, states design 529 plans to specifically promote future access to higher education for children of all economic means. These plans provide a unique savings opportunity for two-year, four-year, or graduate schools, vocational or technical schools, or any accredited educational institution, and the invested dollars can be used any time in your life.

Everyone talks about the amount of money saved in 529 plans, and it is substantial, but I believe the more important statistic is the number of accounts. I don't care whether people are saving $50 or $50,000, as long as they save. I also am not concerned whether they save in one of our two 529 plans or in another plan, in their name in a traditional savings account or some other method. The important thing is that parents are making plans for one of the most important investments in their lives, their child's education. In New Hampshire, we have worked to develop college savings awareness to ensure that every resident, regardless of income, understands and has easy access to the 529 program and other college financing options.

State Oversight

The states have a legitimate, vested interest in making college more affordable and more accessible for their citizens.

State implementation and oversight of 529 plans has been critical in the growth and success of these programs. We have found that the states' strong role in the administration of these programs add credibility and therefore encourages new investors who otherwise might not have considered such a vehicle for their college savings needs Each of us who administer such plans is accessible to talk with customers at any time. In fact, when was the last time the head of a mutual fund company went to a local youth sports event and had a fellow parent come up to them and ask them questions about how their investment account was performing for their child. This has happened to me. My neighbors who participate in our 529 plan know where to find me if they have questions or concerns. For this reason I and my colleagues from the other 50 states take our oversight responsibility very seriously.

States have become very innovative in their approaches to attract college savers, using everything from state tax incentives, scholarship programs, matching grant programs, low-cost mutual funds, easy contribution and withdrawal features, online enrollment and account access, and low investment minimums.

In New Hampshire, the Treasurer's office is responsible for our 529 plans, as is the case for many state treasurers around the country. We have been entrusted with looking after the hard-earned dollars of families who are saving for their children's and grandchildren's futures. Our Advisory Commission meets regularly to review plan operations, the performance of the securities markets and performance of each of the portfolios and investment options available to our investors. We have worked hard to ensure that our 529 plans, whether bought directly or through a financial advisor, offer competitive fees that are fully disclosed to all investors. We also spend much time reviewing the performance of each portfolio to insure that investors are earning competitive returns net of fees compared to the appropriate benchmarks. This allows me, and our Commission, to exercise full and effective control over the program as well as oversee our private-sector program manager. Every significant decision made regarding the program, whether investment-related or administrative, is analyzed and approved by the Commission.

The roles of the Treasurer and the Advisory Commission and the terms of the contract with Fidelity Investments, our plan administrator, have been approved consistent with the process used for all state contracts. This contract, as with all state contracts, was approved as to form and substance by the state Attorney General's office and approved by the Governor and the Governor's Executive Council, again consistent with the process for all state contracts. This level of state oversight of the 529 plans provides an essential layer of protection and accountability for the participants. Our program is governed by state law and administrative rules, ethical standards, and open public records and meetings laws. In addition, both our plans are audited every year by an independent auditor selected not by our Commission or our plan administrator but by the office of director of state audits, who works for the legislative branch of our government. These audited financial statements are then accepted by the legislature in the same manner as any other financial or performance audit contracted for by the state. Each participant in our plans recieves a copy of the annual report, which contains the audited financial statements for each plan and each portfolio within the plan.

I have mentioned some of the oversight activities we perform in New Hampshire to make sure our 529 is the best available option for our state's residents. I would like to now describe to you briefly two important initiatives CSPN is very proud of.

First, 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 this May at the Network's annual meeting. The National Association of State Treasurers also adopted the principles at its annual conference earlier this year. 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

To date, 21 states have begun implementing the principles. More states will implement the principles as they revise their offering materials. Additionally, CSPN is enhancing its' web site to include the disclosure principles as part of each state's information presented on the Network's web site.

Second, we have worked extensively over the past 5 years, in anticipation of the reauthorization of the Higher Education Act to make the impact of 529 plans more rational when it comes to determining a family's eligibility for financial aid. We have been working with many legislators in the House and Senate to make sure that the financial aid rules do not unfairly penalize those families that choose to save in a prepaid tuition program compared to the other options they have for college savings and are hopeful that these changes will be incorporated into the next version of the Higher Education Act.

We are very proud of the voluntary disclosure principles and our efforts to simplify for people the interaction between saving and financial aid. Both are examples of how states can come together on issues of importance to their residents and work together to develop effective solutions to what can be complex issues.

I hope that we can have a dialogue with your committee about the positive aspects of college savings plans. Many improvements have been made over the past ten years as federal and state laws have evolved and state and federal regulators have become more knowledgeable about these investment plans. States continue to improve these plans, as economic and market conditions evolve. These improvements are consistent with the oversight role of the states.

Unfortunately I think the title of your hearing today does a disservice to these many improvements. I know that this committee has spent time discussing the issue of mutual fund fees and expenses and whether those fees and expenses encourage portfolio managers to work in the best interests of investors. You should know that the National Association of State

Treasurers has a long history of supporting thoughtful changes in the mutual fund and investment industry. CSPN and NAST looks forward to the results of the deliberative work of legislators and regulators to examine mutual fund pricing. After all the majority of college savings plans are essentially mutual fund products and the benefits of any industry wide efforts to improve the disclosure of fees and expenses will be passed on to all mutual fund investors of all types including 529 plan investors.

In discussing claims of “disparate tax treatment,” it is important to remember that the college savings programs are STATE programs. Many were started before section 529 of the Internal Revenue Code was enacted. Moreover, section 529 requires that these programs be “created and maintained” by a state. The enactment of section 529 has added essential benefits to the states’ college savings plans by providing substantial federal tax advantages. The enactment and subsequent amendments have largely been responsible for the tremendous growth in these programs over the last few years. Nevertheless, these programs fundamentally remain state programs. They further the states’ public policy of making higher education more accessible and affordable for their citizens. If section 529 were to disappear, state statutes would require us to operate and maintain these programs regardless of the federal income tax benefits.

The state tax treatment of these programs should remain the prerogative of the states. In keeping with the federal/state structure of our nation, each state has created its own program aimed at meeting the needs of its citizenry. In doing so, most of the 43 states with income taxes provide state tax incentives to their residents who choose to save for college through their own state’s plan. Approximately 35 of those 43 states provide that their residents will not be subject to state income tax on any earnings gained through the program when the account is used for qualified education expenses. Many states (26) have provided their residents an additional incentive to save for college by giving a state income tax deduction for at least some of the contribution made into their state's college savings plan.

While providing incentives to save through its college savings program, most states' laws simply do not address the state tax treatment of out-of-state section 529 plans. As a result, in most states taxation of an out-of-state section 529 account owned by a state resident is governed by the state's revenue code generally applicable to similar investments such as out-of state municipal securities or mutual funds.

As of January 1, 2002, however, federal law – the amendments making 529 plan earnings used for qualified expenses exempt from federal income tax -- has had an indirect affect on many states' treatment of out-of-state 529 plans owned by state residents. By state law, many states (34, including D.C.) have chosen to adopt the federal law regarding taxable income. These "conformity" states mirror the federal income tax treatment of section 529 plans. That is, when used for qualified higher education purposes, income from any section 529 plan is not subject to that state's income tax. Of course, if the federal income tax exemption for section 529 plans were to sunset, as scheduled on December 31, 2010, these conformity states would, once again, subject residents' earnings on out-of-state 529 plans to state income tax. The strongest step Congress could take to safeguard these plans would be to repeal the sunset provision and make the favorable federal tax treatment permanent.

On the last point raised in the title of today's hearing, questionable broker sales practices. Although we are aware of the current investigation of broker sales practice by the NASD, I am not aware of any publicized **specific** examples of questionable broker sales practices. In fact, I and my colleagues in the College Savings Plan Network would welcome **specific, detailed** information regarding allegations that brokers are not performing sufficient due diligence for their clients or failing to provide suitable disclosures for the purpose of properly recommending to their clients a college savings plan. If such specific examples exist releasing that information and making it public would be welcome. At this point there are only rumors and innuendo contained in newspaper and magazine articles concerning this issue. If there are in fact inappropriate sales practices I speak for all state plan administrators when I ask for this information to be shared with us so we can properly address this issue with our plan administrators and if appropriate, state securities regulators who are frequently on the front line of protecting individual investors. In fact, our fiduciary responsibilities to program participants and beneficiaries would demand that we act on any such specific allegations of questionable sales practices.

Conclusion

Creating greater access to higher education and encouraging savings over borrowing is sound public policy. 529 plans are designed to improve access to higher education and, through the states' administration of the plans, do in fact improve access. The state 529 plans provide opportunities for investment and savings by low- and middle-income investors, support investor education, and reduce the need for financial aid and loans. In the longer term, the plans provide our states and nation a better-educated workforce, and help individuals to secure higher-paying jobs. And Section 529 is working: Citizens are investing in these plans in great numbers because they trust that the states are administering them in the best interest of the participants. The public policy goals of the Section 529 qualified tuition programs are foremost in the administrative efforts of the states, and the states are in a unique position to further those goals.

I hope that this hearing is the beginning of a dialogue between NAST, CSPN and your committee to protect and preserve one of the best ways for parents to save for one of the most important investments in their lives, the education of their children. You have my commitment to work with you and the other states to continue to improve the 529 plans and make them the best way for American families to save for a college education. Thank you for the opportunity to be here today. I am happy to answer any questions.