Maryland529

formerly College Savings Plans of Maryland

December 15, 2016

The Honorable Edward J. Kasemeyer
Chair, Senate and Budget and Taxation Committee
3 West Miller Senate office Building
Annapolis, MD 21401

The Honorable Maggie McIntosh
Chair, House Appropriations Committee
121 House Office Building
Annapolis, MD 21401

Dear Chairman Kasemeyer and Chairman McIntosh:

The Joint Chairmen's Report for the FY 2017 State Operating Budget directed College Savings Plans of Maryland (Now MD 529) to report the potential implementation of Savings Account Plans at Maryland 529 alongside the two current college savings plans. The purpose of this third plan is to allow contributions to a savings account, rather than an investment account, that is federally insured and established to meet the qualified education expenses of a qualified designated beneficiary. Virginia currently offers this option to its plan holders. In addition, the committees asked for a breakdown of the cost of implementation and whether there are any legal or actuarial barriers to offering a Savings Account Plan.

Please find the requested report attached.

Sincerely,

Lauren Shipley
Executive Director

cc: Nancy Kopp, State Treasurer, Maryland 529 Board Chair
Susanne Brogan, Deputy Treasurer

217 E. REDWOOD STREET | SUITE 1350 | BALTIMORE MARYLAND 21202 | TELEPHONE TOLL FREE 888.4MD.GRAD
TTY MARYLAND RELAY: 800 735 2258 | FAX (410) 333 2295 | www.MARYLAND529.com |

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Report on Feasibility of 529 Savings Account Plans

12/15/2016

The Joint Chairmen's Report for the FY 2017 State Operating Budget directed College Savings Plans of Maryland (Now MD 529) to report the potential implementation of Savings Account Plans at Maryland 529 alongside the two current college savings plans. The purpose of this third plan is to allow contributions to a savings account, rather than an investment account, that is federally insured and established to meet the qualified education expenses of a qualified designated beneficiary. Virginia currently offers this option to its plan holders. In addition, the committees asked for a breakdown of the cost of implementation and whether there are any legal or actuarial barriers to offering a Savings Account Plan.

Maryland 529 very much supports the overall goal of helping as many Maryland families as possible to save for college and to reduce or eliminate their need for burdensome student loan debt. We also understand the opportunity that banks and/or credit unions can provide to reach additional 529 account holders. Federal Deposit Insurance Corporation (FDIC) insured 529 savings products do exist in some states as a mechanism for saving for college; however, there are aspects of the program that are less than desirable to outpace the rising cost of college. Specifically, current returns of less than 1% in an FDIC insured saving product do not outpace the tuition inflation or the U.S. inflation rate. This mismatch could cause unrealistic expectations in reaching long-term college savings goals.

Background

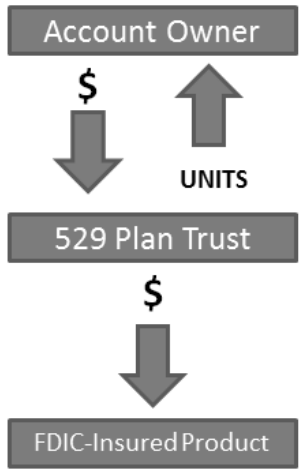
A 529 savings account product is plan that is insured by the FDIC, including savings accounts and bank certificates of deposit (CDs). Because these accounts offer lower risk and coverage up to $250,000, they typically have a lower investment return. However, if there is a significant loss in the markets, the FDIC savings products are generally protected. As with an FDIC insured bank account, a 529 FDIC savings account product is backed by the full faith and credit of the United States government up to certain limits in the event of a bank failure. In addition, because the product is under the 529 IRS tax regulations, the interest is tax-deferred, and as long as the funds are used for a qualified expense as defined by IRS publication 970, the earnings are tax-free upon distribution.

The FDIC savings account product has not been widely adopted across 529 plans and is currently offered by 12 states[1]. Based on research and conversations with some of these state administrators, there are three main examples of FDIC insured college savings vehicles:

1) Omnibus Program – (most common) account holders have an individual account as part of pooled assets managed by a third party similar to the relationship with the program manager for the Maryland College Investment Plan.
2) National Online Program which allows states to contract to serve as Program Manager.
3) Partner Depository – state agency uses a regional bank to serve as the depository for funds, however all assets are actually held and all record-keeping and disbursements actually handled by the agency.

<u>Option 1 - Omnibus Program</u>:

As mentioned above, in this structure account holders have an individual account as part of pooled assets managed by a third party. In the case of the underlying FDIC insured accounts, investments and the earnings that follow are pooled into master accounts held in trust by the 529 plan at the partner banks. The following chart depicts things graphically:



In Utah, they have a chosen a two bank structure to their omnibus program where contributions to and earnings on the FDIC insured investment option are allocated between the two banks according to the following percentages: Sallie Mae Bank (90 percent) and U.S. Bank (10 percent). The bank allocation does not change. The money is insured by the FDIC on a pass-through basis to each account owner at each bank up to the maximum amount set by federal law, which is $250,000. The amount of FDIC insurance provided to an account owner is based on the total of (1) the value of an account owner's investment in the FDIC insured account at each Bank plus (2) the value of other accounts held (if any) at each Bank, as determined by the Banks and by FDIC regulations.

Like savings accounts, the FDIC insured 529 options will earn varying rates of interest. The current year-to-date (YTD) yield for the Utah FDIC insured savings plan is .76%. Additionally, the fund does not have an underlying fund expense ratio, but has a program management fee of .16%. This fee is deducted from individual accounts and is calculated and assessed based on an account's balance on the last business day of each month.

In Nebraska only one bank is used, but is handled the same way. The savings account is an omnibus savings account insured by the FDIC maximum of $250,000 per account and is held in trust by the Nebraska Educational Savings Plan Trust at the Bank. The Bank also serves as Program Manager of the Plan.

The Nebraska Bank Savings Individual Investment Option's current YTD interest is .50%. It is noted that the interest rate generally will be equivalent to short-term deposit rates. Additionally, the fund does not have an underlying fund expense ratio, but the account fund is subject to a .18% Program Management Fee and a State Administrative Fee of 0.02% totaling an overall cost of 0.20%. Like Utah, the fee is deducted from individual accounts and is calculated and assessed based on an account's balance on the last business day of each month

Option 2 - National Online Program:

This option offers an opportunity for individuals across the United States who would like to use an FDIC insured savings vehicle for their college savings. The College **Savings Bank** offers a national product (www.collegesavings.com) available to individuals across the U.S. In addition, the bank separately serves as the Program Manager for an exclusive online banking product contracted by Arizona, Indiana and Montana to provide their residents with FDIC insured products, including: variable rate CDs, fixed rate CDs and a high-yield savings account. BB&T also offers a national option called the CollegeWealth® 529 Savings account that can be opened in any state. Any Maryland family has the ability to utilize a national plan that is open to all US residents; however, they would not be eligible for a Maryland state tax deduction based on existing law.

Option 3 - Partner Depository:

This is the model used in part by Virginia. Virginia currently offers an FDIC product to its residents and has been available for approximately 8 years. Currently the offering has about 16,500 unique account holders and assets of $112 million. Originally, Virginia intended to utilize the complete community bank network across Virginia; however, Union Bank and Trust was the only community bank that actually had services to open the accounts. Unfortunately, within a month they were forced to turn over the record-keeping, reporting and IRS compliance functions to Virginia 529.

The issue was cost related. Community banks generally contract out processing functions to larger institutions because their needs are standardized and economies of scale can bring down costs. However, in 529s, as opposed to standard FDIC insured accounts where tax reporting is done yearly and earnings are not aggregated year-over-year, principal and earnings must be kept separately and reported separately in perpetuity. This occurs because in a 529 tax-deferred account earnings are not realized until there is a distribution. This requires different accounting procedures than a standard savings account. Due to low initial adoption rates, the 529 FDIC insured savings plan business was not big enough for the larger processers to provide these external services.

As a result, Virginia529 changed their model in 2008, still utilizing Union Bank and Trust, but added a regional bank partner, BB&T. This new relationship functions like the national plan model. However, record-keeping and administration of the accounts are still handled by VA 529, but BB&T serves as the depository. According to VA529, one-third of the account holders are new customers to BB&T, the other two-thirds are existing customers opening a separate account.

It is worth noting the accounts actually provide a higher yield than standard market-rate savings accounts. Here is a rate comparison as of 12/14/2016:

Account	Rate
VA529 with BB&T	0.25% APY
VA529 with Union Bank and Trust	starting at 0.50% APY
Bank of America taxable basic savings	.01% APY

There are some challenges with the Virginia529 model. They are:

- **Customers have multiple accounts for the same product** - account holders have both a BB&T account and a VA529 account, since the handling of the money (after it is deposited), reporting, and disbursing are directly from VA529. They receive statements from both and have separate account numbers for both.
- **Limited in branch access** – only a handful of branches across the state have a licensed professional who can handle questions related to 529 complexities.

Even in those scenarios, the customer would still be directed to open the account online since processing is not handled by the bank. This eliminates some of the benefit of personalized banking. Additionally, residents are generally not able to go to a bank and ask a live person questions about the product.

It is also important to note that VA529 has a considerable amount of flexibility in how they set up their programs because they are exempt from Virginia's standard procurement practices. This allows them more flexibility in contract negotiations and a quicker speed to market.

Some states have tried a hybrid model of a partner bank and omnibus program as one offering but did not receive FDIC coverage.

Implementation in Maryland

Legal

Current Maryland law does not allow for an FDIC insured savings account option. With the appropriate enabling legislation, establishing an FDIC insured savings vehicle is legally feasible; however it does present some challenges. They are:

1. **No existing contracts to leverage -** in review of Maryland 529's existing banking contracts, the agency does not have the authority to set up FDIC insured accounts. Additionally, Maryland 529's current program manager for the College Investment Plan, T Rowe Price, no longer has an FDIC insured savings bank, after selling off that part of their business. This would require Maryland 529 to issue an RFP for such services;

2. **Maryland 529's independent agency structure -** due to Maryland's 529's enabling legislation requirement for separate accounting for separate trusts, none of the revenues generated from the Maryland Prepaid College Trust (MPCT) or the Maryland College Investment Plan (MCIP) could be used to

support the operation of an FDIC insured savings program. The enabling legislation for the agency and these Plans states that money from each of the plans may not be considered money or, or commingled with, either of the other plans. In addition, the Maryland 529 (Board) established the MPCT and MCIP as separate trusts, consistent with the enabling legislation. This means that money realized from each trust needs to be used to benefit the participants of that trust. Therefore, funds that the agency has realized from our current plans cannot be used to fund the start-up costs of another plan. As these fee revenues for the MPCT and MCIP are the only revenue sources for MD529, implementation and operation of a savings plan program would require a State appropriation in order to support the program, until the savings accounts generate fees sufficient to sustain the staff and operations supporting the program; and

3. **529 plans are considered to be municipal securities** – Because 529s are state administered, they fall under municipal securities regulations. This structure adds a significant layer of regulatory and record keeping complexity over and above the opening of a regular bank savings account. In Virginia, about 50 banks originally signed agreements with Virginia to offer this type of 529 plan. However, once they learned further detail of the requirements of managing such a plan such as Municipal Securities Rulemaking Board (MSRB) monthly reporting, IRS reporting, fund accounting of tax-deferred earnings, submission of advertising documents to Financial Industry Regulatory Authority (FINRA) and MSRB, and National Association of Securities Dealers (NASD) licensing for sales staff, they all abandoned their effort with the exception of one bank.

   In addition, based on the experience of other states – specifically Virginia and Utah – banks are not always able to permit families to open this type of an account in their branches. Rather, some participating banks only permit the plan to be opened online. State and federal laws governing 529 plans are complex and the banks may not be willing to ensure that qualified NASD licensed employees who can discuss investment products are consistently available to promote in-person enrollments. And failure to meet the 529 requirements would result in the plan being disqualified from its tax-deferred status.

To specifically address the question of actuarial barriers, an addition of a FDIC insured savings product would not impact the soundness of the Trust. As stated above, the MPCT and MCIP need to maintain separate accounting and cannot comingle funds. Therefore, no actuarial barriers preclude the establishment of a 529 savings account program since the program would be separate and distinct from either the prepaid plan or the investment plan.

<u>Costs</u>

If this new FDIC savings plan is created, there will be significant start-up costs to develop the plan, obtain contractual agreements with one or more banks and/or credit unions to manage the plan; and to oversee the operations of the plan. The primary cost categories that would be impacted are personnel, contractual expenses for marketing, community outreach and website development, legal expenses for contract development and execution, and development of account holder agreements and disclosure, systems development, IT, and audit functions.

If a partner depositary model (like Virginia's) would be adopted, additional staff, technology, IT services and printing would be needed to handle the in-house recordkeeping aspect. Also, there would not be a program manager sharing expenses, and would result in higher ongoing marketing, staffing, and technology costs. Approximate costs are outlined below:

	Year 1 (Implementation)	**Ongoing**
Marketing: advertising, collateral, community development, and website development	$300,000	$300,000
Staffing: existing staff time (marketing, Executive Director, legal) plus 2 additional processing and 1 additional customer service associates	$250,000	$250,000
System Development: modification of existing system or the acquiring of a new system	$225,000	$100,000 (maintenance costs)
IT Consultant Services: to manage the implementation of the systems,	$175,000	$50,000

updating in-house technology and database administration		
Audit: added services need for a new program	$20,000	$20,000
TOTAL	$970,000	$720,000

If an omnibus or national model would be considered, the costs could be lower. Below outlines estimated costs assuming an omnibus relationship:

	Year 1 (Implementation)	**Ongoing**
Marketing: advertising, collateral, community development, and website development	$225,000	$150,000
Staffing: existing staff time (marketing, Executive Director, legal)	$125,000	$75,000
System Development: modification of existing system or the acquiring of a new system	$225,000	$50,000 (maintenance costs)
IT Consultant Services: to manage the implementation of the systems and updating in-house technology	$75,000	$15,000
Audit: added services need for a new program	$20,000	$20,000
TOTAL	$670,000	$310,000

Conclusion:

As discussed there are three potential delivery methods of providing a FDIC insured 529 savings product in Maryland and none are without challenges. Those challenges are: 1) a significant layer of regulatory and record keeping complexity over and above the opening of a regular bank savings account; 2) expensive start-up requirements that rely on a State appropriation of general funds; and 3) the effort and expense may not meet account holder's long-term college savings goals.

While existing administrative, budgetary and legal restrictions prevent the agency from pursuing an FDIC insured savings plan for Maryland residents at this time, we welcome the opportunity for further discussion and can be available at the Committees' request.

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[1] The 12 states offering an FDIC insurance product are:

State	Type	Products
Arizona	National	1. Variable rate CD 2. CD with an interest rate linked to the S&P 500 Index 3. Fixed rate CDs with one-year or three-year maturities 4. High-yield savings account
Colorado	Omnibus	One-year time savings account Money market savings account
Idaho	Omnibus	Sallie Mae High-Yield Savings Account
Indiana	National	1. Variable rate CD 2. CD with an interest rate linked to the S&P 500 Index 3. Fixed rate CDs with one-year or three-year maturities 4. High-yield savings account 5. Sallie Mae High-Yield Savings Accounts
Maine	Omnibus	Interest-bearing FDIC insured bank account at Bank of America, N.A.
Montana	National	1. Variable rate CD 2. CD with an interest rate linked to the S&P 500 Index 3. Fixed rate CDs with one-year or three-year maturities 4. High-yield savings account
Nebraska	Omnibus	Savings account held at the First National Bank of Omaha
Nevada	Omnibus	Sallie Mae High-Yield Savings Account
Ohio	Partner Depository	1. Fifth Third Bank Savings Account 2. Fifth Third Bank 529 Certificates of Deposit (CDs)
Utah	Omnibus	FDIC insured savings held in trust by UESP at Sallie Mae Bank and U.S. Bank
Wisconsin	Partner Depository	Bank CD Portfolio issued by banks with a main, home or branch office located in Wisconsin
Virginia	Partner Depository	FDIC insured deposit accounts with participating financial institutions