529 College Savings Plans: Lessons for State Sponsored Retirement Plans

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The States and Not the Federal Government Took the Lead in 529 Development

- States functioned to set up and manage the programs in different ways and have largely been successful. AUM (assets under management) today measured in the billions.
- Financial challenges to establishing successful 529s, were overcome.
  - The principal challenge was "could managers make money managing thousands of small accounts?"
  - The issue of achieving "critical mass" was huge to money managers in the mid to late 90's because they legitimately questioned whether or not the states would put sufficient energy into 529s to make them viable.
  - The states "put sufficient energy into 529s" through state commissions, state Treasurer's offices and the use of tax credits and deductions against state income tax earnings.

What Can We Learn from the 529 Experience?

"It's déjà vu all over again…"

Yogi Berra

"We're going back to the future…"

Marty McFly

"Things are exactly the same except where they are different…"

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- The principal challenge was "could managers make money managing thousands of small accounts?"
- Potentially trillions of savings a reality (another way of saying trillions provided into capital markets for business expansion)?

What Were The Hurdles to Enactment?

A major difference facing the creation of state sponsored retirement plans vs. establishing 529's at the state level:

Q. Who would step forward to oppose saving for college when no alternative plan existed?

A. Virtually no one…only a few bankers who think all money is innately theirs and should go into their institutions as cash and not into "risky" securities markets…

Q. Who would oppose publicly sponsored private retirement plans in IRAs?

A. Local investment / insurance industry who feel it is competing against their ability to sell individual IRAs, NFIB and Chamber .

B. Bankers…who think all money is innately theirs and should go into their institutions as cash and not into "risky" securities markets.

Insurance Industry Concerns

- **Insurance industry declares automatic IRAs either aren't legal or instantly trigger the wrath of ERISA on participating businesses…**

Wrong, wrong, wrong.

DOL Interpretative Bulletin 2509.99-1, pg. 327-330. If business does not contribute funds and follow a few basic rules they are in an ERISA defined "**safe harbor**"…Such plans are not "pension plans" that require ERISA oversight.

- **"Insurance industry is already serving that market"…** Which certainly goes counter to the fact that the average 50 year old has saved less than $44,000 for retirement.

- **"IRAs have been around for years…they just aren't what people want…"** True and false.
  - Not marketed to lower and middle income folks for the reason of "critical mass". Often seen as complex. Individual IRAs don't provide cost benefits available through pooled accounts!

Business Concerns

- Business trade organizations such as the National Federation of Independent Business (NFIB) and the US Chamber argue it is just another expensive business regulation and potential liability.
  - Such a program does not have to be a mandate on either the employer or employee.
  - When a business selects such a program, its only responsibility is for the APD (automatic payroll deposit).
    - Businesses need to understand pursuant to interpretative bulletin 2509.99 they have no liability for fund performance as they might have in an ERISA pension plan.
    - All other things being equal, perspective employees would rather work for a company with a retirement plan.
    - NFIB and Chamber argue states can't manage such a program… but 529s are sure working well… and many businesses already offer APD's for 529s!

The Don’ts…. Or Tripwires for Failure

- Don’t craft a plan that is unworkable on Day 1.
  - ✓ e.g. Phase the plan in or, if a plan can’t pass this session…work it through a study committee. Get it right the first time. (NOTE…529s are illustrative here too!)

- Don’t establish a plan that on Day 1 has so many participants that it cannot be effectively rolled out… think “incrementalism”.

The Do's…. Or Perceived keys to Success

Always, always, always stress the portability of the accounts and **the fact it the employee's money!**

- Create a managing board chaired by someone with single point accountability: Treasurer, Comptroller, Auditor, etc.
- Stress pooled account cost savings and professionally managed assets (the advantages of pooled cost savings are unavailable to individual IRA investors)
- Establish a Board or commission made up of professionals from outside of state government.
- Give board latitude to negotiate to over hurdles:
  a. E.g., Give longer term contracts <with re-openers based on performance> to overcome critical mass issue.
  b. Promote "opt out" language
  c. Avoid mandates (point "c" is specifically noted as my personal opinion based on dealing with politicians <legislators> who want to do retirement accounts but don't want to seem "anti-business")

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