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529 College Savings Plans: Lessons for Publicly Sponsored Private Retirement Plans

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I. Introduction: State Leadership to Address Savings Challenges

Each day for the next 14 years 10,000 baby boomers will retire. According to the Census Bureau, the population age 65 and over in 2030 is projected to be more than 74 million, representing more than 20 percent of the total population.[1] One of the greatest financial challenges facing our nation today is that more than half of working households have no retirement savings in a defined contribution savings plan and almost one-third of households age 55 and older lack retirement savings in a defined benefit plan or defined contribution savings plan, leaving Social Security as the main or only source of retirement income.[2] For seniors living at or below the poverty line, states will be increasingly pressed to deal with the dramatic increases in the cost of social services programs for seniors, including healthcare, housing, food and energy assistance.

In a recent survey, 86 percent of Americans believe that the United States faces a retirement crisis.[3] Many Americans are concerned about the future and 74 percent of those surveyed expressed concern about their ability to achieve a secure retirement.[4] The ability of more workers to improve their retirement readiness is made even more challenging today because approximately half of all private sector workers do not have access to retirement savings programs through their employer.[5] Many small businesses do not provide retirement programs either because the cost is too high or the resource burden is perceived as too great for a small company.[6] As a result, many private sector employees are left without access to the simplest ways to save for retirement, and thus end up not taking any steps to begin saving on their own.

In light of the future fiscal burden presented by this retirement savings gap, many state governments

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have begun to explore state-sponsored initiatives for private sector employees (referred to in this policy brief as "state-sponsored retirement plans" or "state-sponsored retirement initiatives"). Over the last two years, at least 30 states have introduced legislation to either establish a state-sponsored retirement plan or study the feasibility of establishing one. Eight states have enacted legislation to expand accessibility to and effectiveness of retirement savings for private sector workers.[7]

Historical Similarities in Tackling Savings Challenges

These state-led initiatives are consistent with the role the public sector has played in tackling other savings challenges, most notably the need to save for higher education and the creation more than 20 years ago of prepaid tuition plans, the forerunner of today's $266.2 billion Section 529 industry.[8] A closer examination of the history surrounding the development of Section 529 qualified tuition programs and the growth of the college savings market shows there are several parallels and many lessons for state policymakers to help address today's retirement savings challenges:

- ***Savings Shortfalls.*** In saving for college, families either started to save too late, or worse, did not save at all, assuming their children would receive financial aid or take out student loans. Families who managed to save often did so in taxable accounts or through investments or savings accounts in their children's names (e.g., Uniform Gift to Minor Accounts), losing all future control of the assets. Similarly, while traditional and Roth IRAs have been available for a number of years, many individuals have not chosen to use them due to either a lack of easy access in the workplace (where most benefits are funded) or their perceived complexities. State retirement programs are intended to provide a simple, low-cost option for workers to save.

- ***States as Innovators.*** Without the federal government filling the tuition savings gap, states took action just as several now contemplate doing for private sector workers lacking employer-provided retirement plans. States first created tax advantaged vehicles for higher education to help middle-income families make college more affordable at a time of rampant tuition inflation. States accomplished this by allowing families to save for future tuition costs at then prevailing tuition rates. States were viewed as the appropriate level of government to most effectively and successfully address this challenge in light of their natural roles in public higher education.

- ***Existing Governance Framework.*** Almost every state had a student loan authority or other higher education services organization focused on making college affordable and attainable. With a mission toward financing higher education, these entities – many of which had State Treasurers as Board members or Board Chairs – naturally lent themselves to oversight and management of college savings programs, including administrative operations, customer service and consumer outreach. The governance model for college savings programs provides a useful and familiar framework for state-sponsored retirement plans.

- ***Investment and Risk Management Experience.*** When first establishing prepaid tuition plans, state authorities relied on internal investment expertise gained, most often, from professionally managed, pooled investments for defined benefit public pension plans. The similarities in structure and risk management were striking and thus state college savings entities were able to draw upon internal experts alongside nationally recognized independent advisors such as actuaries and investment consultants. As college savings plans evolved, pooled investment management moved more to the private sector, modeled on 401(k) and other defined contribution plans. The investment management expertise currently in place for public pension systems and college savings plans provides a ready-made analytic framework for state-sponsored retirement plans.

- ***Federal Legal and Regulatory Considerations.*** With well-developed prepaid plans offered in a handful of states and significant federal tax challenges, the federal government provided the legislative and regulatory relief needed to propel the adoption of state-sponsored prepaid and college savings plans across the nation. Federal tax advantages, coupled with additional state incentives, enhanced the visibility of and consequent demand for Section 529 plans. The August 2016 Department of Labor release of final regulations clarifying important ERISA and other regulatory considerations for state-sponsored sector retirement initiatives should drive similar growth.

With these parallels in mind, we believe that as states evaluate state-sponsored retirement plans, they should consider the experiences of state 529 plans. The 529 industry demonstrates that states can be very successful encouraging, administering and managing savings tools for private sector workers using publicly sponsored accounts. This policy brief provides background information on the growth of the 529 industry and the development of its management models, and then identifies lessons learned that would apply to state-sponsored retirement plans.

II. Creation of Section 529 Plans: State Actions Build Momentum for Change

States as Policy Leaders: Initiatives Led to Federal Change. Between 1987 and 1996, eight states, including among others, Florida, Kentucky, Michigan, Ohio, and Pennsylvania, created and launched prepaid tuition plans ("Prepaid Plans") relying solely on state legislative authorization.[9] While the Prepaid Plans were largely structured as tax-exempt trusts for state law purposes, the Internal Revenue Service (the "Service") rejected this notion and, beginning in 1988, taxed the earnings on the Michigan Education Trust ("MET") in particular.[10] While the State of Michigan and MET together lost the tax refund claim against the Service at the Tax Court level, in 1994 the federal Sixth Circuit Court of Appeals held that MET was, in fact, a tax-exempt entity of the State of Michigan and as such should be exempt from federal taxation.[11] This victory was soon followed by several actions at the federal and state level to help propel forward the establishment of tax-advantaged prepaid and college savings programs:

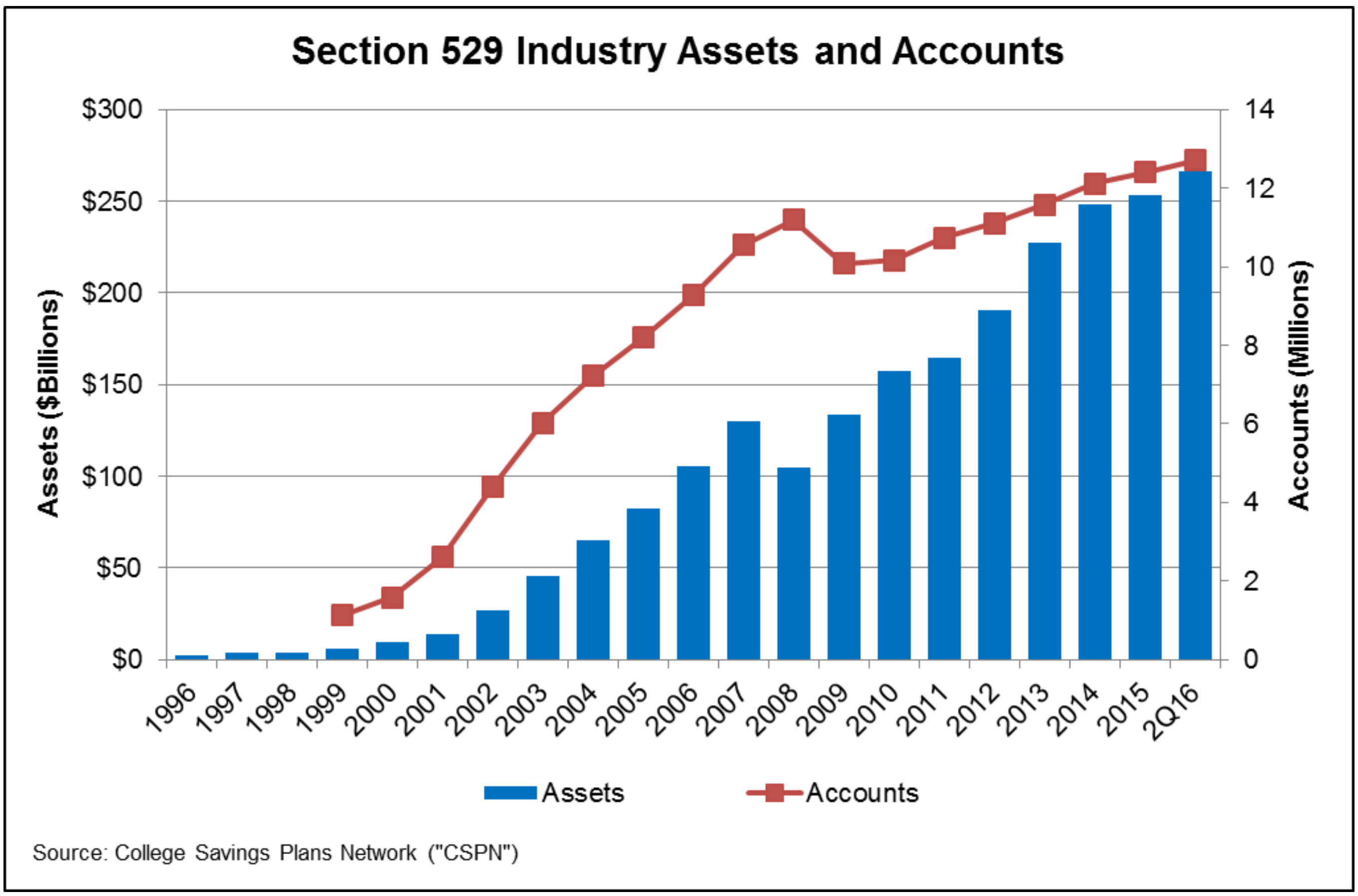
- ***Congress Provides Relief.*** Championed by the bipartisan efforts of Senators Bob Graham (D-FL) and Mitch McConnell (R-KY), Congress enacted Section 529 of the Internal Revenue Code of 1986, as amended (the "Code"), as part of the Small Business Job Protection Act of 1996.[12] This initial action unequivocally conferred upon the states the responsibility "to establish and maintain" qualified state tuition plans. Congress enhanced Section 529 substantially through the Taxpayer Relief Act of 1997 (expanding qualified expenses to include room and board, and by creating favorable gift and estate tax provisions);[13] the Economic Growth and Tax Relief Reconciliation Act of 2001 (providing tax-free qualified withdrawals through 2010);[14] and finally by the Pension Protection Act of 2006 (making permanent the tax-free treatment of earnings on qualified withdrawals).[15]

- ***Regulators Add Support.*** Dating back to the late 1990s, the Treasury Department and the Service released various Private Letter Rulings and Notices to clarify federal tax treatment of 529 plans.[16] Additionally, the Securities and Exchange Commission ("SEC") and the Municipal Securities Rulemaking Board ("MSRB") issued various No-Action Letters, Rules and Interpretive Notices to clarify the securities law treatment of interests in 529 plans, ultimately creating a new kind of municipal securities – municipal fund securities – to capture the distinctions between 529 interests and municipal bonds.[17] Importantly, the MSRB provided guidance on industry best practices by promulgating rules regarding the conduct of business, advertising, sales supervision, and disclosure, among others.[18]

- ***States Provide Additional Incentives Supporting Public-Private Partnerships***. With each federal legislative and regulatory action lending clarity on how to structure and manage Section 529 plans, states quickly enacted legislation to implement Section 529. State legislation often included particular state tax deductions or credits for 529 investments. Today, 28 states offer state tax benefits (e.g., deductions or credits) for investments in their own 529 plans[19] while five additional states offer the same state tax benefits for investment in any 529 plan. Over time, state initiatives also expanded to include non-tax benefits such as bankruptcy protection from creditors, state financial aid preferences, inheritance tax exemptions, and matching grants or scholarships for low- to moderate-income families.

The combination of favorable federal income, gift, and estate tax treatment, together with state tax and other benefits, attracted investment and wealth management firms to the 529 market. Investment managers recognized an opportunity to accumulate and manage assets for an approximate 20-year period, while wealth managers identified financial planning opportunities, particularly for moderate-income to high-net-worth families. As a result, the number of Section 529 plans launched and offered to the public grew substantially from 1998 to 2002, reflecting the true convergence of state public policy goals and private sector business interests. Since then, the market has grown to 103 Section 529 plans overall, including 12 prepaid and 91 college savings plans available to investors today, representing $266.2 billion in assets spread across 12.7 million accounts nationwide, as shown in the chart.[20]

In terms of the 91 different college savings plans (as opposed to the 12 prepaid plans) offered in the



market today, the vast majority of states have engaged private sector investment managers to design and manage pooled investment options that would appeal to a broad array of investors, from the most conservative to the most aggressive. The pooled investment options are modeled on the increasingly popular fund-of-fund and target-date investments offered in privately managed 401(k) plans, typically relying on registered mutual or exchange traded funds as the underlying investments.[21] By offering enrollment and investment option choice directly to the public (referred to as "Direct Plans"), investment managers enabled each state's goal to entice middle-income families to save without the costs associated with professional financial advice. The investment lineups in Direct Plans have largely been kept "simple," with clear choices in order not to overwhelm middle income, straightforward investors acting on their own.

While 48 states plus the District of Columbia offer Direct Plans, 28 states plus the District of Columbia offer separate college savings plans that require the assistance of financial professionals for enrollment (referred to as "Advisor Plans"). Advisor Plans capitalize on investment managers with robust wealth management distribution networks, which strongly supported the additional creation of plans offered solely through the assistance of financial professionals. The key difference between these two distribution channels is that Direct Plans are marketed to the public at large, while Advisor Plans are offered specifically to investors by professional advisors. The involvement of financial advisors also directly increases the overall investment cost due to distribution and servicing fees paid by investors.

III. Establishing and Maintaining Plans: Management Model Considerations

An important part of the evolution of Section 529 plans has been the proliferation of different program management models.[22] The earliest 529 college savings plans tended toward plans run entirely by the appointed state entity (e.g., the Ohio Tuition Trust Authority, the Utah Educational Savings Plan, and the Virginia College Savings Plan). The bulk of 529 plans launched after 1999 – representing 87 percent of all savings plans today – have engaged private sector turnkey program managers who provide all necessary services under one comprehensive management agreement, including investment management, customer service, recordkeeping and administration, marketing and outreach, and distribution. For the most part, investment management firms or recordkeeping firms that have alliances with providers of key services have stepped up to become 529 program managers.[23] More recently, some states have implemented a hybrid structure whereby the various management services required in a 529 plan are split between the states and their private sector partners. The program management decisions for college savings plans offer parallel considerations for states contemplating retirement initiatives for private sector employees.

When enacting legislation to implement Section 529 programs, each state legislature determines where to place authority for its program. To satisfy the requirements of Section 529, the authorizing legislation identifies the entity to "establish and maintain" a Section 529 qualified tuition program, but typically the entity has discretion over how to manage the plan that has been entrusted to its oversight. Today, 49 states and the District of Columbia offer Section 529 prepaid and college savings plans across 24 State Treasurer's or Comptroller's Offices, 12 independent 529 entities, and 13 student loan authorities and higher education-related entities. In turn, the qualified tuition plans available in the market today are managed in one of three ways, with varying implications for the key services that are part of a 529 plan.[24]

In determining the appropriate management model to implement, state entities responsible for 529 college savings plans necessarily have to understand the service silos involved in offering a participantdriven trust with separate accounting, subject to strict regulatory oversight and fiduciary investment responsibility. The services are analogous to those necessitated by the retirement industry and thus how states evaluate whether to provide those services internally or to engage a third party provider can be instructive. For the most part, the initial analysis by a state entity is based on the magnitude of internal resources available either to provide the needed services directly or to oversee the provision of services by external parties and willingness to accept headline risk.

- ***Investment Management.*** Creating single-state, pooled investment trusts for 529s has provided individual families access to professionally managed investments in smaller dollar amounts and at lower costs than individuals would have otherwise. One of the key advantages of a Section 529 college savings plan is that its investors have access to professional investment management at dollar thresholds and fees that an individual, moderate-income investor would not be able to secure individually. This is because many mutual and exchange-traded funds have sizable initial investment requirements that often limit a moderate-income investor's access to those funds. Offering access to investment options comprised of these underlying funds through investment trusts tends to eliminate that minimum investment requirement or at least sets much lower initial deposit requirements than direct investments in these funds would otherwise require. Moreover, by pooling investments from many people, states are able to invest in lower cost mutual or exchange-traded fund share classes than average retail investors would otherwise. Additionally, the array of investment options offered in a Direct Plan generally covers the range of investor risk tolerance without overwhelming the individual with too many choices (in contrast, a wide range of investment choices is deemed acceptable in an Advisor Plan by virtue of the involvement of a financial professional).

  The characterization of investment services as "professionally managed" regardless of the plan management model reflects the fact that all 529 savings plans incorporate professionally managed underlying investments. These investments are then structured to provide 529 plan-level investment options to appeal to many different investors. A few state-run 529 plans design their own investment options, but these are all done with the advice of either independent investment consultants or independent investment advisory committees. Likewise, professionally managed, pooled investment trusts that are modelled after existing 529 college savings plans or public pension plans can provide a useful starting point in designing state-sponsored retirement plans.

- ***Customer Service and Recordkeeping.*** Some public entities are able to offer particular administrative services such as customer service or recordkeeping as a result of large operation centers for other state programs. For example, student loan or other higher education services entities, and even large state Treasury departments, typically have customer service representatives and recordkeeping (or technology) divisions to handle their primary businesses. Extending their coverage to college savings customers is often a natural extension of the public sector service model. For those state entities lacking deep customer service staffing, turnkey private sector providers often allow for warm transfers of customers with state-specific calls or even transfers from the state entity if the state prefers that it provide the initial contact with customers during normal business hours. Similarly, most turnkey providers will customize recordkeeping so communications appear to come directly from the state entity rather than from the unaffiliated, private sector recordkeeper. The decision to outsource the recordkeeping function itself reflects the steep technology costs associated with recordkeeping systems. Public funds and other retirement systems analyze and evaluate these services in a very similar way, as will entities charged with administering state-sponsored retirement plans.

- ***Marketing and Outreach.*** Direct Plans are distributed directly to the public and Advisor

Plans are distributed through professional financial advisors. Where management of college savings plans is outsourced (in a turnkey or hybrid management model), the private sector entity typically funds the entire marketing budget. For both Direct and Advisor Plans, the state 529 entity plays an important role in marketing. For example, the state entity typically approves the marketing message and the marketing materials, which carry the state brand, regardless of the distribution channel. Whether the state actually creates and produces the marketing material is just a matter of execution and varies by the plan management model. In terms of outreach, state 529 entities have broad oversight of (if not direct responsibility for) public outreach, particularly in the Direct Plan channel. Having state representatives front and center on outreach efforts can augment the public service message and thus the importance of the state's initiative. Promoting 529 savings at the workplace is a good example of public sector outreach to encourage critical savings. Several states have worked hand-in-hand with program managers to spread the word on the importance of systematic savings through payroll plans. Clearly, similar efforts in the retirement space would drive home the importance of retirement savings by all employees.

IV. Determining the Right Management Model: Fiduciary and Oversight Considerations

Section 529 of the Code mandates that qualified tuition plans be "established and maintained" by state entities (or, in limited instances, by consortia of educational institutions). Once state legislatures placed authority for 529 plans within appropriate state agencies, each state entity could determine how best to proceed with the design, implementation and operation of its qualified tuition plan. However, regardless of the plan management structure ultimately adopted, each Section 529 board or related governing body implicitly or explicitly serves as a fiduciary to account owners and beneficiaries invested in the plans it offers. The underpinning of fiduciary duties of 529 boards can be found generally in the common law and in certain instances, specifically in state statutes. Importantly, too, the governing boards of college savings plans can look to mutual fund and ERISA governance standards as a matter of best practices.

Fiduciary Responsibilities. Boards and governing bodies satisfy their fiduciary duties by complying with well-established processes, such as adoption of investment policies, investment monitoring and replacement criteria, and engagement of managers through and in accordance with public competitive procurement procedures. They also fulfill their duties of obedience and care by engaging independent, expert advisors when necessary, and by acting in the best interests of the programs' participants at all times. While many states have engaged private sector service providers to manage key components of 529 plans, state boards and other governing authorities cannot delegate their fiduciary duties to 529 participants. In fact, even where states engage turnkey service providers, the state entity remains responsible for the choice of the private sector manager, which must be based on a transparent solicitation process and careful manager due diligence. To this end, college savings oversight offers governance analogies for state-sponsored retirement initiatives.

Fiduciary Role and In-House vs. Turnkey Service Providers. As indicated above, once identified as the state entity with 529 plan authority, that state authority would determine how best to implement plan management and the criteria by which to engage service providers. While most 529 plans have engaged turnkey, private sector service providers and investment advisors, each state has chosen the management model that suits its enterprise. Thus, states with large primary customer service or technology and consumer outreach operations easily undertook these services for the 529 plans. For other states, there has been no shortage of private sector entities to provide the component services pursuant to the appropriate contract term. In recognition of different plan management structures, in May 2010 the College Savings Plans Network, an affiliated entity of the National Association of State Treasurers, adopted general guidance to provide a framework for state administrators of 529 plans to facilitate oversight and monitoring of Section 529 Plans.[25] The guidance intentionally does not set a single strict code for oversight but rather recognizes the different nature of college savings governing structures and essentially establishes that oversight standards must be consistent with the nature, size and operation of each state entity.

Applying these general governance principles to state-sponsored retirement plans, we note that the retirement industry has already established best practices. For example, IRAs must have a trustee or custodian that is a bank, federally insured credit union, a saving and loan association or another entity approved by the Service. All IRA accounts have a written document that describes the role of a custodian or trustee, and a disclosure statement that explains the IRA account rules and how the account operates. Like 529 plans, there are many private sector service providers that act as IRA custodians and maintain customer service and technology platforms for IRAs. As a result, there would be a variety of options available for state-sponsored auto-IRAs should a state establish an auto-IRA program for small employers.

Regulatory Oversight. As indicated in Section II of this paper, dating back to the late 1990s, the Treasury Department and the Service released various Private Letter Rulings and Notices to clarify federal tax treatment of 529 college savings plans. The SEC and the MSRB also issued various No-Action Letters, Rules and Interpretive Notices to clarify the securities law treatment of interests in 529 plans.[26] As a general matter, the state entities governing 529 plans are not directly subject to SEC or MSRB jurisdiction. There are long-standing municipal entity exemptions under the Securities Act of 1933,[27] the Securities Exchange Act of 1934,[28] the Trust Indenture Act of 1939,[29] the Investment Company Act of 1940,[30] and the Investment Advisers Act of 1940.[31] The state entities are similarly beyond the MSRB's jurisdiction, which is limited to municipal dealers and other entities providing advice to municipal issuers (e.g., municipal advisors).

While not directly subject to the jurisdiction of the MSRB, as a matter of best practice, state entities that provide all services in-house tend to be guided by the rules the MSRB promulgates for municipal dealers that distribute 529 securities. Furthermore, the state entities that establish and maintain 529 plans are always subject to the anti-fraud provisions of the Securities Exchange Act of 1934. To that end, regardless of the plan management model chosen by a state 529 authority, the 529 industry is subject to federal securities regulatory oversight, which aims to protect consumers and unsuspecting investors from unfair practices. State 529 administrators have an established dialogue with key regulators including the SEC, the MSRB and the Treasury Department. Depending on how the federal government ultimately characterizes state-sponsored retirement initiatives,[32] this experience will inure to the benefit of state entities ultimately responsible for state-sponsored retirement plans.

V. Lessons from the Success of 529 College Savings Plans

The state experience in designing and implementing college savings plans provides some valuable lessons learned for policymakers interested in providing private sector retirement savings programs.

State programs increase consumer awareness of and access to solutions. After almost two decades, it seems clear that families saving for college recognize the role state entities play in the 529 industry. The concerns expressed when college savings plans were first considered are similar to the concerns being expressed today about state-sponsored retirement savings programs. In the case of 529 plans, time and experience have shown concerns to be without merit. State entities are committed to increasing consumer awareness of the need to save for higher education. They communicate the importance of saving through earned media, public service announcements and continual outreach across multiple community and employer channels. Most importantly, a state's involvement in and oversight of a privately managed investment plan seems to provide some comfort for otherwise reluctant investors.[33]

While association with a private sector investment manager could introduce the possibility of headline or reputational risk for the state entity, an inscrutable procurement process, coupled with extensive manager due diligence, should offset challenges in the future. Consumers have demonstrated broad acceptance of the experts chosen and investment choices made by state-designated and approved boards. By offering Direct Plans – whether through online enrollment, payroll deduction or paper forms – states have simplified consumer access to savings points.

States support program outreach to a broad, diverse range of households, targeting specifically middle- and lower-income families. States have proven in the 529 space that through Direct Plans they can reach a broad and diverse audience that might not otherwise be targeted by wealth managers. Some states have accomplished this by creating incentives such as matching grant or scholarship programs geared toward low- to middle-income investors. Others have deployed effective outreach teams to communicate with a broad range of potential participants on a regular basis. Importantly, we note that states have been a force behind workplace initiatives for 529 savings. To this end, many states have worked with their state's private sector employers and private sector partners to promote payroll deduction or similar automatic savings options at the workplace. It seems only fitting that states would present employees with the same mechanisms to save for their retirement needs. Providing employees the ability to save regularly and automatically is key to imposing the discipline needed to achieve a long term savings goal.

Pooling assets benefits smaller investors by providing access to investments with fewer dollars and at lower costs than would otherwise apply. By creating pooled investment trusts for the benefit of all college savers, states provide moderate or small investors with two key benefits. First, pooled investment trusts reduce the initial contributions typically required of retail investors for most mutual and exchange-traded funds. Barriers to entry can be daunting for investors when the initial contributions for many mutual funds are $250 or more. In contrast, Direct Plans typically have initial contribution requirements of $25 or less and subsequent contributions often have no minimum dollar requirement. Second, pooled investment trusts enable states to invest in lower cost share classes of underlying funds than would be available to a small retail investor. This in turn reduces the investment fees associated with the 529 investment options. Reduced fees and expenses should enhance investment returns, which should result in more dollars available to cover college or retirement costs.

Administrative structures with strong fiduciary and oversight practices have been established. The entities charged with establishing and maintaining 529 plans across the country range from small Treasurer's Offices with limited staff, to large student loan or dedicated college savings authorities with focused customer service, technology and outreach operations. Regardless of where 529 savings plans are housed within state governments, the entities responsible for these plans now operate according to well-honed management models, whether that means engaging a full service turnkey provider or running an operation entirely managed by state employees. Each governing entity's fiduciary responsibility to plan participants – including account owners and beneficiaries of 529 accounts – is essentially uniform across the industry and has set a high standard for oversight. These important lessons and structures will readily translate to state entities entrusted with retirement initiatives on behalf of private sector employees.

Startup costs are real but manageable. As is the case with any new state initiative, establishing a state-sponsored retirement plan would involve startup and ongoing maintenance and administrative costs. This was the same issue facing states and private sector providers when 529 plans were first established. From the state perspective, general fund appropriations or even general fund loans (which would be repaid as plans accumulated assets) were used to cover initial costs; private sector managers typically absorbed the startup costs, hoping to amortize them over time as assets grew. We also note that several early private sector entrants to the 529 marketplace actually used existing IRA platforms to establish 529 recordkeeping systems as most of the required regulatory components were already part of an IRA program. An existing system that could be transformed to accommodate a new product certainly costs less than building a new system from scratch. In addition to technical and functional adjustments to the IRA system, startup costs stemmed from the need to create new investment options, the legal work in connection with drafting entirely new program disclosure documents, and the compilation of policies and procedures for call centers and overall operations, among others.

While state-sponsored retirement plans would have the benefit of selecting from among the many IRA platforms in the market today, there would still be costs similar to those that states faced in the 529 marketplace. With respect to the contemplated retirement initiatives, it is important to note that most communication would be done at the workplace or online. Participants will need access to a call center staffed by representatives conversant on the specific state-sponsored program and its specific state provisions. Depending on each state's authorizing legislation (e.g., whether employees would be enrolled automatically in such a program), this information should be readily available from the state and its applicable service providers and distributed through the employer.

VI. Conclusion

Americans have accumulated $266.2 billion across more than 12.7 million accounts in 529 plans offered by the states. Depending on the ages of the beneficiaries of these accounts, it is possible that these savings would cover billions of dollars of higher education expenses. To that end, the 529 savings plans offer an outstanding model of how adequate retirement savings can be achieved. Importantly, we know that college costs for the most part are finite and are incurred over a relatively short period of time. In contrast, the costs associated with retirement are difficult to predict and cannot be borrowed against. This is what makes saving for retirement in many ways even more fundamentally important than saving for college.

Section 529 college savings plans are popular because they help deliver a promise that most parents desire to give their children, the opportunity for higher education. But more than meeting this altruistic purpose, 529s have become increasingly popular because they are easy to understand, and accounts are relatively easy to open. In many cases, plans are supported by employers who establish automatic payroll contributions on behalf of their employees. Moreover, 529 plans implicitly convey the approval of their state governments, which consumers often view favorably.

State-sponsored retirement plans clearly can work as demonstrated by the $266.2 billion in 529 savings. The lessons of simplicity, easy access and automatic payroll processing that have been very successful for college savings can and should be applied to the retirement savings environment.

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Endnotes

[1] U.S. Government Accountability Office, Retirement Security: Most Households Approaching Retirement Savings Have Low Savings, GAO-15-419. May 2015, p.1.

[2] U.S. Government Accountability Office, Low Defined Contribution Savings May Pose Challenges, GAO-16-408, May 2016, p.11-12.

[3] Diane Oakley & Kelly Kenneally, Retirement Security 2015: Roadmap for Policy Makers Americans' Views of the Retirement Crisis, NIRS, March 2015, p.1.

[4] Ibid.

[5] U.S. Government Accountability Office, Retirement Security: Federal Action Could Help Efforts to Expand Private Sector Coverage, GAO-15-556, September 2015, p.14.

[6] See David Morse, "State Initiatives to Expand the Availability and Effectiveness of Private Sector Retirement Plans", Georgetown University McCourt School of Public Policy Center for Retirement Initiatives, December 2014-01, page 12: http://cri.georgetown.edu/wp-content/uploads/2014/12/Morse_CRIPaper.pdf. See also US News, August 12, 2013, "Why Small Businesses Don't Offer Retirement Plans," Paula Calimafde, Chair of the Small Business Council of America: "In their initial years of existence, many small businesses are fighting for their survival and do not have the stability or resources to establish a retirement plan." Additionally, almost a quarter of the respondents (23 percent) in the Capital One ShareBuilder 401(k) survey indicated they don't offer a 401(k) plan because they can't afford to offer a company match, and 12 percent said management fees are too high. http://money.usnews.com/money/retirement/articles/2013/08/12/why-small-businesses-dont-offer-retirement-plans.

[7] These states are California, Connecticut, Illinois, Maryland, Massachusetts, New Jersey, Oregon and Washington. For more detailed information about state programs and proposals, see the Georgetown Center for Retirement Initiatives website at http://cri.georgetown.edu/states/.

[8] The "Section 529 industry" refers to "qualified tuition programs" authorized by Section 529 of the Internal Revenue Code of 1986, as amended ("Section 529", the "Code" and "Section 529 plans"). Section 529 plans include prepaid plans and college savings plans, both of which enjoy the same tax benefits under Section 529. Prepaid plans are offered directly to the public by the states; college savings plans are offered either directly to the public ("Direct Plans") or through financial professionals ("Advisor Plans"). See Section II, CREATION OF SECTION 529 PLANS: STATE ACTION BUILDS MOMENTUM FOR CHANGE, herein. See also www.sec.gov/investor/pubs/intro529.htm.

[9] See Collegesavings.org, "History of 529 Plans": http://www.collegesavings.org/history-of-529-plans/.

[10] See Savingforcollege.com: "During the next four years, around 55,000 Michigan residents enrolled in the Michigan [Prepaid Plan]. Since the plan was an investment vehicle, Michigan had to pay federal income taxes on any earnings in the trust. In 1990 the plan filed suit requesting a refund from the IRS. The court initially ruled in favor of the IRS, but after an appeal in 1994 the Sixth Circuit Court of Appeals found Michigan in favor and declared MET to be tax-

exempt as an instrument of the state. This monumental decision led to a bipartisan effort to seek federal tax relief for all college savings vehicles, and qualified state tuition programs became part of the Small Business Job Protection Act of 1996. This also led to the creation of Section 529 of the Internal Revenue Code." http://www.savingforcollege.com/articles/infographic-history-of-529-plan.

[11] U.S. Court of Appeals, Sixth Circuit, 40 F.3d 817, November, 8, 1994, Rehearing and Suggestion for Rehearing En Banc denied, February 2, 1995: http://openjurist.org/40/f3d/817/state-of-michigan-v-united-states.

[12] Public Law 104-188, August 20, 1996: https://www.gpo.gov/fdsys/pkg/PLAW-104publ188/pdf/PLAW-104publ188.pdf.

[13] Public Law 105-34, August 5, 1997: https://www.gpo.gov/fdsys/pkg/PLAW-105publ34/pdf/PLAW-105publ34.pdf.

[14] Public Law 107-16, June 7, 2001: https://www.gpo.gov/fdsys/pkg/PLAW-107publ16/pdf/PLAW-107publ16.pdf.

[15] Public Law 109-280, August 17, 2006: https://www.gpo.gov/fdsys/pkg/PLAW-109publ280/pdf/PLAW-109publ280.pdf

[16] As an example, see Internal Revenue Service Notice 2001-81 (eliminating the need for verification of distributions and the imposition of de minimus penalties by plans): https://www.irs.gov/pub/irs-drop/n-01-81.pdf.

[17] See Municipal Securities Rulemaking Board Rule D-12, "Municipal Fund Security": http://msrb.org/Rules-and-Interpretations/MSRB-Rules/Definitional/Rule-D-12.aspx.

[18] See Municipal Securities Rulemaking Board Rule G-17, "Conduct of Municipal Securities and Municipal Advisory Activities": http://msrb.org/Rules-and-Interpretations/MSRB-Rules/General/Rule-G-17.aspx; Rule G-21, "Advertising": http://msrb.org/Rules-and-Interpretations/MSRB-Rules/General/Rule-G-21.aspx; Rule G-27, "Supervision": http://msrb.org/Rules-and-Interpretations/MSRB-Rules/General/Rule-G-27.aspx; and Rule G-32, "Disclosures in Connection with Primary Offerings": http://msrb.org/Rules-and-Interpretations/MSRB-Rules/General/Rule-G-32.aspx.

[19] As of January 1, 2017, Massachusetts will also provide a tax deduction for contributions to its 529 plans, bringing the total to twenty nine states with tax benefits for contributions to their own plans.

[20] College Savings Plans Network, data as of June 30, 2016: http://www.collegesavings.org/529-plan-data/. Assets and accounts represent December 31 data with the exception of 2016, which shows June 30 data. CSPN does not provide account data prior to 1999. Account decrease between 2008 and 2009 reflects a change in CSPN's accounting methodology.

[21] We note that college savers invest in 529 plan investment options, which represent units of a municipal trust. The 529 investor does not own the underlying investments, which are owned instead by the municipal trust.

[22] Unless specifically stated otherwise or referring broadly to "Section 529 plans" or "Section 529 programs", the remainder of this paper focuses on Section 529 college savings plans rather than Section 529 prepaid plans.

[23] Based upon a review of Program Disclosure Statements for currently-offered college savings plans. See also Savingforcollege.com, Compare by Features, Program Manager: http://www.savingforcollege.com/compare_529_plans/?plan_question_ids[]=26&page=compare_plan_questions.

[24] Ibid.

[25] College Savings Plans Network, Guidance for Governance and Maintenance of Section 529 Savings Plans, adopted May 18, 2010: http://www.collegesavings.org/wp-content/uploads/2015/06/Governance-Principles-approved-5-18-2010.pdf.

[26] We note that the MSRB does not consider Section 529 prepaid tuition plans to be municipal securities or subject to MSRB rules. See http://www.msrb.org/EducationCenter/Municipal-Market/529-Plans/Overview/Pre-Paid-Tuition-Plans.aspx.

[27] See Securities Act of 1933, Section 3(a)(2): https://www.sec.gov/about/laws/sa33.pdf.

[28] See Securities Exchange Act of 1934, Section 3(a)(29): https://www.sec.gov/about/laws/sea34.pdf.

[29] See Trust Indenture Act of 1939, Section 304(a)(4)(A): https://www.sec.gov/about/laws/tia39.pdf.

[30] See Investment Company Act of 1940, Section 2(b): https://www.sec.gov/about/laws/ica40.pdf.

[31] See Investment Advisers Act of 1940, Section 202(b): https://www.sec.gov/about/laws/iaa40.pdf.

[32] See David Morse, "Beyond ERISA: Other Regulatory Considerations for State-Sponsored Retirement Plans", Georgetown University McCourt School of Public Policy Center for Retirement Initiatives blog: http://cri.georgetown.edu/beyond-erisa-other-regulatory-considerations-for-state-sponsored-retirement-plans/.

[33] We note that 529 plan disclosure materials are clear that no state guarantees exist for investments in 529 plans. See College Savings Plans Network Disclosure Principles, Statement No. 5, adopted May 3, 2011, Section 3.c.: http://plans.collegesavings.org/includes/pdfs/CSPN%20Disclosure%20Principles%20Statement%20No%20%205.pdf.