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Saving for College: A Policy Primer

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Many experts view postsecondary education as an engine for developing our nation's human capital. It is estimated that by 2018, a majority of all jobs in the United States will require some form of postsecondary education or training. Attaining a college education or other postsecondary degree is one of the best ways to climb the economic ladder.

To help address the rapidly rising cost of higher education—an obstacle to college access and completion for many low- and moderate-income families—it is increasingly important to save for college. This policy primer highlights key policy considerations and challenges, along with specific strategies, to make 529 college savings plans more accessible to families of all incomes.

College Savings for All Families

Although saving is not easy for low-income families, who typically save small amounts, many are able to save more with access to well-designed products and incentives.

» **Savings is part of a comprehensive college-access strategy.** Saving for postsecondary education should be viewed as part of a larger program—along with awards, loans, scholarships, and work study. College savings accounts complement counseling, core curriculum frameworks, and other strategies to increase educational attainment.

» **Savings appears to matter for educational attainment.** There is growing evidence that savings and household assets—even small amounts—are associated with positive differences in children's lives. Controlling for variables such as household income and children's academic achievement, assets are positively related to college attendance and completion.

» **It's not just about the money.** Behaviorally, there is evidence that savings for college may focus attention of parents and children on postsecondary education, affecting outlook, orientation, secondary school course selection, academic performance, and discipline. Money may make postsecondary education possible, but behavioral changes could be as important as money in affecting educational attainment.

College Savings Plans

Participation in state college savings (529) plans[1] has increased rapidly. For financial reasons, saving for postsecondary education is more important than ever. College savings plans can play a key role in financing higher education expenses.

» **College savings plans are not just for college.** Funds can be used to pay for qualified higher education expenses at any eligible educational institution in the country. This includes tuition at community colleges, vocational schools, four-year colleges, and other postsecondary institutions.

- **Account beneficiaries can be any age.** A 529 plan account can be opened for a person of any age, including an adult saving for herself. Beneficiaries must be either a U.S. citizen or a resident alien. Account owners are typically parents, but are also other relatives or friends. Certain organizations such as nonprofits and tribal governments can own an account in most states.
- **Money can be used to cover more than tuition.** 529 accounts can be used to pay for qualified higher education expenses such as fees, books, supplies, and equipment, as well as tuition.
- **Federal and state tax benefits are popular.** Earnings in 529s grow free from federal income tax when used to pay for qualified educational costs. Many states offer tax deductions or credits to families saving in a 529.
- **State 529 plans offer a range of investment options.** Age-based funds have been the most popular type of 529 savings plan option—as the beneficiary approaches college age, assets automatically shift to more conservative investments. Capital preservation funds, including bank products offering FDIC insurance, are also available. Thus, participants can choose the level of risk that they are comfortable with.

Challenges and Opportunities

Despite growth in 529 college savings plans, low-income families are less likely to participate than wealthier families. However, there is potential for greater participation by families of all income levels.

- **Like IRAs and 401(k)s, college savings plans are regressive.** The current tax structure of 529s does not benefit the poor. Lower-income families, since they have little or no tax liability, cannot receive a tax benefit.
- **Some 529s are more progressive than others.** Some states have introduced innovative features to make their 529 plans more progressive and inclusive. However, inclusive features, discussed in detail below, have costs.
- **Many states have low-cost college savings plans, but not all 529 plans have low fees.** Lower costs enable 529 participants to put more money toward their children's future education. To accumulate assets over time, it is essential that families save in accounts with low fees. The median average annual fee for all 529 direct-sold plans[2] is about 0.61%.The trend is toward lower fees.

Inclusive College Savings Plans

Some 529 plans are more inclusive and innovative than others. Aspects of the state 529 policy design—including low deposit minimums, matched savings, and other inclusionary features—make 529s an attractive savings vehicle for low- and moderate-income families.

- **Some states offer 529 savings matches.** Matches for low-and moderate-income households provide less wealthy households with a financial incentive to save for postsecondary education. About ten states currently offer matching deposits in 529 savings accounts to low- and moderate-income families.
- **529 plans require very low minimum contributions.** 529 plans typically require a minimum initial contribution to open an account. In the majority of states, accounts may be opened with a $25 check, money order, or electronic funds transfer. This contrasts greatly with individual mutual funds, which typically require $3,000 or more to open an account.
- **A few states connect their 529s with GEAR UP.** Gaining Early Awareness and Readiness for Undergraduate Programs (GEAR UP)[3] and college savings plans partner to provide postsecondary financial resources and information to lower-income, at-risk students. Partnerships range from establishing 529 accounts for the benefit of GEAR UP students to conducting seminars with students and families on the benefits of saving for college.
- **A number of states exempt assets, including 529s, from eligibility calculations for public assistance programs.** Asset tests in public assistance programs such as Temporary Assistance for Needy Families (TANF), Medicaid, Children's Health Insurance Program (CHIP), and the Supplemental Nutrition Assistance Program (SNAP, formerly Food Stamps) require households to "spend down" or keep assets to a minimum to qualify. These asset tests create a disincentive for low-income families to save. Recent federal legislation excludes all tax-preferred education accounts, including 529s, from asset tests in SNAP. 529 assets are exempted from public benefit

eligibility tests in some states.

- **529 plan balances are not included in many state student financial aid calculations.** Approximately 17 states exempt assets in 529 plans from state financial aid calculations. These reforms to state financial aid programs help remove potential barriers to saving. In determining need-based financial aid for postsecondary education, the federal government currently pays far more attention to income than assets. Most low- and moderate-income families, therefore, receive federal need-based financial aid based on their income, not on assets.

- **Some states offer tax credits for 529 contributions.** Refundable tax credits provide a greater benefit to low-income families. The Obama Administration has proposed changing the federal Saver's Credit to include savings in 529s and to make the credit refundable so that families without tax liabilities would also benefit. Thus far, a few states offer only nonrefundable tax credits for 529 contributions.

- **A few states offer a default investment to simplify choices.** Innovative program features such as a default investment simplify the enrollment process and help remove potential barriers to 529 sign-up. Some 529 applicants find it difficult to select from an array of different investments and might be inclined to delay or even fail to complete enrollment. A 529 default investment may make it easier for more families to save for college.

- **Most states use inclusive marketing approaches to reach out to families of all income levels.** These marketing strategies take the college savings message to special events, learning facilities, cultural spots, and other places that draw families with young children. Popular marketing venues include state fairs, zoos, and libraries. States feature 529 promotions and competitions for school children and their families. For example, state plans partner with libraries to award summer reading prizes, where families and libraries can win money for participation.

Policy Direction

Given the potential influence of savings on attainment of a postsecondary degree, it is important to make college savings plans more inclusive. Since 2001, CSD has researched state 529 savings plans as a promising platform for educational savings, especially for low- and moderate-income families. We have no particular commitment to 529s per se. Rather, it is the policy features of 529 savings plans that interest us. The inclusive 529 policy features outlined in this primer may facilitate college savings for families of all incomes.

Resources

For additional information about topics highlighted in this policy primer, please see the materials listed below, most of which are available at http://csd.wustl.edu/AssetBuilding/Pages/529Pubs.aspx.

College Savings for All Families

The Center for Social Development has conducted research that shows a positive association of savings with college success. Learn more by reading these reports or briefs.

Elliott, W., & Beverly, S. (2010). *Staying on course: The effects of savings and assets on the college progress of young adults* (CSD Research Brief 10-13). St. Louis, MO: Washington University, Center for Social Development. (For more details, see full report.)

Elliott, W., & Beverly, S. (2010). *The role of savings and wealth in reducing "wilt" between expectations and college attendance* (CSD Research Brief 10-04). St. Louis, MO: Washington University, Center for Social Development. (For more details, see full report.)

Zhan, M., & Sherraden, M. (2010). *Assets and liabilities, race/ethnicity, and children's college education* (CSD Research Brief 10-09). St. Louis, MO: Washington University, Center for Social Development. (For more details, see full report.)

College Savings Plans

The following resources examine the nuts and bolts of college savings plans including enrollment procedures, investment choices, and advantages of saving in a 529.

Clancy, M., & Jovanovich, J. (2009). *College Savings Plans: Investment options, safety, and policy implications* (CSD Policy Brief 09-18). St. Louis, MO: Washington University, Center for Social Development.

The College Savings Plans Network (2010). The 529 classroom: Common questions.

Savingforcollege.com (2010). *College savings 101: What is a 529 plan?*

The U.S. Department of the Treasury (2009). *An Analysis of Section 529 College Savings and Prepaid Tuition Plans*. Washington, DC.

Challenges and Opportunities

Limitations of 529s, along with potential policy reforms and other strategies for making 529s more progressive, are examined in the publications listed below.

Clancy, M., Orszag, P., & Sherraden, M. (2004). *College Savings Plans: A platform for inclusive saving policy?* (CSD Perspective 04-25). St. Louis, MO: Washington University, Center for Social Development.

Clancy, M., & Sherraden, M. (2003). *The potential for inclusion in 529 savings plans: Report on a survey of states* (CSD Report 03-25). St. Louis, MO: Washington University, Center for Social Development.

Sherraden, M. (2009). *Saving and educational attainment: The potential of College Savings Plans to increase educational success* (CSD Research & Policy Brief 09-29). St. Louis, MO: Washington University, Center for Social Development.

Sherraden, M. (2009). *A promising platform for college saving* (CSD Perspective 09-21). St. Louis, MO: Washington University, Center for Social Development.

Inclusive College Savings Plans

Many states have inclusive policy strategies to make their 529 plans more accessible to all families. The following resources provide examples of activity in specific states and discussion of these policies.

Boshara, R., Clancy, M., Newville, D., & Sherraden, M. (2009). *The basics of progressive 529s*. St. Louis, MO: Washington University, Center for Social Development; Washington, DC: New America Foundation.

CFED. (2009). *Lifting asset limits in public benefit programs* (2009-2010 Assets & Opportunity Scorecard). Washington, DC: CFED.

Clancy, M., Cramer, R., & Parrish, L. (2005). *Section 529 savings plans, access to post-secondary education, and universal asset building* (CSD Research Report). St. Louis, MO: Washington University, Center for Social Development.

Clancy, M., & Lassar, T. (2010). *College Savings Plan accounts at birth: Maine's statewide program* (CSD Policy Brief 10-16). St. Louis, MO: Washington University, Center for Social Development.

Clancy, M., & Miller, R. (2009). *Creative partnerships between GEAR UP and state College Savings Plans: Experience and policy potential* (CSD Policy Brief 09-23). St. Louis, MO: Washington University, Center for Social Development.

Clancy, M., Mason, L. R., & Lo, S. (2008). *State 529 matching grant program summary.* St. Louis, MO: Washington University, Center for Social Development.

Lassar, T., Clancy, M., & McClure, S. (2010). *Toward more inclusive College Savings Plans: Sample state legislation* (CSD Policy Report 10-02). St. Louis, MO: Washington University, Center for Social Development.

Mason, L. R., Lo, S., & Clancy, M. (2008). *Pursuing 529 College Savings Plan exclusion from Oklahoma asset limit tests* (CSD Policy Brief). St. Louis, MO: Washington University, Center for Social Development.

Newville, David (2010). *The potential of inclusive 529 college savings plans*. Washington, DC: New America Foundation.

O'Brien, R. (2009). *529s and public assistance: Asset limits as a barrier to college savings*. Washington, DC: New America Foundation.

Endnotes

1. 529s are either prepaid or college savings plans. In a prepaid program, one purchases tuition credits for higher education expenses, whereas in a college savings plan, one contributes to an account for a beneficiary's higher education expenses. This primer focuses on college savings plans.
2. Direct-sold 529 plans, which are purchased from the state, have lower total annual expenses than broker-sold plans that are accessed through financial advisors and charge investors additional fees.
3. GEAR UP is a federal grant program designed to significantly increase the number of low-income students who are prepared to enter and succeed in postsecondary education.

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