NEW AMERICA FOUNDATION
Center for Social Development
GEORGE WARREN BROWN SCHOOL OF SOCIAL WORK
Washington University in St. Louis

COLLEGE SAVINGS INITIATIVE

LOW-COST STATE INNOVATIONS TO HELP FAMILIES SAVE FOR COLLEGE

NOVEMBER 2009

By Mark Huelsman and Margaret Clancy[1]

At a time when low-income students are underrepresented in higher education and the cost of attendance is becoming increasingly unaffordable, 529 college savings plans have the potential to address issues of college readiness, access and completion. Savings can help reduce higher education debt, making college more affordable, and has the potential to change aspirations and behaviors of both students and their parents. Research from the asset building field shows that even a relatively small amount of savings may have positive impacts on behavior and educational achievement.

Awareness and participation in college savings plans have grown significantly since they were created by states in the 1980s, inserted into the Federal tax code as Section 529 in 1996, and given federal tax-advantaged status in 2001. But because lower income families receive little or no tax benefits from saving in 529 plans, 529 participants tend to be middle or high income. Removing potential barriers and creating new incentives for participation could increase the number of low- and moderate- income families that save in 529s and make it easier to build assets for higher education.

While 529 plans are defined in the federal tax code, individual states have considerable latitude to innovate and make their plans more inclusive. Some states have undertaken large-scale initiatives, such as matching contributions or establishing accounts at birth. Other states have been exploring a number of smaller, lower-cost innovations to remove disincentives and increase savings, as detailed below. States are often the testing ground for future federal policies, and several of these initiatives could also be enacted at the federal level.[2]

DEFAULT INVESTMENT

Issue: Research shows that inertia and indecision limit people's ability to save and invest. One way to help families save in 529s is to provide a default investment for each direct-sold 529 savings plan.

State Policy Option: Provide a default investment option when participants do not wish to select an investment. If the federal government issues guidelines on 529 default investment options, more states might be encouraged to create a 529 default investment option.[3]

LOW-FEE CAPITAL PRESERVATION INVESTMENT OPTIONS

Issue: Many families have lost significant portions of their 529 plan assets; others hesitate to invest for college in the wake of the recent financial crisis. Offering reliable, safe, and low-fee investment options could help assuage these fears and increase enrollment in 529s. Some states currently offer FDIC-insured or capital preservation investment options, while others do not. In addition, not all of these funds have low fees.

State Policy Option: Offer at least one low-fee guaranteed or capital preservation option.

---

[1] Mark Huelsman is a Program Associate with the College Savings Initiative at the New America Foundation. Margaret Clancy is Director of the College Savings Initiative at the Center for Social Development (CSD) at Washington University in St. Louis. The authors thank College Savings Initiative team members Terry Lassar and Rebekah Miller at CSD, and David Newville at New America for edits and suggestions.

[2] Clancy, Newville and O'Brien. *Five Low-Cost Federal Policy Ideas to Help Families Save for College.* April 2009. Available at http://collegesavingsinitiative.org

[3] Clancy, Lassar, & Miller (forthcoming). *Streamlined 529 Enrollment and Default Investment: Innovations in the University of Alaska College Savings Plan.*

529 ENROLLMENT AND CONTRIBUTION ON STATE TAX FORMS
Issue: Some state tax forms allow contributions to existing accounts, but individuals cannot currently enroll in a 529 college saving plan via the state tax form. Allowing individuals to open 529 plan accounts on their state tax forms and funding them with a state tax refund could increase plan enrollment.

State Policy Option: Ensure that the state-sponsored 529 account can be opened and state tax refunds can be deposited into 529s through a relatively simple process. For certain states, this option may be more feasible and inexpensive than others, depending on the structure and administration of the 529 plan.

EMPLOYER TAX CREDIT FOR 529 ACCOUNTS
Issue: Payroll deduction and employer matching has dramatically increased enrollment in retirement savings plans. Using the same strategy for college savings plans could encourage employees to save for their children's college education or their own retraining. Meanwhile, low-income families cite employer matching as the most likely incentive to motivate them to start saving for higher education.[4] The State of Illinois recently passed a law which will provide a tax credit for employers to match employee contributions to the state 529 plan.[5]

State Policy Option: Provide a small state tax credit for employers to facilitate account opening, payroll deduction, and potential matching contributions for 529 plans up to a certain amount.

529S AND ASSET LIMITS FOR PUBLIC ASSISTANCE PROGRAMS
Issue: Many public assistance programs limit the amount of assets individuals can hold, which is a disincentive for low-income families to save for college. Recent federal legislation exempts 529 contributions from asset tests in the Supplemental Nutrition Assistance (Food Stamps) Program. Several states currently exempt assets, including 529s, from eligibility calculations in programs such as TANF and Medicaid. But many other states have not followed suit.[6]

State Policy Option: Exempt 529 assets from state eligibility calculations for assistance programs such as TANF and Medicaid.

529S AND STATE FINANCIAL AID
Issue: Currently, up to 5.6% of the value of a parent-owned 529 account may be used in calculating eligibility for federal financial aid. States, however, vary in their eligibility calculations for distributing need-based awards. Approximately 17 states currently exempt assets in 529 plans from financial aid calculations. This uncertainty creates a disincentive for many low-income families to save for college, out of fear that financial aid awards will be diminished if they were to put money into a 529 college savings account.

State Policy Option: Exempt 529 contributions from need-based financial aid calculations for public colleges and universities, and for private colleges and universities in the few cases where states provide need-based financial aid for students attending those institutions.

THE COLLEGE SAVINGS INITIATIVE
The College Savings Initiative was launched in 2009 as a joint venture of the Asset Building and Education Policy Programs of the New America Foundation and the Center for Social Development (CSD) at Washington University in St. Louis. This work is supported by the Lumina Foundation for Education and the Bill & Melinda Gates Foundation.

For background information on 529 college savings plans or the College Savings Initiative please go to http://collegesavingsinitiative.org

---

[4] Sallie Mae and Gallup. *How America Saves for College 2009*. 2009. Available at http://www.salliemae.com/about/news_info/research/how_America_saves/
[5] Illinois Public Act 096-0198. Available at http://www.ilga.gov/legislation/publicacts/fulltext.asp?Name=096-0198
[6] Mason, Clancy, & Lo. *Excluding 529 College Savings Plan accounts from Oklahoma public assistance asset limit tests.* (2008). Available at http://csd.wustl.edu/Publications/Documents/PR08-14.pdf