



Securities Industry Association

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March 24, 2004

The Honorable Michael G. Oxley
Chairman
Committee on Financial Services
U.S. House of Representatives
2129 Rayburn House Office Building
Washington, DC 20515

Re: 529 College Savings Plans

Dear Chairman Oxley:

I am writing on behalf of the Securities Industry Association¹ (SIA) to provide additional information regarding state-sponsored 529 tuition savings plans which have received increased attention from your Committee and the newly-created “Chairman’s Task Force on College Savings Plans,” referenced in Chairman Donaldson’s response to you, dated March 12, 2004 (SEC letter).

The securities industry is very interested in working with you and the Securities and Exchange Commission (SEC) to help investors understand how the plans work and the fees they may pay. In recognition of the issues that you and the SEC have raised regarding the level of understanding about 529 plans by investors, we are reviewing our existing investor education efforts to see how we can help the public and the clients of our member-firms understand the workings and costs of 529 plans.

In your letter of February 4, 2004, you expressed concern over disclosure practices and fees relating to 529 plans, and the value of the federal tax benefit authorized by Congress in 2001. This tax benefit provides for tax-free treatment of 529 plan distributions that are used to pay for educational expenses at the college and post-graduate levels. SIA supported the tax benefit that was provided and has had extensive

¹ The Securities Industry Association, established in 1972 through the merger of the Association of Stock Exchange Firms and the Investment Banker's Association, brings together the shared interests of nearly 600 securities firms to accomplish common goals. SIA member-firms (including investment banks, broker-dealers, and mutual fund companies) are active in all U.S. and foreign markets and in all phases of corporate and public finance. According to the Bureau of Labor Statistics, the U.S. securities industry employs 780,000 individuals. Industry personnel manage the accounts of nearly 93-million investors directly and indirectly through corporate, thrift, and pension plans. In 2003, the industry generated an estimated \$209 billion in domestic revenue and \$278 billion in global revenues. (More information about SIA is available on its home page: www.sia.com.)

dialogue with the Securities and Exchange Commission (SEC), the Municipal Securities Rulemaking Board (MSRB) and the state agencies sponsoring these plans. I would like to provide the following additional information for your consideration as you and the SEC examine the regulatory structure governing 529 plans.

Tax Benefits of 529 Plans

The tax benefit authorized by Congress has been an important factor in the increased participation in 529 plans by parents who are concerned about the rising costs of college education. In 2003, the average 529 plan account had assets of \$8,200. With over \$35 billion now invested in 529 plans, about 4 million households are using this important benefit. SIA strongly supports making Section 529 tax-free withdrawal for qualified educational distributions permanent law.

The example given on page A-13 and A-14 in the SEC letter is misleading. Higher fees, whether charged as a load or as an annual asset-based fee, reduce the after-tax returns that investors ultimately realize. This is true of all investments, whether taxable or tax-advantaged. The tax ramifications of investing in a fully taxable account would likely be greater, since mutual fund investors generally pay capital gains taxes on distributions on an annual basis. A more realistic analysis suggests that the actual rate of taxation would be in the area of 15 percent.

Fees Associated With 529 Plans

The conventional wisdom regarding state-sponsored 529 plans suggests that this is a “pretty simple financial product.” This could not be further from the truth. From an individual investor standpoint, a parent should analyze the other education savings options available. Then, if establishing a 529 account makes sense, the investor must consider the appropriate investment options, investment style, as well as fees – just like other mutual fund investments. However, because 529 plans were created to incentivize saving for education, an additional layer of considerations are added to the mix of issues that must be sorted out before making an investment. Each state has at least one type of 529 savings plan; some states offer a pre-paid option. Many states have established policies for proprietary tax treatment, beneficiary policies, account owners, and even the date upon which the accounts are subject to distribution. All of these issues are addressed differently in each of the state plans.

Many individuals considering 529 plans are understandably overwhelmed by these issues and turn to a financial adviser for assistance in weighing the pros and cons of each option. The example offered by the SEC on page A-3 does not address the inherent differences among the plans offered or that an investor working with a broker is paying for assistance in making investment decisions as well as assessing the impact of the diverse rules that exist among the various plans available, which make the process complex and labor intensive.

A second factor that must be considered in analyzing the fee structure for 529 plans is proprietary tax treatment. At least 22 states provide residents who invest in the in-state plan with a tax deduction for contributions; a smaller number of states have chosen to tax distributions from non-state 529 plans. These types of policies have effectively limited consumer choice and encourage investors to place undue emphasis on tax benefits rather than evaluating investment options, risk, manager track record, and expenses. If 529 plans were subject to a level playing field with consistent tax treatment by the states, consumer choice would be greatly enhanced and competitive forces would likely lead to lower fees and less confusion. SIA has worked extensively at the state level to level the playing field, but has had only limited success in an environment of rising state deficits.

Finally, the fees associated with the individual state plans may also appear to be lower because states sometimes subsidize the costs of administering the plans. The example of Utah is an instructive one. Utah has established an endowment fund, the proceeds of which are used to increase investment returns or decrease expenses.² In addition, the state subsidized the administration for the most conservative investment option. On the other hand, other states have revenue sharing agreements with the 529 program manager(s). Revenue that is shared with the state is often used to provide scholarships and other grant assistance to students. This type of revenue sharing likely leads to increased fees in states where these arrangements exist.

Disclosure

The SEC letter correctly explains the regulatory structure for state-sponsored 529 plans in that the Investment Company Act does not directly apply to 529 plans since these are municipal securities. However, most 529 plan disclosures are consistent with the type of investment related disclosure required by the Investment Company Act since most of the investment options available to 529 plan investors are mutual funds. This can be evidenced by the fact acknowledged by the SEC that about 75 percent of 529 plans are sold through a broker and any marketing material referring to the performance of the registered investment company underlying the plan must comply with the National Association of Securities Dealers' (NASD) advertising rules.

The SEC criticism of broker-dealer disclosure to 529 plan participants is inconsistent with the record. As the SEC indicates, it has full authority to review broker-dealer sales practices, while the NASD has authority to review sales and advertising pieces used by broker-dealers. To our knowledge, no systemic problems have been uncovered relating to the sale of 529 plans by broker-dealers. The additional disclosures now being advocated by the SEC in Rule Proposal 33-8358 relating to point of sale and confirmation disclosure would drastically increase the costs incurred by broker-dealers, without providing investors any additional help in comparing the various 529 plan options.

² Utah Education Savings Plan Fact Booklet, page 5.

http://www.uesp.org/UESP_BENFITS/Fact_Booklet/UESPFactbook4-4-03.pdf

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In closing, SIA is interested in working with you and the SEC to address particular areas of concern and we hope that your efforts and those of the SEC Task Force's will make a positive contribution. At the same time, we note that much of the complexity and corresponding fees associated with 529 plan investments are a by product of the structure and tax treatment of such plans under a multitude of differing state laws. Please do not hesitate to call on me if you have additional questions. With best wishes, I am

Sincerely yours,

Marc E. Lackritz
President

cc: The Honorable William H. Donaldson
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