STATEMENT OF

CHARLES TOTH

ON BEHALF OF

THE COLLEGE SAVINGS FOUNDATION

AND THE

SECURITIES INDUSTRY ASSOCIATION

BEFORE THE

UNITED STATES SENATE

COMMITTEE ON FINANCE

ON

THE ROLE OF HIGHER EDUCATION FINANCING IN STRENGTHENING U.S. COMPETITIVENESS IN A GLOBAL ECONOMY

JULY 22, 2004

U. S. Senate Finance Committee – Testimony of Charles Toth
on behalf of the College Savings Foundation and the Securities Industry Association

INTRODUCTION

Good morning Mr. Chairman and members of the Committee.

My name is Chuck Toth and I am the Director of Education Savings at Merrill Lynch & Co. Inc. In that capacity I am responsible for educating and encouraging Merrill Lynch's individual clients on the need to prepare in advance to finance ever-escalating college costs. I work closely with the Treasurer and Finance Authority of Maine in assisting them to administer the NextGen College Investing Plan, Maine's section 529 college savings program. I also serve as Chairman of the College Savings Foundation, a not-for-profit organization dedicated to the promotion of section 529 college savings programs, and my firm is a member of the Securities Industry Association (or SIA). Both of these organizations share a mission of helping American families achieve their education savings goals and have been actively involved in all aspects of the evolution of section 529 education savings plans.

On behalf of the College Savings Foundation and the SIA, I thank you for giving me the opportunity to appear today to discuss the importance of saving for college. Due in large measure to the bipartisan efforts of the Finance Committee, huge strides have been made in recent years to increase the level of college savings in America, especially through the creation and expansion of section 529 college savings plans.

We commend the members of this Committee for what you have already accomplished and encourage you to continue your efforts to promote policies that will help families prepare to send future generations on to college. Congress' creation of Section 529 and its subsequent enhancements to the law have strongly supported the important public policy goal of helping Americans save for higher education. And, as I will discuss later, the specific improvements made by Congress in the Economic Growth and Tax Relief Reconciliation Act of 2001 (EGTRRA), have had the most significant positive impact.

The College Savings Foundation (or CSF) is an organization of firms that assists States in the management, marketing, and operation of their 529 programs and/or participate in those programs as investment managers. Associate members include State governments and agencies. The primary focus of the College Savings Foundation is building public awareness of and providing public policy support for 529 savings plans – an increasingly vital college savings vehicle.

The Securities Industry Association[1] brings together the shared interests of nearly 600 securities firms to accomplish common goals. As financial intermediaries and providers

---

[1] The SIA was established in 1972 through the merger of the Association of Stock Exchange Firms and the Investment Banker's Association. 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

of investment advice, SIA member firms are deeply committed to reviving a national culture of saving. SIA members are actively involved in all phases of the management and marketing of 529 plans and in educating the public about those plans.

Today, American families confronting college education costs for one child face a formidable task. For families with two, three or more children, college education costs can be overwhelming. In fact, costs of college exceed home purchase costs for many families. Section 529 plans and other education savings vehicles pioneered by this Committee (like the Coverdell Education Savings Accounts) are for the first time providing specifically targeted help to families starting to save for college education.

We are pleased to report that 529 savings plans have been a tremendously successful education savings innovation under the leadership of State governments. With almost 5 million 529 accounts in existence, college savings through 529 plans has been increasing exponentially. For example, we have seen a 371% increase in 529 assets in just over two years (from $8.5 billion at the end of 2001 to over $40 billion in the first quarter of 2004).[2]

Almost overnight, 529 programs are becoming the bedrock of higher education savings strategies for more and more American families. The 529 plan holds the promise of revolutionizing the way Americans finance college – shifting away from "pay-as-you-go" financing and "pay-after-you-go" loans to a more certain and less disruptive prefunding of a growing portion of higher education costs. Regrettably, that promise will not be fulfilled unless the December 31, 2010 sunset on the section 529 tax advantages is eliminated and the current 529 plan rules are made permanent. We urge you to act promptly to ensure that participants can save in 529 plans with complete certainty as to the future tax rules applicable to these plans. Anything less is unfair to those families who have children reaching college age after the sunset date.

THE EDUCATION SAVINGS CHALLENGE

A post-secondary education is critical to helping many people reach their full personal and professional potential. Indeed, financing a child's college education can often be the chief economic goal of an entire extended family. The high cost of getting a college degree is well documented. For the 2003-2004 academic year, the average annual cost of attending an in-state 4-year public college or university increased 9.8% to $10,636.[3] The average annual cost of attending a 4-year private college or university increased 5.7% to $26,854.[4] Assuming such costs increase by 5% a year, the projected total cost of college in 15 years will be about $100,000 for a 4-year public college and more than $200,000 for a 4-year private college. Consequently, it is more important than ever to encourage Americans to save for their children's higher education.

---

domestic revenue and $278 billion in global revenues. (More information about SIA is available on its home page: www.sia.com).

[2] Financial Research Corporation, Quarterly Update April 2004.

[3] The College Board, "Trends in College Pricing" (2003).

[4] id

Today, most families fund college education through a combination of "pay-as-you-go" financing and "pay-after-you-go" student loans. Over the last two decades, even as college tuition and other education costs have continued to rise, direct financial aid has diminished. As a result, it has become increasingly more difficult for families to cover college expenses as they are incurred. That, in turn, has meant that student and parent loans have been used to finance an increasing share of higher education costs. For many, financing a college education now involves having to deal with an overwhelming repayment burden that can stretch decades beyond graduation. All too often, loan defaults and demoralizing bankruptcy proceedings can result.

Financing higher education is an escalating challenge because the level of education and specialization required to compete in today's globally competitive job market is rapidly increasing. In the 1970s, a college degree replaced a high school diploma as a prerequisite for many jobs and translated into a marked enhancement in economic well-being. Indeed, full-time workers with bachelors degrees earn about 60% more than those with only a high school degree. Over a lifetime, the gap in earnings between those with only a high school diploma and those with a bachelors degree or higher exceeds $1 million.[5]

Today, four years of college is often not enough training. It has become increasingly common that graduate training is necessary to stay current with either the technology or techniques in a given field. This needed graduate training (together with the continuing education required for many employees after they have started working) further increases the total costs of higher education. Furthermore, as individuals more frequently deal with the reality of job changes and lay-offs, an increasing number are going back to school later in life to retrain for their "second careers." Our history has clearly demonstrated that education has been America's most successful differentiating advantage in the increasingly competitive global economy.

Federal government programs and policies have historically been designed to help people deal with the cost of college through assistance with "pay-as-you-go" and "pay-after-you-go" methods of financing. Over the years, Federal assistance has taken many forms, ranging from grants and other financial aid, tax credits, subsidized higher education loans and tax advantages for student loans (such as the ability to deduct student loan interest). For those who have wanted to save for college in advance, there has been little incentive and considerable confusion as to how or whether saving in advance made sense.

Mr. Chairman, let me be clear that I am not saying that subsidized loans (and other Federal programs) to help pay for college education are bad. Just the opposite, student loans have helped many millions of Americans attend college. I certainly do not know how I would have made it through college without the availability of loans. Most families with children in college will continue to need all available resources -- including grants, student jobs, loans, tax credits, and personal savings.

[5] The College Board, "Trends in College Pricing" (2003).

Yet, reliance on "pay-as-you-go" incentives and loans can be risky. To begin, there is no guarantee that those sources will be available in sufficient amounts when a child reaches college age. In many cases, families that have not saved for a college education in advance are forced to make imprudent choices. Some may not be able to attend the college of their choice or any college at all. Other families are forced to choose between depleting retirement savings or paying for education. Often, such families choose to fulfill their obligation to prepare their children for the world, but in doing so jeopardize their own long-range financial security. With the baby boom generation having children later in life than previous generations, depleting retirement assets is particularly dangerous because there are relatively fewer years between the age when children finish college and the parents' retirement.

The way to finance college education with the least disruption for families, and the smallest financial burden after college graduation, is to save as much as possible for college in advance. By saving before a child reaches college age, families can help ensure that adequate funds will be there to allow their children to attend college. Moreover, by beginning an education savings strategy for a child at an early age, the family further reduces its overall burden through the power of compounding.

Despite those and other advantages, there was, until recently, no targeted program designed to help families save for college. Recognizing the important policy goal of helping American families cope with the growing burden of college costs, many States pioneered the creation of dedicated pre-paid tuition plans in the 1980s. These plans permitted residents to contribute to a trust to lock-in the costs of future tuition payments. The Federal tax rules governing contributions to and earnings in these plans, however, was uncertain during the early years of the plans' existence. To address that uncertainty, Congress approved an amendment to the tax code (Section 529 of the Internal Revenue Code) in 1996 to exempt State programs from federal income taxes on the earnings until the funds were distributed. Congress amended the rules for these Section 529 plans again in 1997 by including room and board expenses and making other technical changes. The most significant, beneficial change to Section 529 plans, however, came in 2001 when Congress authorized the tax-free treatment of distributions used for higher educational purposes as part of the Economic Growth and Tax Relief Reconciliation Act of 2001 (EGTRRA).

THE EVOLVING 529 PLAN SUCCESS STORY

With 529 plans, the Congress, in cooperation with the States, has finally provided a vehicle that allows Americans to meet college costs by contributing to tax-favored, State-sponsored qualified tuition savings plans. Today, each of the 50 States and the District of Columbia has established and maintains a 529 program.

Generally, under the federal income tax rules, individuals can make after-tax contributions into 529 plans, have earnings grow tax-free, and receive tax-favored distributions for amounts used for qualified higher education expenses. While individual States create their own 529 plans, federal law does not require a State resident to invest in his or her own State's 529 program; instead, it provides a platform upon which a nationwide network of State-sponsored 529 plans can compete, providing Americans

with multiple opportunities to save for post-secondary education expenses on a tax-favored basis.

With the enhanced federal tax benefit provided by EGTRRA, the increase in the popularity of Section 529 savings plans has been nothing short of spectacular. At the end of 2001, there were 1.4 million 529 plan accounts. By the close of the first quarter of 2004, the number of accounts had grown to 4.7 million, a stunning 236% increase in just over two years.[6] This means that today, between 7% to 8% of families with children under 18 own a 529 savings plan account.[7]

The growth in total college savings through 529 plans has been equally impressive. At the end of 2001, there was about $8.5 billion held in 529 savings plans accounts. Through the first quarter of 2004, assets have grown to $40 billion.[8] A recent survey conducted by the College Savings Foundation indicated that 73% of all accounts had balances less than $10,000. The average account balance in 529 savings programs as of March 2004 was $8,223,[9] making it clear that millions of American families have only just begun to take advantage of the 529 plans this Committee helped create. Naturally, and as noted above, the majority of these accounts have been established in just the last several years subsequent to Congress making qualifying distributions tax-free. Many of these individuals have learned through their own personal experience with 401(k) plans that the way to save for longer-term goals is by taking a disciplined approach and setting aside some portion of their monthly income.

In the future, we anticipate that many more of these account balances will grow to the amounts needed to achieve the goal of funding a college education. Many families are saving by dollar cost averaging, where they have set up a systematic process to regularly deposit monies into their child's 529 savings program on a monthly or quarterly basis. The results of a College Savings Foundation survey indicate that 39% of households contributing to 529 plans have established some sort of automatic investment program.

An interesting note is that we are seeing considerable interest by grandparents to help finance their grandchildren's college education through 529 plan contributions. For many of these grandparents, their children were the first in the family to be able to attend college. Having witnessed the positive impact that a college education has had on their children's lives, they realize the importance of giving the gift of education.

The dramatic growth in 529 plan usage has occurred at the same time that the various States have continued to improve the administration and attractiveness of their programs. Without the States' involvement, 529 savings plans would not exist. States either manage a 529 plan on their own, or select an outside manager (usually a brokerage firm, mutual fund company, or insurance company). States approve selection of investment

---

[6] Financial Research Corporation.

[7] Cerulli Associates Presentation and Profile of Households Saving for College; Investment Company Institute Research Series, Fall 2003, p. 43.

[8] Financial Research Corporation, Quarterly Update April 2004.

[9] *Id.*

options, administration issues, and fees. States usually approve the methods of distribution both in-State and nationally, and broker-dealers that distribute 529 plans must also coordinate with the States to negotiate selling agreements and produce marketing and other program literature.

Of course, the rapid expansion of 529 plans has not come without some growing pains. States and the outside managers that work with them have been constantly revising and improving their administrative functions and investment options to better serve the needs of 529 plan account holders. With section 529 plans continuing to grow and evolve, the challenges and choices facing the States that establish and maintain these plans -- and the financial institutions that administer them -- can be expected to continue.

Yet, as awareness of 529 plans continues to grow and these programs continue to improve to meet consumer demands, I fully expect that it will not be long before the phrase "529 plan" joins "401(k) plan" in the daily vocabulary of almost every American. When that happens, we will have succeeded in dramatically increasing financial preparation for college education costs. Before we get there, however, it will be necessary to address the single most important concern facing 529 plans today – the fact that the Federal tax incentives are not permanent.

MAKE THE TAX-FREE TREATMENT OF DISTRIBUTIONS PERMANENT

Although an increasing number of U.S. families are utilizing 529 savings plans, there is growing concern about whether the Federal tax benefits will be there when the child goes to college. Probably the greatest inhibitor to investing in 529 plans today is the uncertainty regarding whether the tax incentive will be renewed after it sunsets on December 31, 2010. If Congress does not extend the policy of tax-free withdrawals from 529 plans, then beginning after December 31, 2010, earnings in the account will be taxed at the recipient's rate as they are withdrawn.[10]

It is critical to understand that the problems the EGTRRA sunset creates for 529 plans are completely different than for the other tax provisions of EGTRRA that are scheduled to sunset. Consumers today invest with the expectation that distributions for qualified higher education expenses will be tax-free when their child goes to college. However, the sunset effectively means that anyone with a child who does not finish college before December 2010 (generally all children under the age of 16) cannot be certain that this tax advantage will be there when it is are needed.

Contrast this treatment with the result of the sunset for most other tax provisions of EGTRRA. For example, EGTRRA increased the amounts that could be contributed to a 401(k) plan. However, for amounts contributed before the EGTRRA sunset, the favorable 401(k) tax treatment continues even after the 2010 sunset. The same is true for almost all of the other provisions of EGTRRA, including, for example, contributions to IRAs, Roth IRAs, and Coverdell Education Savings Accounts. Only the 529 plan contributions are left with the potential "gotcha" of an individual making a contribution

[10] The recipient's income tax rate will in most cases be higher than the capital gains tax rate due on taxable investment accounts. This will clearly deter families from making contributions to 529 plans.

based on one set of expected post-sunset tax rules and then losing the favorable tax treatment if Congress fails to act.

Uncertainty with respect to section 529 tax treatment creates an unfortunate deterrent to the saving that is needed to meet the ever-rising costs of higher education. Surveys consistently show that the need to save for a child's college education is second only in importance to one's own retirement. Individuals with younger children are interested in starting now to save for college. However, due to the sunset provision they are reluctant to make the long-term commitment to a 529 savings plan because they are uncertain that the tax benefit will be there when their child begins college.

Congress should make the tax-free treatment of 529 plan distributions permanent as soon as possible to ensure that participants can invest in these plans with complete certainty that the tax incentive will exist when they make their withdrawals.

CONCLUSION

In order to continue to help American families save for their children's post-secondary education and to keep up the critical momentum established to date, Congress should continue to encourage and provide incentives for education as it has in the past. As the promise of tax-free distributions is one of the most attractive features of investing in 529 savings plans, Congress should make the tax-free treatment of qualified withdrawals permanent to ensure that American families can invest in these plans with well-deserved confidence that the tax incentives available today will be there tomorrow. In so doing, you will help to further strengthen our nation by creating a better educated workforce to compete in a global economy.

Thank you again for the opportunity to appear before you today. I would be happy to answer any questions you may have.