HOUSE RESEARCH ORGANIZATION bill analysis | 4/30/2001 | HB 1446 Junell, Raymond (CSHB 1446 by Rangel)

SUBJECT: Creating a higher education savings plan

COMMITTEE: Higher Education — committee substitute recommended

VOTE: 8 ayes — Rangel, F. Brown, Farabee, Goolsby, Morrison, E. Reyna, Uher, West

0 nays

1 absent — J. Jones

WITNESSES: For — None

Against — None

On — Andrew Ruth, Comptroller's Office

BACKGROUND: Texas has a prepaid college tuition program, the Texas Tomorrow Fund, administered by the comptroller, but does not have a college savings plan. Federal law allows states to offer a tax-deferred college savings plan under which participants can set aside funds to cover the full cost of attending college, including room and board. The maximum amount an individual can contribute may be as high as the cost of attending the highest-priced college in the United States, typically around $150,000. A college savings plan also can allow adults to set aside funds for their own education.

Unlike a prepaid tuition program, the state does not guarantee benefits under a college savings plan. An individual may earn more than the amount by which tuition and fees increase, depending on how the investment performs. In the typical college savings plan, the state contracts with a major investment company that offers participants a choice of portfolios. Participants may select more aggressive investments for a young child and may shift to safer investments as the child approaches the age for entering college.

College savings plans generally do not have a residency requirement and generally allow benefits from the plan to be used at any college or university in the nation.

DIGEST: CSHB 1446 would create a higher education savings plan covering all higher education expenses. The Prepaid Higher Education Tuition Board would have to:

- develop and implement the plan;
- select the plan manager;
- collect administrative fees and services charges not to exceed the costs of establishing and maintaining the plan;
- adopt rules regarding withdrawals, including penalties and policies for nonqualified withdrawals;
- develop and approve a savings trust agreement;
- approve and review informational materials for compliance with applicable law;
- adopt a policy to prevent account contributions in excess of those necessary to pay the beneficiary's qualified higher education expenses;
- monitor contributions and withdrawals for each account to ensure that applicable limits were not exceeded; and
- prepare and file statements and returns related to the accounts as required by federal or state tax law.

The board would have to amend the plan as necessary for account owners and beneficiaries to obtain and maintain federal income-tax benefits and exemptions under federal securities laws. The board could seek rulings and guidance from relevant federal agencies, including the U.S. Department of the Treasury, the Internal Revenue Service, and the Securities and Exchange Commission.

A person could establish a savings trust account to save money for the qualified higher education expenses of a beneficiary. The board would have to hold money contributed to an account in trust for the account owner and beneficiary. Account owners and beneficiaries would not have to be Texas residents.

Selection and duties of plan manager. The board would have to select a financial institution or institutions to be the plan manager. The board would have to solicit proposals and select a plan manager based on:

- financial stability and integrity;
- ability to satisfy recordkeeping and reporting requirements;
- strategy for and investment in promoting the plan;
- historic ability of the proposed investment strategies to track the estimated costs of higher education;
- proposed maintenance fees, if any, for account holders;
- required minimum contributions and willingness to accept payroll deduction contribution plans; and
- any other proposed benefits to Texas or Texas residents.

The board would have to ensure that investments were made with prudent discretion and judgment and that investments were not speculative but made in regard to the eventual disposition of the funds.

The board could require the plan manager to provide several investment options, taking into consideration the beneficiary's age and the length of time remaining before the beneficiary likely would enroll at an eligible educational institution. The plan manager would have to:

- take all action required to keep the plan in compliance with state and federal law;
- keep adequate records for each account and provide them to the board to prepare reports required by federal tax law, or file those reports on behalf of the board;
- compile information for account owners' statements and statements required by federal law and provide compilations to the board;
- provide the board with access to records as necessary to determine compliance with the plan manager's contract;
- hold all accounts in trust as authorized by the board in the plan manager's contract;
- make investments according to the "prudent person" standard; and
- develop a strategy to promote the plan, have it approved by the board, and promote the plan according to the strategy.

Contract between board and plan manager. The bill would require a term of at least five years for a contract between the board and the plan manager. The contract could be renewable. If the contract was not renewed, the bill would apply the following conditions, so long as they would not disqualify the plan as a qualified state tuition program under federal law:

- the board would have to maintain the plan at that financial institution;
- previously established accounts could not be terminated, except in accordance with the bill's provisions;
- account holders could make additional contributions to their accounts;
- new accounts could not be opened at that financial institution; and
- the board could transfer the accounts to another financial institution acting as plan manager if the board determined that this would be in the best interest of the account owners.

The board could cancel a contract at any time for violation of the contract or of the bill's provisions. If the contract was canceled, the board would have to take custody of accounts and transfer them promptly to another financial institution (a new plan manager) and into investment instruments as similar to the original investment instruments as possible. The board would have to select the new plan manager.

Accounts. A person could open an account by entering into a savings trust agreement with the board and making the minimum contribution required by the plan manager. A savings trust agreement would have to include:

- name and address of the account owner;
- name, address, and date of birth of the beneficiary;
- maximum and minimum permitted contributions;
- provisions for withdrawals, refunds, transfers, and penalties;
- terms and conditions for substituting a different beneficiary;
- terms and conditions for terminating the account, including refunds, withdrawals, transfers, applicable penalties, and the name of the person entitled to terminate the account;
- all other rights and obligations of the account owner, plan manager, and board; and
- other terms and conditions the board deemed necessary or appropriate.

The agreement also would have to provide that if, after a specified period of time, the agreement had not been terminated and the beneficiary had not exercised rights in the plan, the board would have to make reasonable efforts to contact the owner and beneficiary or their agents and would have to report unclaimed account money to the comptroller.

An account owner could change the designated beneficiary as provided by federal tax law and in accordance with the board's procedures.

Contribution, withdrawals, and penalties. CSHB 1446 would allow only cash contributions to a savings account. The board would have to adopt rules governing when a withdrawal was qualified or nonqualified. These rules could require an owner to provide certification of a qualified higher education expense to make a qualified withdrawal. Any penalties collected would have to be used to cover the costs of administering the plan, with excess treated as earnings of the accounts in the plan.

The penalty for a nonqualified withdrawal would be 10 percent of the portion of the withdrawal that constituted income, as determined in accordance with federal tax law. The board could increase the penalty if it determined that a higher penalty was necessary to constitute a greater than *de minimis* penalty for purposes of qualifying the plan as a qualified state tuition program under federal law. The board could decrease the penalty if it determined that it was greater than necessary and that the penalties plus other revenue generated by the program were producing more revenue than required to cover past and current operating costs of the plan.

Administration of accounts. The plan manager would have to provide a separate accounting for each account and provide an annual statement to each owner. The statement would have to include contributions made during the reporting period, total contributions made through the end of the period, the value of the account at the end of the period, withdrawals made during the period, and any other information required by the board. Distributions from an account to or for the benefit of any person would have to be reported to the IRS and to the account owner or beneficiary, as required by federal law.

Owners and beneficiaries could not direct the investment of any contributions to or earnings on an account. Accounts would be exempt from attachment, execution, and seizure for satisfying a debt or liability of an owner or beneficiary. An account would be not be assignable, could not be used as security or collateral for a loan, and would not be subject to alienation, sale, transfer, assignment, pledge, encumbrance, or charge.

Plan limitations. The board would have to require that every agreement, deposit slip, or other document used in connection with a contribution to an account clearly indicate that the account was not insured by the state and that the state did not guarantee the return of the principal or investment. Nothing in the bill or any agreement could be construed to:

- give a beneficiary a right or legal interest in an account, unless the beneficiary was the owner;
- guarantee that amounts saved would be sufficient to cover the qualified higher education expenses of a beneficiary; or
- establish state residency for any purpose for a person designated as a beneficiary.

Nothing in the bill or any agreement could be construed to create an obligation of the state, any state agency or instrumentality, or the plan manager to guarantee:

- return of any amount contributed to an account;
- rate of interest or return on an account;
- payment of interest or other return on an account; or
- tuition rates or cost of related education expenses.

Opening or maintaining an account would not promise or guarantee that a beneficiary would be admitted to any eligible educational institution, be admitted to a particular educational institution, be allowed to continue enrollment after admission to an educational institution, or receive a degree or certificate from an eligible educational institution.

Promotion and disclosure of information. The board would have to adopt policies for promoting the plan and disclosing plan information to owners and beneficiaries, consistent with this subchapter and federal law. The board

would have to ensure that promotional materials specified that the state did not insure the plan or guarantee return of principal or interest and that the material disclosed fees.

Confidentiality. Information, including personally identifiable information, about an owner or beneficiary would be confidential, except that the board could disclose that information to an account owner. All other information relating to the plan would be public and subject to disclosure.

Termination or modification of plan. If the comptroller determined that the plan was not feasible, the comptroller would have to notify the governor and the Legislature and recommend that the board not administer a plan or that the plan be modified or terminated. If the plan was terminated, the balance of each account would have to be paid to the account owner, to the extent possible. Unclaimed assets would escheat to the state under state laws regarding unclaimed property.

Amendments to Texas Tomorrow Fund statute. CSHB 1446 also would amend definitions in Education Code, subchapter F relating to the Texas Tomorrow Fund to distinguish that fund from the Texas college savings plan account. It also would also require the Prepaid Higher Education Tuition Board to administer both the prepaid higher education tuition program and the higher education savings plan.

Sunset provision. The bill would specify that the Prepaid Higher Education Tuition Board is subject to the Texas Sunset Act and that the board and both the Texas Tomorrow Fund and the Texas college savings plan account would expire September 1, 2007, unless continued by the Legislature.

This bill would take immediate effect if finally passed by a two-thirds record vote of the membership of each house. Otherwise, it would take effect September 1, 2001.

SUPPORTERS SAY:

CSHB 1446 would provide tax benefits for Texans who need to save money for higher education expenses. Internal Revenue Code, sec. 529 allows states to offer a savings plan with tax deferral advantages, similar to the federal tax treatment of prepaid tuition. Funds in such a plan grow tax-deferred until they are used for college, after which the gain in value is taxed at the

student's tax rate. Legislation pending in Congress would eliminate the tax when the benefits were used for qualified higher education expenses.

This bill would make college more affordable for Texas beneficiaries and their families. Since 1980, the cost of college tuition has risen at twice the rate of inflation. Low- and middle-income families have been hit hardest by this rapid tuition increase. While student aid also has increased over this period, it has not increased enough to keep pace with inflation, and most of the increase has been in student loans. A college savings plan would allow participants to set aside funds to cover room and board (the largest expense), books, and other costs beyond tuition. The maximum contribution would be far in excess of what a person can set aside in the Texas Tomorrow Fund's private college plan.

CSHB 1446 would complement the successful Texas Tomorrow Fund with a college savings plan. It would not create new state bureaucracy. The state would contract with a major investment company, and the company would offer participants a choice of portfolios.

The bill would not affect residency. Savings plans could be offered without a residency requirement because the plans would not confer residency status on the college student for purposes of tuition. The benefits could be used at any college or university in the nation. Grandparents with children who live outside of Texas could participate in the plan, too. There would be no age limit, so adult participants could save money for their own college expenses.

OPPONENTS SAY:

CSHB 1446 would create a college savings program that would be handled more appropriately by private-sector organizations and that would compete with those organizations.

Plan participants could lose money in a market downturn. Also, the program would be at a disadvantage when compared to the Texas Tomorrow Fund program, because it would not feature a guaranteed return.

NOTES:

The committee substitute would require the Prepaid Higher Education Tuition Board to develop and approve a savings and trust agreement, whereas the filed version would have required the board to review and approve the savings and trust agreement.

The bill as filed would have provided that money contributed to an account would be held in trust by the plan manager and the board. The committee substitute would provide that contributions would be held in trust by the board and would require the plan manager to hold the accounts in trust as authorized by the board in the plan manager's contract.

The companion bill, SB 555 by Ellis, passed the Senate on April 4 by 29-0 and was reported favorably, as substituted, by the House Higher Education Committee on April 24, making it eligible to be considered in lieu of HB 1446.