Commonwealth of Virginia
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Report to the Governor and the General Assembly of Virginia

VA529 Oversight Report

JULY 2016

JLARC
JOINT LEGISLATIVE AUDIT
AND REVIEW COMMISSION

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Overview

The Virginia College Savings Plan (VA529) administers the state's tax-advantaged savings programs. The programs are authorized by Sections 529 and 529A of the Internal Revenue Code and are sponsored in 49 states and the District of Columbia. VA529 administers a prepaid tuition program, three college savings programs, and is establishing two disability savings programs in response to recent state and federal legislation.

VA529's prePAID program allows participants to purchase contracts that cover the future cost of college tuition and fees, as defined in the contracts.

The college savings programs—CollegeAmerica, inVEST, and CollegeWealth—allow participants different options to save for educational expenses at institutions in Virginia and across the U.S. The programs offer federal and state income tax advantages on college savings and investment earnings.

In 2015, VA529's mission was expanded to include 529A, or "ABLE" programs that provide tax-advantaged savings accounts for individuals with disabilities. These programs were authorized under state and federal "Achieving a Better Life Experience" legislation. The ABLE programs will offer federal and state income tax advantages on savings and investments that are used for qualified disability expenses, such as education, medical care, housing, and transportation. VA529 intends to establish two ABLE programs, ABLEAmerica and ABLEnow, by calendar year 2017.

VA529 is the largest 529 plan in the country, with $55 billion in assets and a 21 percent share of the national market. Assets of $49 billion are held in the CollegeAmerica program, managed by a private partner under the supervision of VA529. Approximately 10 percent of CollegeAmerica's accounts are held by Virginia residents. The program's fee revenues are sufficient to pay all of VA529's operating expenses.

TABLE 1
VA529 programs

	Type of program	Accounts	Assets ($B)
Prepaid tuition			
prePAID	Contracts for future tuition & fees	65,849	$2.3
College savings			
CollegeAmerica	Advisor-sold investments	2,180,549	$49.2
inVEST	Direct-sold investments	212,123	$3.2
CollegeWealth	Fixed-rate savings	17,885	$0.1
Disability savings			
ABLEAmerica	Advisor-sold investments	*	*
ABLEnow	Direct-sold investments	*	*

SOURCE: VA529 program data as of March 31, 2016.
NOTE: Disability savings programs currently being established and have not opened for participation. Approximately 10 percent of CollegeAmerica accounts are based in Virginia.

1. prePAID program

prePAID contracts cover tuition and fees for a set period, typically ranging from one to eight semesters at a university or college.

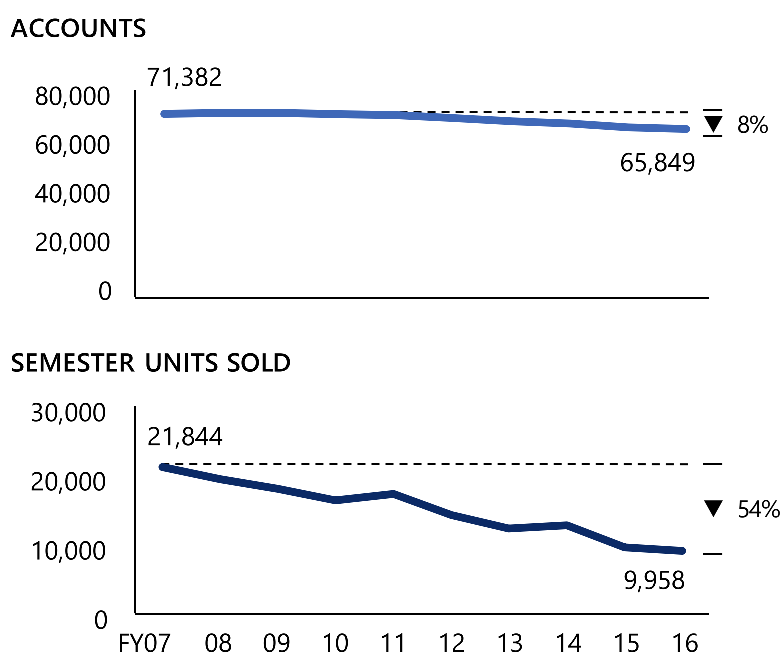
The prePAID contracts define tuition and fees as the normal, in-state, undergraduate, full-time tuition and mandatory fees assessed to all students. Contracts do not cover tuition, fees, or charges associated with a specific program, course, or major.

prePAID is a defined benefit program that offers prepaid tuition contracts to Virginia residents. prePAID benefits pay for tuition and fees at public colleges and universities in Virginia, under specific terms that are defined in the contracts. prePAID benefits do not cover certain categories of expenses, such as additional charges to students enrolled in business and other high-cost programs. prePAID benefits can be used at private and out-of-state institutions, but may not cover the full cost of tuition and fees at those institutions. The prePAID program paid $159 million in benefits in FY15.

prePAID participation

Participation in the prePAID program has declined over the past 10 years (Figure 1). Two measures of prePAID participation are the number of participant accounts and the number of new contracts sold. The number of prePAID accounts declined by eight percent over the 10-year period from FY07 to FY16. prePAID contracts are sold in semester units, and the total number of semester units sold for participants attending four-year institutions has declined by 54 percent over the same time frame. Sales of prePAID contracts for two-year institutions have experienced a similar decline.

FIGURE 1
prePAID program participation



SOURCE: VA529 program data.
NOTE: Figure shows semester units sold in contracts for four-year institutions (eight semester, four semester, two semester, and single semester contracts), which account for over 80 percent of contracts sold under the program, by volume. Does not include contracts for two-year institutions, contracts that mix two- and four-year institutions, or other combinations. Figures reported as of June 30 end of fiscal year except for 2016, which is as of March 31.

Participation in prePAID has declined as the cost of contracts increased and consumers shifted toward more affordable savings vehicles. The price of a prePAID contract to cover eight semesters at a four-year university increased from $37,332 in FY07 to $65,200 in FY16, due to the rising cost of tuition.* Price increases have likely made the prePAID program less affordable to many Virginians, whose median annual household income is estimated at $66,155. Participants in 529 programs nationwide have increasingly chosen to use college savings programs, such as Virginia's inVEST, instead of prepaid tuition programs. College savings programs give participants the flexibility to contribute at their own pace instead of committing to higher-cost prepaid contracts.

Part of the decline in prePAID participation is attributable to timing. Many prePAID accounts were created shortly after the program was established in 1996. Those accounts are now being used, resulting in a surge in account drawdowns and closures as the program reaches maturity.

prePAID investment performance

VA529 investment advisory committee is composed of the board chairman, staff CEO, staff CFO, and at least four investment professionals appointed by the board chairman. All members have voting privileges.

The prePAID program held $2.3 billion in assets as of March 31, 2016. Program assets are managed under a single enterprise fund and are divided into four asset classes: public equity, core fixed income, non-core fixed income, and alternatives (Figure 2).

The VA529 board and its investment advisory committee oversee the prePAID fund. The board determines the fund's overall asset allocation. The investment advisory committee determines what investment strategies should be implemented within each asset class and retains private investment management firms to implement those strategies. VA529 staff and a consulting firm oversee these external managers, monitor their performance, and make recommendations to the board and investment advisory committee.

The prePAID fund has remained relatively stable over the past five years (Figure 2). Net deductions, primarily for benefit payouts, have been relatively level with additions from investment returns, contract sales, and fee revenues.

prePAID fund underperformed long-term return assumption and benchmarks

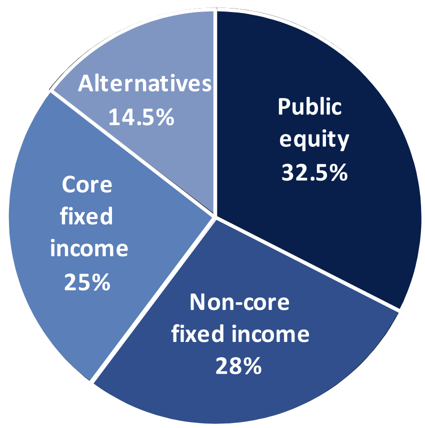
The prePAID fund's recently reported investment returns were negative in the near term, below assumptions that have been set for the long term, and trailed their benchmarks (Figure 2). For the most recent one-year period, ending March 31, the fund's investments achieved a return of −1.5 percent. The fund's 10-year return was 4.5 percent, which was below the 6.25 percent long-term rate of return that has been assumed by VA529 for its investments. The fund underperformed its benchmarks for all periods, with higher margins of underperformance in the one-, three-, and five-year periods. The fund has underperformed its one-year benchmarks for several successive years, which has brought its 10-year performance down below the benchmark (Figure 3).

*Price for contract purchased for kindergartner. Contract prices vary depending on age of child for whom contract is purchased and whether the contract is for a two- or four-year institution.

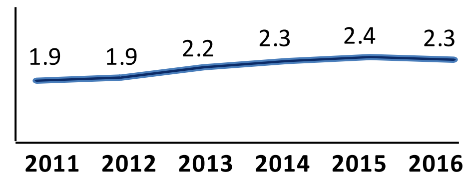
FIGURE 2
prePAID fund asset allocation and investment performance

ASSET ALLOCATION
as of March 31, 2016

$2.3 billion total assets



Total assets ($ billions)



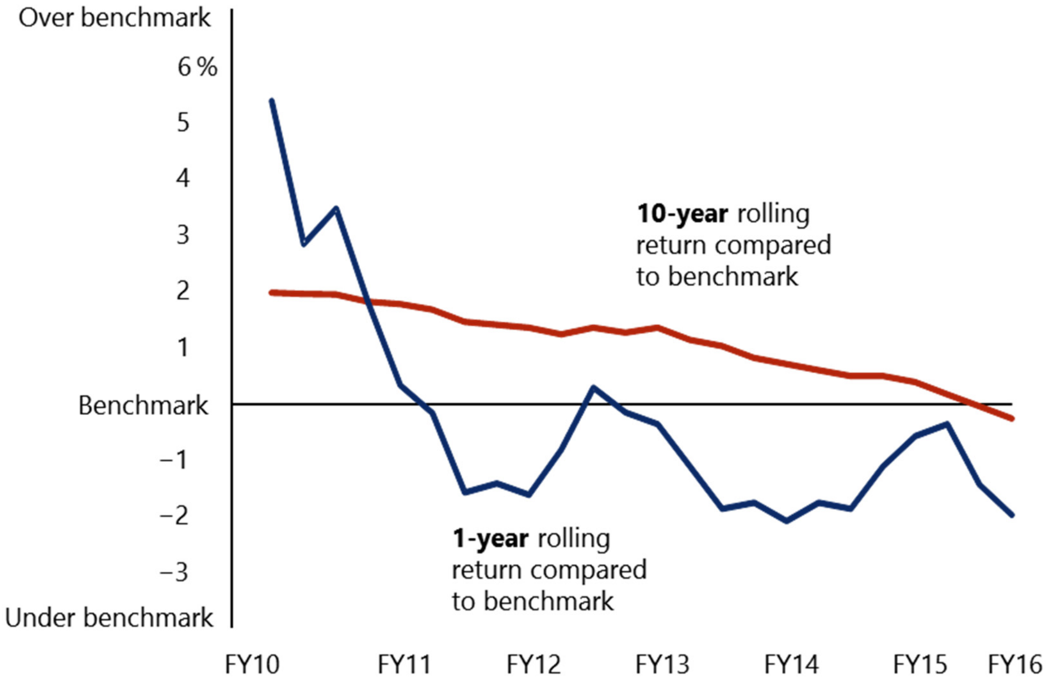
Actively managed assets
(percent of asset class)

FUND INVESTMENT PERFORMANCE
for the period ending March 31, 2016

	FY to date	1 year	3 years	5 years	10 years
Total fund	−1.5%	−1.5%	3.0%	4.3%	4.5%
Benchmark	0.2	0.3	4.5	5.5	4.7
Public equity	−7.5	−7.8	3.6	4.6	4.3
Benchmark	−4.3	−3.8	6.1	5.8	4.1
Non-core fixed income	0.6	0.4	2.7	4.6	4.5
Benchmark	−0.1	0.1	3.4	5.7	5.1
Core fixed income	0.4	0.4	0.5	2.6	3.9
Benchmark	2.9	1.7	1.3	3.2	4.4
Alternatives	4.5	5.4	5.7	5.0	2.3
Benchmark	4.9	6.5	7.3	7.1	3.0

SOURCE: VA529 program data.
NOTE: **Public equity** includes $756 million in stocks and other equity securities for publicly traded companies in the U.S. and abroad. **Non-core fixed income** includes $646 million investments in high yield bonds, convertible bonds, and emerging market debt. **Core fixed income** includes $586 million in U.S. dollar-denominated securities that pay a specific interest rate, such as government bonds, corporate bonds, and U.S. Treasury bills. **Alternatives** includes $338 million investments in real assets (real estate, infrastructure, and natural resources), private equity (investments in privately-held companies) and hedge funds (unique strategies to provide higher returns, more consistent returns, or lower risk than standard market investments).

FIGURE 3
Historical prePAID fund performance relative to benchmark



SOURCE: VA529 program data.
NOTE: Figure depicts rolling one- and 10-year returns reported quarterly by VA529. Labels indicate the June 30 end of the fiscal year return, except for FY16, which is for March 31, 2016.

The fund has trailed benchmarks even though it employs actively-managed investment strategies. Active management is an investment strategy that seeks to provide better returns or lower risk than the overall market, and 86 percent of prePAID's assets are held by active managers. Two-thirds of active managers, representing about half of the actively managed funds, trailed their benchmarks over the most recent five-year period (Figure 4).

According to VA529's investment leadership (chairmen of the board and investment advisory committee, chief financial officer, and investment consultant) there are two main reasons why the fund and its managers have trailed benchmarks. First, the portfolio's public equity assets have underperformed relative to benchmarks because of VA529's decision to tilt the fund towards "small cap" U.S. equities and non-U.S. emerging markets. These equities have been outperformed by "large cap" and developed-market equities, especially in the U.S., causing individual managers and the public equity class as a whole to underperform benchmarks. Second, the portfolio's alternatives asset class has underperformed because it includes several relatively new private equity investments. New private equity investments tend to initially trail their benchmarks because they take five or more years to mature and start providing strong returns. VA529's private equity investments have been in place for five years or less, so all of these investment managers have underperformed their longer-term benchmarks.

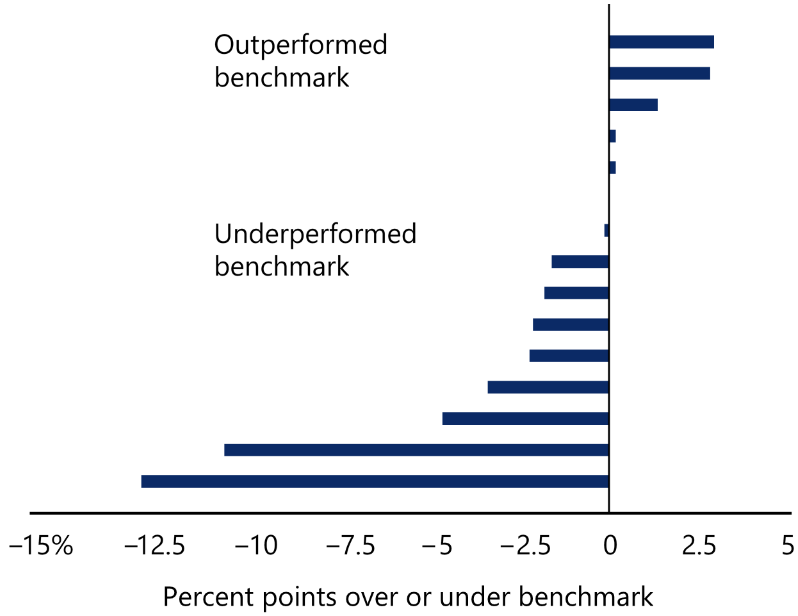
Public equity includes stocks for companies that are traded in public markets, such as stocks traded on the New York Stock Exchange.

U.S. equities include stocks traded for U.S. companies. Non-U.S. equities include stocks traded for companies in developed international markets, such as Europe and Japan, and emerging markets such as China and Brazil.

Investment managers often focus on investing in large, medium, or small companies, based on the total capitalized market value of their stock shares.

For example, "large cap" stocks are companies with stocks that have a market value over $10 billion, whereas "small cap" stocks are companies valued at less than $2 billion.

FIGURE 4
prePAID's actively managed investment strategies compared to five-year benchmarks



SOURCE: VA529 program data.
NOTE: Return and benchmark figures used are for the five year period ending March 31, 2016. Only 16 of the 25 active management strategies used by VA529 have been in place long enough to report five-year data.

Private equity includes investments in companies that are typically not publically traded. Private equity firms use investor money to buy undervalued or new venture companies. They then attempt to address problems with the companies to improve profitability and value. Because the firm must identify, buy, and "turnaround" companies, it can take five or more years before investments start providing strong returns to investors.

Private equity investments have potential to provide greater returns than public markets and steady returns during periods of high market volatility. Private equity investments are normally only available to institutional and other large-scale investors.

VA529's investment leadership said they were not concerned about the overall performance of the prePAID fund or its managers, and they expect that the fund will outperform its benchmarks over time. They said that the allocations to "small cap" and emerging markets should pay off as market conditions become more favorable. As evidence, they noted that several of the fund's investment managers in these areas outperformed their 10-year benchmarks even though they underperformed in the more recent five-year period. Private equity investments are also expected to begin outperforming their benchmarks as they reach maturity within the next few years, according to VA529's leadership.

VA529 board determined the prePAID fund's current asset allocation was preferable to other options

VA529 concluded a review of the overarching investment strategy for the prePAID fund earlier this year. The VA529 staff, investment consultant, and actuary reviewed the fund's strategic asset allocation and evaluated whether it should be changed. They examined the risks and returns anticipated under the current asset allocation and compared them to outcomes that could be achieved under different allocations. Findings from the review were then presented to the board and its investment advisory committee for consideration.

The VA529 board and investment advisory committee agreed to keep the fund's current asset allocation unchanged, based on the review's findings. The review found that the current allocation provided the best combination of risk and return. The other allocation options that were examined included shifting some equity assets to fixed income and shifting different combinations of equity and fixed income assets to alternatives. The study also examined "de-risking" the portfolio by converting a substantial portion of the fund's assets to low-risk fixed income investments, such as U.S. Treasury bills and highly-rated government and corporate bonds. The review found that these other approaches provided inferior outcomes because they did not effectively hedge against tuition growth. Tuition growth is expected to continue, which means the fund must keep up by achieving moderate returns in future years.

The study was focused on the fund's overall asset allocation and so did not examine whether VA529 should continue its public equity tilt toward small and non-U.S. companies. Although the public equity strategy was not examined as part of the review, it has been discussed in previous meetings of the board and investment advisory committee.

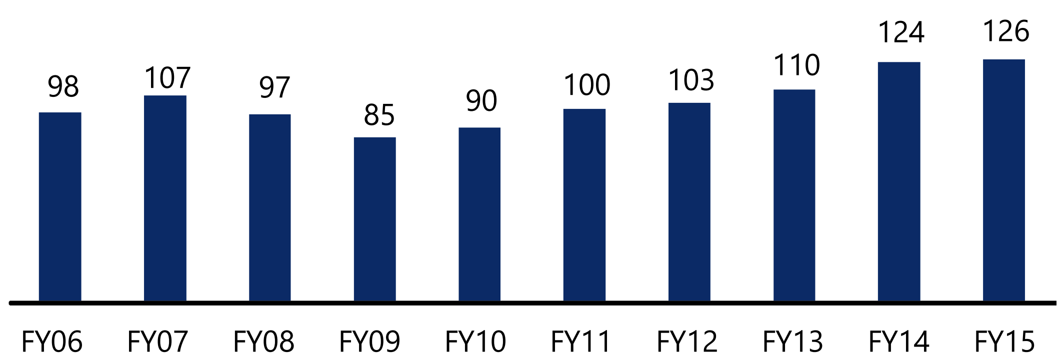
prePAID funded status

VA529 must maintain sufficient assets in the prePAID fund to pay the program's future obligations. The fund receives revenue from three sources: prePAID contract sales, fund investment returns, and fee revenues from prePAID and other VA529 programs. Assets must be sufficient to cover future benefit payments, refunds, and other payouts. Pursuant to statute, surplus fee revenues from other VA529 programs are allocated to the prePAID fund at the end of the fiscal year.

prePAID program is 126 percent funded

According to the VA529 actuary, the prePAID fund currently has sufficient assets to cover its liabilities. prePAID's funded status was 126 percent at the end of FY15. Over the past 10 years, prePAID's funded status has not been lower than 85 percent (Figure 5).

FIGURE 5
prePAID percent funded status



SOURCE: VA529 actuarial data.

This low point occurred at the end of the 2007-2009 recession, when there were major declines in the domestic and international equity and credit markets that affected many of the program's investments.

A portion of fee revenues from prePAID and other VA529 programs, most notably the CollegeAmerica program, benefit the prePAID fund. Fee revenues are first used to pay VA529's operating expenses. Any additional fee revenues remain in the fund and are invested along with other assets. From the end of FY10 to FY15, $127 million in fee revenues remained in the fund. These revenues have contributed to the program's favorable funded status, accounting for about six percent of the fund's $2.3 billion in assets, after adjusting for investment returns.

Key actuarial assumptions changed

VA529 approved changes to two of prePAID's key actuarial assumptions last year. The tuition growth assumption was reduced from 7.5 percent per year to 6.5 percent. This assumption is used to determine the future value of the program's obligations. The investment return assumption was reduced from 6.75 percent per year to 6.25 percent. This assumption is used to determine the future value of the program's assets, which are used to pay off its obligations.

The changes to the tuition and investment assumptions slightly increased the program's funded status and lowered contract prices. Lowering the tuition assumption pushed the funded status higher and reduced contract prices. Lowering the investment return had the opposite effect, but in this instance was more than offset by the change to the tuition assumption. The net result of the changes was a $17 million increase in assets used to calculate the program's funded status and a five percent reduction in contract prices, relative to what they would have been under the old assumptions.

The changes to the tuition and investment return assumptions are largely consistent with what was recommended under JLARC's quadrennial audit of VA529 (completed 2013). The audit recommended VA529 lower its tuition assumption using a gradual scale that grades down to a more sustainable rate and reduce its investment return assumption to a more conservative figure.

VA529 assessing overall sustainability of prePAID program

VA529 staff indicated that college tuition and fees have become difficult to predict, prompting concerns about the sustainability of the prePAID program as it is currently structured. Differences in tuition and fees charged by Virginia's public universities make it difficult to determine fair and equitable prices for prePAID contracts. Tuition and fees now vary substantially among Virginia's public four-year universities, ranging from $8,300 to $19,400 per year for a full-time, in-state undergraduate in 2015-16. The cost differences make prePAID benefits more valuable for beneficiaries who are admitted to higher-cost schools, and less valuable for other beneficiaries.

The tuition models used by Virginia's higher education institutions are changing, making it more difficult to forecast future costs. Some Virginia institutions have implemented "fixed" tuition pricing models that are different from traditional pricing approaches. Different institutions increase tuition and fees based on their own model; this makes it difficult to predict what these costs will be in the future, across the board.

prePAID contracts could become less desirable to participants if the pricing models used by Virginia's higher education institutions continue to change. Several institutions have begun charging additional tuition and fees for specific programs or courses. These costs are not covered under prePAID contracts. The growing use of these charges reduces the scope of college expenses that prePAID contracts cover. Altering future prePAID contracts to cover these costs may not be feasible, because this would increase contract prices and make the program's overall costs even less predictable than they are currently.

VA529 staff are currently reviewing the prePAID program to determine what changes, if any, should be made. VA529 staff will report their findings and recommendations to the board in August 2016. There are four options under consideration:

- Keep prePAID as it is but simplify contract pricing;
- Implement a risk-sharing approach where institutions of higher education bear some of the costs associated with prePAID contract obligations, under certain circumstances;
- Change program benefits so that future contracts pay only the weighted average of mandatory tuition and fees at all Virginia public institutions instead of tuition and fees for the specific institution that the beneficiary attends; or
- Close the program to new enrollment.

Any changes to the prePAID program would only apply to future contracts.

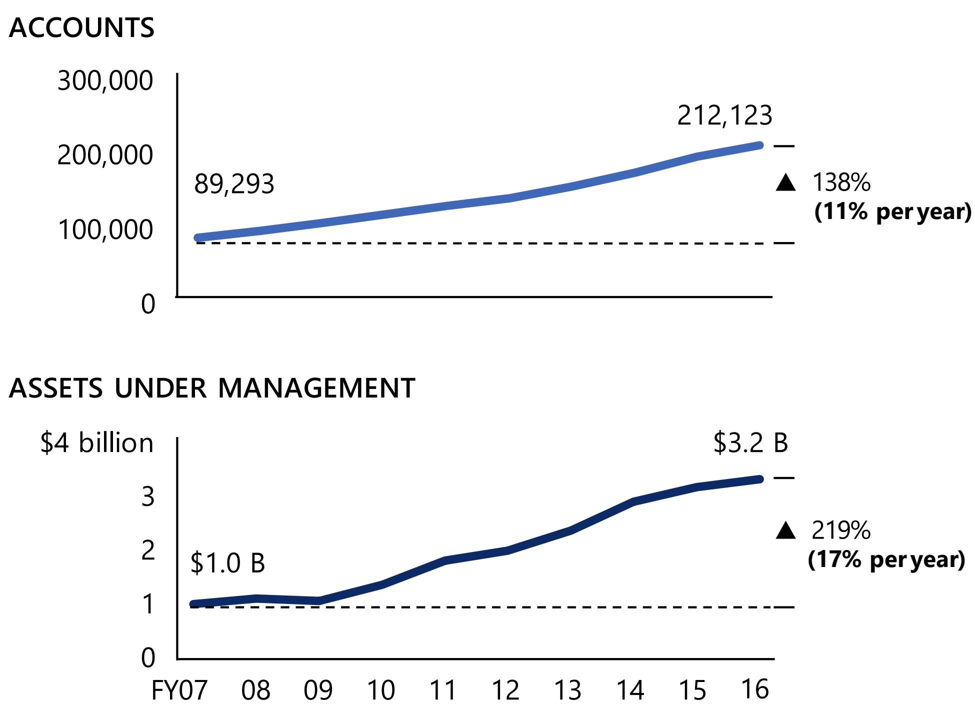
2. inVEST Program

inVEST is a college savings program sold directly by VA529 to program participants. Participants contribute to their individual accounts and determine how funds are invested by selecting from a menu of options. Investment earnings are exempt from federal taxes as long as they are used to pay for qualified higher education expenses, such as tuition, books, and housing. Virginia also exempts earnings from state taxes and offers an income tax deduction for contributions made to this and other VA529 college savings programs. Funds from inVEST accounts can be used at institutions in Virginia and other states. The program distributed $169 million to participants in FY15.

inVEST participation

Participation in the inVEST program has increased over the past 10 years (Figure 6). Two measures of program participation are the number of participant accounts and the total assets under management. The number of inVEST accounts more than doubled in the 10 years from 2007 to 2016, increasing by an average of 11 percent per year. The value of assets under management tripled from $1.0 billion to $3.2 billion. This growth is attributable to both new contributions and investment returns. The increase in inVEST participation follows a national trend for college savings programs, which have steadily grown over the past decade.

FIGURE 6
inVEST account and asset growth



SOURCE: VA529 program data.
NOTE: Figures reported are as of the June 30 end of the fiscal year except for 2016, which is as of March 31

inVEST investment performance

The inVEST program held an aggregate of $3.2 billion in assets as of March 31, 2016. Assets are owned by program participants, who have their own individual accounts. Individual participants determine how their money is invested.

Program participants may choose any combination of 21 different investment options. Investment options include traditional individual investment options, such as stock and bond investments, and target-date portfolios that automatically adjust over time. Thirteen options are actively managed, with the goal of providing better returns or lower risk than the overall market. The remaining eight options are passively managed and track market indices.

The inVEST investment options generally outperformed long-term benchmarks and had more mixed performance in the near-term. All of the actively managed investment options met or outperformed their five- and 10-year benchmarks. However, several underperformed their one- and three-year benchmarks by relatively small margins (less than 20 basis points). Performance data was not yet available for several of the options, including three that were implemented within the past year and have yet to report one-year returns. A majority of the passively managed options met or outperformed their benchmarks for most periods (adjusted for fees). However, half of the options underperformed their benchmarks in the most recent one-year period.

TABLE 2
inVEST program investment performance

for the period ending March 31, 2016

	1 year	3 years	5 years	10 years
Actively managed options				
Met or exceeded benchmark	6	3	9	6
Total number of options	10	9	9	6
Passively managed options				
Met or exceeded adjusted benchmark	4	7	6	6
Total number of options	8	8	8	8

SOURCE: VA529 program data.
NOTE: The total number of investment options can change because longer-term performance data is not available for newer options. Three of the actively managed options were created in 2015 and are not yet reporting one-year performance data. Performance is reported net of investment fees. Passively managed options are expected to provide returns equal to their benchmark index, less any fees charged to participants. Benchmarks were adjusted to account for the estimated impact of fees. Some passively managed options continued to trail the benchmark after this adjustment was made.

The inVEST investment line-up includes three new actively managed options that were approved by the VA529 board in 2015. The options added were the Active Aggressive Portfolio, Active Moderate Portfolio, and Active Conservative Portfolio. VA529 decided to add these options because there were few actively managed options for participants to choose from, other than the age-based portfolios. VA529 staff indicated that even with the addition of these new options, the program's investment line-up remains consistent with investment management industry best practices by offering a relatively small number of clearly defined investment choices.

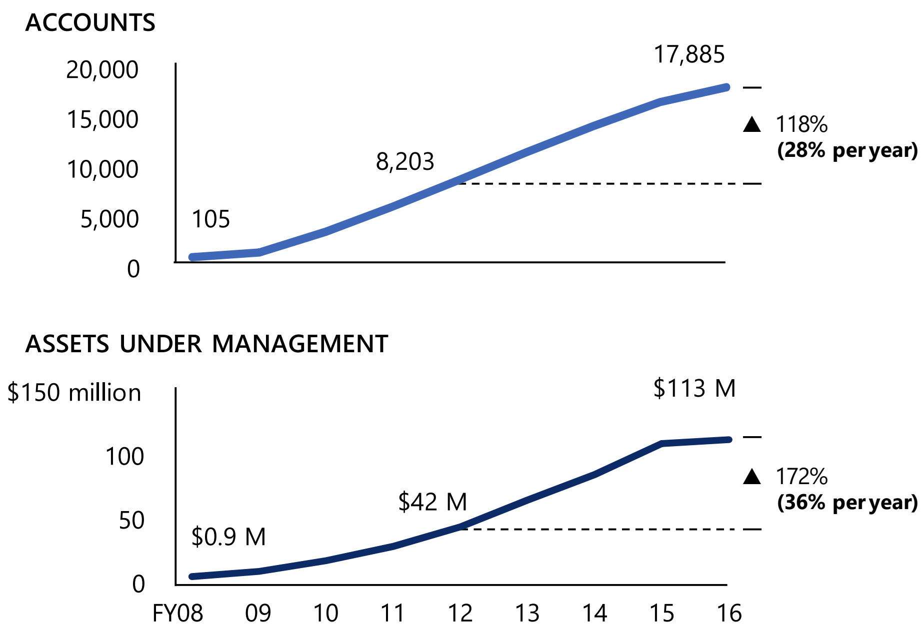
3. CollegeWealth program

CollegeWealth is an FDIC-insured college savings program that offers accounts through VA529's partnership with two financial institutions, BB&T and Union Bank & Trust. CollegeWealth account owners make contributions to savings accounts held by one of the sponsoring banks. Savings grow at a pre-determined interest rate, which varies by financial institution and by amount held in the account. Interest earnings are exempt from federal taxes as long as they are used to pay for qualified higher education expenses, such as tuition, books, and housing. Virginia also exempts earnings from state taxes and offers an income tax deduction for contributions made to this and other VA529 college savings programs. The program distributed $15 million to participants in FY15.

CollegeWealth participation

Participation in the CollegeWealth program has increased since the program was established in 2008 (Figure 7). Two measures of program participation are the number of participant accounts and the total assets under management. The number of CollegeWealth accounts more than doubled from FY12 to FY16, increasing by an average of 28 percent per year. The value of assets under management nearly tripled from $42 million to $113 million. This growth is attributable to new contributions and fixed interest rate returns. The program has grown as it continues to mature from its 2008 inception. The program's growth follows a national trend for college savings programs.

FIGURE 7
Account and asset growth



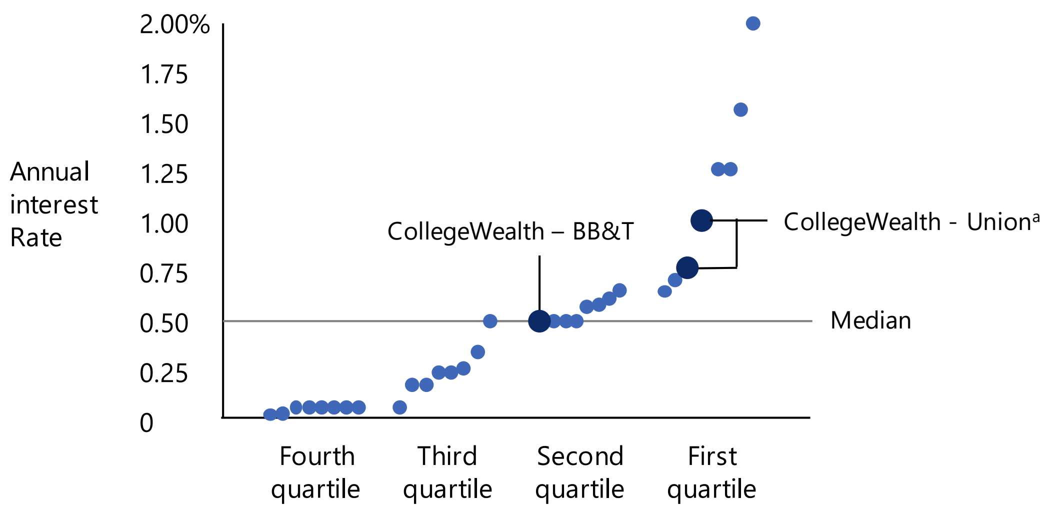
SOURCE: VA529 program data.
NOTE: Figures reported are as of the June 30 end of the fiscal year except for 2016, which is as of March 31

CollegeWealth return rates

The CollegeWealth program's interest rates are competitive with those offered by similar FDIC-insured college savings programs in other states (Figure 8). Participants who hold an account with Union Bank & Trust receive the most favorable rates, ranging from 0.75 to 1.0 percent depending on their account balance. These rates are among the highest offered nationwide. Participants who hold accounts with BB&T receive a 0.5 percent rate, which is about average for these types of savings programs.

Although the interest rates offered under each of the CollegeWealth partner institutions are fixed, they are subject to change. For example, in 2014 each partner institution offered rates at or above two percent. The rates were reduced because they were out of line with the broader market of similar savings vehicles.

FIGURE 8
CollegeWealth interest rates compared to programs in other states



SOURCE: VA529 program data and other states FDIC-insured programs data, reported as of April 28, 2016.
NOTE: Several states, like Virginia, offer multiple FDIC-insured investment options with different fixed interest rates depending on account size and other factors. This figure shows all rates for all options, including the highest and lowest rate offered under each option. Two states, Arizona and Indiana, have options with variable interest rates tied to tuition inflation or stock market performance. These options are not shown.
[a] Participants with Union Bank & Trust accounts receive a rate of 1.0% if their account holds $10,000 or more, and 0.75% if their account is under that amount.

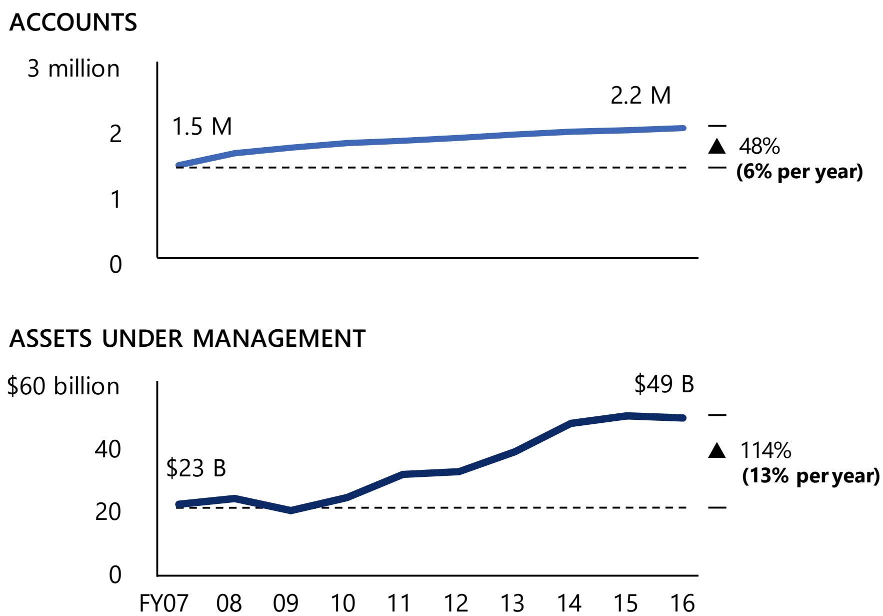
4. CollegeAmerica Program

CollegeAmerica is a college savings program offered under a partnership between VA529 and a private mutual fund company. CollegeAmerica accounts are sold by VA529's partner, Capital Group, through private financial advisors. Program participants contribute to individual accounts and work with their advisor to determine how money is invested. Investment earnings are exempt from federal taxes as long as they are used to pay for qualified higher education expenses, such as tuition, books, and housing. Virginia also exempts earnings from state taxes and offers an income tax deduction for contributions made to this and other VA529 college savings programs. Funds from CollegeAmerica accounts can be used at institutions in Virginia and other states. The program distributed $3.2 billion to participants in FY15.

CollegeAmerica participation

Participation in the CollegeAmerica program has increased over the past 10 years (Figure 9). Two measures of program participation are the number of participant accounts and the total assets under management. The number of CollegeAmerica accounts increased by an average of almost six percent per year in the 10 years from 2007 to 2016. The value of assets under management more than doubled, from $23 billion to $49 billion. This growth is attributable to both new contributions and investment returns. The increase in CollegeAmerica participation follows a national trend for college savings programs, which have grown steadily over the past decade.

FIGURE 9
CollegeAmerica account and asset growth



SOURCE: VA529 program data.
NOTE: Figures reported are as of the June 30 end of the fiscal year except for 2016, which is as of March 31.

CollegeAmerica investment performance

The CollegeAmerica program held an aggregate of $49 billion in assets as of March 31, 2016. Assets are owned by program participants, who have their own individual accounts. Individual participants determine how their money is invested.

Program participants may choose from 44 different investment options offered under Capital Group's American Funds mutual funds. Investment options include traditional individual investment options, such as stock and bond investments, target-date portfolios that automatically adjust over time as the beneficiary approaches college age, and diversified portfolios based on different investment strategies such as growth or capital preservation. All of the CollegeAmerica options are actively managed, with the goal of providing better returns or lower risk than the overall market.

The CollegeAmerica investment options generally outperformed their benchmarks. CollegeAmerica reported near- and long-term performance data for its individual stock and bond investment options. Most of the individual options outperformed their one-, five-, and ten-year benchmarks. CollegeAmerica reported only one- and three-year data for its College Target Date and Portfolio Series funds. Most of these investment options outperformed their benchmarks, although several options in the Portfolio Series underperformed their three-year benchmarks. Performance data is not yet available for five of the recently established CollegeAmerica investment options.

TABLE 3
CollegeAmerica program investment performance

for the period ending December 31, 2016

	1 year	3 years	5 years	10 years
Individual options				
Met or exceeded benchmark	16	n/a	16	15
Total number of options	27		23	20
College target date options				
Met or exceeded adjusted benchmark	5	4	n/a	n/a
Total number of options	6	6		
Portfolio series options				
Met or exceeded adjusted benchmark	4	2	n/a	n/a
Total number of options	6	6		

SOURCE: VA529 program data.
NOTE: The total number of investment options can change because longer-term performance data is not available for newer options. One-year data is not yet available for five of the recently established CollegeAmerica investment options. Performance is reported net of investment fees.

The CollegeAmerica investment line-up includes five new investment options that were approved by the VA529 board over the past two years. The options added to the investment line-up were the Inflation Linked Bond Fund, Corporate Bond Fund, Strategic Bond Fund, Emerging Markets Bond Fund, and College 2033 Fund. The new bond options were added to increase bond options available to participants and maintain parity with the program's competitors. The College 2033 Fund is a target-date portfolio that adjusts over time as the participant approaches college age. A new target-date portfolio is added every three years as an existing target date portfolio reaches its end point and closes.

5. ABLE Programs

The new Achieving a Better Life Experience (ABLE) programs are intended to offer tax-advantaged 529A savings accounts for individuals with disabilities. Account funds can be used to pay for qualified disability expenses such as education, training, medical care, housing, and transportation. State-run ABLE programs were authorized under a December 2014 federal law, and Virginia became the first state to enact ABLE legislation in March 2015.

Under Virginia's ABLE act, VA529 was vested with responsibility for establishing and managing programs for ABLE savings accounts. VA529 intends to establish two separate ABLE programs, modelled on its college savings programs. Both programs are intended to be national programs and will be open to enrollment by residents of Virginia and other states.

The ABLEnow program will be a "direct-sold" investment program similar to inVEST. Under this program, participants will establish investment accounts directly with VA529. VA529 has agreed to retain PNC Financial Services to be the program's administrator. The company will handle all aspects of account management, including program enrollment, contributions, and disbursements. VA529 will be responsible for program marketing, customer service, and investment oversight. Similar to inVEST, VA529 will separately retain investment management firms to provide investment options for participants to select from. VA529 expects ABLEnow to be open for enrollment by December 2016.

The ABLEAmerica program will be an "advisor-sold" investment program similar to CollegeAmerica. Under this program, participants will establish investment accounts through private financial advisors. VA529 has partnered with Capital Group, its CollegeAmerica partner, to manage the program. Capital Group will handle most administration and investment management duties. VA529 will retain the authority to approve investment options and other aspects of the program's operations. VA529 expects the program to be operational by January 2017.

A key consideration of the new ABLE programs is how eligibility is determined. Under federal guidelines, responsibility for determining eligibility rests with the individual establishing the ABLE account, not the state 529 program. The individual who establishes the account could be the participant, a parent, or a legal representative. Individuals are responsible for certifying that the participant is eligible, under penalty of perjury. The individual establishing the account must send documentation of the participant's medical diagnosis to the Internal Revenue Service and the state ABLE program administrator upon request. However, state ABLE programs will not be required to request or maintain sensitive tax or medical information.

6. Agency and Program Management

VA529 agency and program operations are entirely funded through fees charged under its college savings programs. The VA529 board approves the agency's budget and any changes to programs, including the fees charged to participants. Notable issues relating to agency and program management include trends in its operating budget, changes to the two fees that provide most of VA529's revenue, recent legislation affecting the agency, and new appointments to the VA529 board.

Operating budget

VA529's board-approved operating budget increased by $6.2 million, or 27 percent, from FY15 to FY18. Budget growth is primarily driven by increased staff and marketing expenses and the re-establishment of scholarships offered under the SOAR Virginia program. VA529 staff indicated that the agency's budget increases are necessary to support its mission and growing operations.

VA529's budgeted staff (personal services) costs increased by $2.0 million over the four-year period. The increase is mainly due to the addition of 10 new staff positions, five of which are to support the new ABLE programs. The other five positions are to support administration, marketing, and information technology operations. The 10 new positions raise VA529's maximum employment level to 115 full-time equivalent positions.

Even though VA529's maximum employment level increased, the agency has actually reduced its staff. Several positions within the agency's finance office were consolidated in 2016, leaving the agency with a total of 90 filled positions. The decision to contract with private companies to develop and administer the new ABLE programs may reduce the number of newly created positions that will be filled in FY17-18.

TABLE 4
Trends in VA529 board-approved operating budget

	FY15 ($M)	FY18 ($M)	Change ($M)	Change (%)
Personal service	11.6	13.6	2.0	17%
Marketing & communications	4.1	5.3	1.2	29
Professional services	2.8	3.6	0.8	31
SOAR Virginia[a]	--	2.0	2.0	
Information technology	1.3	1.5	0.3	22
Facilities and leases	1.3	1.2	−0.1	−6
Other[b]	1.5	1.5	0.0	−2
Total	22.6	28.8	6.2	27%

SOURCE: VA529 program data as of March 31, 2016.
NOTE: Numbers may not sum due to rounding.
[a] SOAR Virginia is VA529's early commitment scholarship program. No money was budgeted for SOAR scholarships in FY14 or FY15. [b] Other expenses include Administrative Services; Meetings, Conferences, and Training; Supplies and Materials; and Professional Development, Memberships, and Subscriptions.

The VA529 marketing budget increased by $1.2 million from FY15 to FY18, not including staff compensation. The increase is mainly from VA529's effort to expand advertising in Northern Virginia to include network television and to increase advertising in the rest of the state to a year-round cycle. Other marketing activities that contribute to budget growth are the development of materials for the new ABLE programs and increased spending on special promotional campaigns, such as "529 Day." These increases are offset by a substantial reduction in planned spending on VA529's sponsorship arrangements.

VA529's professional services budget increased by $0.8 million over the four-year period. Most of the additional funds are for external services: recordkeeping for the prePAID program and a consultant to assist with establishment of the new ABLE programs.

The other major change to the board-approved budget is to the SOAR Virginia program. Under SOAR, VA529 partners with non-profit organizations to provide scholarships and assistance to Virginia public school students from low- and moderate-income households. The VA529 board established SOAR as a pilot program in 2010 and made it permanent in 2015. The board-approved operating budget for FY17-FY18 includes $2 million annually in SOAR scholarships that were not included in the last budget. VA529 had budgeted for SOAR scholarships in the past, but did not include them in the FY15-FY16 budget because sufficient funds were already on hand to complete the pilot phase of the program.

Fees reduced for inVEST and CollegeAmerica programs

The VA529 board approved a reduction in administrative fees for the inVEST and CollegeAmerica programs in June 2016. The goal of this fee reduction was to keep fees on par with those charged by other 529 programs nationwide. Administrative fees are annual fees charged to each participant based on the average daily value of their account. The CollegeAmerica fee is VA529's largest source of revenue, providing $42 million out of $49 million in revenue during FY15. The inVEST fee is the second largest source, providing over $4 million in revenue that same year.

A **basis point** is one hundredth of one percent. Basis points are commonly used to express investment fees and performance relative to benchmarks.

The fee reductions will directly benefit participants, but the impact will be relatively small to the average account holder. CollegeAmerica's administrative fee was reduced from an effective rate of 8.8 basis points to 7.0 basis points per year, lowering the actual dollar fee paid by the average account holder by $4. The inVEST fee was reduced from 15 to 10 basis points per year, lowering the fee paid by the average account holder by $8.

Lower administrative fees will reduce revenue in the near term but are not expected to adversely impact agency or program operations. Lowering the fees is expected to reduce revenue by $10.5 million, based on the value of assets on March 31, 2016. Most of the revenue reduction is from lowering the CollegeAmerica fees. However, VA529 collected $29 million in surplus revenue this past year, and the fee reduction is expected to simply reduce the surplus amount. Future fee revenues are expected to increase as the inVEST and CollegeAmerica programs continue to grow.

Recent legislation

The General Assembly makes changes to VA529 programs through legislation, and approves VA529 spending, including appropriations for administrative spending and payments made under the prePAID program. The 2015 and 2016 General Assembly passed several bills and budget amendments changes that affected VA529 and its programs. Most legislation was related to the ABLE program.

TABLE 5
VA529 legislation enacted by 2015 and 2016 General Assembly

2015 session	
House bill 1998	**Private retirement savings work group.** Requires the Virginia Retirement System (VRS) to convene a work group to review current state and federal programs that encourage citizens of the Commonwealth to save for retirement. VA529 is one of the designated work group members.
House bill 2306 Senate bill 1404	**ABLE savings trust accounts.** Creates program to provide tax-advantaged savings accounts for individuals with disabilities. Program is to be administered by VA529.
Appropriation Act item 479	**Savings program revenue and distributions removed from budget.** Removed revenue and distributions for VA529's inVEST and CollegeWealth savings programs from the appropriation act. Savings program revenue and distributions represent a transfer of investor-owned funds, not state moneys.
2016 session	
House bill 1103	**ABLE accounts means-test exclusion.** Excludes ABLE account holdings, contributions, and distributions from consideration when determining eligibility and benefit levels for state means-tested assistance.
Appropriation Act § 3-5.11	**ABLE contribution tax deduction.** Allows individual tax deductions of up to $2,000 per year for contributions to ABLE accounts.

SOURCE: Virginia Legislative Information System.

Board appointments

Shawn P. McLaughlin was reappointed to the VA529 board by the governor in August 2015. He was originally appointed to the board in 2009 and currently serves as the board's chair. His new term will expire in 2019. McLaughlin is president and CEO of McLaughlin Ryder Investments.

Edward H. Bersoff was appointed by the governor to the VA529 board in October 2014. His term will expire in 2018. Bersoff is chairman of Greenwich Associates, a business advisory firm, and managing director of PFF, a business finance company.

Reginald D. Samuel was appointed by the governor to the VA529 board in August 2015. His term will expire in 2019. Samuel is a partner at the Leumas Group, a real estate brokerage and private equity investment firm.

Peter M. Vogt was appointed by the Speaker of the Virginia House of Delegates to the VA529 board in June 2015. His term will expire in 2017. Vogt is the owner of PMV Acquisition Consulting, which provides professional services in federal acquisition, program management, and system engineering-related activities.

Timothy J. Sullivan was appointed by the Senate Rules Committee to the VA529 board in April 2015. His term will expire in 2017. Sullivan is president emeritus of the College of William & Mary.

The VA529 board is a supervisory board that is directly vested with authority for managing and overseeing most aspects of VA529. Board members serve four-year terms, but several of the appointments noted above are for shorter periods because the individual was appointed to fill an unexpired term. The board delegates day-to-day management responsibilities to the chief executive officer.

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