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Proposed Change to Payout Model of Virginia's Prepaid529 Program

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Proposed Change to Payout Model of Virginia's Prepaid529 Program

SUMMARY The current payout model of Virginia's Prepaid529 program covers tuition and fees at public institutions in Virginia. A proposed new payout model—the WAT model—would instead be based on weighted average tuition (WAT). The WAT model would address several concerns with the current Prepaid529 program including the lack of flexibility for purchasing contracts; the growing disparity in payouts, depending on the institution attended; changes in tuition and fee policies at institutions; declining program participation; and the actuarial complexity of the program. Implementing the WAT model would have some drawbacks, though. For example, the standard payout would no longer cover annual tuition and fees at *all* Virginia public institutions. However, the benefits of the WAT model likely outweigh its drawbacks, and if Virginia529 is to maintain a prepaid college savings program, the WAT model would be an improvement over the current Prepaid529 program. Steps could be taken to design the WAT model in ways that address the drawbacks.

Prepaid529 is the defined benefit college savings program offered to Virginia residents by Virginia529. The program offers contracts that cover tuition and fees. As of June 30, 2018, the Prepaid529 program had 63,083 active accounts and approximately $2.7 billion in assets under management.

Due to concerns about the sustainability of the current program, Virginia529 sought a significant change in the Prepaid529 program's payout model during the 2018 General Assembly session. The proposed weighted average tuition (WAT) model would change the Prepaid529 contract benefit from the current model, which is designed to cover tuition and fees at the specific Virginia public institution a beneficiary attends (and return-adjusted payouts to students who attend out-of-state and Virginia private institutions) (sidebar), to a WAT payout that would be the same for all students, regardless of where they attend college (in-state, out-of-state, public, or private). The WAT model proposal resulted from a 2016 sustainability study performed by Virginia529 that examined several possible options for the future of the Prepaid529 program.

Legislation to change the Prepaid529 program was proposed during the 2018 General Assembly session and carried over to the 2019 session (HB 1199 and SB 656). JLARC staff were directed by the 2018 Appropriation Act to review Virginia529's proposed WAT model and report how it would differ from the existing payout model, including how it would impact contract costs, contract payouts, program sustainability, and overall complexity of the program.

The Prepaid529 payout is for **tuition and fees**, defined as in-state, undergraduate tuition and all mandatory fees assessed to all students, for a normal full-time course load for a general course of study. The program offers participants protection against investment risk and higher-than-anticipated tuition growth.

Weighted average tuition is the average tuition and fees paid by students, weighted by enrollment across Virginia's four-year public universities.

Proposed WAT model

The proposed WAT model would change the Prepaid529 program from the current model, in which the payout each beneficiary receives is based on the institution they attend, to a model in which payouts are the same regardless of the institution. Like the current program, the WAT model would still be a college savings option with a guaranteed payout that tracks tuition. As a result, it would still offer protection against rising tuition costs and investment risk.

The WAT model would only apply to customers who make their purchase after program changes are implemented. Any customers purchasing a contract under the existing Prepaid529 program would receive a payout consistent with the terms and conditions for the current program, regardless of when the contract is redeemed. Furthermore, the WAT model would offer the same federal and state tax advantages on contributions and investment earnings as the current Prepaid529 model.

Payout from current Prepaid529 program varies depending on institution attended

Customers purchase Prepaid529 contracts on a semester basis. Customers can purchase contracts ranging from one to 10 semesters and the payout corresponds to the number of semesters purchased and redeemed. For example, an eight-semester contract would cover eight semesters of tuition and fees.

The payout for the current Prepaid529 program varies depending on the type of institution a beneficiary attends (in-state, out-of-state, public, private) (Table 1). Beneficiaries attending Virginia public institutions receive a payout equal to the tuition and fees of the institution they attend. Beneficiaries who attend Virginia private or out-of-state institutions receive a payout calculated using contract payments plus a rate of return as defined in statute and program policy. Regardless of where the contract is used, the student or family is responsible for those higher education expenses, such as room and board, that are not covered by the Prepaid529 contract. Additionally, in recent years only 20 percent of Prepaid529 customers purchased an eight-semester contract intended to cover a traditional four years of college, so most beneficiaries pay for tuition and fees out of pocket, with loans, with other college savings plans, or through other means, during at least a portion of their enrollment.

TABLE 1
Contract payout for current Prepaid529 program, by institution type

Type of institution	Description of payout
Virginia public	The in-state undergraduate tuition and all mandatory fees assessed to all students, for a normal full-time course load for a general course of study at the specific institution attended.
Virginia private	The lesser of (1) the payments made on the contract plus the actual rate of return earned on the Prepaid529 fund or (2) the highest undergraduate tuition and mandatory fees at a Virginia public school in the same academic year in which the benefits are used.[a]
Out-of-state (public or private)	The lesser of (1) the payments made on the contract plus interest at the reasonable rate of return or (2) the average in-state undergraduate tuition and mandatory fees at Virginia public schools for the same academic year in which the benefits are used.[b]

SOURCE: Virginia529 Prepaid529 program policy and Code of Virginia.
NOTE: Beneficiaries attending Virginia community colleges can either (1) redeem a contract purchased specifically for use at community colleges that pays tuition and mandatory fees (sales of these community college contracts ended after 2012-13) or (2) convert a contract for a four-year institution into a contract for a community college. For all types of institutions, a contract holder has the option to transfer the total amount of all payments, accumulated at the reasonable rate of return, to another Virginia529 savings program such as Invest529, and request a distribution from the respective program to pay for qualified higher education expenses. The reasonable rate of return tracks the quarterly performance of the Institutional Money Funds Index as reported in the Money Fund Monitor by iMoneyNet.
[a] Payout is typically the payments made on the contract plus the actual rate of return earned on the Prepaid529 fund. [b] Payout is typically the payments made on the contract plus interest at the reasonable rate of return.

A majority (69 percent) of the 11,907 Prepaid529 beneficiaries who redeemed a contract during the 2017-18 academic year attended a Virginia public institution (Table 2). The remaining beneficiaries attended out-of-state institutions (14.4 percent), Virginia private institutions (6.1 percent), or Virginia community colleges (10.5 percent).

TABLE 2
Institutions attended by Prepaid529 beneficiaries, by contracts redeemed in 2017-18

Type of institution	Percentage
Virginia public	69.0%
Virginia private	6.1
Out-of-state (public or private)	14.4
Virginia Community Colleges	10.5

SOURCE: Virginia529 Prepaid529 program information.

More Prepaid529 beneficiaries attend certain Virginia public four-year institutions. The number of students with a Prepaid529 contract attending each Virginia public four-year institution during 2017-18 ranged from a high of 1,881 at Virginia Tech to a low of five at Norfolk State (Table 3). Approximately 7 percent of in-state students (134,351) at Virginia public four-year institutions redeemed a Prepaid529 contract during the 2017-18 academic year.

TABLE 3
Virginia public four-year institutions attended by Prepaid529 beneficiaries by contract holders in 2017-18

Institution	Students
Virginia Tech	1,881
University of Virginia	1,609
Virginia Commonwealth	1,274
James Madison	1,053
George Mason	878
William & Mary	609
Christopher Newport	445
Old Dominion	411
Radford	330
Longwood	290
University of Mary Washington	262
Virginia Military Institute	64
UVA-Wise	23
Virginia State	15
Norfolk State	5
Total	**9,149**

SOURCE: Virginia529 Prepaid529 program information.
NOTE: 1,321 students across all Virginia community colleges utilized Prepaid529 contract in 2017-18.

Proposed WAT model would provide the same guaranteed payout to all beneficiaries

Virginia529's proposed Prepaid529 WAT model would provide a payout that is guaranteed to be equal to the weighted average tuition across Virginia public institutions for the academic year in which benefits are used. The weighted average tuition would be the average of tuition and fees as defined by the current Prepaid529 program, weighted by enrollment across Virginia's four-year public universities. The weighted average tuition for academic year 2018-19 is $13,210 (Table 4).

TABLE 4
Weighted average tuition for the 2018-19 academic year

Institution	Tuition and fees	In-state undergraduate enrollment	Percentage distribution (i.e., weight)
William & Mary [a]	$21,830	3,965	3.1
Virginia Military Institute	18,862	1,151	0.9
University of Virginia [a]	16,258	10,973	8.6
Christopher Newport	14,754	4,437	3.5
Virginia Commonwealth	14,490	18,874	14.8
Virginia Tech	13,620	19,380	15.2
Longwood	13,590	4,200	3.3
Mary Washington	12,714	3,416	2.7
George Mason	12,462	18,196	14.3
James Madison [a]	11,544	14,411	11.3
Radford	11,210	7,404	5.8
Old Dominion	10,872	13,603	10.7
UVA-Wise	10,119	902	0.7
Norfolk State	9,490	3,424	2.7
Virginia State	9,056	3,184	2.5
Total	--	**127,520**	**100%**
Weighted average tuition	**$13,210**	--	--

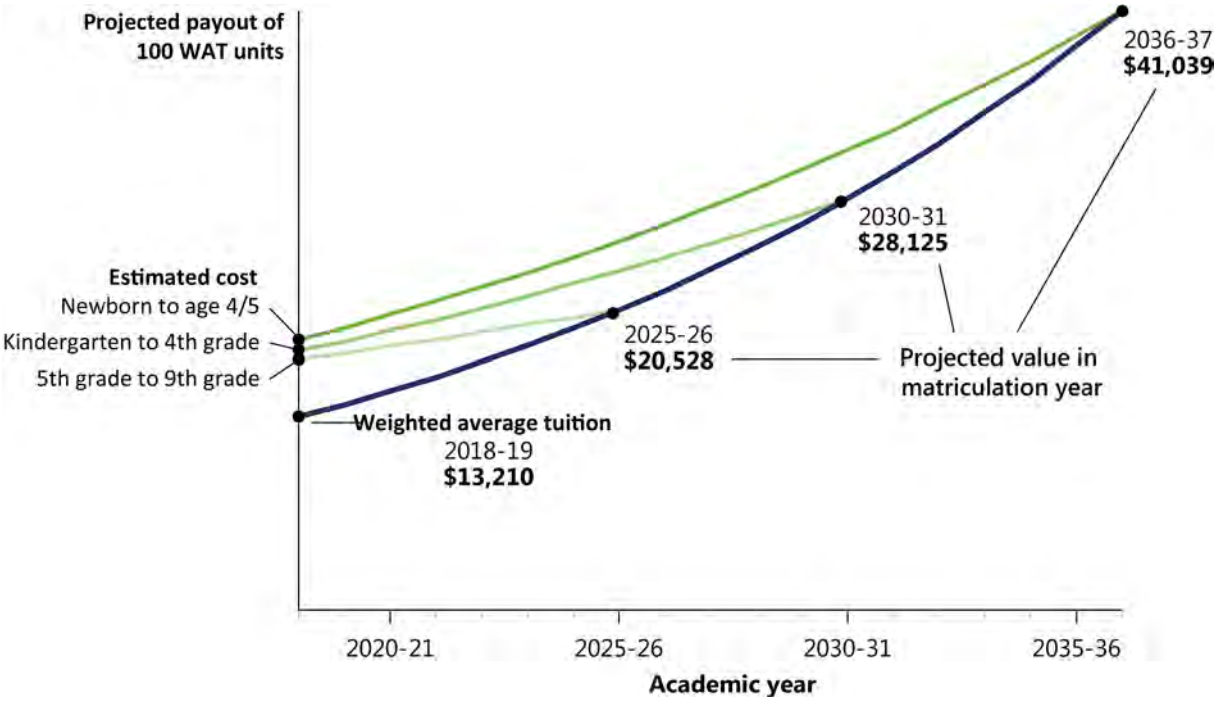
SOURCE: JLARC analysis of Virginia529 program information.
NOTE: Based on projected fall enrollment. Includes only tuition and mandatory fees paid by in-state students.
[a] Tuition and fee levels vary by incoming class-years. Amount shown is average of tuition and fees for all four class-years, weighted by the enrollment in each class-year.

Contracts under the WAT model would have the same payout value regardless of where the beneficiary attends college. Contracts would be sold in units, with a payout value of each unit equal to one percent of the value of annual (two semesters) weighted average tuition. One hundred WAT units would provide a payout equal to the weighted average tuition for the academic year for which it was used. For example, for the 2018-19 academic year, 100 WAT units would pay out $13,210. Each WAT unit would have a value of one percent of weighted average tuition, or about $132 in 2018-19.

A **WAT unit** is equal to one percent of weighted average tuition and fees in any year in which it is redeemed, regardless of tuition growth or market conditions. WAT units would be fully fungible, having a cash value that can be used to cover costs at any eligible educational institution for any qualified higher education expense.

The WAT model would provide a guaranteed payout that is independent of capital market conditions. Instead, growth in the payout value of WAT units would equal the growth of weighted average tuition between the time of purchase and the year in which they are redeemed to pay higher education costs (Figure 1). For example, 100 WAT units purchased in 2018-19 for a newborn child would have an estimated value of over $41,000 by time that child reaches college age in 2036-37 (using the program's 6.5 percent annual tuition growth assumption). This growth, indexed to the weighted average tuition, is guaranteed regardless of market fluctuations.

FIGURE 1
WAT model payout would be equal to weighted average tuition regardless of year in which redeemed (100 units)



SOURCE: JLARC analysis of Virginia529 program data.
NOTE: Weighted average tuition shown to grow at Prepaid529's assumption of 6.5 percent annually. Actual weighted average tuition growth may vary. WAT units purchased for younger beneficiaries would likely be more expensive because the program's tuition growth assumption of 6.5 percent per year is greater than the program's investment return assumption of 5.75 percent per year. Therefore, tuition growth is anticipated to outpace investment return to a greater extent over a longer period of time. The relationship between the tuition growth assumption and investment return assumption may vary over time. Exact pricing for WAT units has not yet been determined.

At payout, 100 WAT units would more than cover one year of tuition and fees at a lower-cost institution but would not cover the annual cost of a high-cost institution. To address this, WAT units could be redeemed in smaller or larger increments as needed. For example, a payout of 75 WAT units would be equivalent to 75 percent of the weighted average tuition in the year in which the units were redeemed. Therefore, a beneficiary attending a lower-cost institution could redeem fewer units, or redeem 100 units and use the excess funds to pay costs beyond tuition and fees (such as room and board). Likewise, 125 WAT units would result in a payout equivalent to 125 percent of the weighted average tuition. This means that customers who assume their beneficiary will attend a higher-cost institution—or would like to pay for costs beyond tuition and fees—could purchase a larger quantity of WAT units. Otherwise, a beneficiary attending a higher-cost institution could redeem 100 units and pay for remaining tuition and fees out of pocket, with loans, with other college savings plans, or through other means.

Some prepaid college savings programs in other states pay full tuition and others pay average tuition

Some prepaid college savings programs in other states offer a full tuition and fee payout like Virginia's current Prepaid529 program, while others use an average tuition payout comparable to the proposed WAT model. Currently, 10 prepaid college savings plans are open to new enrollment; six of the 10 programs, including Virginia's, have a payout model that covers full tuition and fees at in-state public institutions (Table 5). Four programs have a payout based on weighted average tuition, or a similar average tuition calculation. Under both models, the payout terms for private and out-of-state institutions vary.

Few prepaid college savings programs have switched from a full tuition and fees model to a weighted average tuition, or similar, model. It is therefore difficult to determine whether either type of payout structure is more desirable to customers or viable in the long term. A number of factors, such as the disparity of tuition and fees across a state's public institutions or the structure of the state's higher education system, likely contribute to the policy decision for which type of payout a program offers.

TABLE 5
Prepaid college savings program payout type by state

	Payout type for in-state public institution	
	Full tuition and fees	Weighted average tuition or similar
Florida	✓	
Maryland	✓	
Massachusetts		✓
Michigan	✓	
Mississippi	✓	
Nevada	✓	
Pennsylvania		✓
Texas		✓
Virginia	✓	
Washington		✓

SOURCE: Program information from other states.
NOTE: Payout terms for private or out-of-state institutions vary by program. Includes only programs open to new enrollment.

WAT model would address several concerns with the Prepaid529 Program

The WAT model has several benefits compared to the current Prepaid529 program. These benefits address several concerns with the current program, including (1) the lack of flexibility for the purchase of Prepaid529 contracts, (2) the growing disparity in payouts depending on the institution attended, (3) changes in tuition and fee policies at Virginia's public institutions, (4) declining program participation, and (5) the actuarial complexity of the program.

Funded status is the actuarially determined ratio of assets to obligations for the Prepaid529 program

Virginia529's WAT model proposal is not due to concerns about the current financial soundness of the Prepaid529 fund. The Prepaid529 fund has sufficient assets to cover the estimated value of the future liability associated with current contracts. As of June 30, 2018, the program's funded status (sidebar) was 137 percent, which represents an estimated 98 percent likelihood that fund assets would be sufficient to cover current program liabilities. Program assumptions are reviewed annually by Virginia529 staff, board, committees, actuary, and investment consultant. Furthermore, a 2017 actuarial audit by the JLARC actuary confirmed that the assumptions used to calculate the Prepaid529 funded status are reasonable and actuarially sound.

WAT model could lower entry price and increase purchasing flexibility

Contract prices for Prepaid529 are actuarially determined. Prices factor in current tuition and fee rates, a tuition growth assumption, an investment return assumption, and other past plan experience such as the distribution of student attendance across different institutions and the amount of contract cancellations.

The WAT model could result in lower entry prices for participation and increased purchasing flexibility compared to the current Prepaid529 program. Under the current model, Prepaid529 contracts are sold by semester. The price for each semester varies slightly depending on the age of the beneficiary at the time of purchase. A Prepaid529 contract can be purchased with a single payment, through monthly installments over time, or through a combination of down payment and monthly installments. For the 2017-18 enrollment period, contract prices for beneficiaries currently in kindergarten through 4th grade ranged from $8,485 for a one-semester contract to nearly $68,000 for an eight-semester contract (Table 6).

TABLE 6
Prepaid529 contract prices by type of contract

Type of contract	2017-18 enrollment period contract cost
1 semester	$8,485
2 semester	16,970
4 semester	33,940
8 semester	67,880

SOURCE: Virginia529 Prepaid529 program information.
NOTE: Contract prices shown are for beneficiary currently in kindergarten through 4th grade. Contract prices vary depending on age of beneficiary for whom contract is purchased. Contract for beneficiary age newborn through ages 4-5 is $8,825 per semester ($70,600 for 8 semesters) and contract for beneficiary in 5th grade through 9th grade is $8,145 per semester ($65,160 for 8 semesters).

The WAT model would allow customers to purchase units instead of a contract, thereby lowering the entry price of the program. This is because one year of weighted average tuition would be equal to 100 units, which could be purchased in any quantity at a given time, with no minimum purchase requirement. For example, had the WAT model been in place for 2017-18, a single WAT unit would have cost an estimated $157 for a beneficiary currently in kindergarten through 4th grade. This compares to a cost of $8,485 for a one-semester contract, the smallest increment available for purchase under Prepaid529, which can be paid in full at time of purchase, through installments over time, or through a combination of both.

The WAT model's increased purchasing flexibility means that customers would not have to commit to a large up-front payment or monthly installments. Instead, customers could purchase WAT units as their financial situation allows. For example, a family could use a tax refund in April and money received as a gift in December to buy additional WAT units, while electing not to purchase any WAT units in months with unanticipated expenses or vacation expenses. Customers would have the option to establish a monthly purchase plan for WAT units.

Purchasing 100 WAT units (one year of weighted average tuition and fees) may be slightly less expensive than purchasing a two-semester (one-year) contract under the current Prepaid529 program. For 2017-18, 100 WAT units would have cost an estimated $15,700 for beneficiaries currently in kindergarten through 4th grade. This compares to the purchase price of $16,970 for Prepaid529's two-semester contract. The higher prices for a one-year Prepaid529 contract correspond to a higher average payout. Under the current model, the contract price may be as much as eight percent higher than a comparable WAT contract would be, because the average payout is about eight percent higher than weighted average tuition.

The lower minimum purchase price, greater payment flexibility, and lower cost of one year of WAT units means a customer who purchases the standard 100 WAT units may receive a proportionally smaller future payout, relative to the current Prepaid529 program. However, according to Virginia529 staff, these factors would likely be more appealing to customers who are hesitant or unable to commit to the high-priced contracts under the current model.

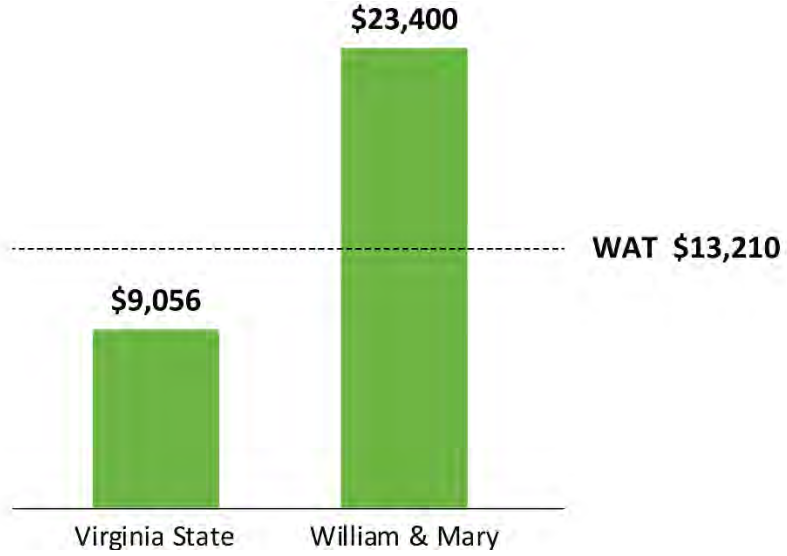
WAT model would result in more equitable contract payouts

The WAT model would provide an equal payout for all beneficiaries regardless of the institution they attend (in-state, out-of-state, public, or private). The equal payout would address the current Prepaid529 program's large disparity in payouts across different institutions. Under the current program, contracts for all beneficiaries are purchased at an identical price (adjusting for year of purchase, number of semesters, and payment method). This means that the return on investment can vary greatly from one beneficiary to another. It also means that beneficiaries receiving less generous payouts are essentially subsidizing the more generous payouts to other beneficiaries.

WAT model would address wide and growing disparity in payout across Virginia public institutions

The WAT model's uniform payout to all beneficiaries would resolve the current model's payout disparity, which reflects the wide range of tuition and fees at Virginia's public institutions. For the 2018-19 academic year, tuition and fees across Virginia public institutions range from a high of $23,400 at William & Mary (for incoming 2018 students) to a low of $9,056 at Virginia State (Figure 2). This means that the payout for a Prepaid529 beneficiary who attends the College of William & Mary may be as much as 258 percent of the payout for a beneficiary who attends Virginia State. A payout for the College of William & Mary beneficiary would be 177 percent of weighted average tuition ($13,210), whereas the payout for the Virginia State beneficiary would be just 69 percent of weighted average tuition.

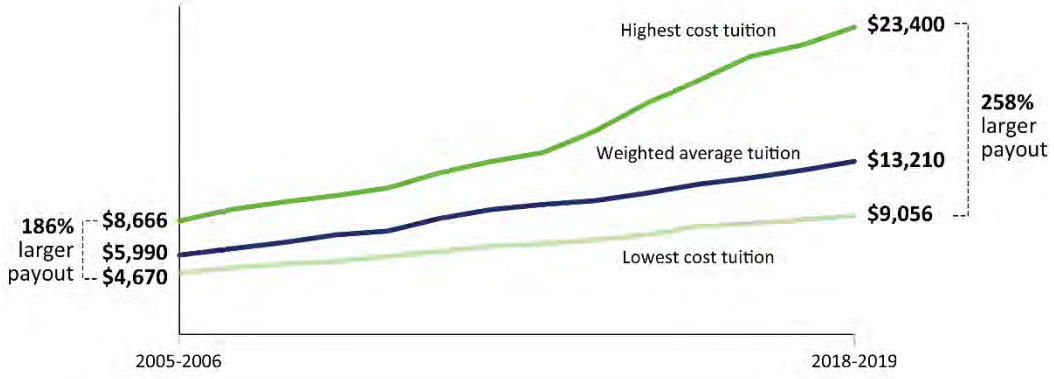
FIGURE 2
Current Prepaid529 payout at lowest- and highest-cost Virginia public institutions relative to WAT (2018-19)



SOURCE: Virginia529 program data.
NOTE: Price for William & Mary is for 2018 incoming students; returning students have a lower cost depending on the year they began attendance. Those attending in-state institutions have the option to transfer the total amount of all payments, accumulated at the reasonable rate of return, to a Virginia529 savings program such as Invest529, and request a distribution from the respective program to pay for qualified higher education expenses; this often results in a more generous payout for those attending lower cost institutions. Payout should never be less than payments made for the contract plus the reasonable rate of return.

Payouts to Prepaid529 beneficiaries have become more unequal as the disparity in tuition and fees at Virginia's lower- and higher-cost public institutions has grown. The tuition and fees at the highest cost Virginia public institution has grown from 186 percent of the lowest-cost institution in 2005-06 (the year with the lowest level of disparity) to 258 percent of the lowest-cost institution in 2018-19 (Figure 3). Likewise, tuition and fees at the highest-cost Virginia public institution has grown from 145 percent of WAT to 177 percent of WAT in the same time period. Any additional growth in the disparity between the lower- and higher-cost Virginia public institutions would further increase the inequality in payout received by Prepaid529 beneficiaries attending those schools.

FIGURE 3
Disparity in tuition and fees between lowest- and highest-cost Virginia public institutions (2005-06 through 2018-19)

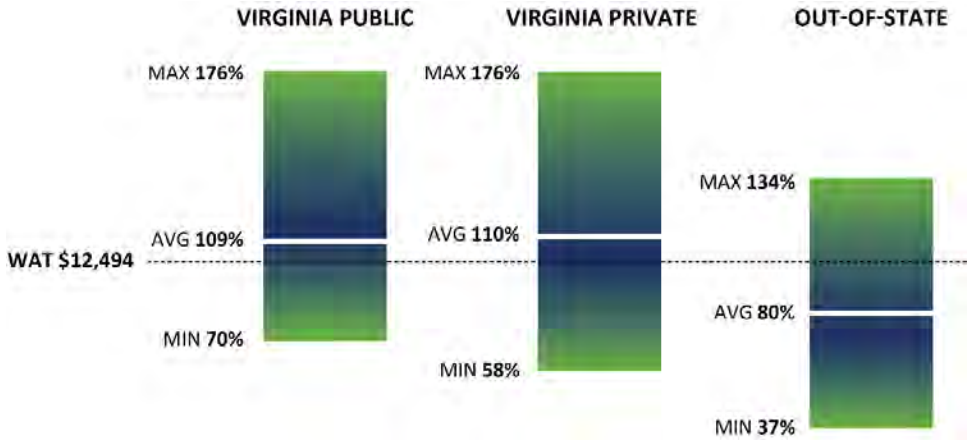


SOURCE: Virginia529 program data.
NOTE: Highest-cost institution represents highest cost for any single class-year. For example, the incoming 2018 class at William & Mary represents the highest cost for 2018-19.

WAT model would address wide disparity in payouts across different types of institutions

The WAT model's uniform payout to all beneficiaries would address the disparity in payout across different types of institutions (public, private, in-state, and out-of-state). Payouts for the current Prepaid529 program, which are defined in statute and by program policy, vary greatly depending on the type of institution a beneficiary attends (Table 1, page 5). Last year (2017-18), beneficiaries attending Virginia public institutions received payouts ranging from 70 percent to 176 percent of weighted average tuition, with an average of 109 percent (Figure 4). Beneficiaries attending a Virginia private institution received payouts ranging from 58 percent to 176 percent of weighted average tuition, with an average of 110 percent. Beneficiaries attending out-of-state institutions received payouts ranging from 37 percent to 134 percent of weighted average tuition, with an average of just 80 percent.

FIGURE 4
Range of Prepaid529 payouts by type of four-year institution: As a percentage of WAT (2017-18 academic year)



SOURCE: Virginia529 program actuary, Milliman.

Most contract payouts to beneficiaries attending out-of-state institutions are substantially less generous due to how the payouts are calculated, according to statute and program policy. Payouts for beneficiaries attending out-of-state institutions are most commonly calculated as "principal [contract payments] and a reasonable return on such principal as determined by the board" (§ 23.1-707). Traditionally, the Virginia529 board has used the Institutional Money Funds index as the reasonable rate of return. Money funds of this type have experienced low returns, often near zero percent, for the past several years. This has resulted in payouts for out-of-state beneficiaries (14.4 percent of total Prepaid529 beneficiaries in 2017-18) that often do not represent a substantial growth from the payments made for the original contract.

Elimination of payout disparity would address subsidization across beneficiaries

The elimination of payout disparity under the WAT model would also address the subsidization of payouts between Prepaid529 beneficiaries. Subsidization occurs because assets that were collected from the contract purchases of beneficiaries who ultimately receive a lower payout (typically those attending low-cost Virginia public institutions and out-of-state institutions), are in effect, subsidizing the relatively more generous payouts received by other beneficiaries (typically those attending high-cost Virginia public institutions and Virginia private institutions). This subsidization of some beneficiaries by others, which raises questions about program fairness, would be addressed under the WAT model's equal payout.

WAT model would allow greater flexibility for payouts

The WAT model would provide greater flexibility to beneficiaries in the use and redemption of payouts. One unit of WAT would have a payout value equal to one percent of weighted average tuition in the academic year in which it is used. Under the WAT model, beneficiaries could redeem WAT units in any increment (rather than only on a semester basis, as under the current model). Furthermore, WAT units could be used to cover qualifying higher education expenses beyond normal tuition and fees, such as program or course specific charges and room and board.

WAT model payouts would be more flexible for non-traditional four year students and community college students

WAT model payouts would better align with the payment schedules for students who do not follow the traditional four-year higher education path. WAT units could be redeemed over varying amounts of time and in any increment. For example, a student attending a community college, which costs approximately 40 percent of the public four-year weighted average tuition, could use 40 WAT units to cover their costs. Under the current Prepaid529 program, a contract purchased for a four-year intuition can be used for community college, but it is subject to a conversion formula that does not always result in a good value for the beneficiary. Similarly, a part-time student taking a relatively small credit load over a longer time period could use the applicable amount of WAT units to cover part-time tuition and fees. This is in contrast to the current Prepaid529 program, which offers less flexibility. Part-time students often have to convert their contracts into a college savings account, and this process typically results in a less generous overall payout.

WAT model contracts could be used to cover qualifying higher education expenses beyond tuition and fees

Qualified higher education expenses include tuition, fees, room and board, books, program and course specific fees, and education equipment.

WAT model payouts could be used to pay for other qualified higher education expenses beyond tuition and fees. Under the current Prepaid529 program, beneficiaries attending a Virginia public institution receive contract payouts equal to tuition and fees. However, the full cost of college attendance often requires additional expenses such as room and board, fees assessed for optional services such as parking, or educational equipment such as lab supplies. A beneficiary who has accrued enough WAT units to cover costs beyond tuition and fees could use the remaining units to pay for these additional higher education expenses. Under the current Prepaid529 program, these additional expenses are paid out of pocket, with loans, with other college savings plans, or through other means.

WAT model would reflect evolving higher education tuition and fee structures

WAT model payouts would address evolving higher education tuition and fee structures. In recent years, institutions have adopted the practice of assessing course or

major-specific fees and major-specific tuition rates, also known as "differential tuition," to students enrolled in certain programs such as business or engineering school. The current Prepaid529 program's definition of tuition and fees does not include course-specific or major-specific fees or differential tuition. These additional expenses are paid out of pocket, with loans, with other college savings plans, or through other means. Under the WAT model, a beneficiary who has accrued enough WAT units to cover costs beyond normal tuition and fees could use WAT units to pay for these additional charges.

WAT model may help increase Prepaid529 program participation

The WAT model's purchasing terms, equitable payouts, and payout flexibility could potentially address Prepaid529's declining participation. Prepaid529 is one of the college savings programs offered by Virginia529 to help achieve its goal of enhancing accessibility and affordability of higher education for Virginia's citizens. Prepaid529 is unique among Virginia529's college savings offering because it is the only guaranteed college savings program available to Virginia residents who want a savings vehicle that is free from capital market risk and that provides protection against greater-than-anticipated tuition growth.

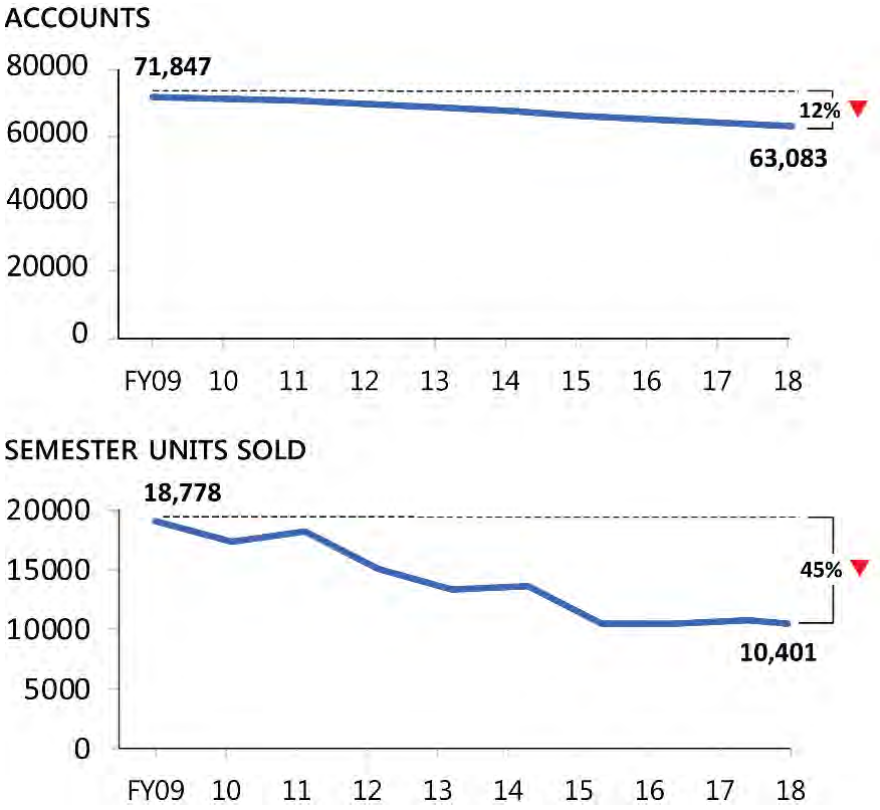
Prepaid529 program participation has declined

Invest529 is a college savings program sold directly by Virginia529 to program participants. Participants contribute to their individual investment accounts and determine how funds are invested by selecting from a menu of options. Savings grow based on investment returns and are subject to capital market risk.

Participation in Prepaid529 has declined and the program has fallen out of favor relative to other college savings programs offered by Virginia529, such as Invest529. According to Virginia529 staff, a significant factor contributing to the decline is the increase in the price of contracts. The price of a Prepaid529 contract to cover eight semesters at a four-year university increased from $44,060 in 2008-09 to $67,880 in 2017-18. Rising contract prices are primarily due to the rising cost of tuition during that time. Price increases have made the Prepaid529 program less affordable to many families. Virginia's median annual household income increased by just over $500 during the same period, from $70,745 in 2008 to $71,293 in 2017.

Prepaid529 program participation is decreasing both in terms of existing accounts and new contracts sold. The total number of Prepaid529 accounts declined by 12 percent over the 10-year period from FY09 to FY18 (Figure 5). The number of new contracts sold each year declined by just six percent from FY09 to FY18, but the number of semester units covered by those new contracts declined by 45 percent during that time.

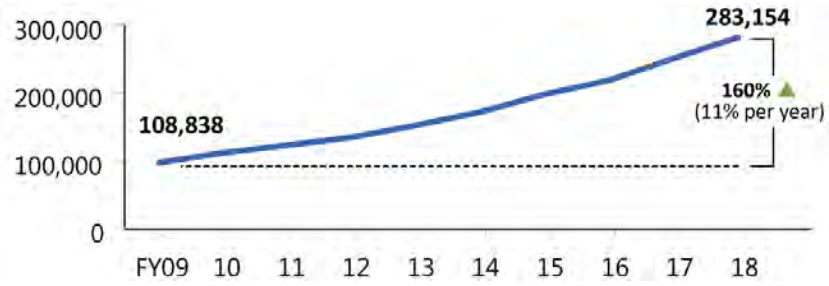
FIGURE 5
Prepaid529 program participation has declined



SOURCE: Virginia529 program data.
NOTE: Contracts are sold in eight-semester, four-semester, two-semester, and one-semester increments. Semester units sold does not include contract sales that are a combination of two or more different types of semester increments. Figures reported as of June 30 of each year.

Conversely, program participation in Virginia529's college savings program, Invest529, has grown dramatically over the same time period. The number of Invest529 accounts more than doubled in the 10 years from 2009 to 2018, increasing by an average of 11 percent per year (Figure 6). According to Virginia529, the growing price of Prepaid529 contracts and lack of program flexibility have likely contributed to this trend. College savings plans such as Invest529 allow customers to save at their own pace and do not require the purchase of an expensive contract. Invest529 accounts carry a cash value, equal to the principal invested plus investment returns (minus administrative and investment fees), that can be used equally at any type of higher education institution and for any type of qualified higher education expense. Invest529 also does not financially reward some beneficiaries more than others—as the Prepaid529 program currently does—depending on which institution they attend.

FIGURE 6
Invest529 participation (accounts)



SOURCE: Virginia529 program data.
NOTE: Figures reported as of June 30 of each year.

WAT model may improve program participation

The WAT model has the potential to increase program participation due to its benefits over the current Prepaid529 program. For instance, the WAT model's low entry price and flexible payment terms would likely appeal to customers who are hesitant to commit to a high-priced contract. The equitable payout of the WAT model may be more appealing to customers who are uncertain where their beneficiary will attend college. In addition, the more flexible WAT model could have greater appeal for customers who want to cover higher education costs beyond normal tuition and fees, or for customers who anticipate their beneficiary will follow a path other than the tradition full-time attendance at a four-year institution.

The **pricing reserve** on a Prepaid529 contract is a portion of the contract price that is in excess of the amount estimated to be needed to pay future contract benefits; currently set at 10 percent of the contract cost.

Pricing reserves are commonly used for prepaid college tuition contracts and other financial products.

The pricing reserve generates surplus revenue to protect the fund against risk.

WAT model would reduce, but not eliminate, actuarial uncertainty of the Prepaid529 program

The WAT model would reduce the actuarial uncertainty of the Prepaid529 program due to its uniform payout to all beneficiaries, which in turn reduces risk to the Prepaid529 fund. This would occur because the WAT model would remove the risk that a higher-than-anticipated proportion of beneficiaries could attend high-cost institutions and receive higher-than-expected payouts. Likewise, the WAT model would eliminate the risk associated with projecting the type of institution (in-state, out-of-state, public, or private) a beneficiary will attend.

There would still be actuarial uncertainty associated with projecting program liabilities and fund growth under the WAT model. Therefore, a pricing reserve to protect the fund against risk would still be appropriate. However, according to Virginia529 staff, the reduction in uncertainty resulting from the WAT model may justify a decrease in the pricing reserve from the level used for the current Prepaid529 program.

According the Virginia529 actuary, a change to the WAT model would not impact the funded status of the Prepaid529 fund or the actuarial soundness of the program. WAT model contracts, like contracts sold under the current Prepaid529 program, would be set at the estimated price needed to cover future liabilities associated with that contract.

WAT model would present some drawbacks

The change to the WAT model would have some drawbacks compared to the current Prepaid529 program. The two most notable drawbacks are: (1) purchasing a full-year of a WAT model units(100 units) would not cover the annual cost of tuition and fees at *all* of Virginia's public institutions, and (2) the WAT model would no longer incentivize program beneficiaries to attend a Virginia public institution.

One year of weighted average tuition payout would not cover annual tuition and fees at all Virginia public institutions

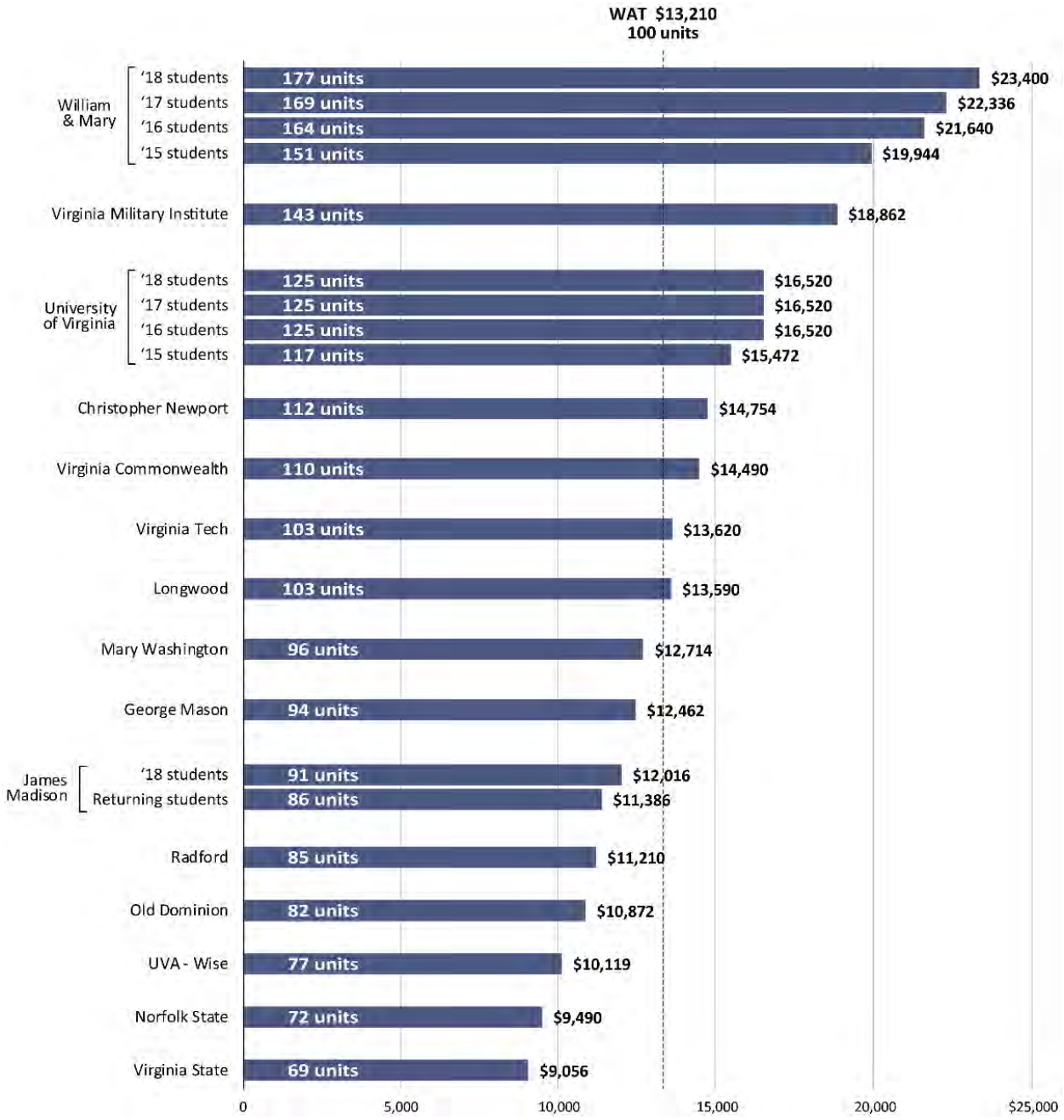
The WAT model's payout for one year of weighted average tuition (100 units) would not cover the annual tuition and fees at *all* of Virginia's public institutions. In the 2018-19 academic year, seven of 15 four-year institutions have annual tuition and fees that are *greater* than the statewide weighted average. In order to cover the entire cost of tuition and fees, beneficiaries who attend higher-cost institutions would need to redeem additional WAT units or pay remaining costs out of pocket, with loans, with other college savings plans, or through other means. This means that customers would have to clearly understand the program and plan their purchases in order to meet their savings goals.

WAT units needed to cover tuition and fees would vary by institution

The number of WAT units that would be needed to cover one year of tuition and fees varies greatly by institution as of the 2018-19 academic year. Amounts range from a low of 69 units needed to cover the approximately $9,000 cost of Virginia State to 177 units needed to cover the $23,400 cost of a 2018 first year student at William & Mary (Figure 7).

Customers who intend to use the WAT model to cover the annual cost of tuition and fees at Virginia public institutions with costs above the weighted average would need to purchase more than 100 WAT units for each year of attendance. For example, a customer intending to cover the cost of tuition and fees at William & Mary, based on 2018-19 costs, would need to acquire 177 units for each year. According to Virginia529 staff, the program would allow customers to purchase up to 700 WAT units, which is the approximate amount needed to cover William & Mary's annual cost over four years.

FIGURE 7
WAT units needed to cover one year of tuition and fees by institution (2018-19 tuition and fees)



SOURCE: Virginia529 program data.
NOTE: 2018-19 tuition and fees at the University of Virginia, William & Mary, and James Madison differ based on year of enrollment.

Nearly two-thirds of the 9,149 Prepaid beneficiaries attending Virginia public four-year institutions in 2017-18 were enrolled at those with tuition and fees that were higher than the weighted average. Three institutions have tuition levels substantially above weighted average tuition—William & Mary, Virginia Military Institute, and the University of Virginia—and about one-fourth of beneficiaries were enrolled at the three institutions combined. Under the WAT model, beneficiaries who attend these higher-cost institutions would have to use additional WAT units or pay the additional costs out of pocket, with loans, with other college savings plans, or through other means. However, the remaining one-third of beneficiaries who attended a Virginia public institution that cost less than the weighted average would have received a higher payout under the WAT model (when redeeming 100 units) than they received under the current model. Customers could also purchase fewer than 100 WAT units for each year of attendance and still cover annual tuition and fees at these institutions.

WAT model would require customers to understand the payout value and plan their purchases accordingly

The WAT model would require customers to understand the payout value and plan their purchases to achieve their desired payout. Under the current model, a beneficiary attending a Virginia public institution receives a payout equal to tuition and fees. Under the WAT model, customers who intend to cover the entire amount of tuition and fees at a target institution would need to plan their purchases in order to have the appropriate amount of WAT units available to redeem for their beneficiary. To do so, they would need to have an understanding of the quantities of WAT units needed to cover tuition and fees across different institutions and how that amount may change over time.

WAT model may be less appealing to customers aiming for high-cost institutions

The WAT model may be less appealing than the current Virginia529 program to customers who expect their beneficiary to attend a higher-cost Virginia public institution. Under the current program, beneficiaries attending higher-cost Virginia public institutions receive more generous payouts than beneficiaries attending lower cost Virginia public institutions or other institution types (primarily out-of-state institutions). This would no longer be the case under the WAT model; beneficiaries attending higher-cost institutions would need to purchase additional WAT units to cover the higher costs.

Current Prepaid529 program covers entire tuition and fees for few beneficiaries

Although the standard WAT model payout would not cover annual tuition and fees at all Virginia public institutions, the current Prepaid529 program payout rarely does so as well. Only about 20 percent of customers have purchased an eight-semester contract during the past three years of contract sales. Customers tend to purchase one- and two-semester contracts that cover less than a traditional full four years of college. This means that a majority of Prepaid529 beneficiaries will still have tuition and fees to cover from other sources for at least a portion of their enrollment, even when attending a Virginia

public institution. Furthermore, the proliferation of additional tuition and fees specific to certain courses and programs often results in instances in which current Prepaid529 program beneficiaries who attend Virginia public institutions do not actually receive a payout that covers their entire cost of tuition and fees. Finally, tuition and fees are only a portion of the total cost of college attendance. This means that all current Prepaid529 customers, even those with a beneficiary who attends a Virginia public school, have to plan and save for additional costs such as room and board and books.

WAT model would not incentivize beneficiaries to attend Virginia public institutions

Beneficiaries would receive the same payout under the WAT model regardless of which type of institution they attend, thus removing any incentives for where to attend. This differs from the current Prepaid529 program's payout, which tends to be more generous to beneficiaries attending a Virginia public institution. In 2017-18, 69 percent of beneficiaries who redeemed Prepaid529 contracts attended a Virginia public institution. Although the current Prepaid529 program's incentive for beneficiaries to attend a Virginia public four-year institutions would be removed under the WAT model, the WAT model would still be consistent with Virginia529's broader goal established in statute to "enhance accessibility and affordability of higher education for citizens of the Commonwealth" (§ 23.1-701).

WAT model implementation

The WAT model would address several of the concerns with the current Prepaid529 program and would allow Virginia to maintain a guaranteed colleges savings offering. However, several important considerations would need to be addressed including how to help ensure customers meet their savings goal and how to accurately market the new model.

WAT model would address concerns with current Prepaid529 program

The WAT model would provide several benefits that address concerns with the current Prepaid529 program (Table 7). These concerns include the lack flexibility for purchasing contracts, the growing disparity in payouts depending on the institution attended, the ability to use Prepaid529 to cover costs under evolving tuition and fees structures, declining program participation, and the actuarial complexity of the program. The WAT model would also have drawbacks, some of which could be addressed through the program's design.

TABLE 7
Summary of benefits and drawbacks of WAT model

Benefits of WAT model	Drawbacks of WAT model
• Improves equity for payouts across Virginia public institutions and between types of institutions (public, private, in-state, out-of-state) • Lower entry price and increased purchasing flexibility • Greater flexibility of payouts for: higher education costs beyond tuition and fees, differential tuition, program or course specific fees, part-time tuition, community colleges. • May help address declining Prepaid529 program participation • Would reduce actuarial uncertainty existing under the current payout model	• One year of WAT units would not cover annual tuition and fees at all Virginia public institutions • Would require customers to have an understanding of the payout model and plan their purchases accordingly to achieve the desired payout at their target institution(s) [a] • Would not provide an incentive for Prepaid529 contract holders to attend in-state public institutions through more generous payout

SOURCE: JLARC analysis of Virginia529 program data.
[a] The current Prepaid529 program also requires an understanding of program payout and necessitates planning in order to achieve desired college savings targets.

Other approaches for addressing concerns with the Prepaid529 program have limitations

Some of the concerns with the current Prepaid529 program could be addressed through a change to the existing program framework, but this approach has limitations. For example, Virginia529 could address the comparatively low payouts for beneficiaries attending out-of-state and lower cost Virginia public institutions by changing the definition of a reasonable rate of return used for the current program. This would increase the program's low payout amounts for this group of beneficiaries, but would not fully address the wide disparity in payouts across Virginia public institutions. Furthermore, more generous payouts to certain beneficiaries would increase the estimated liability of the program, which would, in turn, necessitate increases to contract prices.

Another option to address concerns with the Prepaid529 program would be to close the program to new enrollment without implementing a replacement program. This decision would be primarily driven by declining program participation, which may make continuing to administer the program unjustifiable. Prepaid529 is one of just 10 state-administered prepaid college savings programs that remain open nationwide. More than half of prepaid college programs have closed since 529 programs became available in the 1990s; in most of these cases, states have done so due to lack of actuarial soundness of the program. However, Virginia's Prepaid529 program is actuarially sound.

The WAT model presents an opportunity to address concerns with the existing Prepaid529 program and allow Virginia529 to continue offering a guaranteed college savings option to Virginia residents. The loss of such an option would affect residents who would like to have access to a risk-protected college savings program.

RECOMMENDATION 1

If Virginia529 continues to offer a prepaid college tuition program, the General Assembly may wish to consider amending §§ 23.1-700, 23.1-704, 23.1-707, and 23.1-711 of the Code of Virginia to change the Prepaid529 program from its current payout model to a weighted average tuition payout model.

Current Prepaid529 program would have to be administered until all beneficiaries have used their contracts

If the Prepaid529 program is either changed to the WAT model or closed to new enrollment, the program will have to continue to be administered until the contracts for all current beneficiaries are used. All current Prepaid529 beneficiaries would still be entitled to a payout according to the terms and conditions of their existing contract. The Virginia529 actuary assumes that, of those currently enrolled in Prepaid529 as of 2017-18, the final beneficiaries will receive Prepaid529 payouts in the 2042-43 academic year.

Additional measures could help WAT model customers achieve their savings goals

A key drawback of the WAT model is that, due to varying tuition and fees at Virginia's public institutions, one year of weighted average tuition payout (100 units) would cover varying proportions of annual tuition and fees at Virginia public institutions. To address this concern, Virginia529 could take steps that would improve the capacity of customers to achieve their savings goals using the WAT model.

Virginia529 should offer guidance on purchasing WAT contracts to help customers achieve their savings goal

Providing customers structured guidance for their WAT unit purchases would help them achieve their savings goal under the WAT model. Virginia529 staff indicated that they believe this is an effective way to address concerns about the value of WAT payouts. Under the WAT model, different numbers of WAT units are needed to cover tuition and fees at different institutions. For example, based on current pricing, a customer who intends to have sufficient WAT units to cover annual tuition and fees at William & Mary would need to purchase 177 WAT units for each year of attendance, while a customer intending to cover annual tuition and fees at James Madison may only need to purchase about 90 WAT units per year. Determining the number of WAT units needed for the target institution may be challenging for customers.

Virginia529 could offer an application—mobile or web-based—to guide customer's WAT unit purchases to best fit their savings goals. The application could collect information, though a series of guided questions, and produce a customized plan to suit the needs of the customer.

For example, a customer could indicate that they intend to use the WAT model to cover the approximate annual cost of tuition and fees at Virginia Commonwealth University, for four full years, to be purchased over the course of 11 years. Such a customer would be guided to purchase 40 WAT units per year over the 11-year period to meet this goal (440 units total). If Virginia Commonwealth University's anticipated tuition and fees became more or less expensive relative to weighted average tuition during the 11-year period, the application could notify the customer and help them adjust their purchase schedule accordingly. This type of application could also help customers meet savings targets for community colleges, private, or out-of-state institutions.

RECOMMENDATION 2

If Virginia529 begins offering a prepaid college savings plan with a weighted average tuition payout model, the Virginia529 board should offer a mobile or web-based application to guide the WAT unit purchases of customers, using information about individual purchasing timelines, savings goal, and target institutions.

Set a value for WAT units that is above weighted average tuition

An option to further help customers achieve their savings goal under the WAT model would be to set the value of WAT units equal to some percentage greater than weighted average tuition. WAT units would be sold for a higher price, but have correspondingly higher value at the time of redemption. This option would not be fundamentally different than the proposed WAT model or payout structure. Instead, it would represent a different scale of WAT units that "better fit" the tuition and fees at charged by Virginia's public institutions. A 100-unit payout would be more likely to cover, or come close to covering, annual tuition and fees across Virginia public institutions.

For example, valuing WAT units at 15 percent above the current weighted average tuition ("115 percent WAT model") would produce a payout that is likely to cover annual tuition and fees at more institutions (Table 8). Seven of Virginia's 15 public institutions currently have tuition and fees that are higher than the 2018-19 weighted average. A payout greater than the standard 100 WAT units would be needed to cover annual tuition and fees at these institutions. However, only three Virginia institutions have tuition and fees that would not be covered by 100 units under the 115 percent WAT model.

The prepaid college savings program in the state of Washington uses an approach similar to the 115 percent WAT model. There, the value of each unit sold for the prepaid college savings program is tied to the cost of Washington's most expensive public university. This means that a customer who purchases one year of average tuition and fees would be able to meet the tuition cost of the most expensive institution or redeem fewer units to cover tuition at a less expensive institution.

TABLE 8
WAT units needed for payout equal to annual tuition and fees: Standard WAT model vs. 115 percent WAT model (2018-19)

Institution	Tuition & fees	Standard WAT units needed for payout equal to annual tuition & fees	115 percent WAT units needed for payout equal to annual tuition & fees
William & Mary	$19,944-$23,400	151-177	131-154
Virginia Military Institute	18,862	143	124
University of Virginia	15,472-16,520	117-125	102-109
115% weighted average	**15,192**	--	**100**
Christopher Newport	14,754	112	97
Virginia Commonwealth	14,490	110	95
Virginia Tech	13,620	103	90
Longwood	13,590	103	89
Weighted average	**13,210**	**100**	--
Mary Washington	12,714	96	84
George Mason	12,462	94	82
James Madison	11,368-12,016	86-91	75-79
Radford	11,210	85	74
Old Dominion	10,872	82	72
UVA-Wise	10,119	77	67
Norfolk State	9,490	72	62
Virginia State	9,056	69	60
		Indicates greater than 100 WAT units needed	

SOURCE: JLARC analysis of Virginia529 program information.
NOTE: Tuition and mandatory fees paid by in-state students at four year universities. James Madison, University of Virginia, and William & Mary tuition and fee levels vary by incoming class-years.

Virginia529 staff expressed some concern over valuing WAT units above weighted average tuition. Such a program could be confusing for customers. This approach would also raise the price of each WAT unit (15 percent in this example).

OPTION 1

The Virginia529 board could base the price and value of WAT units on an amount that is proportionally greater than weighted average tuition to better cover annual tuition and fees at a majority of Virginia public institutions.

The approach to marketing the WAT model would need to be carefully considered

If the WAT model is adopted, Virginia529 would need to carefully consider its approach to marketing the WAT model so that potential customers would fully understand the program. Although the WAT model would have several advantages over the current Prepaid529 program, it would provide a more abstract benefit, particularly for beneficiaries who attend in-state public institutions. (Customer confusion also arises with the current Prepaid529 program in cases where differential tuition is charged or when beneficiaries attend a Virginia private or out-of-state institution.) Virginia529 would need to develop a program name and straightforward program description that accurately conveys the benefit it provides. Otherwise, customer confusion may arise.

Virginia529 should assess customer demand for WAT model

Although Virginia529 staff have indicated that they believe the benefits of the WAT model would lead to greater program participation, there is uncertainty about whether there would be customer demand for the product. Participation in the current program has steadily declined in recent years, and it is not a given that changing the program to a WAT payout model would generate greater participation.

If the General Assembly decides to proceed with the WAT model, program demand should be assessed after a trial period, such as three years, to determine the long-term viability of the model. Results of contract sales and program participation should be reported to the General Assembly at the end of the trial period. This approach would allow Virginia529 to create a WAT model program, perform marketing, and test the market in order to gather more concrete evidence of the demand for the program. Doing so would likely result in a minimal increase to administrative costs, compared to continuing to operate the current program over the same time period.

RECOMMENDATION 3

If Virginia529 begins offering a prepaid college savings plan with a weighted average tuition payout model, the Virginia529 board should assess the demand for the weighted average tuition model prepaid college savings program after the program has been implemented for a trial period of three years. The board should submit a report on program demand, and long-term viability of the model, to JLARC and the House Appropriations and Senate Finance Committees.

Additionally, Virginia529 could perform an assessment of demand for a WAT model prepaid college savings program *before* moving forward with the change to the program. The assessment could include market analysis, such as a survey of current and potential customers, and a review of the demand for and participation in programs with similar average tuition models in other states. Results of the assessment could be presented to the Virginia529 board and the General Assembly to inform the decision about whether to adopt the WAT model. This option would likely delay legislative action and implementation of the WAT model by at least a year.

OPTION 2

The General Assembly could request that Virginia529 perform an assessment of the demand for a weighted average tuition model prepaid college savings program before taking legislative action to adopt the model.

If an assessment shows a lack of demand for the WAT model, or a probable continued decline in program participation, the Virginia529 board and General Assembly should evaluate closing the program to new enrollment. There may be a point at which having a prepaid plan is no longer administratively justifiable.

Appendix A: Study mandate

Chapter 2 (2018 Appropriation Act); Item 31.F.11

The Joint Legislative Audit and Review Commission (JLARC) is hereby directed to review Virginia529's proposed weighted average tuition (WAT) payout model for the Prepaid529 program and report how the WAT payout model would change Prepaid529 relative to the existing model. In conducting the review, JLARC should address how the proposal would impact 1) program payout, 2) contract costs, 3) program sustainability, 4) overall complexity of the program, 5) any other factors relevant to the program. JLARC should complete the review and submit a final report, including any recommendations, to JLARC and the Chairman of the House Appropriations and Senate Finance Committee by November 30, 2018. Virginia529 shall provide assistance on this review upon request.

Appendix B: Research activities and methods

JLARC staff conducted the following primary research activities:

- analysis of institutional tuition and fee data and payouts of the current Prepaid529 program;
- interviews with Virginia529 staff, the Virginia529 plan actuary, and prepaid tuition programs in other states; and
- document review.

Analysis of tuition and fee data at Virginia's public institutions and data related to the current Prepaid529 program

JLARC staff analyzed tuition and fee data at Virginia's public institutions to understand the differences in tuition and fees across Virginia's public institutions. JLARC staff also analyzed Virginia529 actuarial data regarding the payouts under the current Prepaid529 program, to illustrate the disparity in payouts across Virginia public institutions and across different institution types (in-state, out-of-state, public, and private). In addition, JLARC staff analyzed participation data for the current Prepaid529 program, including attendance patterns of Prepaid529 beneficiaries (in-state, out-of-state, public, and private). Data was provided by Virginia529 staff and the program actuary.

Interviews with Virginia529 staff, the Virginia529 plan actuary, and prepaid tuition programs in other states

JLARC staff conducted numerous interviews over the course of the study pertaining to the proposed WAT model. JLARC staff interviewed Virginia529 staff on several occasions to better understand the proposed WAT model and how it compares to the current Prepaid529 plan. JLARC staff interviewed the Virginia529 plan actuary to determine the actuarial implications of the proposed WAT model, whether it would affect the financial health of the Prepaid529 fund, and how it compares to prepaid college savings plans in other states. JLARC staff also interviewed staff at prepaid college savings plans in other states to better understand their programs, in particular the different approaches to implementing a WAT model.

Document review

JLARC staff reviewed documents from Virginia529, including the 2016 Prepaid529 sustainability study and those available to the Virginia529 Board and Audit and Actuarial Committee. JLARC staff also reviewed plan documents and program guidelines from other states on the structure of their prepaid college savings plans.

Appendix C: Agency response

As part of an extensive validation process, the state agencies and other entities that are subject to a JLARC assessment are given the opportunity to comment on an exposure draft of the report. JLARC staff sent an exposure draft of this report to Virginia529. Appropriate corrections resulting from technical and substantive comments are incorporated in this version of the report.

This appendix includes a response letter from Virginia529.

Dream Save Achieve

Mary G. Morris
Chief Executive Officer
Direct: 804-786-0832

November 5, 2018

Hal Greer
Director
Joint Legislative Audit and Review Commission
919 East Main Street, Suite 2101
SunTrust Building
Richmond, Virginia 23219

Re: Report on Proposed Change to Virginia529 Prepaid Program Benefits Payout

Dear Mr. Greer:

Thank you for the opportunity to review and comment on the exposure draft of the *2018 Proposed Change to Payout Model of Virginia's Prepaid529 Program* (the Report).

The Virginia College Savings Plan (Virginia529 or the Plan) is an independent agency of the Commonwealth of Virginia, and operates pursuant to its statutory authority under Title 23.1, Subtitle II, Chapter 7 of the Code of Virginia (Va. Code §§ 23.1-700 et seq.). Virginia529 has two aspects to its planning and saving mission, the first of which is to assist families and others in achieving their education goals through three education savings programs, Prepaid529 (Prepaid529), Invest529 (Invest529), and CollegeAmerica, as part of our statutory mandate to help make college more affordable and accessible. Virginia529 has a more recent, but no less important mission, to assist individuals with disabilities save for qualified disability expenses while retaining most federal and state means-tested benefits through its two ABLE disability savings programs, ABLEnow and ABLEAmerica.

In 2013, Virginia529 first raised concerns with JLARC about the changing tuition and fee policies at public universities and the growing disparity in program benefits payable and posed a question whether legislative changes would be needed in the future. Virginia529 continued to monitor the situation and the potential negative impacts of unpredictable tuition growth, changes in tuition and fee models, disparity among low- to high-tuition public institutions within the Commonwealth, customer expectations in light of changes in funding models (focusing on "differential tuition") and record low interest rates and modest projected investment returns.

In August 2015, the Virginia529 Board authorized a study (the Study), to be completed in 2016, to examine program sustainability, considering all options including: (i) maintaining the current program unchanged, (ii) maintaining the status quo with minimal modifications (e.g., single price model), (iii) closing the program to new enrollment, (iv) a new structure such as a WAT payout program for new contracts and (v) a new model which would include some aspect of risk sharing with Virginia public universities. The Study was conducted working with the Plan's actuary, Milliman Inc., and investment consultant, Mercer. This review resulted in a white paper which was presented to the Virginia529 Board in October 2016. The Study recommended that a single-tier contract model be adopted for the 2016-17 enrollment period (this was done) and that Virginia529 explore the development and implementation, prospectively only, of an enrollment-weighted average tuition (WAT) payout model to replace the current benefit payout structure. No changes to the benefit model would impact existing contracts.

Following a year of planning and development, again working with Milliman and Mercer, Virginia529 developed the basic structure of the proposed WAT benefit proposal. Also during 2017, Virginia529 staff met with all 15 Virginia public universities and the Combined Independent Colleges of Virginia (CICV) to discuss the concept; we received no opposition to the proposal. In addition, staff met with key members of the General Assembly, House Appropriations Committee staff and Senate Finance staff, providing periodic updates along the way to the Virginia529 Board and Committees. In October 2017, the Virginia529 Board authorized moving forward with proposed legislation to enable a move to a WAT benefit model for new Prepaid529 accounts.

In the 2018 General Assembly Session, Virginia529's proposed legislation was introduced in the House by Del. Robinson (HB 1199) and in the Senate by Senator Hanger (SB 656). SB 656 passed the Senate; both HB 1199 and SB 656 were carried over to the 2019 Session by the Education Subcommittee of House Appropriations. Additionally, amendments to the 2018 Appropriation Act provided for the JLARC study being presented in the Report to the Commission on November 13, 2018.

JLARC staff have attended all relevant meetings of Virginia529's Committees and Board since the Study was authorized and, in addition, did a significant amount of independent analysis and review this fall for the Report. We appreciate the thoroughness of that work by JLARC staff and agree that the Report accurately describes the proposed Prepaid529 WAT model. In addition, we concur with the Report's findings that the benefits of the proposed change to a WAT benefit model "would be an improvement over the current Prepaid529 program." The draft Report analyzes five major benefits of the WAT model and all are compelling.

The Report also notes two potential drawbacks to the proposed change – that a WAT benefit payout would not necessarily cover full tuition and mandatory fees at all Virginia public institutions and that the program would no longer provide an incentive to attend a Virginia public institution. Virginia529 believes the benefits outweigh any potential drawbacks and will result in increased

participation in the program by Virginia citizens. As the Report notes, fewer and fewer families are receiving the full tuition and mandatory fee coverage today because they cannot afford an eight semester contract – a direct result of the impact of increased tuition and fees over the 22 years history of the program. With the WAT benefit, in some instances the benefit will cover MORE than tuition and mandatory fees. In all situations, the benefit will be easy to determine and consistent for all account holders.

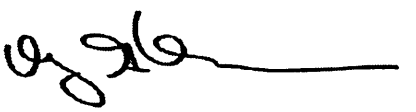
Although the incentive to attend a Virginia public institution is removed in the WAT proposal, as the Report points out, the change allows Virginia529 to meet its statutory mandate to help make college more affordable and accessible to all Virginians. The enhanced program with a WAT benefit model would offer Virginia's citizens increased flexibility and control of their decisions and certainty in the anticipated payout for any account. In addition, the WAT model would be significantly more affordable, allowing more Virginians to participate in the program at the level which they can afford and without required monthly contract payments. The cost to get started – which is a primary deterrent to commencing to save – would be reduced to the cost of a single unit. Younger families, with less ability to afford a full eight semester contract currently, would benefit from knowing that their investment will have the same value regardless of where their beneficiary – 18 years or more in the future – decides to attend college.

Virginia529 staff understands that the proposal marks a substantial departure from the current structure and that the Plan bears the responsibility for explaining the changes and benefits of the new structure and developing interest and acceptance. In addition, as suggested by the Report, the Virginia529 team anticipates developing new tools and messaging to assist families in assessing progress in their goal to meet the future cost of education. Virginia529 conducted focus groups of existing customers in developing this proposal and will continue to assess understanding of the program and ways to improve our customer service. If structured as envisioned by Virginia529, the program will be much easier to understand and apply than the existing Prepaid529 model.

The Prepaid529 program is the heart of this organization, even though today it is by far our smallest program – in terms of number of accounts and assets under management. It was the commitment of the Virginia legislature – and a handful of other "early adopter" states – to help families address the burden of paying for increasingly important and expensive post-secondary education that created what is now the 529 education savings industry which is helping millions of citizens across the country. Without prepaid programs, there would be no IRC § 529. We encourage this Commission and the General Assembly to embrace the evolution of this important program to a model that is more affordable, flexible, simple and sustainable and will better meet the needs of Virginia citizens for the next twenty plus years. We hope that after receiving and considering the Report, the House will act to move the continued legislation (HB 1199 and SB 656) forward to the 2019 Session, where the legislation may be approved.

We again express our appreciation to JLARC's staff and primary author Joe McMahon for the professional, courteous and cooperative manner in which they conducted their work. I also have to commend the Virginia529 team and its Board and Committees for years of work on this issue. We are dedicated to helping as many Virginia families as possible find an affordable way to meet their education savings goals and have expended thousands of man-hours in researching, reviewing, discussing and developing this proposed new model. Virginia529 has a proven track record in developing and implementing programs – resulting in becoming the largest by far 529 plan in the country and, with the recently received (third in a row) Gold rating of our Invest529 program by Morningstar, objectively one of the most highly regarded plans in the country. If the proposed WAT benefit model is approved by the General Assembly, we will work tirelessly to implement the change and continue to provide a market risk free option for college savings to many more Virginians in the coming years. I will be pleased to answer any questions you may have when the Report is presented to the Commission on November 13, 2018.

Sincerely,



Mary G. Morris

c: Members, Virginia529 Board
Kimberly Sarte, JLARC
Joe McMahon, JLARC

PROPOSED CHANGE TO PAYOUT MODEL OF PREPAID529

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