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Report to the Governor and the General Assembly of Virginia

Virginia529 Oversight Report

2022

JLARC
JOINT LEGISLATIVE AUDIT AND REVIEW COMMISSION

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Overview

The Virginia College Savings Plan (Virginia529) administers the state's tax-advantaged savings programs. The programs are authorized by Sections 529 and 529A of the Internal Revenue Code and sponsored in 49 states and the District of Columbia. Virginia529 administers two defined benefit savings programs, two defined contribution education savings programs, and two disability savings programs. Virginia529 is also implementing a new state-sponsored retirement savings program for private-sector employees without access to retirement savings through their employers.

Virginia529's defined benefit programs allow participants to purchase contracts that cover the future cost of college tuition and fees. The Legacy Prepaid529 program was closed to new participants after its final enrollment period in 2019, but existing accounts will continue to pay benefits in the future. Virginia529 opened a new defined benefit program—Tuition Track Portfolio—in February 2021. Together, the Legacy Prepaid529 and Tuition Track Portfolio programs are referred to as the Defined Benefit 529 program.

The defined contribution education savings programs—Invest529 and CollegeAmerica—provide participants with options to save for educational expenses. Funds from the savings programs can be used to pay for qualified educational expenses. The programs offer federal and state tax advantages on contributions and investment earnings.

The disability savings programs—ABLEnow and ABLEAmercia—provide tax-advantaged savings accounts for eligible individuals with disabilities. Funds from the programs can be used to pay for qualified disability expenses, such as education, medical care, housing, and transportation. ABLEnow opened to customers in 2016, and ABLEAmerica opened to customers in 2018. Like Virginia529's defined contribution education savings programs, ABLEnow and ABLEAmerica offer federal and state tax advantages on contributions and investment earnings.

Virginia529 is the largest 529 plan in the country, with $97.2 billion in assets and a 21 percent share of the national market as of March 31, 2022. Assets of $86.3 billion are held in the CollegeAmerica program, managed by a third-party program manager under contract with Virginia529. Virginia residents hold approximately 6 percent of CollegeAmerica's accounts.

As of 2017, all college savings plans can also be used at elementary and secondary public, private, and religious schools. Previously, college savings plans could be used only at higher education institutions. The U.S. Congress enacted this change, which allows college savings plans to be used for a broad range of educational programs.

TABLE 1
Virginia529 programs

	Type of program	Accounts	Assets ($)
Defined benefit programs			
Legacy Prepaid529	Contracts for future tuition & fees	49,897	$3.1B
Tuition Track Portfolio	Contracts for future tuition & fees	4,082	$52.9M
Education savings			
CollegeAmerica	Adviser-sold investments	2,544,826	$86.3B
Invest529	Direct-sold investments	430,043	$7.6B
Disability savings			
ABLEnow	Direct-sold investments	12,881	$87.7M
ABLEAmerica	Adviser-sold investments	1,826	$25.7M

SOURCE: Virginia529 program data as of March 31, 2022.

1. Virginia529 defined benefit programs

Virginia529 has two defined benefit college savings plans—Legacy Prepaid529, which was closed to new participants in 2019, and a new defined benefit program, Tuition Track Portfolio, which opened in early 2021. Both programs require participants to be Virginia residents. The Legacy Prepaid529 program paid $179 million in benefits in FY21 and will continue to pay benefits into the future for existing participants even though the program is closed. The Tuition Track Portfolio has not yet started paying benefits. For actuarial and investment purposes, Virginia529 combines the programs into a single Defined Benefit 529 fund.

Legacy Prepaid529 contracts cover tuition and fees for a set period, typically ranging from one to eight semesters at a university or college.

The Legacy Prepaid529 contract defines tuition and fees as the normal, full-time, in-state, undergraduate, mandatory fees assessed to all students. Contracts do not cover additional tuition, fees, or charges associated with a specific program, course, or major.

Payouts for students attending private institutions in Virginia or out-of-state institutions are calculated using contract payments plus a rate-of-return as defined by program policy.

New Tuition Track Portfolio program opened in 2021

Virginia529 opened a new defined benefit college savings plan—Tuition Track Portfolio (TTP)—in February 2021 as the successor to the Legacy Prepaid529 program. Virginia529 closed the Legacy Prepaid529 program because of concerns about the sustainability of the program. Concerns included 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.

The TTP program stems from a 2016 sustainability study by Virginia529 recommending that the board explore the possibility of replacing the Legacy Prepaid529 program with a weighted average tuition (WAT) model, which would provide the same payout regardless of the institution the student attended. (Payout amounts under the Legacy Prepaid529 program depend on the institution attended.) A 2018 JLARC study found that a WAT model would address several of the concerns identified with the Legacy Prepaid529 program. In 2019, the General Assembly enacted legislation to replace the Legacy Prepaid529 program with a WAT model, and Virginia529 branded the new program as TTP.

In 2018, JLARC published the report, Proposed Change to Payout Model of Virginia's Prepaid529 Program, in response to a directive in the 2018 Appropriation Act. Legislation proposed in the 2018 General Assembly session would have replaced the Legacy Prepaid529 program with a WAT model. However, the legislation was carried over until the following session, and JLARC staff were directed to review Virginia529's proposed WAT model in the meantime.

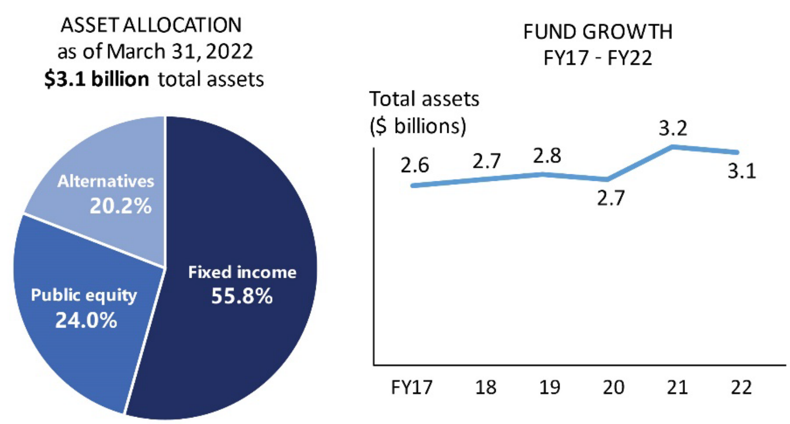
Using the WAT model, the TTP program pays the enrollment-weighted average tuition at Virginia public universities as the basic contract benefit. The WAT payout is the same for all students, regardless of where they attend college (in-state, out-of-state, public, or private). The WAT payout may be more or less than the actual cost of tuition and fees, depending on where a student attends college. Students who attend more expensive institutions will be required to cover the difference between the WAT payout and actual tuition and fee costs, and students who attend less expensive institutions may have funds left over, which could be used for other expenses such as room and board. The TTP program sells contracts in unit increments, with 100 units equal to one year of weighted average tuition at a public four-year university in Virginia. The price of TTP units is based on weighted average tuition at Virginia's four-year public universities. Virginia529 does not assess a fee to cover administrative costs or assess a pricing reserve to protect the fund against risk.

Virginia529 expects TTP to be more popular than the Legacy Prepaid529 program, which had seen declining participation, because of TTP's greater flexibility, simplicity, and lower cost barrier. However, increased participation is not guaranteed, and TTP should be monitored. A total of 4,159 TTP accounts were established from the program's opening in early 2021 through March 31, 2022, and nearly 367,000 WAT units were sold. To ensure that TTP has sufficient participation and appropriate pricing, the 2018 JLARC report recommended that Virginia529 assess the demand for a WAT-based defined benefit program after the program has operated for a trial period of three years. Virginia529 should conduct this assessment in spring 2024, and findings from the assessment and any recommendations for program changes should be reported to the Virginia529 board.

Defined Benefit 529 fund increased to more than $3 billion in 2022

The Defined Benefit 529 programs held $3.1 billion in assets as of March 31, 2022. Fund assets are managed within a single enterprise fund and are divided into three asset classes: fixed income, public equity, and alternatives (Figure 1). Assets in the Defined Benefit 529 fund have increased 15.5 percent ($421 million) over the past five years, and 46 percent ($984 million) over the past 10 years. Assets in the fund increased 19.2 percent ($521 million) between 2020 and 2021 but have declined slightly since the beginning of FY22—by 3.3 percent, or $107 million.

FIGURE 1
Defined Benefit 529 fund asset allocation and growth



SOURCE: Virginia529 program data.
NOTE: FY17-21 reported as of June 30; FY22 reported as of March 31, 2022.

The **Virginia529 investment advisory committee** includes the board chairman, chief executive officer, and at least four investment professionals appointed by the board chairman. All members have voting privileges.

The Virginia529 board and its investment advisory committee (sidebar) oversee the Defined Benefit 529 fund. The board determines the fund's overall asset allocation. The investment advisory committee determines the investment strategies for each asset class. Virginia529 staff and a consulting firm select and retain private investment management firms to implement those strategies, oversee these external managers, monitor their performance, and make recommendations to the board and investment advisory committee.

Defined Benefit 529 fund underperformed most benchmarks, but alternative assets outperformed benchmarks in nearly all time periods

The Defined Benefit 529 fund's investment returns outperformed the longer-term and near-term benchmarks, but the fund underperformed its benchmarks for the intermediate periods (Table 2). The fund achieved a return of 5.63 percent for the one-year period ending March 31, 2022, exceeding the period's benchmark by 89 basis points and slightly outperforming the 5.5 percent long-term rate of return the Virginia529 board assumes for its investments. The total fund achieved a return of 6.48 percent since its inception, outperforming this benchmark as well as the long-term rate of return. However, the fund underperformed its benchmarks in the three-, five-, and 10-year periods by approximately 40–70 basis points depending on the period.

TABLE 2
Defined Benefit 529 fund performance

FUND INVESTMENT PERFORMANCE
for the period ending March 31, 2022

	CY to date	1 year	3 years	5 years	10 years	Since inception
Total fund	-3.36%	5.63%	8.96%	7.46%	6.46%	6.48%
Benchmark	-1.87	4.74	9.47	8.14	6.89	6.02
Fixed income	-4.73	-2.27	2.93	2.98	3.36	5.08
Benchmark	-4.58	-2.26	4.12	4.10	3.83	5.11
Public equity	-6.48	2.28	13.50	10.51	9.21	7.55
Benchmark	-5.26	4.64	13.16	11.42	9.88	6.54
Alternatives	3.93	33.44	18.83	15.53	10.41	7.72
Benchmark	8.14	22.16	16.40	12.53	9.43	7.32

SOURCE: Virginia529 program data.
NOTE: Performance as of March 31, 2022 and reported relative to custom benchmarks and net of fees. Total fund, fixed income, and public equity have inception date of October 1997; alternatives inception was May 2005.

The Defined Benefit 529 total fund has generally underperformed its benchmarks for several years, although the current level of underperformance is less than that reported in the 2020 JLARC biennial report. This underperformance has occurred in both strong market conditions and down markets, which is concerning. Given the value of the total fund, this underperformance represents substantial forgone investment income the fund could have earned with better performance.

In the past year, the Virginia529 board has taken several steps that may improve the Defined Benefit 529 fund's performance. These steps include adjusting the approach to managing public equity and fixed income assets and delegating certain investment responsibilities to Virginia529 staff (discussed below), who have developed additional expertise in recent years. To help ensure the total fund's performance continues to improve, Virginia529 staff should evaluate the impact of these changes at the end of 2022 and identify any additional changes needed. JLARC staff will also continue to monitor investment performance and actions taken by the board, the investment advisory committee, and Virginia529 staff.

Fixed income. The fixed income program is the largest Defined Benefit 529 asset class, with $1.7 billion in assets. The program primarily consists of U.S. dollar-denominated securities that pay a specific interest rate (government bonds, corporate bonds, and U.S. treasury bills), high yield bonds, convertible bonds, and emerging market debt. Fixed income investments typically exhibit lower volatility relative to most other asset classes and are expected to generate steady returns even in down equity markets. The fixed income portfolio underperformed its benchmarks for all periods, including by more than 100 basis points for the three- and five-year periods. The portfolio almost met its benchmarks for the one-year and since-inception periods. Nearly all managers underperformed most of their applicable benchmarks.

As in prior years, Virginia529 staff attribute the underperformance of the fund's fixed income assets to managing the portfolio with a defensive posture to guard against rising inflation and interest rates. This approach results in relatively lower returns during periods of level or declining Federal funds rates, as in recent years. According to staff, the underperformance of fixed income assets over the three-, five-, and 10-year periods (the periods with the largest underperformance) primarily reflected the defensive approach used by convertibles managers within the non-core fixed income portfolio, which represents more than two-thirds of fixed income assets. The approach led to substantial underperformance of convertible bond assets, which underperformed their three- and five-year benchmarks by more than 700 basis points—among the lowest performing assets in the fixed income portfolio. Virginia529 staff eliminated the convertibles sub-asset class in 2021 and said this change should improve the performance of fixed income assets in the future.

Public equity. Public equity is the Defined Benefit 529 fund's second-largest asset class, with $751 million in assets. The program consists of stocks and other equity securities for publicly traded companies in the U.S. and abroad. Public equity investments are typically more volatile than bonds but offer potential for greater long-term growth. The public equity portfolio underperformed its benchmarks for the one-, five-, and 10-year periods, and outperformed its benchmarks for the three-year and "since inception" periods.

Value exposures are investments in companies whose stock prices do not reflect their intrinsic worth. By investing in these companies, investors believe stock prices will increase to more accurately reflect their intrinsic worth.

The underperformance of the public equity asset class primarily reflects Virginia529's longstanding defensive posture for public equity, which is intended to protect fund assets in down markets and periods of market volatility. The Defined Benefit 529 fund's domestic equities have been invested more heavily in small and mid-cap equities and value exposures (sidebar), which have detracted from the domestic equity class's performance during the prolonged increase in growth and large-cap technology equities over the last several years. Domestic equity comprises 60 percent of public equity assets.

Because public equity has hindered the total fund's performance over the last 10 years, at the end of 2021 Virginia529 investment staff took steps to improve the performance of its domestic equity portfolio. With approval from the investment advisory committee and assistance from its investment consultant, investment staff restructured the portfolio to largely eliminate the tilt toward small and mid-cap equities and value exposures. The domestic equity portfolio was also converted to passive management after determining that an active management strategy was not likely to deliver outperformance over time. Virginia529 staff expect that these changes will improve the asset class's performance.

Alternatives. Alternative assets are the fund's smallest asset class with $633 million in assets under management. Alternatives primarily consist of investments in private equity (investments in privately held companies) and real estate. Alternative investments have the potential to provide greater returns than public equity markets and steady returns during periods of high market volatility. The alternative asset class outperformed its benchmarks for all periods with the exception of the "calendar year-to-date" period. Alternative assets achieved substantial returns for the one-, three-, five-, and 10-year periods, including a 33.4 percent return over the one-year period, exceeding the benchmark by more than 11 percentage points. The performance of the fund's alternative assets has continued to improve in recent years, and in part, reflects the time it takes for alternative assets, such as private equity, to mature and perform.

Virginia529 hired a new investment director

Virginia529 hired a new investment director in June 2022. The previous investment director, who was the agency's first, left in September 2021. The new investment director was an existing member of Virginia529's investment staff and had been acting investment director since September. Virginia529 conducted a formal search, which considered both internal and external candidates, to fill the investment director position.

A 2017 JLARC report that reviewed the investment management structure of Virginia529's Legacy Prepaid529 fund recommended creating an investment director position. The report found that an investment director would provide greater accountability for fund management and performance, and that the size and complexity of the fund justified such a position. Language in subsequent appropriation acts requires the investment director position to assist the board and chief executive officer with managing Virginia529 assets. The investment director serves at the pleasure of the board.

Virginia529 board and investment advisory committee delegated key investment responsibilities to staff

In 2021, the Virginia529 board formally delegated to staff key responsibilities for managing investments of the Defined Benefit 529 fund. The board approved revisions to its Defined Benefit 529 investment policy and guidelines that give staff responsibility for selecting and terminating investment managers, determining when to use active versus passive investment strategies, and maintaining investments consistent with the approved asset allocation policy. The board and the investment advisory committee retained their responsibilities for setting the asset allocation policy and overall portfolio structure, including style and asset class weights. Staff and the advisory committee continue to work with Virginia529's investment management consultant, which provides recommendations regarding asset allocation, capital market forecasting, and underlying fund selection.

As part of delegating additional responsibilities to investment management staff, the board revised the asset allocation policy to give staff greater flexibility to manage investments consistent with the board's overall asset allocation. The revised asset allocation policy eliminated many of the policy targets for sub-asset classes, giving staff more discretion to manage investments within a given asset class. For example, the revised policy reduced from seven to two the number of sub-asset classes within the fixed income asset class. The revised policy also removed hedge funds as a sub-asset class. Because of the changes, the target allocation for alternatives decreased, and the allocation for fixed income increased (Table 3). The new asset allocation targets are being implemented over 18 months.

TABLE 3
Virginia529 strategic asset allocation policy for Defined Benefit 529 program

Asset class	Previous policy target	New policy target	Change
Fixed income	52.5%	55.0%	↑ 2.5
Public equity	22.0	22.0	N/A
Alternatives	25.5	23.0	↓ 2.5

SOURCE: Virginia529 board meeting documents.

Delegating responsibilities to investment management staff allows the Virginia529 board and investment advisory committee to focus more on strategic decisions. The size and complexity of the Defined Benefit 529 portfolio have grown substantially. The investment advisory committee meets 5–6 times per year so is best positioned to focus on strategic issues rather than the day-to-day and tactical investment decisions like hiring and firing investment managers. Virginia529 staff surveyed investment advisory committee members on a range of governance issues in 2021, and the overwhelming majority of committee members said their focus should be on more strategic issues such as investment policies, asset allocation, and the appropriate use of asset classes. A majority of members did not feel they could adequately evaluate and select investment managers.

Defined Benefit 529 funded status increased to 194 percent, and long-term rate of return decreased

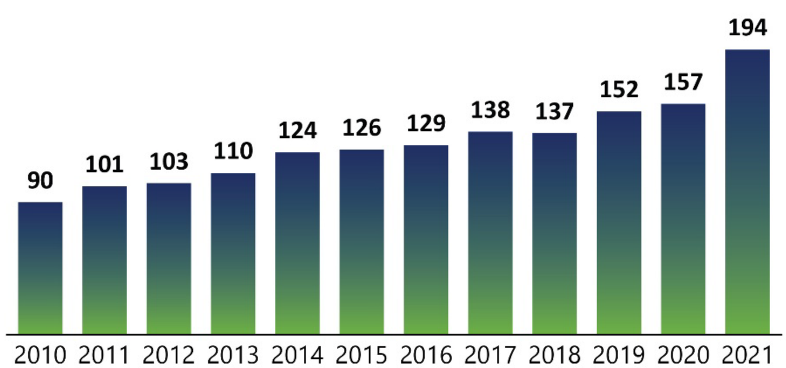
Virginia529 must maintain sufficient assets in the Defined Benefit 529 fund to pay the current and future obligations of the Legacy Prepaid529 and TTP programs. The fund receives two sources of revenue: (1) payments from contract holders and (2) fund investment returns. In previous years, the fund also received net operating revenue each year, much of which was composed of administrative fees from other Virginia529 programs, primarily the CollegeAmerica program. Assets in the fund must be sufficient to cover future benefit payments, refunds, and other payouts.

Funded status is the actuarially determined ratio of assets to obligations for the Defined Benefit 529 program.

The Defined Benefit 529 fund currently has more than sufficient assets to cover its estimated obligations. The program's funded status was 194 percent as of June 30, 2021. The funded status increased 37 percentage points between 2020 and 2021, primarily because of higher-than-expected investment returns, and is at the highest level in the program's 23-year history. The funded status has steadily increased over the past 10 years and has not been lower than 100 percent since 2010 (Figure 2). The funded status declined to 90 percent in 2010, one year after the 2007–2009 recession, when there were major declines in the domestic and international equity and credit markets that affected many of the fund's investments. The fund recovered to a funded status of more than 100 percent the following year.

The Defined Benefit 529 fund's **actuarial reserve** is the best estimate of the present value of the surplus (or deficit) that will result once all currently held obligations are paid over time, using the assets currently held in the fund.

FIGURE 2
Defined Benefit 529 percent funded status (as of June 30)

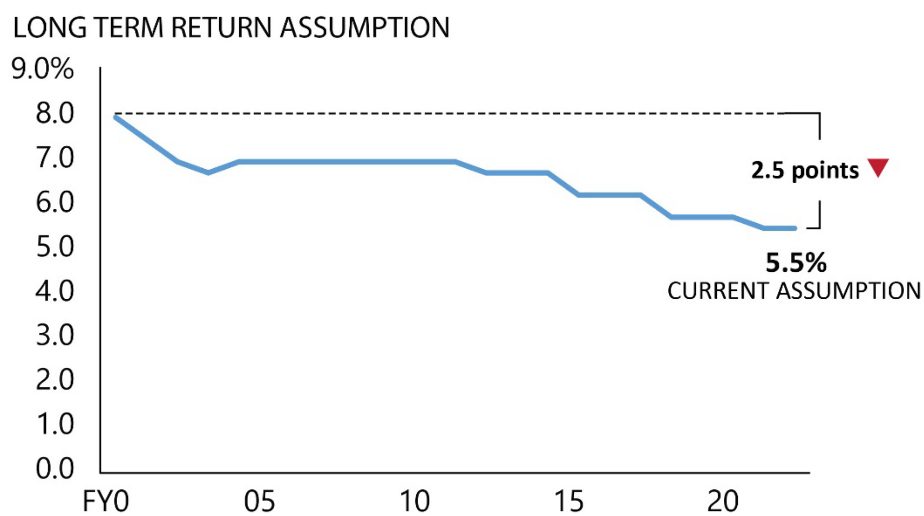


SOURCE: Virginia529 actuarial data.

The Defined Benefit 529's funded status indicates it is highly likely to cover future obligations for the Legacy Prepaid529 and TTP programs. Virginia529's plan actuary estimates that, at a funded status of 194 percent, the plan has an actuarial reserve of a little more than $1.6 billion. At this level, there is a 99 percent chance of meeting or exceeding future obligations, as estimated by the plan actuary in the 2021 fund valuation using current actuarial assumptions. The actuarial reserve of the Defined Benefit 529 fund has more than doubled since 2017, when it had a reserve of $787 million and a funded status of 138 percent.

In 2021, the Virginia529 board reduced the long-term rate of return assumption from 5.75 percent to 5.5 percent for the Defined Benefit 529 fund. The long-term rate of return assumption is an annualized percentage return on investments expected in the future based on a 20-year forecast. The long-term rate of return has important implications for the program's funded status. The board's decision to reduce the assumed rate of return, which was made with input from its investment consultant, is based on expected declines in future returns for both the public and private equity markets. On several prior occasions since 2000, the board has reduced the long-term rate of return for the Defined Benefit 529 fund in response to changing market conditions (Figure 3).

FIGURE 3
Defined Benefit 529 long-term investment return assumptions steadily declined over the past decade



SOURCE: Virginia529 actuarial data.

2. Invest529 program

Invest529 is a college savings program sold directly by Virginia529 to program participants. Participants contribute to their individual accounts and have several investment options. Investment earnings are exempt from federal taxes if they are used to pay for qualified education expenses, such as tuition, books, housing, and student loan repayment. For state residents, Virginia also exempts earnings from state taxes and offers an income tax deduction for contributions made to this and other Virginia529 savings programs. Funds from Invest529 accounts can be used at institutions in Virginia and other states. The program distributed $479 million to participants in FY21.

Invest529 participation and assets

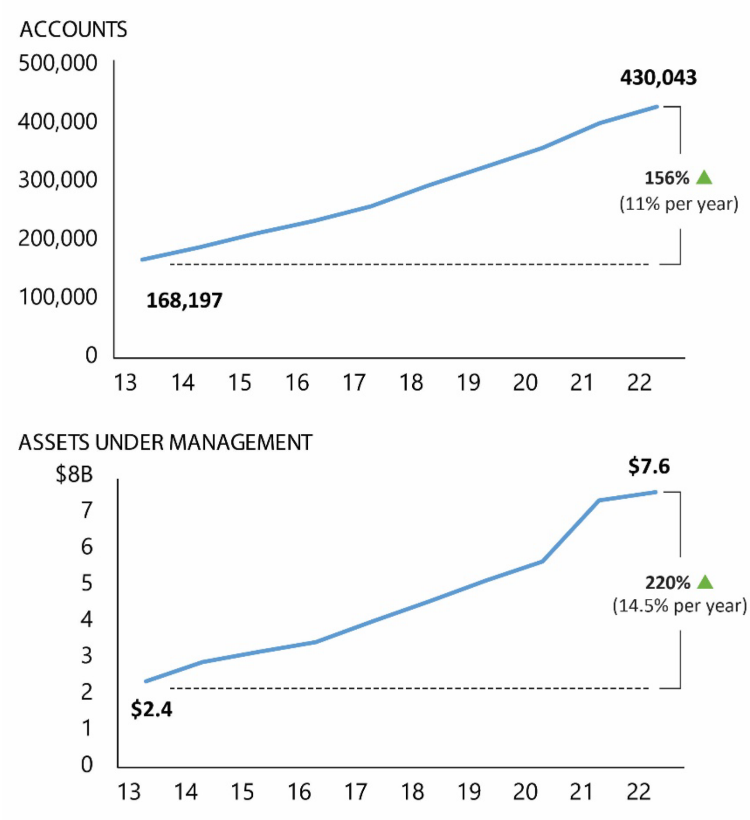
The Invest529 program has increased substantially over the past 10 years in both program participation and total assets under management (Figure 4). The number of Invest529 accounts more than doubled in the 10 years from FY13 through March 31, 2022, increasing by an average of 11 percent per year. The value of assets under management grew at a substantially faster pace over this period, more than tripling from $2.4 billion to $7.6 billion. Invest529 assets increased nearly 30 percent ($1.7 billion) between FY20 and FY21, in part because of substantial investment returns. Assets have increased at a more modest rate of 3 percent in FY22 ($231 million). The growth in assets over the last 10 years is attributable to both new contributions and investment returns. The increase in Invest529 participation over this period follows a national trend for college savings programs, which have steadily grown over the past decade.

Invest529 underperformed nearly all investment benchmarks

The Invest529 program held an aggregate of $7.6 billion in assets as of March 31, 2022. Assets are owned by program participants, who have individual accounts. Individual participants invest in options offered by the program.

Program participants may choose any combination of 22 investment options. Investment options include traditional investments, such as stock and bond investments, and target-date portfolios that automatically adjust over time as the participant approaches college age. Thirteen options are actively managed, with the goal of providing better returns or lower volatility than the overall market. The remaining nine options are passively managed and track market indices.

FIGURE 4
Invest529 account and asset growth



SOURCE: Virginia529 program data.
NOTE: Figures reported are as of the June 30 end of the fiscal year except for 2022, which is as of March 31.

The Invest529 investment options generally underperformed both long-term and near-term benchmarks (Table 4). Most passively managed investment options that underperformed trailed their benchmarks by less than 20 basis points (adjusted for fees). By comparison, most actively managed investment options that underperformed trailed their benchmarks by more than 20 basis points. Virginia529 staff attribute the underperformance of Invest529 investment options to many of the program's individual managers underperforming their benchmarks. Much of managers' underperformance was due to their exposure to emerging markets and their tilt toward growth equities, according to Virginia529 staff.

TABLE 4
Invest529 program investment performance

for the period ending March 31, 2022

	1 year	3 years	5 years	10 years
Actively managed options				
Met or exceeded benchmark	3	7	2	3
Total number of options	14	13	12	7
Passively managed options				
Met or exceeded adjusted benchmark	3	2	2	2
Total number of options	9	9	9	8

SOURCE: Virginia529 program data.
NOTE: The total number of investment options in each period can differ because longer-term performance data is not available for newer options. Performance is reported net of investment and administrative 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 still trailed the benchmark after this adjustment was made.

Invest529 received downgraded ratings from Morningstar in 2020 and 2021

The Invest529 program received downgraded ratings from Morningstar each of the last two years. In 2020, Morningstar downgraded the program from the gold to silver rating. Morningstar cited an updated rating system, which takes a positive view of exclusively indexed funds (which Invest529 is not), as the principal reason for its downgrade. Invest529 was further downgraded from silver to bronze in 2021, primarily because of the departure of Virginia529's investment director. Morningstar ratings are an important measure of the quality and cost of an education savings plan and may be used by individuals to decide which type of savings plan to open.

3. CollegeAmerica program

CollegeAmerica is an education savings program offered under a partnership between Virginia529 and Capital Group, a private mutual fund company. CollegeAmerica accounts are sold through private financial advisers and invested in a suite of American Funds mutual funds. Program participants contribute to individual accounts and work with their adviser to determine how money is invested. Investment earnings are exempt from federal taxes as long as they are used to pay for qualified education expenses, such as tuition, books, and housing. For state residents, Virginia also exempts earnings from state taxes and offers an income tax deduction for contributions made to this and other Virginia529 college savings programs. Funds from CollegeAmerica accounts can be used at institutions in Virginia and other states. The program distributed $5.3 billion to participants in FY21.

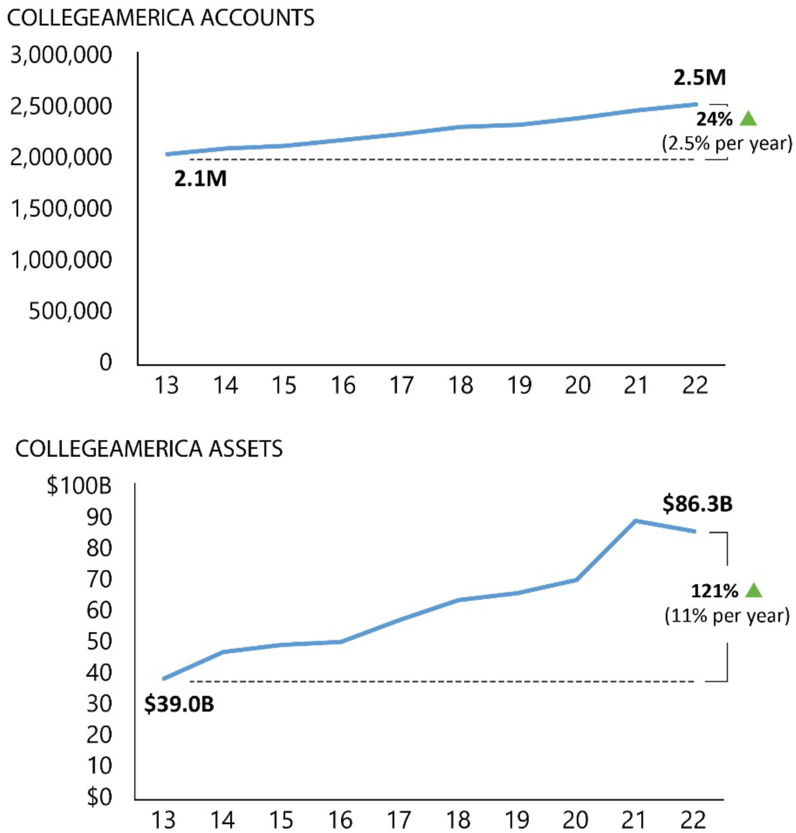
CollegeAmerica participation and assets

The CollegeAmerica program has increased over the past 10 years in both the number of participant accounts and the total assets under management (Figure 5). The number of CollegeAmerica accounts increased an average of 2.5 percent per year from FY13 to FY22. The value of assets under management increased substantially faster over this period. Assets under management more than doubled between FY13 and FY22, from $39.0 billion to $86.3 billion. This growth is attributable to both new contributions and investment returns. The increase in CollegeAmerica participation follows a nationwide trend for college savings programs, which have grown steadily over the past decade.

CollegeAmerica investment performance

The CollegeAmerica program held an aggregate of $86 billion in assets as of March 31, 2022. In consultation with their adviser, program participants have 44 investment options from 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 ("Portfolio Series") based on different investment strategies, such as growth or capital preservation. CollegeAmerica began offering two new investment options that the Virginia529 board approved in the last two years: the College 2039 Fund, a target-date portfolio, and the Multi-Sector Income Fund, an individual series option. All of the CollegeAmerica options are actively managed, with the goal of providing better returns or lower risk than the overall market.

FIGURE 5
CollegeAmerica account and asset growth



SOURCE: Virginia529 program data.
NOTE: Figures are reported as of the June 30 end of the fiscal year except for 2022, which is reported as of March 31.

The CollegeAmerica investment options showed mixed performance as of March 31, 2022 (Table 5). A slight majority of the individual series options outperformed their benchmarks for all or nearly all periods. The performance of the college target-date and portfolio series options was less positive. All but two of the college target-date options underperformed applicable benchmarks in the one-, three-, and five-year periods. All but one of the portfolio series options missed their benchmarks for all or nearly all periods.

TABLE 5
CollegeAmerica program investment performance

for the period ending March 31, 2022

	1 year	3 years	5 years	10 years
Individual options				
Met or exceeded benchmark	17	18	19	15
Total number of options	31	31	30	25
College Target-Date options				
Met or exceeded benchmark	1	1	0	n/a
Total number of options	7	6	5	
Portfolio Series options				
Met or exceeded benchmark	4	1	1	n/a
Total number of options	6	6	6	

SOURCE: Virginia529 program data.
NOTE: The number of investment options can change because longer-term performance data is not available for newer options. Three- and five-year data is not yet available for one recently established college target-date option. All college target-date and portfolio series options have inception dates of 2012 or later and therefore do not have 10-year performance to report. Performance is reported net of investment fees. Investment performance comparisons are for the "A" share class; 85 percent of CollegeAmerica assets are invested in A shares. Individual options and portfolio series options are benchmarked against the Lipper Funds Index. College target-date options are benchmarked against the Lipper Funds Average.

CollegeAmerica downgraded by Morningstar in 2020

Morningstar downgraded the CollegeAmerica program from silver to bronze in 2020, and the program remained at a bronze rating in 2021. In downgrading the program in 2020, Morningstar cited the program's fees, which it found were higher than other programs with smaller asset bases and the median fee level for all college savings plans.

4. ABLE programs

The Achieving a Better Life Experience (ABLE) program is 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. A 2014 federal law authorized state-run ABLE programs, and Virginia became the first state to enact ABLE legislation in March 2015.

Under Virginia's ABLE act, Virginia529 was given responsibility to establish and manage programs for ABLE savings accounts. Virginia529's two ABLE programs are modeled on its two education savings programs. Both Virginia529 ABLE programs are national programs, open to enrollment by residents of Virginia and other states. Virginia529's ABLEnow direct-sold program opened in 2016, and the ABLEAmerica adviser-sold program opened in 2018.

ABLEnow direct-sold program

The ABLEnow program is a "direct-sold" investment program similar to Invest529. Under this program, participants establish investment accounts directly with Virginia529. Virginia529 is responsible for customer service, investment oversight, and marketing. As with Invest529, Virginia529 offers ABLEnow participants several investment options through external investment management firms. Virginia529 has retained PNC Bank to be the program's custodian. The company handles most aspects of account management, including program enrollment, contributions, and disbursements.

ABLEnow participation and investment performance

The ABLEnow program is relatively small compared with Virginia529's education savings programs. This is for two main reasons: (1) ABLEnow is relatively new, and (2) the potential customer base is diverse (in terms of age and other factors) and more difficult to reach than the customer base for education savings. Furthermore, ABLE programs have requirements set by federal statute—such as annual contribution limits and that the beneficiary must also be the account holder—that may make the programs less appealing, according to Virginia529 staff. Though it remains relatively small, the ABLEnow program continues to grow rapidly, with total assets increasing 27 percent ($18.8 million) for the fiscal year to date as of March 31, 2022. The program had 12,881 accounts and $87.7 million in total assets as of March 31, 2022.

ABLEnow offers four investment portfolios that vary in asset allocation and investment return potential. They include the aggressive growth, moderate growth, and conservative income portfolios, which are composed of different proportions of equity (stocks) and fixed income (bond) investments. These three options are passively managed and track market indices. The fourth option is a money market portfolio that invests entirely in cash and cash equivalents. Because ABLEnow is relatively new, the program intentionally offers fewer and less expensive (passively managed) investment options. The investment advisory committee and board will consider additional options as the program grows.

All four ABLEnow investment portfolios underperformed their benchmarks (adjusted for fees) for the one-, three-, five- and since-inception periods as of March 31, 2022 (Table 6). The aggressive growth, moderate growth, and conservative income portfolios—which contain varying portions of public equities—underperformed their benchmarks by an average of 57, 29, and 51 basis points, respectively. The money market portfolio, which consists of safer cash and cash equivalent funds, underperformed its benchmarks by an average of nine basis points. According to Virginia529 staff, the ABLEnow investment options underperformed their benchmarks primarily because price adjustments that account for differences in the closing times of international and U.S. markets were made during periods of extreme market volatility in early 2022. The price adjustments are typically small but can be large and significant during periods of volatility.

TABLE 6
ABLEnow program investment performance

for the period ending March 31, 2022

	1 year	3 years	5 years	10 years	Since inception
Portfolio options					
Met or exceeded adjusted benchmark / Total number of options	0/4	0/4	0/4	n/a	0/4

SOURCE: Virginia529 program data.
NOTE: Inception of all investment options was December 2016. 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.

ABLEAmerica adviser-sold program

The ABLEAmerica program is an "adviser-sold" investment program similar to the CollegeAmerica education savings program. Under this program, participants establish investment accounts through private financial advisers. Virginia529 partners with Capital Group, its CollegeAmerica partner, to manage the program. Capital Group handles most administration and investment management duties. Virginia529 retains the authority to approve investment options and other aspects of the program's operations. ABLEAmerica continued to grow rapidly over the last two years. The number of accounts increased 145 percent over this period, and program assets more than tripled. The program had 1,826 accounts and $25.7 million in assets as of March 31, 2022.

Similar to ABLEnow, the ABLEAmerica program offers seven investment portfolios that vary in their asset allocation and investment return potential. Five of these seven portfolios outperformed their benchmarks for the one-year period. Longer-term investment performance data is not available because the ABLEAmerica program became operational in 2018.

5. State-sponsored private retirement program

The 2021 General Assembly enacted HB 2174, which created a state-sponsored private retirement savings program for private-sector employees in Virginia. State-sponsored retirement programs are designed to provide retirement savings options to employees who may not have access to retirement savings programs at their private employers. HB 2174 directs Virginia529 to administer the plan, including enrolling eligible employers and employees and managing employees' savings. The legislation requires all employers that do not offer a qualified retirement plan and employ at least 25 eligible employees to participate in the program. Employees are eligible for the program if they work at least 30 hours per week. Virginia529 is required to make the program available to employers and employees by July 1, 2023. The costs of implementing the program are funded by a non-interest bearing loan of up to $2 million annually from the Virginia Department of Treasury. Virginia529 is required by the legislation to begin repaying the loan once the program has a positive cash flow from fees paid by employees.

Virginia529 has begun program implementation

Virginia529 is required to open the state-sponsored private retirement program in 2023. The agency is planning to launch a small-scale pilot of the program by April 1, 2023, before opening the program statewide on July 1, 2023. Virginia529 has taken several steps to develop the program. As required by HB 2174, in 2021 Virginia529 created an advisory committee to assist the board and staff with developing and managing the program. The advisory committee has nine members, including four from the Virginia529 board as well as private-sector representatives. Virginia529 also created and filled a retirement program director position in 2021.

In April 2022, Virginia529 made several key decisions regarding program design and investment management. The board approved a Roth IRA as the default IRA for individual participants (with the option of a traditional IRA), set the default contribution rate at 5 percent with automatic escalations of 1 percent each year, and set the maximum contribution rate at 10 percent. The board also selected BlackRock to manage employee retirement accounts and approved a set of basic investment options employees can choose from to invest their savings. The options are passively managed index funds and include target date funds, U.S. and international equity funds, a fixed income fund, and a capital preservation fund.

Two additional steps will have important implications for the viability of the state-sponsored private retirement program. First, Virginia529 recently selected a program administrator. In addition to maintaining records on employees' accounts and savings, the program administrator will be responsible for assisting with conducting outreach to employers and employees and making sure they understand the program. Because many private-sector employees have limited familiarity with retirement savings options, this outreach will be critical to ensuring their participation in the program.

Second, Virginia529 needs to conduct financial modeling to estimate the number of savers and total program assets for the years after the program opens. The modeling will be critical to determining the appropriate fees to charge individual savers. Because the state-sponsored private retirement program will depend solely on these fees to cover program costs, projections of annual fee revenue will determine when Virginia529 can expect to repay its Treasury loan. Virginia529 is working with the Retirement Savings Project at the Pew Charitable Trusts to conduct this modeling later in 2022.

Restrictions on employer and employee eligibility may affect the financial sustainability of the program

The current statutory restrictions on employer and employee eligibility to participate in a state-sponsored private retirement program may hinder the financial viability of the program. According to Virginia529, restricting the program to employers with at least 25 employees reduces the pool of employees eligible to participate in the program by more than 500,000 and leaves more than 40 percent of private-sector employees ineligible to participate. (Virginia529 has not been able to quantify the impact of the 30-hour per week restriction on the pool of eligible employees because reliable data on the number of hours private-sector employees work is not available.) Virginia529 staff believe relaxing these restrictions will be important to the long-term success of the program.

The employer size and employee hours worked requirements may make it more difficult for the program to become financially sustainable and repay its Treasury loan. Employees' willingness to participate in the program will depend partially on the program's annual fees. However, restrictions that reduce the pool of eligible employees will limit the total amount of program assets under management. This will likely result in higher fees, because program costs will be spread over a smaller asset base.

When Virginia529 conducts financial modeling to estimate the number of program participants and assets under management, it should compare the fees needed to fund the program with and without the current restrictions on employer and employee eligibility. This information will be important to determine the impact of these eligibility restrictions and when, and if, the program can repay its Treasury loan.

6. Agency and program management

Virginia529 agency and program operations are funded almost entirely through fees charged by Virginia529's college savings programs. The Virginia529 board approves the agency's budget and all changes to programs, including the fees charged to participants. Like all state agencies, Virginia529's operating funding must be appropriated by the General Assembly through the appropriation act.

Agency budget increased more than 60 percent over the last 5 years largely because of access and affordability initiatives

SOAR Virginia is a scholarship program for high school students from low- and moderate-income households. Through SOAR, Virginia529 partners with nonprofit organizations to provide individual advising to students, such as assistance with the college admissions process and with financial aid applications, and grants a scholarship contribution of up to $2,000 to a Virginia529 account. SOAR is an early commitment program; recipients enter the program in 10th grade and must adhere to program criteria to receive their scholarship.

Virginia529's agency budget increased $16.1 million over the five-year period from FY17 to FY21 (Table 7). This represents a 66 percent increase, with an average annual increase of 13.9 percent. Much of this increase reflects additional spending on its higher education access and affordability initiative. Spending on this initiative increased $7.5 million in FY21 when Virginia529 allocated additional net operating revenue to several programs providing advising and mentoring services and scholarships for high school and college students. Spending on its access and affordability initiative also increased in FY18 when Virginia529 received a $1 million increase (for a total of $2 million) in its appropriation for its SOAR Virginia scholarship program (sidebar).

TABLE 7
Trends in Virginia529 agency budget

	FY17 ($M)	FY21 ($M)	Change ($M)	Change (%) [a]
Personal services	$10.9	$16.0	$5.1	46%
Marketing & communications	5.9	6.8	0.9	16
Professional services	2.9	4.1	1.1	38
Information technology	1.4	2.1	0.7	51
Facilities and leases	1.2	1.2	--	--
Other [b]	1.2	.9	-0.3	-22
Access and affordability initiatives [c]	1.0	9.5	8.5	850
Total	**24.5**	**40.1**	**16.1**	**66**

SOURCE: Virginia529 program data: budget vs. actual reports.
NOTE: Numbers may not sum due to rounding.
[a] Percentage changes in spending may not equal figures in table because of rounding. [b] Other expenses include administrative services; meetings, conferences, and training; supplies and materials; and professional development, memberships, and subscriptions. [c] Access and affordability initiatives include SOAR Virginia and seven additional programs being undertaken by other organizations to support higher education access and affordability in Virginia.

Virginia529 spending growth was also driven by increases in the agency's four largest spending categories: personal services (staff), marketing and communications, professional services (consulting, outside fiscal services, etc.), and information technology. Virginia529's personal services costs increased more than $5 million over the past five years, primarily because of growth in the number of staff. Virginia529 has added 39 new positions since FY18, increasing its total staffing by 50 percent to 117 full-time equivalent positions. All but seven of the new positions created since FY18 are in the finance division, including additional call center staff, and the information technology division. According to Virginia529 staff, additional call center staff were needed to handle increases in the volume of customer account inquiries as the overall number of college and disability savings accounts has grown in recent years. Spending on professional services increased by $1.1 million between FY17 and FY21. Increased spending on professional services was primarily related to outside legal services, banking and actuarial services, increased transaction costs, and IT services.

Virginia529 reduced fees for college savings programs, but revenue should continue to support its operating budget

To reduce costs for program participants, Virginia529 continues to reduce administrative fees for the Invest529 and CollegeAmerica savings programs as assets under management increase. Program fees are used to fund the agency's budget. In 2021, the board reduced the annual administrative fee for Invest529 accounts from an effective rate of nine basis points to five, representing a 44 percent reduction. For an Invest529 account with assets totaling $10,000, the annual administrative fee declined from $9 to $5. For CollegeAmerica accounts, the board lowered the dollar breakpoint (sidebar) in its tiered fee structure by reducing from $100 billion to $75 billion the level of assets subject to a rate of three basis points. This change represented an effective fee reduction of 7 percent. For a CollegeAmerica account with assets totaling $10,000, the annual administrative fee declined from $5.90 to $5.50. Both fee reductions took effect on January 1, 2022.

Breakpoints are commonly used in mutual funds, including 529 accounts, to offer investors discounted fees for larger investments. For example, an investor may pay a lower percentage fee on each additional $10,000 invested.

Expected growth in the Invest529 and CollegeAmerica programs over time is anticipated to more than offset any decline in program revenue due to the fee reductions, according to Virginia529 staff. Fee revenue from the two programs has consistently exceeded Virginia529 operating costs.

Virginia529 is substantially increasing funding to expand its higher education access and affordability initiative

Virginia529 is substantially increasing its funding for its higher education access and affordability initiative in Virginia. In 2021, the board approved more than $13 million in spending (which includes the $7.5 million in FY21 referenced above) to support seven additional access and affordability programs over the FY21–23 period (Table 8). This represents a substantial increase in funding for its access and affordability initiative, which totaled $2 million annually for the SOAR Virginia program in previous fiscal years. The programs are administered by other public and private organizations in Virginia, and Virginia529's increased funding will support expansion or implementation of the programs. The largest commitment, totaling $3.75 million over the three-year period, is for FastForward and supports additional career coaches for students enrolled in the New Economy Workforce Credential Grant program. Other programs provide advising, mentoring, and other support services for at-risk high school students, including students in the foster care system, rural localities, and high-poverty schools.

Net operating revenue is fee revenue that is generated beyond what is needed to fund Virginia529's agency budget. Nearly 90 percent of Virginia529's fee revenue is generated through the CollegeAmerica program. The remaining fee revenue is from Invest529, Legacy Prepaid529, and other programs.

Virginia529 is funding the programs in its higher education access and affordability initiative with annual net operating revenue generated by administrative fees from its programs, primarily the CollegeAmerica program (sidebar). The Virginia Department of Planning and Budget approved spending of the net operating revenue for this purpose for FY21–FY22. Prior to FY21, Virginia529 allocated net operating revenue to its Prepaid529 fund each year (now the Defined Benefit 529 fund). Net operating revenue allocated to the Prepaid529 fund totaled $353 million over 16 years, contributing to the Defined Benefit 529 fund's high funded status and substantial actuarial surplus. Given this high funded status, in 2020 JLARC staff concluded that "it would be appropriate in the future to reexamine how that fee revenue can best be used to support college affordability goals in Virginia." Virginia529 staff subsequently began examining opportunities to support programs intended to increase higher education access and affordability in the state. Staff conducted interviews with higher education stakeholders in Virginia, including the State Council of Higher Education for Virginia and the Virginia secretary of education's office, to identify programs that aligned with the state's higher education goals and priorities.

TABLE 8
Virginia529 has committed to providing more than $13 million in additional funding for higher education access and affordability programs (FY21–23)

Program	Purpose of funds	Funds committed
FastForward	Additional 15 career coaches [a] to support the New Economy Workforce Credential Grant program at each VCCS college	$3,750,000
GEAR UP Virginia	Scholarships [b] for the 2021–28 student cohort of the GEAR UP Virginia program	2,625,000
Virginia Foundation for Community College Education	Career coaches for additional 400 foster care youth and additional 4,200 underrepresented high school students in rural Virginia	2,600,050
Virginia College Advising Corps	29 additional advisors to serve an additional 8,700 high school students	2,025,000
Communities in Schools Virginia	Pilot programs to provide social support services, tutoring, & other interventions at 3 high-poverty high schools in Central Virginia	1,007,500
Virginia Latino Higher Education Network	Summer programs providing mentoring and coaching for Hispanic high school students	805,000
Great Aspirations Scholarship Program [c]	Additional 16 advisors in schools in areas of high need to provide career counseling, financial education, and financial aid advising	512,000
	Total	**$13,320,050**

SOURCE: JLARC analysis of information from Virginia529.
NOTE: [a] The 15 additional career coaches supplement the eight coaches at VCCS colleges, ensuring one coach at each of the 23 community colleges. [b] Virginia529 funding for scholarships allows GEAR UP Virginia to allocate additional funding for program services, including college and career preparation, advising, and financial aid awareness. [c] Funding is for FY22–23 only.

Recent legislation

The General Assembly makes changes to Virginia529 programs through legislation. The General Assembly also approves Virginia529 spending, including appropriations for administrative spending, access and affordability initiatives, and payments made under the defined benefit program.

The 2021 and 2022 General Assembly took significant action through legislation and the appropriation act relating to Virginia529. As previously discussed, the 2021 General Assembly enacted HB 2174 creating a state-sponsored private retirement savings program for private-sector employees in Virginia. The legislation directs Virginia529 to administer the plan, including enrolling eligible employers and employees and managing employees' savings.

The 2022 Appropriation Act includes several provisions related to Virginia529 programs. The Appropriation Act authorizes a non-interest bearing loan from the Virginia Department of Treasury of up to $2 million annually for the FY23–24 biennium to fund Virginia529's implementation of a state-sponsored private retirement program. The appropriation act also removed an additional $16 million in non-general fund net operating revenue that was included in the introduced budget and that Virginia529 would have used over the FY23–24 biennium to further increase funding for its higher education access and affordability initiative. The act directs JLARC to review Virginia529's access and affordability initiatives, including

- the effectiveness of SOAR Virginia and other Virginia529 initiatives and
- whether net operating revenue from Virginia529 can best support the SOAR program or other state access and affordability initiatives.

The General Assembly considered but did not approve legislation (SB 466) that would have potentially removed more than $1 billion in surplus funds from the Defined Benefit 529 fund and allocated these funds to scholarships for students attending "non-legacy" higher education institutions. The legislation would have required Virginia529 each year to remove any surplus funds exceeding a funded status of 105 percent, provided the board determined that doing so would not jeopardize the fund's ability to meet its obligations, result in insufficient funds to ensure actuarial soundness, or violate the standard of care set in statute. A new state foundation would have been responsible for administering the scholarship program. At the request of the bill patron, JLARC is reviewing this option as part of its ongoing reviews of higher education financial aid in Virginia that will be presented to the Commission in fall 2022.

Board appointments

Dante D. Jackson was appointed by the governor to the Virginia529 board in July 2020. His term will expire in June 2025. Jackson is an independent capital markets consultant and previously was a vice president at Bank of America.

Catherine Beck was appointed by the House of Delegates to the Virginia529 board in September 2020. Her term will expire in June 2024. Beck is an advocate for individuals with varying abilities. She successfully lobbied the U.S. Congress to pass the Stephen E. Beck, Jr. Achieving a Better Life Experience Act of 2014, also known as the ABLE Act.

Elliot J. Dubin was appointed by the House of Delegates to the Virginia529 board in August 2021. His term will expire in June 2025. Before retiring in 2019, Dubin was the director of policy research for the Multistate Tax Commission.

Edward H. Bersoff and Lauren Kent Stack were elected by the board to serve as chair and vice-chair, respectively, for 2022. The chair and vice-chair serve one-year terms.

The Virginia529 board is a supervisory board that is directly vested with authority for managing and overseeing most aspects of Virginia529. The board has 11 members, including four appointed by the governor, three appointed by the General Assembly, and four ex officio members (the state treasurer, state comptroller, a representative of the State Council of Higher Education for Virginia, and a representative of the Virginia Community College System). Board members serve four-year terms. The board appoints the chief executive officer who oversees the day-to-day management of Virginia529 and its programs. The board also appoints the investment director to assist with managing program assets.

VIRGINIA529 OVERSIGHT REPORT 2022

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