SUNSET ADVISORY COMMISSION

Prepaid Higher Education Tuition Board

Staff Report
November 2006

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In 1977, the Texas Legislature created the Sunset Advisory Commission to identify and eliminate waste, duplication, and inefficiency in government agencies. The 12-member Commission is a legislative body that reviews the policies and programs of more than 150 government agencies every 12 years. The Commission questions the need for each agency, looks for potential duplication of other public services or programs, and considers new and innovative changes to improve each agency's operations and activities. The Commission seeks public input through hearings on every agency under Sunset review and recommends actions on each agency to the full Legislature. In most cases, agencies under Sunset review are automatically abolished unless legislation is enacted to continue them.

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Summary

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The Prepaid Higher Education Tuition Board (Board) helps Texans save for college through two programs, a Prepaid Plan that locks in future college tuition and fees at today's prices, and a Savings Plan that allows individuals to invest money for college expenses. Both plans offer federal tax advantages, but only the Prepaid Plan is backed by the full faith and credit of the State. Given the significantly rising costs of higher education, Sunset staff concluded that these programs serve a clear need and should be continued.

Sunset staff found that while the Board has successfully helped thousands of Texans save for college, changes could be made to improve the operation of the programs. Of critical concern is the Board's suspension of enrollment in the Prepaid Plan since 2003. The Board took this action due to fear that it could not accurately predict future college costs once the Legislature deregulated tuition.

As issues related to tuition deregulation clearly exceed the scope of this review, Sunset staff examined potential statutory changes that could be made, within a tuition deregulated environment, to facilitate the Board's ability to eventually reopen the Prepaid Plan. Key obstacles identified, beyond simply rising costs, are the increasingly divergent tuition rates set by Texas universities and problems tied to shifting higher-than-average costs to the universities. The recommendations that follow aim to give the Board additional tools that may help it reopen the Prepaid Plan in the future, while promoting fairness to both plan purchasers and Texas universities.

The Board has successfully helped thousands of Texans save for college.

With enrollment in the Prepaid Plan suspended, the State's Savings Plan now functions as Texas' only state-sponsored tool to help families save for college. Sunset staff found that, while growing, Texas' Savings Plan has lower enrollment and assets than plans in other states that began at the same time. Sunset staff identified two restrictions in how the Board contracts for a plan manager that, if changed, could potentially increase interest in, and competition for, managing the Texas plan. The Board would also benefit from more clearly tracking its advertising campaign to ensure it is cost-effectively generating new enrollment in the Savings Plan.

The following material summarizes the Sunset staff's recommendations regarding the Prepaid Higher Education Tuition Board.

Issues and Recommendations

Issue 1

Statutory Changes Could Help Facilitate the Board's Ability to Reopen the Prepaid Plan Within a Tuition Deregulated Environment.

Key Recommendations

- ♦ Remove the weighted average requirement for any new prepaid tuition contracts the Board sells.
- ♦ Authorize the Board to issue refunds for new prepaid tuition contracts if a purchaser pays more for a contract than the actual cost of the beneficiary's tuition.
- ♦ Authorize the Board to require a delay from the contract purchase date to when the student claims benefits, allowing time for investments to grow.
- ♦ Require the Board to reassess whether it can reopen the Prepaid Plan, no later than December 2007, and annually as long as the Plan remains closed.

Issue 2

The Savings Plan Could Benefit From the Board's Reconsideration of Restrictions in Its Request for Proposals and the Cost-Effectiveness of Its Advertising.

Key Recommendations

- ♦ The Board should consider restructuring its next Request for Proposals for the Savings Plan manager to encourage a wider variety of respondents.
- ♦ The Board should regularly evaluate the impact of its advertising campaign to ensure that it is cost-effectively generating new enrollment.

Issue 3

The Board's Statute Lacks Ethics Provisions That Are Important Safeguards for Boards With Significant Investment Oversight.

Key Recommendation

- ♦ Require in law an ethics policy for Board members and staff that includes disclosure of conflicts of interest and recusal when conflicts exist.

Issue 4

Texas Has a Continuing Need for the Prepaid Higher Education Tuition Board.

Key Recommendation

- ♦ Continue the Prepaid Higher Education Tuition Board for 12 years.

Fiscal Implication Summary

None of the recommendations in this report would have a significant fiscal impact to the State.

Issues

Issue 1

Statutory Changes Could Help Facilitate the Board's Ability to Reopen the Prepaid Plan Within a Tuition Deregulated Environment.

Summary

Key Recommendations

- Remove the weighted average requirement for any new prepaid tuition contracts the Board sells.
- Authorize the Board to issue refunds for new prepaid tuition contracts if a purchaser pays more for a contract than the actual cost of the beneficiary's tuition.
- Authorize the Board to require a delay from the contract purchase date to when the student claims benefits, allowing time for investments to grow.
- Require the Board to reassess whether it can reopen the Prepaid Plan, no later than December 2007, and annually as long as the Plan remains closed.

Key Findings

- The Board has suspended any new enrollment in the Texas Guaranteed Tuition Plan since 2003, but continues to manage its more than 158,000 existing prepaid tuition contracts.
- Deregulation has caused tuition at four-year, public, Texas universities to diverge considerably, making it difficult for the Board to accurately price new contracts.
- Continuing to apply the weighted average requirement to new contracts could unfairly shift a growing portion of beneficiaries' future tuition costs to universities with tuition that exceeds the weighted average.
- The Board lacks authority to issue refunds for certain plans to help protect purchasers who pay more for the contract than the actual cost of tuition.
- Unlike Texas, most prepaid tuition plans in other states require a delay from the contract purchase date to when the student claims benefits, allowing time for investments to grow.

Conclusion

Through the Texas Guaranteed Tuition Plan (Prepaid Plan), the Prepaid Higher Education Tuition Board (Board) has helped thousands of Texas families afford college tuition for their young family members. However, the Board has not sold new prepaid tuition contracts since the Legislature deregulated tuition in 2003.

The Sunset review examined key obstacles to reopening the Prepaid Plan, including the increasingly divergent tuition rates set by Texas universities, and limits in existing law that were created in the environment prior to tuition deregulation. The recommendations aim to give the Board additional tools that may help it reopen the Plan in the future, and restore the Plan to a self-sustaining status while promoting fairness to both plan purchasers and Texas universities.

Support

The Board has suspended any new enrollment in the Texas Guaranteed Tuition Plan since 2003, but continues to manage its more than 158,000 existing prepaid tuition contracts.

- From 1996 to 2003, the Prepaid Higher Education Tuition Board (Board) sold more than 158,000 prepaid tuition contracts through its Texas Guaranteed Tuition Plan (Prepaid Plan). Backed by the full faith and credit of the State through a constitutional amendment, the Prepaid Plan allowed Texas families to prepay the future college tuition and required fees for their young family members. The Board based the price of contracts on current tuition and required fees, giving purchasers significant savings on future tuition costs.

  The most popular type of contract, the Senior College Plan, guaranteed up to five years of tuition and required fees at any four-year, public, Texas university. In 2003, families that purchased a Senior College Plan when their child was a newborn could pay a lump sum of $17,460, or $152 per month, until the child graduates from high school. The textbox, *Types of Prepaid Tuition Contracts*, describes the four types of contracts the Board sold from 1996 to 2003.

Types of Prepaid Tuition Contracts
1996 to 2003

Senior College Plan. Up to five years of full-time tuition and required fees at any four-year, public, Texas university. (84% of all contracts sold)

Junior-Senior College Plan. Two years of full-time tuition and required fees at a Texas community college, plus two years at a four-year, public, Texas university. (9% of all contracts sold)

Junior College Plan. Up to two years of full-time tuition and required fees at a Texas community college. (4% of all contracts sold)

Private College Plan. Up to five years of full-time tuition and required fees at a four-year, private, Texas college or university. (2% of all contracts sold)

- In 2003, the Legislature deregulated tuition and, anticipating the potential for significant tuition increases, added the "weighted average requirement" to the Board's statute to help protect the Plan's assets.[1] The provision, which only applies to Senior College contracts, requires four-year, public, Texas universities to waive any portion of a contract beneficiary's tuition and required fees that exceeds the weighted average tuition and required fees of all four-year, public universities in the state.

  Also in 2003, the Legislature authorized the Board to temporarily suspend new enrollment in the Prepaid Plan, if necessary to protect its assets. Even with the weighted average requirement in place, the Board decided to temporarily close the Prepaid Plan until it could discern the long-term effects of deregulation.

The Board paid $57.5 million in tuition to universities on behalf of 15,134 students in fiscal year 2005.

- Although the Prepaid Plan is closed, the Board continues to manage the Fund's $1.6 billion in assets, and paid $57.5 million in tuition benefits on behalf of 15,134 students in fiscal year 2005. That year, the majority of students using contract benefits, about 62 percent, attended a four-year, public, Texas university.

Deregulation has caused tuition at four-year, public, Texas universities to diverge considerably, making it difficult for the Board to accurately price new contracts.

♦ The Board's greatest challenge to reopening the Plan is setting new contract rates for its popular Senior College Plan, which number more than 133,000, or 84 percent of all contracts the Board previously sold. Since deregulation, tuition increases at different four-year, public, Texas universities have varied considerably, a factor the Senior College Plan's single pricing structure was not designed to accommodate. Increasingly, the Board's future payment obligations depend on which university each beneficiary chooses to attend.

The difference in cost between the least and most expensive four-year, public, Texas universities poses the biggest challenge. For example, for the 2006-2007 academic year, the least expensive school, Sul Ross University-Rio Grande, charges $3,218 for two full-time semesters, while the University of Texas at Austin charges a business major almost three times that amount, $8,688. Examples of current tuition prices at four-year, public, Texas universities are provided in the table, *Examples of Tuition Prices*.

Tuition at some public Texas universities is nearly three times higher than at others.

Examples of Tuition Prices
Academic Year 2006-2007

Four-Year, Public, Texas University	Tuition & Required Fees, 32 hours	Percent Increase from 2005-2006
Sul Ross University-Rio Grande	$3,218	4.3%
University of Texas-Brownsville	$4,395	12.8%
Texas A&M University-Kingsville	$4,900	1.3%
Lamar University-Beaumont	$5,124	3.9%
Texas Southern University	$5,724	21.8%
Texas State University	$5,970	7.7%
Texas A&M University-College Station	$7,066	8.7%
University of Texas at Austin-Liberal Arts	$7,630	9.4%
University of Texas at Austin-Business	$8,688	12.7%

Tuition increases have fluctuated dramatically at different institutions. Between the 2005-2006 and 2006-2007 academic years, increases in tuition ranged from around one to more than 20 percent at different four-year, public, Texas universities. For example, Texas A&M University-Kingsville's tuition increased only 1.3 percent, while Texas Southern University's tuition increased almost 22 percent.

Compounding the Board's difficulty in pricing contracts, individual institutions have begun to set independent tuition rates for different programs of study. For example, the University of Texas at Austin now charges tuition based on the student's major, with a business major costing $8,688 for the 2006-2007 academic year, and a liberal arts major costing $7,630.

Continuing to apply the weighted average requirement to new contracts could unfairly shift a growing portion of beneficiaries' future tuition costs to universities with tuition that exceeds the weighted average.

The six largest universities in the state waived more than $7 million in tuition for Prepaid Plan beneficiaries in fiscal year 2005.

- According to the weighed average requirement, any university with tuition and required fees above the weighted average of all four-year, public, Texas universities must waive the difference in cost between their tuition and required fees and the weighted average amount.[2] The Board calculated the weighted average for one year of full-time tuition and required fees at $5,801 for the 2005-2006 academic year, and $6,086 for the 2006-2007 academic year. The six largest universities in the state waived more than $7 million in tuition and required fees for Prepaid Plan beneficiaries in fiscal year 2005, as shown in the table, *Waived Tuition and Required Fees for Prepaid Plan Beneficiaries*.

Waived Tuition and Required Fees for Prepaid Plan Beneficiaries – FY 2005

University	Total Waived Tuition
University of Texas (Arlington, Austin, Dallas, and San Antonio)	$3,570,458
Texas A&M University (College Station)	$1,813,826
Texas Tech University	$1,074,357
University of North Texas	$339,882
Texas State University-San Marcos	$130,693
University of Houston	$89,635
TOTAL	**$7,018,851**

Students with Plan benefits tend to go to higher priced universities.

- While the weighted average requirement protected contracts in place at the time of tuition deregulation, reopening the Plan under this arrangement would shift an ever-increasing portion of the Prepaid Plan's costs to universities. Already in fiscal year 2005, 8,252 out of the total 10,297 students who attended a four-year, public, Texas university with tuition contract benefits went to one of the six schools most affected by the weighted average requirement.

  According to the Board's actuary, if the Board reopened the Plan, the tendency for students with contract benefits to attend a higher priced university would continue. As a consequence, these universities may shift the increasing cost of waived tuition for contract beneficiaries to other students, in the form of higher tuition or reduced financial aid.

The Board lacks authority to issue refunds for certain plans to help protect purchasers who pay more for the contract than the actual cost of tuition.

- State law does not allow the Board to issue refunds to purchasers of Senior or Junior College Plans if they pay more for the contract than the actual cost of tuition and required fees when the beneficiary attends school. Law does allow such a refund for purchasers of Private College Plans.[3] Without the authority to issue these refunds, the Board faces the unworkable task of pricing contracts high enough to cover the more expensive universities, without charging more than a beneficiary would need for a lower-cost university.

  Other states have been able to continue selling prepaid tuition contracts by raising contract prices or adding a premium and offering a refund to those who pay too much. For example, Kentucky's and Washington's prepaid tuition plans price contracts based on the highest-priced public university in their states, instead of using the much lower weighted average of all universities. Other states, such as Virginia, added a large premium to the cost of the contracts to protect their funds' assets. If beneficiaries of one of these states' plans attend a university that is cheaper than the price of their contracts, they receive refunds that they can use for any qualified higher education expense, such as books or housing. If the Board had a similar refund authority, it could price new contracts higher, ensuring the Prepaid Plan's assets were protected, but also protecting an individual purchaser from paying more than the actual cost of tuition.

Refund authority would protect purchasers if the Board needs to raise contract prices.

Unlike Texas, most prepaid tuition plans in other states require a delay from the contract purchase date to when the student claims benefits, allowing time for investments to grow.

- Under current law, the Board does not have clear authority to require a maturity period before prepaid tuition contract benefits may be used, or limit the age of the beneficiary at the time of enrollment. State law requires the Board to sell contracts on behalf of any beneficiary who is under 18, or 18 or older and enrolled in high school when the contract is purchased.[4] In the past, purchasers were able to buy contracts for students who could begin using tuition benefits within one or two years. If the Board reopens the Plan, many families will likely purchase contracts for students who are close to high school graduation, reducing the length of time needed for the investment income from the contract payments to grow.

  Six states require a two- to five-year maturity period from the time a person purchases a contract to the time the student begins using benefits. Other states, such as Alabama, Virginia, and West Virginia, require the beneficiary to be in 9th grade or lower at the time the contract is purchased. Only three states, Michigan, Ohio, and Texas, do not require a maturity period or restrict the age of enrollment below 12th grade.

Recommendations

Change in Statute

1.1 Remove the weighted average requirement for any new prepaid tuition contracts the Board sells.

This recommendation would remove the requirement that any university with tuition and required fees above the weighted average of all four-year, public, Texas universities waive the difference in cost between their tuition and required fees and the weighted average amount. Because this provision is important to the soundness of tuition contracts the Board sold previously, the recommendation would only apply to new contracts issued if the Board reopens the Prepaid Plan in the future. The weighted average requirement would still apply to all Senior College contracts the Board sold from 1996 to 2003.

The Board has documented the tendency for tuition contract beneficiaries to attend more expensive universities, and this trend is likely to continue in the future. If the Plan reopens with the weighted average requirement in place, these universities would be required to bear an increasingly inequitable portion of the Plan's total tuition liabilities. With the changes recommended in this report, the Board would have more opportunities to create a self-sustaining program that is capable of paying universities the actual cost of tuition.

1.2 Authorize the Board to issue refunds for new prepaid tuition contracts if a purchaser pays more for a contract than the actual cost of the beneficiary's tuition.

This recommendation would authorize, but not require, the Board to issue refunds for Junior, Senior, and Junior-Senior College Plans, if necessary. Pricing contracts higher could help protect the Board's assets and enable the sale of new contracts, but a refund provision may be necessary to protect future purchasers' investments. The intent of the recommendation is to give the Board a tool that may help it reopen the Prepaid Plan. Refund authority for new Junior, Senior, and Junior-Senior College contracts could be handled in a similar manner as refunds for the Private College Plan.

1.3 Authorize the Board to require a delay from the contract purchase date to when the student claims benefits, allowing time for investments to grow.

This recommendation would authorize, but not require, the Board to require a maturity period before a beneficiary could use prepaid tuition benefits. Such a delay from the time a contract is purchased would ensure sufficient time for the Board's investments to grow before the beneficiary claims tuition benefits. The intent of the recommendation is to give the Board additional flexibility to protect the Plan's assets, which may help reopen the Prepaid Plan. For example, the Board could phase in new contracts slowly, initially offering plans only for newborns, and then opening enrollment further if possible.

1.4 Require the Board to reassess whether it can reopen the Prepaid Plan, no later than December 2007, and annually as long as the Plan remains closed.

Currently, state law authorizes the Board to temporarily suspend new enrollment in the Prepaid Plan, if needed to ensure the Fund's actuarial soundness.[5] However, neither statute nor rule offer guidance on how the Board should determine when and if reopening the Plan is possible. This recommendation would require the Board to create a procedure in rule that clearly outlines criteria to use when analyzing whether the Prepaid Plan may reopen. As part of this procedure, the Board should consider the Plan's current structure and whether additional statutory changes are needed for it to reopen.

Reassessing the Plan by December 2007 would ensure consideration of the impact of any legislative changes adopted by the 80th Legislature. If the Board decides to keep the Plan closed, an annual assessment required by law would ensure that the Board revisits the potential for reopening this popular program on a regular basis.

Fiscal Implication

These recommendations would not have a significant fiscal impact to the State. The Board would continue to be required by law to make decisions, including whether to reopen the Prepaid Plan, that preserve the long-term soundness of the Plan's assets.

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[1] The Board considers the total number of undergraduate students enrolled at each university when calculating the weighted average to more accurately predict the average cost of tuition and required fees per student. For example, the University of Texas at Austin's higher tuition is weighted more heavily because it has the largest total number of enrolled students.

[2] Texas Education Code, sec. 54.623 (b).

[3] Texas Education Code, Sec. 54.619 (d).

[4] Texas Education Code, sec. 54.621 (a).

[5] Texas Education Code, sec. 54.619 (j).
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Issue 2

The Savings Plan Could Benefit From the Board's Reconsideration of Restrictions in Its Request for Proposals and the Cost-Effectiveness of Its Advertising.

Summary

Key Recommendations

- The Board should consider restructuring its next Request for Proposals for the Savings Plan manager to encourage a wider variety of respondents.
- The Board should regularly evaluate the impact of its advertising campaign to ensure that it is cost-effectively generating new enrollment.

Key Findings

- Two key components of the Board's Request for Proposals to run the Savings Plan may unnecessarily restrict fund manager applicants, reducing the competitiveness of the Plan.
- The Board devotes significant funds to television advertising for the Savings Plan but fails to clearly track its impact on new enrollment.

Conclusion

The Prepaid Higher Education Tuition Board (Board) is responsible for contracting with vendors to ensure that the State's 529 Savings Plan is well managed and accessible to individuals wishing to save for their children's or grandchildren's educations. Texas' 529 Savings Plan is relatively new and growing; however, many other states' plans, which began at approximately the same time, are significantly larger.

Sunset staff found that two key components of the Board's contracting process may have limited the competitiveness of the Savings Plan. The Board restricted respondents to only those firms who did not manage other states' plans, and required a significant annual, upfront marketing contribution from the plan manager, potentially impacting the Board's ability to attract larger, more established plan managers.

Sunset staff also found that the Board could benefit from clearer oversight of the Savings Plan's advertising campaign to ensure the cost-effectiveness of its efforts to increase enrollment.

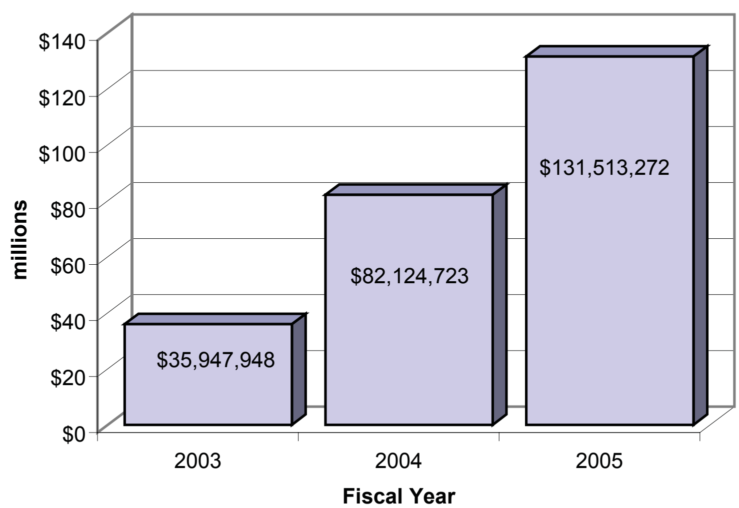
Support

The State created Tomorrow's College Investment Plan to encourage Texans to save money for college.

The Savings Plan is Texas' only open, state-sponsored college savings tool.

- In 2001, the Legislature created Texas' second 529 plan, Tomorrow's College Investment Plan (Savings Plan), to complement Texas' existing Prepaid Plan, and to provide parents and other interested parties with a means to save for future college expenses. Since enrollment in the State's Prepaid Plan is currently suspended, the Savings Plan is Texas' only state-sponsored college savings tool available for future college students. Like the Prepaid Plan, the Savings Plan offers a tax-advantaged way to save for college. Unlike the Prepaid Plan, the Savings Plan does not carry a State guarantee. At the end of fiscal year 2005, the Savings Plan had approximately 16,000 account holders and more than $131 million in assets under management, as shown in the graph, *Savings Plan Fund Net Assets*.

Savings Plan Fund Net Assets
FYs 2003 – 2005



In 2006, Congress made permanent the federal tax break for Savings Plan disbursements.

- The Prepaid Higher Education Tuition Board (Board) contracts with Enterprise Capital Management (Enterprise) to manage the Savings Plan. Enterprise oversees the various investment portfolios offered through the Savings Plan, and provides all account services. Account holders may select from among 19 different investment portfolios to align investments with their personal financial goals. Account holders make after-tax contributions to their individual savings accounts. All earnings and contributions may be withdrawn at a later date, free from federal taxes, and used for qualified higher education expenses, including tuition, fees, room and board, and books.

  In 2006, the U.S. Congress made permanent 529 savings account holders' ability to withdraw funds for qualified education expenses free from federal income tax. Savings plans always provided tax-deferred growth on earnings but previously, tax-free distributions were only authorized through 2010. As a result, individuals may now be more likely to open 529 savings plans, and increase investments in existing 529 plans, potentially leading to significant growth in the savings plan industry.[1]

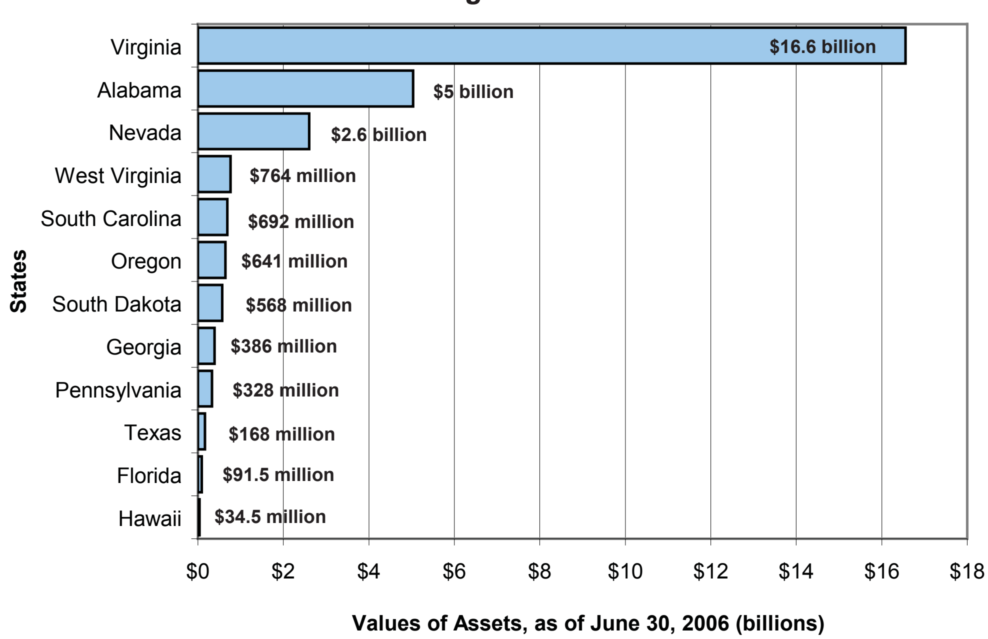
- Section 529 of the Internal Revenue Code authorizes states to create college savings plans and allows individuals to purchase plans from any state. As a result, plans from different states compete against each other. Plans, including the Savings Plan, typically attract residents by promoting direct investment options that have lower management and account maintenance fees for residents than for non-residents. In states with state income taxes, plans may also offer income tax deductions to state residents. Some state plans attract their residents through matching gifts or grants.

  Account holders in Texas may either invest directly in the Savings Plan or invest with the help of a financial adviser. All non-residents must go through financial advisers to open accounts. Approximately 73 percent of Savings Plan investment comes from Texans, and 55 percent of account holders are direct investors.

Texas' Savings Plan has lower enrollment than most plans that began at the same time.

- Many states began offering savings plans in 2002; however, Texas' plan, while growing, continues to have lower enrollment and total assets under management than most plans that began in the same year. The graph, *State Savings Plans Established in 2002*, demonstrates the relatively small size of Texas' Savings Plan compared with other plans that began offering accounts at about the same time.[2]

State Savings Plans Established in 2002



Three of the plans that began in 2002 now have more than $1 billion in assets. In fact, Virginia's CollegeAmerica 529 Savings Plan is the largest in the country with over $16.6 billion in assets and 1.3 million account holders. In addition to meeting the savings needs of more individuals, larger plans can also create certain benefits for account holders and the sponsoring states, as indicated in the textbox, *Benefits of Larger Plans*.

Benefits of Larger Plans

In general, the more assets in the plan, the more asset-based fees accumulate to the plan manager and, in some cases, to the state itself. Larger profits allow states to attract the most competitive plan managers. In addition, the significant growth in at least two state savings plans allowed those states to negotiate new benefits for account holders. In Virginia, the plan was able to slash fees charged to account holders. In New Mexico, the increase in the profit to the state allowed it to set up scholarships for low-income families.

Two key components of the Board's Request for Proposals to run the Savings Plan may unnecessarily restrict fund manager applicants, reducing the competitiveness of the Plan.

- The Board, in its plan manager Request for Proposals (RFP), prohibited respondents from marketing other states' savings plans within Texas. In effect, this prohibition limited respondents to those smaller firms that did not already manage other states' plans. The Board intended this provision to limit competition, so that financial advisers affiliated with the plan manager would not market more than one plan to clients, potentially recommending other plans over the Texas plan.

  However, by the time the Texas plan began offering services, most experienced plan managers were already administering plans in one or more states, preventing them from applying to operate the Texas Savings Plan. Most states do not place this type of restriction on plan managers. As a result, several firms manage more than one state plan, with one single plan manager responsible for savings plans in 10 states. Ultimately, the Board had only four respondents to the 2001 plan manager RFP.

Texas' Savings Plan has a limited network of financial advisers marketing the Plan.

- By restricting the respondent pool to smaller firms, the Board limited the network of financial advisers available to market the Savings Plan. Growth in savings plans is the result of both direct sales and indirect sales through financial advisers. Financial advisers typically generate a significant amount of in-state and out-of-state investment for a plan. Considering the variety of plans available, advisers are most likely to recommend a savings plan when they are familiar with underlying investments and with the firm managing the accounts. Savings plan managers that have relationships with large networks of financial advisers are generally better able to market their savings plans within individual states and across the nation.

  In 2003, recognizing that the Savings Plan was not as attractive to financial advisers as originally intended, the Board authorized an increase in sales charges. By increasing sales charges, the Board increased commissions to financial advisers, a move intended to ensure that the financial advisers did not steer clients towards other states' plans with higher commissions.

However, increasing commissions also increases the fees paid by account holders who invest through advisers, potentially discouraging investors from opening accounts.

- ♦ The Board's RFP also required the plan manager to "provide a substantial annual financial contribution to the Board towards the marketing effort for the Plan."[3] The RFP indicated that a successful respondent would be willing to contribute $2.5 million annually toward marketing activities. The Savings Plan contained no assets when it opened. As a result, the plan manager could not be reimbursed through asset-based fees for required marketing expenses and would have to pay for marketing directly. According to Board staff, at least one large firm did not respond to the RFP because of this marketing contribution requirement.

The Board devotes significant funds to television advertising for the Savings Plan but fails to clearly track its impact on new enrollment.

The Board only advertises the Savings Plan in Texas' four largest cities.

- ♦ The Board contracts with a separate vendor to develop and implement the Savings Plan's advertising campaign. Since the Savings Plan began enrollment in 2002, the Board has decreased the annual advertising contribution from a high of $2 million to $825,000 for 2005. The plan manager, and not the State, pays all advertising costs. However, the plan manager pays the Board for marketing from fees assessed on individual account holders. Even though the Board continues to reduce the annual advertising budget, Texas' 2005 budget of $825,000 was among the more expensive of the 26 states for which information was available.[4]

- ♦ The Board's current advertising strategy focuses on television ads that run for one four-to-six week period per year. Ads are shown in Texas' major media markets of Dallas-Fort Worth, Houston, San Antonio, and Austin. Ads for the Savings Plan do not air in other parts of Texas or across the nation. The table, *Advertising Costs per New Account*, demonstrates the cost of the television advertising campaign per new enrollee. Since the annual advertising budget funds Texas marketing efforts only, the actual advertising cost per new Texas enrollee is higher than the costs listed in the chart; however, Enterprise could not provide information on the number of Texas accounts.

Advertising Costs per New Account

Fiscal Year	Total New Enrollees	TV Advertising Budget	Cost of Advertising per New Enrollee
2003	6,516	$2,000,000	$306.94
2004	6,042	$1,750,000	$289.64
2005	4,086	$1,125,000	$275.33
2006	4,318	$825,000	$191.06

- ♦ In years past, the Texas Prepaid Plan, as well as other states' 529 plans, have benefited from non-paid media campaigns, which involve seeking favorable press coverage opportunities. However, the Board does not currently use other advertising strategies such as print media, grassroots marketing, or non-paid media to complement the seasonal television campaign.

- ♦ The Board does not currently require its advertising contractor to produce measures that clearly demonstrate the impact of the television ads. The Board receives an annual report on the advertising campaign in which the contractor provides information on the number of new accounts established in the major media markets. However, since these markets are the largest population centers in the state, it is difficult to determine whether the television ads, or perhaps other factors, encouraged individuals to open accounts. In addition, the plan manager does not ask callers who contact the Savings Plan call center how they learned about the program.

  Other state agencies responsible for large media campaigns, including the Texas Department of Transportation and the Texas Lottery Commission, survey customers to determine how the customers learned about the agency's products. Because the Board does not collect this kind of information about the Savings Plan, the Board may not have the best information possible for critically evaluating the cost-effectiveness of its advertising strategy and for making decisions about future strategies.

Recommendations

Management Action

2.1 The Board should consider restructuring its next Request for Proposals for the Savings Plan manager to encourage a wider variety of respondents.

This recommendation would direct the Board to consider restructuring the plan manager RFP to improve the volume and quality of respondents. The Board should evaluate eliminating the current requirement that the plan manager exclusively manage the Texas plan. By removing this requirement, the Board would allow many additional firms with good standing in the 529 market to respond. In addition, the Board should reconsider the marketing cost charged to the plan manager to ensure that the required contribution does not unreasonably restrict the RFP respondent pool. By requiring the plan manager to contribute more than the firm can expect to profit from accounts, the Board may have discouraged potential respondents. These considerations would impact the Board's next review of the plan manager contract, scheduled for August 2007.

2.2 The Board should regularly evaluate the impact of its advertising campaign to ensure that it is cost-effectively generating new enrollment.

The Board should routinely assess the advertising plan for the State's Savings Plan, and for the Prepaid Plan should enrollment reopen. The Board should require that the contracted advertising vendor provide regular reports that assess the volume of new business generated by the advertising campaign. The advertising vendor could work with the plan manager to collect information pertaining to how account holders learn about the Plan. Information could be collected on enrollment forms or through calls to the call center. In addition, the advertising vendor and the Board should regularly evaluate the existing advertising plan to ensure that it provides the best mix of advertising to effectively reach the broadest segment of the Texas college-bound population.

Fiscal Implication

These recommendations would not have a fiscal impact to the State.

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[1] Fidelity Investments, *Fidelity Poll Shows New Pension Law Could Significantly Increase National Adoption of 529 Plans* (Boston, Mass., 2006). Online. Available: http://www.collegesavingsfoundation.org/pdf/529%20Research%20PR%20FINAL%20_NTL_.pdf. Accessed: November 9, 2006.

[2] The College Savings Plan Network, *Table 104: Qualified Tuition Programs*; and *Table 106: Program Data (as of June 30th, 2006)*. All data provided by the Texas Comptroller of Public Accounts (October 2, 2006).

[3] Texas Comptroller of Public Accounts, *Request for Proposals, No. 129b, A Plan Manager for the Higher Education Section 529 Savings Plan* (Austin, Texas, October 2001), p. 10.

[4] In 2005, the College Savings Plan Network collected savings plan budget data, including marketing budget information, from 26 states and the District of Columbia. Texas's marketing budget ranked sixth out of these 27 entities. The College Savings Plan Network, *Table 116: Annual Operating Costs*. All data provided by the Texas Comptroller of Public Accounts (October 2, 2006).
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Issue 3

The Board's Statute Lacks Ethics Provisions That Are Important Safeguards for Boards With Significant Investment Oversight.

Summary

Key Recommendation

- ♦ Require in law an ethics policy for Board members and staff that includes disclosure of conflicts of interest and recusal when conflicts exist.

Key Findings

- ♦ Prepaid Higher Education Tuition Board members and staff are involved in investment decisions regarding the Board's two 529 college savings programs.
- ♦ Though the Board follows an ethics policy, and has not encountered any problems, the Board's statute does not specify ethical standards for Board members and staff.
- ♦ Other state agencies and boards with investment responsibilities have ethics requirements in their statutes.

Conclusion

The Prepaid Higher Education Tuition Board (Board) and its staff oversee investments of almost $2 billion in Texas' two college savings plans. The Board has established and uses an ethics policy to guide its members and staff when dealing with a variety of potential ethical challenges. However, unlike other government bodies with investment authority, the Board has no requirement in law to have an ethics policy. Placing provisions of the Board's existing ethics policy in statute would help ensure that the actions of future Board members avoid any conflicts of interest or other ethical violations. Placing ethics policy requirements in statute also makes them more visible to the public and investors.

Support

Prepaid Higher Education Tuition Board members and staff are involved in investment decisions regarding the Board's two 529 college savings programs.

The Board oversees investments of almost $2 billion.

- State law charges the Prepaid Higher Education Tuition Board (Board) with investing the assets of both the Texas Guaranteed Tuition Plan (Prepaid Plan) and Tomorrow's College Investment Plan (Savings Plan). The Board and its Investment Committee, along with the Board's contracted financial adviser, develop an investment policy to guide asset allocations and other investment strategies for the Prepaid Plan Fund, which had $1.6 billion in assets at the end of fiscal year 2005. Investment fund managers with whom the Board contracts, and not the Board or its staff, make daily investment decisions about the Prepaid Plan's assets. The Board contracts administration of the Savings Plan to a private firm, Enterprise Capital Management, but still closely monitors the Plan and its investor accounts, worth more than $131 million.

Though the Board follows an ethics policy, and has not encountered any problems, the Board's statute does not specify ethical standards for Board members and staff.

- The Board developed an ethics policy in 2004, in response to a State Auditor's Office recommendation. The policy established conflict-of-interest and other ethical principles that Board members and staff must follow.[1] Board members and staff must read and sign the ethics policy, and then review it annually.

  The policy requires that any Board member or staff whose personal or business relationships present possible conflicts with investments held by the Board disclose and resolve these conflicts. As a method of resolution, the ethics policy requires Board members and staff to recuse themselves from discussions and decisions where conflicts may exist.

The Board's statute neither requires an ethics policy nor explicitly outlines ethical responsibilities for Board members and staff.

- The Board also requires vendors and contractors to disclose any existing or potential conflicts of interest when responding to Requests for Proposals for contracts with the Board. The Board incorporates the disclosure requirement into contracts with those vendors who receive an offer from the Board.
- Board staff report that conflicts of interest rarely occur. On the one occasion that a Board member had an existing relationship with a potential Board fund manager, the member recused himself from voting on whether to award the manager a contract with the Board.
- While the Board's ethics policy appears to be effective, and no allegations of impropriety have been reported, the Board's statute neither requires an ethics policy nor explicitly outlines ethical responsibilities for Board members and staff. The Board's statute contains general conflict-of-interest provisions for Board members applied to most state agencies through the

Sunset process, as described in the textbox, *Board Member Conflict-of-Interest Requirements*.[2] While these statutory provisions cover a variety of possible conflicts, they were not specifically designed for agencies with investment authority and do not address Board member or staff personal investments or relationships that may present financial conflicts of interest. In particular, statute does not require that individuals disclose potential conflicts of interest relating to Board investments, or recuse themselves from making decisions or giving advice when a conflict exists.

Board Member Conflict-of-Interest Requirements

- Board members may not be employed by, or own a significant interest in, companies that receive money from the Board.
- Board members cannot receive goods, services, or compensation from the Board, other than reimbursement for Board meeting expenses.
- Board and staff cannot be compensated by higher education trade associations or have spouses that are compensated as employees, officers, or paid consultants by higher education trade associations.
- Board members cannot be registered lobbyists for professions related to the operations of the Board.
- Board members cannot be closely related to individuals who are employees, officers, or paid consultants of trade associations in the banking, securities, or investment industries.

Other state agencies and boards with investment responsibilities have ethics policy requirements in their statutes.

- The Teacher Retirement System of Texas (TRS) statute requires an ethics policy for Board staff, consultants, and advisers to the agency, in addition to prohibiting Board trustees, staff, consultants, and advisers from having interests in TRS investments, loans, or contracts.[3] Law requires TRS employees, consultants, and advisers to disclose in writing any relationships that could cause conflicts of interest in performing TRS duties. Employees must recuse themselves from giving advice or making decisions regarding the conflicting relationships. Certain employees must also file annual financial statements to be kept by the agency.

- Texas law requires the State Board of Education to adopt and enforce an ethics policy that provides standards of conduct for the management and investment of the Permanent School Fund.[4] The policy must address general ethical standards, conflicts of interest, and prohibited transactions and interests, among other matters. The Board must submit the policy to both the Texas Ethics Commission and the State Auditor's Office for their comments before adoption.

- A provision in the Employee Retirement System of Texas' statute requires the agency's Board of Trustees to develop an investment policy that contains a code of ethics.[5] The provision specifies that the code of ethics must contain standards of ethical conduct and disclosure requirements for both trustees and employees.

Recommendation

Change in Statute

3.1 Require in law an ethics policy for Board members and staff that includes disclosure of conflicts of interest and recusal when conflicts exist.

This recommendation would add a provision to the Board's statute that would require the Board to maintain an ethics policy that addresses the following issues for Board members and staff:

- general ethical standards;
- conflicts of interest, including disclosure and recusal requirements;
- acceptance of gifts and entertainment; and
- compliance with, and enforcement of, the ethics policy.

The Board's current policy contains these provisions, so the Board would not need to develop a new policy. Placing these requirements in statute would help ensure that future Board members adhere to an ethics policy. Placing ethics requirements in statute also makes them more transparent to the public and to the investors for whom the Board is responsible.

Fiscal Implication

This recommendation would not have a fiscal impact to the State.

[1] State Auditor's Office, *A Follow Up Report on the Texas Treasury Safekeeping Trust Company, the Texas Guaranteed Tuition Plan, and the Texas Local Government Investment Pool*, no. 04-007 (Austin, Texas, October 2003); and Prepaid Higher Education Tuition Board, *Ethics Policy* (Austin, Texas, September 15, 2004).

[2] Texas Education Code, sec. 54.608.

[3] Government Code, sec. 825.210-212.

[4] Texas Education Code, sec. 43.0031.

[5] Government Code, sec. 815.213.

Issue 4

Texas Has a Continuing Need for the Prepaid Higher Education Tuition Board.

Summary

Key Recommendation

- ♦ Continue the Prepaid Higher Education Tuition Board for 12 years.

Key Findings

- ♦ The Prepaid Higher Education Tuition Board oversees the State's two tax-advantaged college savings plans.
- ♦ Texas has a continuing interest in, and the Board has been successful with, helping thousands of Texas families save for college.
- ♦ While other state agencies deal with higher education, none offer advantages over the Office of the Comptroller of Public Accounts for housing the Board's college savings plans.
- ♦ All 50 states have either a prepaid tuition or savings plan, and many states administer the plans through their treasury offices.

Conclusion

The Legislature recognized the need to help Texans save for college expenses in 1995 when it established the Prepaid Higher Education Tuition Board (Board). The Board administers both of the State's 529 college savings plans, called the Texas Guaranteed Tuition Plan and Tomorrow's College Investment Plan. As the costs of higher education continue to rise, these programs become increasingly important to college-bound Texans and their families. The Sunset review considered organizational alternatives to housing the Board at the Office of the Comptroller of Public Accounts, but found that no other agency could provide benefits over the current structure. The review concluded that the Board successfully accomplishes its mission and should be continued for 12 years.

Support

The Prepaid Higher Education Tuition Board oversees the State's two tax-advantaged college savings plans.

- The Legislature created the Prepaid Higher Education Tuition Board (Board) in 1995 to help students attend college by administering the State's prepaid, guaranteed tuition plan.[1] Originally called the Texas Tomorrow Fund, the Board later changed the name to the Texas Guaranteed Tuition Plan (Prepaid Plan). In 1997, Texas voters approved a constitutional amendment that established the Texas Tomorrow Fund as a constitutionally protected trust fund backed by the full faith and credit of the State.[2] In 2001, the Legislature added a second college savings program to the Board's authority, called Tomorrow's College Investment Plan (Savings Plan). Both plans are authorized under Section 529 of the Internal Revenue Code, so investments grow tax-deferred, and distributions to pay for qualified college costs are federally tax-free.[3] The textbox, *How Do the State's Two Plans Work?,* briefly describes the two plans.

> ***How Do the State's Two Plans Work?***
>
> The Board's Prepaid Plan works much like a defined benefit plan, in that the Board invests contract holders' assets to provide sufficient funds in the future to pay college tuition and required fees for plan beneficiaries.
>
> The Board's Savings Plan is similar to a 401(k) retirement account, except that the Plan requires after-tax dollars, in that beneficiaries have only the funds they have accumulated in their accounts available to pay qualified college costs that include tuition, fees, room and board, and books.

  In response to the Legislature's deregulation of higher education tuition in 2003, the Board temporarily suspended enrollment in the Prepaid Plan. Increases in tuition became too unpredictable to accurately price prepaid tuition contracts, potentially jeopardizing the actuarial soundness of the Prepaid Plan Fund. The Plan continues to honor all existing contracts.

The Board receives no state appropriations, but instead relies on contract payments, investment income, and fees to cover costs.

- A seven-member, part-time Board oversees the two plans and reimburses the Comptroller of Public Accounts for 21.5 staff to operate the Prepaid Plan. The Board receives no state appropriations, but instead relies on prepaid tuition contract payments, investment income, and fees to cover administrative costs and tuition benefits. The Board approved an operating budget of about $7.6 million in fiscal year 2005, much of which paid the Board's 11 investment managers. The Board contracts with Enterprise Capital Management in Atlanta, Georgia to operate the Savings Plan, which reimbursed the Board almost $900,000 for marketing and other administrative expenses.

- At the end of fiscal year 2005, the Prepaid Plan Fund held assets of almost $1.6 billion. That year, the Board paid about $57.5 million in tuition and fees to colleges on behalf of contract holders. Also in fiscal year 2005, Savings Plan account holders invested $46 million, bringing the total Savings Plan Fund to more than $131 million at the end of the fiscal year.

Texas has a continuing interest in helping Texans save for college expenses.

- As higher education costs continue to rise – average tuition and fees at Texas public universities increased more than 60 percent from fiscal years 2002 to 2006 – Texans more than ever need tax-advantaged college savings plans.[4] Also, increasing numbers of students in Texas are seeking higher education; from 1999 to 2005, the number of students attending Texas colleges and universities increased by more than 23 percent.[5] Studies have shown that, on average, individuals with college degrees earn much larger incomes than those whose education ended with a high school diploma. A 2002 U.S. Census Bureau study shows college graduates earning almost 60 percent more than high school graduates.[6]

A Census Bureau study shows college graduates earning almost 60 percent more than high school graduates.

The Board has been successful in helping thousands of Texas families save for college.

- The Board sold more than 158,000 prepaid tuition contracts before temporarily suspending enrollment in 2003. With assets of almost $1.6 billion at the end of fiscal year 2005, the Prepaid Plan is the second largest in the country, after Florida. The Savings Plan, begun six years after the Prepaid Plan, has almost 16,000 account holders, and has disbursed about $11 million for qualified higher education expenses since its inception in 2002. The Board receives few complaints about either plan, indicating overall customer satisfaction.

- The actuarial soundness of the Prepaid Plan Fund has been improving in recent years, and the Fund was 95 percent funded at the end of fiscal year 2005, with its future liabilities exceeding its net assets by $108 million. The Fund returned 14.3 percent in fiscal year 2005, well above the Board's investment return assumption of 8.25 percent. The Fund's average rate of return over a five-year period, ending in fiscal year 2005, was 4.93 percent, higher than most of the State's other major funds.[7]

The Prepaid Plan's investments earned 14.3 percent in FY 2005, well above the Board's assumption of 8.25 percent.

While other state agencies deal with higher education, none offer advantages over the Office of the Comptroller of Public Accounts for housing the Board's college savings plans.

- Like the Board, both the Higher Education Coordinating Board and Texas Guaranteed Student Loan Corporation (TG) assist students with college education. The Coordinating Board helps meet the goals of the State's higher education plan by approving degree programs at colleges and universities, reviewing formulas for allocation of state funds to public institutions, and administering the State's financial aid programs, among other functions. TG's programs include issuing guarantees to private lenders for the repayment of federal higher education loans, helping borrowers avoid loan delinquency through education, reimbursing lenders for loans not paid by borrowers, and collecting from borrowers who have defaulted on their loans. Unlike the Board, however, neither agency focuses on savings programs, nor do the agencies have investment expertise.

- The Texas Constitution requires the Comptroller of Public Accounts to "take the actions necessary to implement" the Texas Tomorrow Fund into which Prepaid Plan beneficiary payments are deposited.[8] This requirement indicates the intent of the Legislature and the people of Texas that the programs should be housed at the Comptroller's Office. While reimbursed for staff dedicated to the Board's activities, the Comptroller's Office also provides a significant amount of support services, such as payroll, information technology, and legal services, at no charge.

All 50 states have either a prepaid tuition or a savings plan, and many states administer the plans through their treasury offices.

- Across the country, 17 states have prepaid tuition plans, and 49 have savings plans.[9] Washington is unusual because it has only a prepaid plan. State treasurers administer savings and prepaid plans in 32 states, either solely or together with another state agency. The remaining states administer their plans through higher education authorities, nonprofit partnerships, or dedicated boards, as in Texas. While Texas' Board is housed at the Office of the Comptroller of Public Accounts, the Comptroller does not administer the plans, though serves as Chair of the Board. In Texas, the functions of the state treasury merged into the Comptroller's Office in 1996.

Recommendation

Change in Statute

4.1 Continue the Prepaid Higher Education Tuition Board for 12 years.

This recommendation would continue the Board, housed at the Comptroller of Public Accounts, for the standard 12-year period.

Fiscal Implication

Because the Prepaid Higher Education Tuition Board receives no state appropriations, continuing the Board for 12 years would have no fiscal impact to the State.

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[1] Texas Education Code, ch. 54.

[2] Texas Constitution, art. VII, sec. 19.

[3] United States Code, title 26, sec. 529 (2006).

[4] Texas Comptroller of Public Accounts, *Texas: Where We Stand: Comparative Facts and Figures About the Lone Star State* (Austin, Texas, February 2006). Online. Available: http://www.window.state.tx.us/comptrol/wwstand/wws0512ed/. Accessed: October 30, 2006.

[5] Ibid.

[6] U.S. Census Bureau, *The Big Payoff: Educational Attainment and Synthetic Estimates of Work-Life Earnings*, by Jennifer Cheeseman Day and Eric Newburger (Washington, D.C., July 2002), p. 2.

[7] Legislative Budget Board, *Annual Report on Major State Investment Funds: Fiscal Year 2005* (Austin, Texas, April 2005), p. 2.

[8] Texas Constitution, art. VII, sec. 19 (d).

[9] The following states currently have prepaid tuition programs: Alabama, Florida, Illinois, Kentucky, Maryland, Massachusetts, Michigan, Mississippi, Nevada, Ohio, Pennsylvania, South Carolina, Tennessee, Texas, Virginia, Washington, and West Virginia. Two states, New Mexico and Wyoming, dismantled their prepaid tuition programs recently due to low enrollment. Colorado terminated its program in 2002 to protect contributors' assets in light of poor stock market performance and rising tuition costs.
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Across-the-Board Recommendations

Prepaid Higher Education Tuition Board

Recommendations	Across-the-Board Provisions
Do Not Apply	1. Require public membership on the agency's policymaking body.
Modify	2. Require provisions relating to conflicts of interest.
Already in Statute	3. Require unbiased appointments to the agency's policymaking body.
Do Not Apply	4. Provide that the Governor designate the presiding officer of the policymaking body.
Modify	5. Specify grounds for removal of a member of the policymaking body.
Update	6. Require training for members of the policymaking body.
Already in Statute	7. Require separation of policymaking and agency staff functions.
Already in Statute	8. Provide for public testimony at meetings of the policymaking body.
Update	9. Require information to be maintained on complaints.
Apply	10. Require the agency to use technology to increase public access.
Do Not Apply	11. Develop and use appropriate alternative rulemaking and dispute resolution procedures.

Board Information

Board Information

Board at a Glance

The mission of the Prepaid Higher Education Tuition Board (Board) is to help Texas students attend college. The Board accomplishes its mission by overseeing the State's two 529 college savings programs, named after the section of the Internal Revenue Code that authorizes them. The Texas Guaranteed Tuition Plan (Prepaid Plan) allows buyers to lock in future college tuition and required fees at today's prices, and Tomorrow's College Investment Plan (Savings Plan) is a savings program that works much like a 401(k) but with after-tax dollars.

In 2003, the Board temporarily suspended enrollment in the Prepaid Plan because of the uncertain effects of the deregulation of tuition. The Board feared that, because it could not accurately predict future costs of tuition, it could potentially sell new tuition contracts at inadequate prices and jeopardize the Plan's assets. The Savings Plan remains open.

The Board's mission is to help Texas students attend college.

Key Facts

- **Staffing.** The Board has no staff of its own, but reimburses the Office of the Comptroller of Public Accounts for 21.5 staff to support the day-to-day operations of the Board. Because the Board contracts out administration of the Savings Plan, the 21.5 staff primarily support the Prepaid Plan.
- **Funding.** The Board receives no appropriation to operate the two plans, but instead relies on prepaid tuition contract payments, investment income, and fees to cover administrative costs and tuition benefits. In fiscal year 2005, the Board spent about $7.6 million in Prepaid Plan administrative costs, which included staff salaries and payments to fund managers. The Board also received almost $900,000 from the Savings Plan contractor for reimbursement of administrative and marketing expenses for that program.
- **Texas Guaranteed Tuition Plan (Prepaid Plan).** From 1996 to 2003, the Board sold more than 158,000 prepaid tuition contracts to Texas families, allowing them to pay for future college tuition and fees at current prices. With $1.6 billion in assets at the end of fiscal year 2005, the Prepaid Plan Fund is one of the State's largest investment funds and is backed by the full faith and credit of the State. The Plan has paid almost $151 million in tuition and fees in the last four academic years.
- **Tomorrow's College Investment Plan (Savings Plan).** By the end of fiscal year 2005, almost 16,000 account holders had invested more than $131 million in Savings Plan accounts. The Plan has disbursed approximately $11 million for college costs from its inception in 2002 through fiscal year 2005.

Major Events in Board History

1995 The Legislature creates the Prepaid Higher Education Tuition Board to administer the state's prepaid tuition program, originally called the Texas Tomorrow Fund.

1996 The U.S. Congress adds section 529 to the Internal Revenue Code, authorizing a federal tax break until 2010 for prepaid tuition plans and college savings accounts administered by the states.

1997 The Legislature and Texas voters make the Texas Tomorrow Fund a constitutionally protected trust fund backed by the full faith and credit of the State.

2001 The Legislature authorizes the Board to create a college savings plan, named Tomorrow's College Investment Plan. The Board places both plans under the umbrella term Texas Tomorrow Funds, and changes the prepaid tuition program's name to the Texas Guaranteed Tuition Plan.

2003 The Legislature deregulates tuition, and the Board temporarily suspends new enrollment in the Texas Guaranteed Tuition Plan to protect its actuarial soundness.

2006 The U.S. Congress makes permanent the federal tax incentives in section 529 of the Internal Revenue Code.

Organization

Policy Body

The Board consists of seven members with the Comptroller serving as the presiding officer.

The Prepaid Higher Education Tuition Board consists of seven members, including the Comptroller of Public Accounts, who serves as the presiding officer. The Governor appoints two board members with the advice and consent of the Senate. The Lieutenant Governor appoints the remaining four members, at least two of whom must be recommended by the Speaker of the House of Representatives. All appointed members serve staggered six-year terms and must have expertise in higher education, business, or finance. The table, *Prepaid Higher Education Tuition Board*, identifies current board members.

Prepaid Higher Education Tuition Board

Member Name	City	Term Expires
Honorable Carole Keeton Strayhorn, Presiding Officer	Austin	2007
Honorable John C. Anderson	Plainview	2007
Michael D. Gollob, CPA	Tyler	2009
Jack R. Hamilton, CFA	Houston	2007
E.J. Pederson	Galveston	2003
Honorable Mark W. Stiles	Dallas	2005
Beth M. Weakley	San Antonio	2005

The Board's primary responsibility is to oversee the State's two 529 college savings plans. The Board's general duties for both plans include developing administrative rules and entering into, and monitoring, contracts for professional services. The Board is also responsible for investing and allocating the assets of the Prepaid Plan Fund, which consists of tuition contract payments and investment earnings, in addition to approving investment and actuarial assumptions used to manage the Fund, determining Prepaid Plan enrollment periods, and overseeing payment of tuition contracts. The Investment Committee, a three-member subcommittee of the Board, assists the Board in managing both plans by providing investment oversight, in addition to actuarial policy recommendations for the Prepaid Plan Fund. The Board typically meets quarterly.

The Board oversees the State's two 529 college savings plans.

Staff

While the Board has no direct employees, designated staff at the Office of the Comptroller of Public Accounts carry out the Board's day-to-day operations. The Comptroller's Office currently has 21.5 staff assisting the Prepaid Plan, and these employees are counted against the Comptroller's FTE cap. The Board contracts management of the Savings Plan to Enterprise Capital Management based in Atlanta, Georgia; therefore, the Savings Plan has no designated employees. Comptroller's Office employees carry out customer service and accounting functions for Prepaid Plan participants, monitor contract compliance with vendors, and conduct investment transactions authorized by the Board. Certain administrative tasks such as publication production, mailing, and legal services are carried out by separate divisions at the Comptroller's Office, and not by designated Board staff.

In addition to its contract with Enterprise Capital Management, the Board contracts with vendors to provide advertising services and investment advice. The Board uses television advertisements to educate the public and boost enrollment in the Savings Plan. The Plan's advertising budget has ranged from $2 million in fiscal year 2003 to about $825,000 in fiscal year 2005. The Board's contracted investment adviser monitors the performance of both the Prepaid and Savings plans, helps the Board to develop and implement its investment strategy, and apprises the Board of national trends affecting investments and 529 plans. Contracted vendors are paid from the earnings of the two separate plans and do not receive state funding.

Designated staff at the Comptroller's Office carry out the Board's day-to-day operations.

Because the staff supporting the Board comprises such a small portion of the Comptroller's overall staff, no analysis was prepared comparing the staff's workforce composition to the overall civilian labor force.

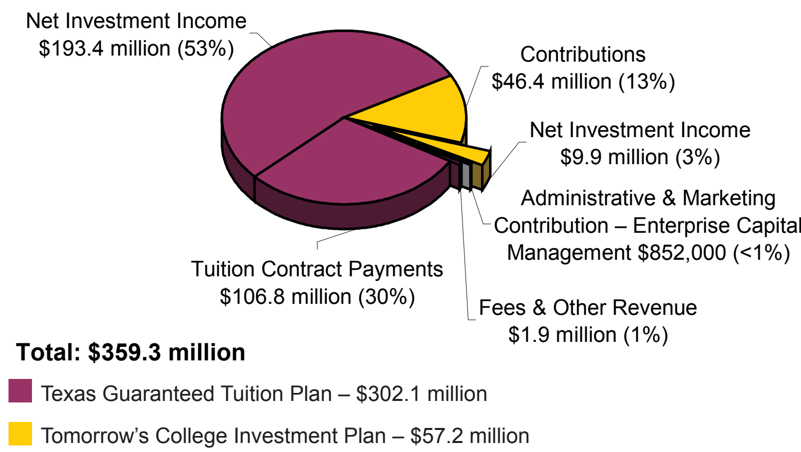
Funding

Revenues

The Board receives no state appropriation for either the Prepaid Plan or the Savings Plan. Instead, the Board relies on prepaid tuition contract payments, investment income, and fees to cover administrative costs and tuition benefits.

In fiscal year 2005, the Board's two programs – the Prepaid Plan, with total assets of $1.6 billion, and the Savings Plan, with total assets of $131 million – had more than $359 million in revenues. The pie chart, *Sources of Revenue*, describes the Board's revenue in more detail.

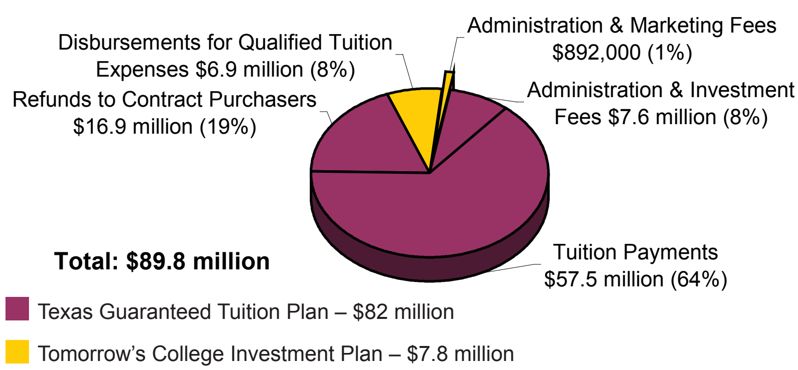
Sources of Revenue – FY 2005



Expenditures

In fiscal year 2005, the Board distributed about $57.5 million for tuition payments from the Prepaid Plan Fund, and $6.9 million for qualified tuition expenses from Savings Plan accounts. The Board also spent approximately $8.5 million for administrative expenses, mostly for payments to fund managers and financial advisers, and for marketing. The Board reimbursed the Comptroller's Office approximately $1 million for full-time staff salaries and benefits in fiscal year 2005, but did not reimburse more than $188,000 for technical, legal, and human resources services the Comptroller's Office provides. The pie chart, *Expenditures*, depicts the Board's expenditures in more detail.

Expenditures – FY 2005



Appendix A describes the Board's use of Historically Underutilized Businesses (HUBs) in purchasing goods and services for fiscal years 2002 to 2005. Over the last four years, the Board has generally fallen short of state goals in all categories except other services.

Board Operations

The Board, housed in the Office of the Comptroller of Public Accounts, oversees the State's college prepaid tuition and savings plans.

Texas Guaranteed Tuition Plan (Prepaid Plan)

From 1996 until 2003, the Board sold more than 158,000 prepaid tuition contracts to Texans, allowing them to purchase the future college tuition and fees of their young family members at current prices. The Texas Constitution guarantees the tuition contracts, as explained in the textbox, *The Prepaid Plan's Constitutional Guarantee*.

> ***The Prepaid Plan's Constitutional Guarantee***
>
> In 1997, the Legislature, with voter approval, amended the Texas Constitution to guarantee the payment of tuition contract benefits from state funds in the event that the Plan's assets cannot cover tuition payments. The guarantee provides extra security to the Plan's purchasers, and also places a higher burden on the Board to make sound investment decisions.

After the Legislature deregulated tuition in 2003, the Board voted to temporarily suspend new enrollment to protect the Prepaid Plan's assets. Average tuition and fees at Texas public universities have since increased more than 60 percent from fiscal years 2002 to 2006, making it difficult for the Board to accurately predict the future cost of tuition and reopen the Plan.[1] In addition, the range between the least and most expensive tuition costs has increased dramatically, adding to the Board's difficulty in determining an accurate price for tuition contracts.

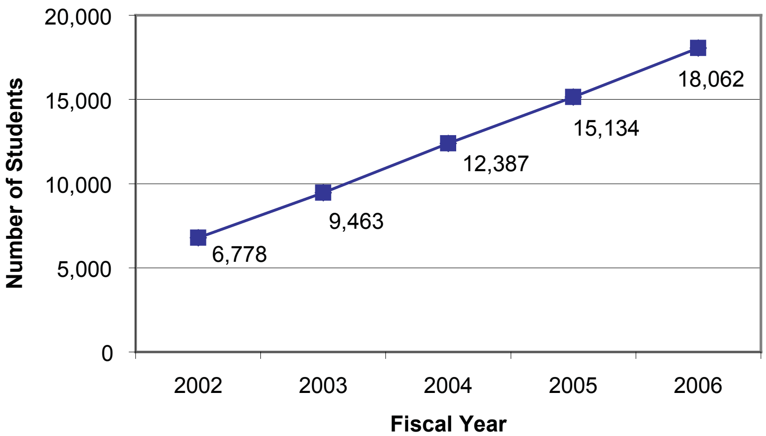
When the Prepaid Plan was open to enrollment, purchasers could choose between four types of tuition contracts, each of which offered affordable payment options. State law requires either the parent or guardian, or the beneficiary to be a Texas resident, but the purchaser may live out of state. Families that purchased a senior college contract in 2003, when their child was a newborn, could pay a lump sum of $17,460, or $152 per month until the child graduates from high school in 2021. The table, *Prepaid Tuition Plan Types*, describes the types, cost, and popularity of the tuition contracts available for purchase during the last open enrollment period.

Prepaid Tuition Plan Types

Type of Plan	Description	Lump Sum Cost for Newborn in 2003	Monthly Payment Until Graduation From High School for Newborn (2003 – 2021)	Percentage of Total 158,438 Contracts Purchased (1996 – 2003)
Senior College	128 credit hours (4 years) at a four-year, public, Texas university	$17,460	$152	84%
Junior-Senior College	128 credit hours 64 credit hours (2 years) at a Texas community college, and 64 credit hours (2 years) at a four-year, public, Texas university	$12,130	$106	9%
Junior College	64 credit hours (2 years) at a Texas community college	$3,532	$33	4%
Private College	128 credit hours (4 years) at a Texas private college or university	$52,313	$448	2%

The Prepaid Plan's benefits are both portable and flexible. If a beneficiary decides to attend a different type of college than covered by the contract, the Prepaid Plan transfers tuition benefits to the college, which can be any accredited in- or out-of-state, public, or private institution. The Plan pays an amount to the different college based on the value of the purchased contract's benefits, and the beneficiary is responsible for any extra amount due. Alternately, if beneficiaries decide to attend a less expensive type of college, they can save credit hours for future education, including graduate school, or cancel their contracts and receive refunds for unused credit hours.

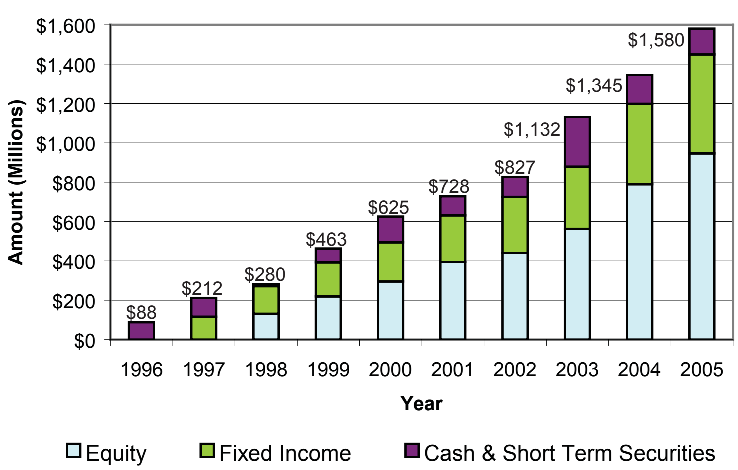
Prepaid Plan Student Enrollment
FYs 2002 – 2006



The Prepaid Plan is also flexible in addressing changing financial needs. Families could purchase one-year increments of tuition benefits if they could not afford two- or four-year plans, and can downgrade to a less expensive plan if the payments become burdensome. Additionally, purchasers can transfer contracts to other immediate family members if the original beneficiary receives a scholarship or decides not to attend college.

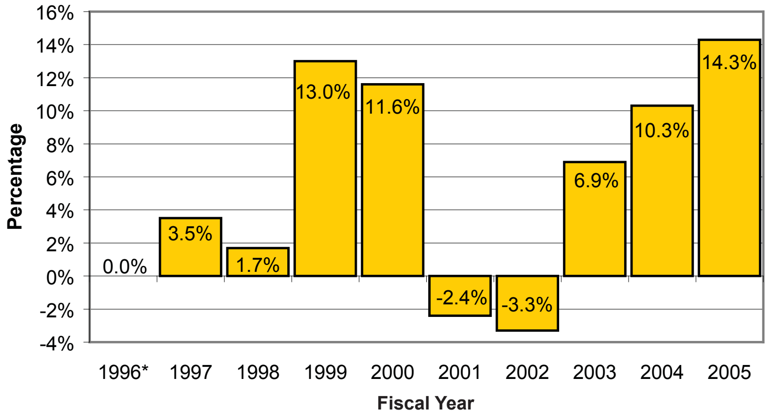
Although the Board has not sold any new plans since 2003, many purchasers continue to pay off their contracts, contributing more than $106 million to the Prepaid Plan Fund in fiscal year 2005. That year, the Plan paid $57.5 million in tuition and fees on behalf of 15,134 students, 62 percent of whom attended a four-year, Texas, public university. The graph, *Prepaid Plan Student Enrollment*, shows how many students received tuition benefits over the last five fiscal years.

Portfolio Diversification – Ending Market Values
Prepaid Plan Fund
FYs 1996 – 2005



With assistance from its contracted financial adviser, the Board and its Investment Committee review and approve an investment strategy for the Prepaid Plan Fund and vote on contract awards to individual fund managers. In fiscal year 2005, the Prepaid Plan Fund returned 14.3 percent, well above the Board's investment return assumption of 8.25 percent. The graphs, *Portfolio Diversification – Ending Market Values*, and *Annual Rates of Return*, show the Board's investment strategy and the performance of the Prepaid Plan Fund over its history.

Annual Rates of Return
Prepaid Plan Fund
FYs 1996 – 2005

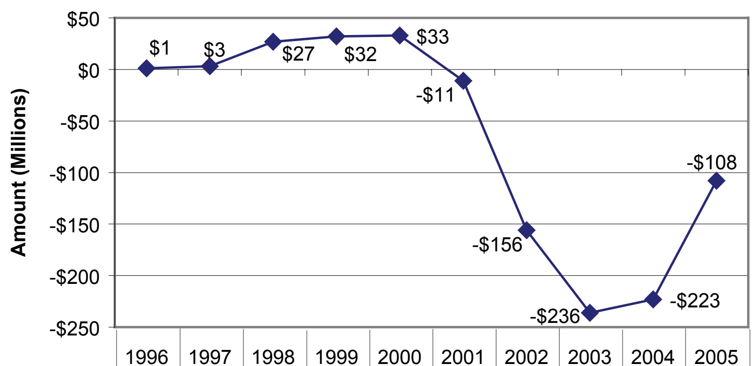


* The Board held the Fund's assets in the treasury until it began making investments in fiscal year 1997.

The Board's actuary reported that as of August 31, 2005, the Prepaid Plan Fund was approximately 95 percent funded, with the Fund's net assets $108 million short of the cost of future tuition benefits payable. Although under-performance of the stock market and tuition deregulation have threatened the Fund's assets in the past, in recent years the Fund's actuarial soundness has improved. The graph, *Unfunded Actuarial Accrued Liability*, shows the status of the Fund's liabilities over its history.

The Prepaid Plan was approximately 95 percent funded at the end of FY 2005.

Unfunded Actuarial Accrued Liability
Prepaid Plan Fund
FYs 1996 – 2005



	1996	1997	1998	1999	2000	2001	2002	2003	2004	2005
Percent Funded	100%	101%	105%	104%	104%	99%	90%	88%	89%	95%

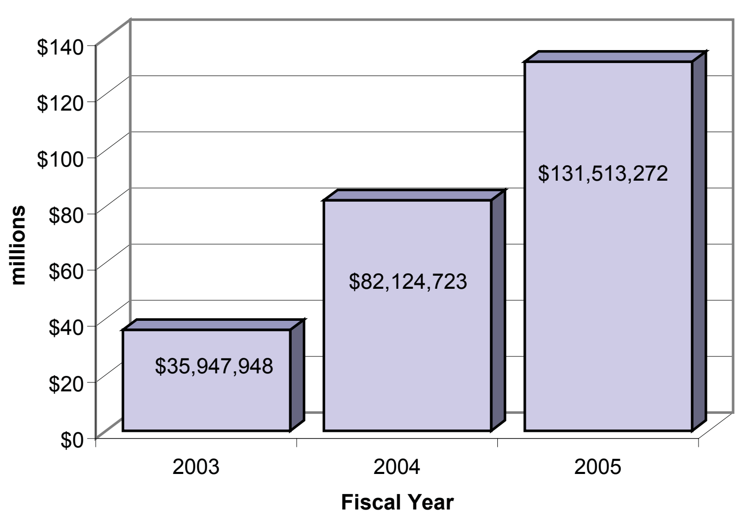
Tomorrow's College Investment Plan (Savings Plan)

Unlike the Prepaid Plan, the State does not guarantee that contributions to the Savings Plan will meet future tuition requirements. Instead, the State offers the Savings Plan as an additional tool to assist families in meeting future college costs. By federal law, the Savings Plan allows account holders to contribute after-tax income to individual investment accounts. All deposits and earnings may later be withdrawn, free from federal taxes, to meet qualified higher education payments, including tuition, fees, room and board, books, and supplies. Savings Plan funds may be used to meet obligations at any post-secondary institution that is eligible to participate in federal student financial aid programs, including most public and private universities, community, vocational, and graduate schools. The table, *Comparison of the Prepaid and Savings Plans*, provides a side-by-side description of the two plans.

Comparison of the Prepaid and Savings Plans

Prepaid Plan	Savings Plan
Backed by state guarantee	No state guarantee
Locks in tuition prices	No lock on tuition prices
Covers tuition and required fees only	Covers all qualified expenses, including tuition, room and board, fees, and books
Beneficiaries must be younger than 18, or 18 or older but still in high school, when a contract is purchased	No age limit
Beneficiary must be a Texas resident, or a nonresident child of a resident parent	No residency requirement
Lump sum and installment payments based on age of beneficiary and years of tuition purchased	Minimum $25/month or $15/month for direct deposit; maximum account limit of $257,460
State invests contract payments	Account holders choose investment options

Savings Plan Fund Net Assets
FYs 2003 – 2005



At the end of fiscal year 2005, the Savings Plan had approximately 16,000 account holders and more than $131 million in assets under management. About 73 percent of the Plan's investment comes from Texas residents. The graph, *Savings Plan Fund Net Assets*, shows how the Fund has grown since its inception.

The Board's Savings Plan manager offers year-round enrollment and allows account holders to choose from among 19 different investment portfolios designed to meet different savings goals. The different portfolios are grouped into three types, as described in the textbox, *Savings Plan Account Investment Options*. Account holders can select investment portfolios based on the beneficiary's age, the account holder's desire for fixed asset allocation, or the account holder's preference for single-fund investments. The plan manager handles the Plan's daily operations, including operating a call center and providing some marketing services.

Unlike the Prepaid Plan, Savings Plan membership is not restricted to the account holder's state of residency. Texans may invest in college savings plans from other states, and individuals from other states may invest in Texas' Savings Plan. As a result, state plans compete for account holders by offering various incentives relating to account fees, sales charges, minimum balances, investment options, and other account features. States typically offer special benefits to attract residents. Most of the Savings Plan's administrative fees are similar for both Texans and out-of-state account holders, and are described in the table, *Savings Plan Features*.

Savings Plan Account Investment Options

The current plan manager allows account holders to select from three basic types of investment portfolios.

Age-Based Portfolios: These portfolios seek to temper the risk and expected returns on investments with the time period remaining until the beneficiary needs the Plan to pay for tuition. Generally, the longer the beneficiary's time horizon, the riskier the investment mix.

Static-Allocation Portfolios: These portfolios offer options to account holders who prefer fixed asset allocation. Account holders can choose from a portfolio allocated to stocks (60 percent) and fixed-income securities (40 percent) or a portfolio allocated only to stocks.

Single-Fund Portfolios: The plan manager offers 12 portfolios that focus on a single investment strategy or asset class. These portfolios offer a variety of strategies that allow account holders to more specifically focus on investment goals such as growth, principal preservation, or capital appreciation.

Savings Plan Features

Plan Features	Texas Residents	Non-Texas Residents
Initial Investment Minimum	$25, with $25 minimum additional deposits	$25, with $25 minimum additional deposits
Direct Deposit or Automatic Purchase Plan Minimum	$15, with $15 minimum additional deposits	$15, with $15 minimum additional deposits
Maximum Account Contribution Limit	$257,460	$257,460
Enrollment Fee	$0	$0
Annual Account Maintenance Fee	Waived	$30 or waived for automatic payroll deduction or for accounts with a value greater than $25,000
State Fee	$0	Waived
Wire Transfer Fee	$10	$10

The Board contracts with a manager who handles the Savings Plan's daily operations.

In addition to administrative fees, account holders pay annual portfolio fees to cover costs associated with account maintenance and distribution, and may pay sales charges when they purchase or sell shares of funds. Texas residents can invest directly in seven of the Plan's 19 portfolios, avoiding the charges associated with investing through financial advisers. Texans can invest indirectly in the remaining 12 portfolios with the assistance of an adviser.

All non-Texas residents must invest through financial advisers and pay the associated sales charges. Account holders pay annual fees and sales charges from their portfolios' assets, reducing the total value of their account. The table, *Asset-Based Fees and Sales Charges*, shows the differences between what Texas residents and nonresidents pay.

Asset-Based Fees and Sales Charges

Fee Type	Texas Resident Direct Investment Fees (percent of assets)	Texas Resident Indirect Investment Fees (percent of assets)	Non-Texas Resident Indirect Investment Fees (percent of assets)	Explanation of Fee
Annual Portfolio Fees	1.00%*	0.45% – 2.70%	0.45% – 2.70%	Portfolio fees cover the costs associated with maintaining, administering, and marketing portfolios.
Sales Charges (Initial and Deferred)	None	1.00% – 4.75%	1.00% – 4.75%	Sales charges may be applied either when an account holder purchases or sells shares of a fund. The fee compensates the broker that sells the shares.

* Texans who buy shares in single-fund portfolios pay investment fees of between 0.45 percent and 2.20 percent.

[1] Texas Comptroller of Public Accounts, *Texas: Where We Stand: Comparative Facts and Figures About the Lone Star State* (Austin, Texas, February 2006). Online. Available: http://www.window.state.tx.us/comptrol/wwstand/wws0512ed/. Accessed: October 4, 2006.

APPENDICES

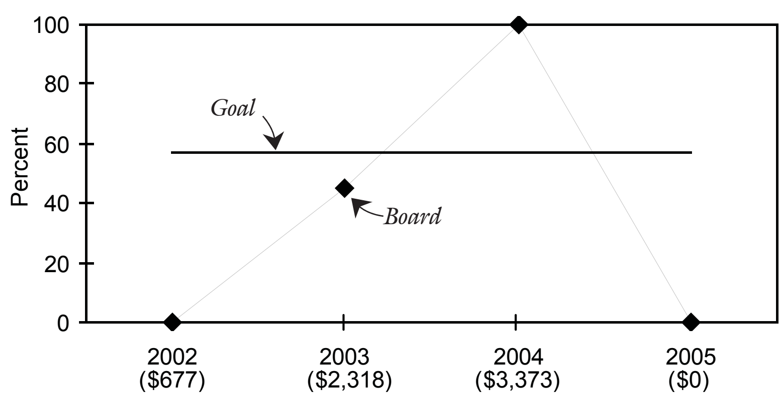
Historically Underutilized Businesses Statistics

2002 to 2005

The Legislature has encouraged state agencies to increase their use of Historically Underutilized Businesses (HUBs) to promote full and equal opportunities for all businesses in state procurement. The Legislature also requires the Sunset Commission to consider agencies' compliance with laws and rules regarding HUB use in its reviews.[1] The review of the Prepaid Higher Education Tuition Board revealed that the Board is generally complying with state requirements concerning HUB purchasing.

The following material shows trend information for the Prepaid Higher Education Tuition Board's use of HUBs in purchasing goods and services. The Board maintains and reports this information under guidelines in the Texas Building and Procurement Commission's statute.[2] In the charts, the flat lines represent the goal for HUB purchasing in each category, as established by the Texas Building and Procurement Commission. The diamond lines represent the percentage of Board spending with HUBs in each purchasing category from 2002 to 2005. Finally, the number in parentheses under each year shows the total amount the Board spent in each purchasing category. The Board has generally fallen short of state goals in all categories except other services.

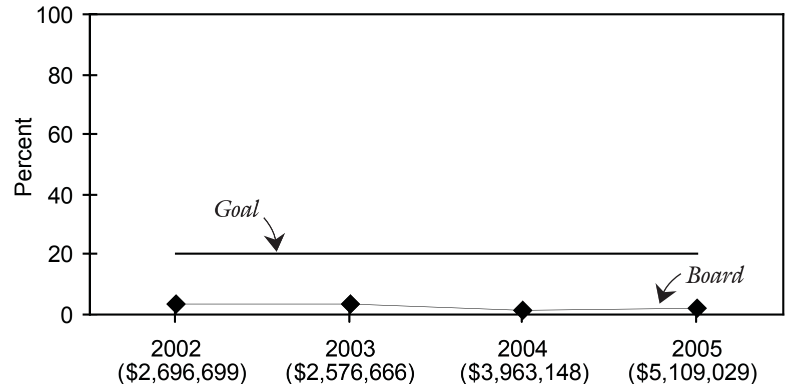
Special Trade



The Board fell below the state goal for HUB special trade purchases in 2002 and 2003, but exceeded the goal in 2004. In 2005, the Board made no purchases in this category.

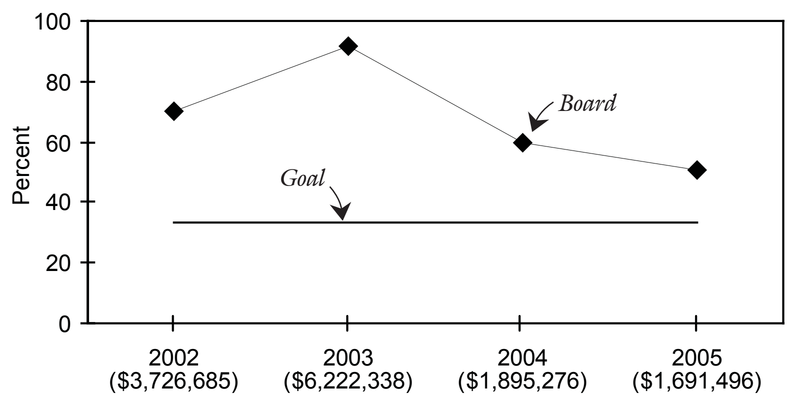
Appendix A

Professional Services



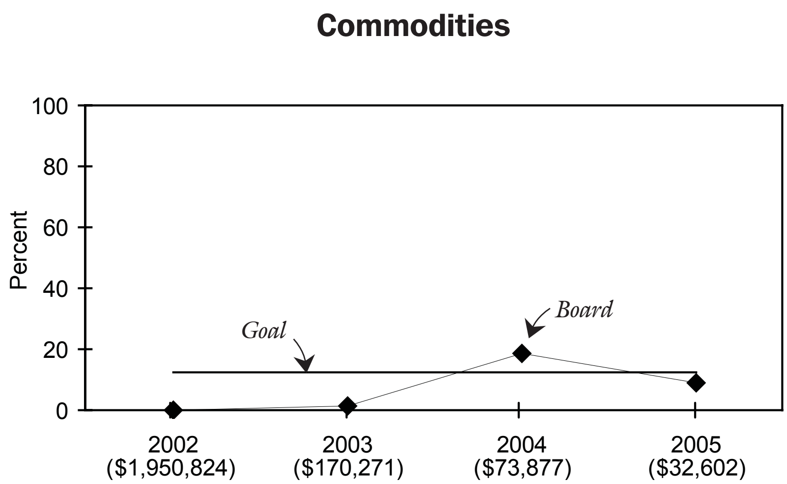
The Board has failed to meet goals in this category for the last four years.

Other Services



The Board has exceeded goals in this category for the last four years.

Appendix A



The Board met the goal for this category in 2004, but fell short in the other three years.

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1 Texas Government Code, sec. 325.011(9)(B).

2 Texas Government Code, ch. 2161.
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Appendix B

Staff Review Activities

During the review of the Prepaid Higher Education Tuition Board, Sunset staff engaged in the following activities that are standard to all Sunset reviews. Sunset staff worked extensively with Board personnel; attended Board meetings; interviewed legislative staff; conducted telephone interviews with interest groups; reviewed Board documents and reports, state statutes, legislative reports, previous legislation, and literature; researched the organization and functions of similar state boards and agencies in other states; and performed background and comparative research using the Internet.

In addition, Sunset staff also performed the following activities unique to this review.

- Interviewed or met with staff from the Legislative Budget Board, State Auditor's Office, Texas Higher Education Coordinating Board, and Texas Guaranteed Student Loan Corporation.
- Attended meetings of the Board's Investment Committee.
- Conducted phone interviews with various Board members.
- Interviewed representatives from colleges and universities who interact with the Prepaid Plan.
- Met or conducted phone interviews with Board contractors including the Savings Plan manager, investment adviser, actuary, and advertising firm.
- Interviewed a financial adviser regarding sales of 529 savings plans.
- Interviewed U.S. Internal Revenue Service staff.

Sunset Review of the
Prepaid Higher Education Tuition Board

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