GET Committee Meeting

February 11, 2016

Welcome & Approval of Minutes

Chair's Report

Today's Agenda Items:

- **Chair's Report**

- **GET Investment Report**
  - **Allyson Tucker**, Washington State Investment Board

- **Director's Report**
  - **Betty Lochner**, GET Director

- **Feasibility Study Update**
  - **Betty Lochner**, GET Director
  - **Matt Smith**, State Actuary
  - **Jamie Canup**, Attorney, Hirschler Fleischer

Chair's Report

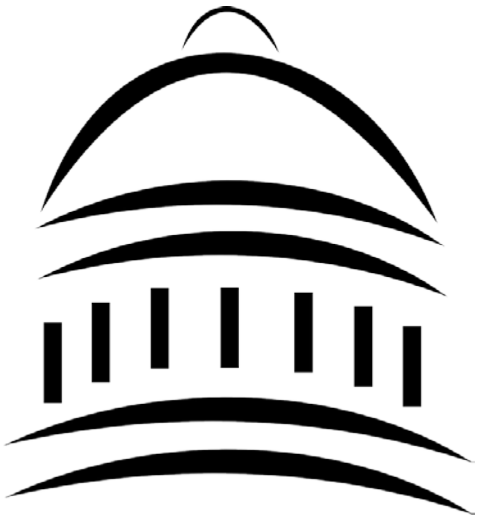
Objectives

- Legislative Update
- Investment Update (WSIB)
- Program Statistics
- Feasibility Study Update
    - What has been done?
    - What is left to complete?
    - Information needed/next steps

Chair’s Report

Legislative Update

- Legislative Advisory Committee to the GET Committee
- 529 Savings Plan Legislation
- Next Generation Savings Plan Legislation
- ABLE Legislation
- Budget Update



GET Investment Update

Guaranteed Education Tuition℠

Allyson Tucker, Senior Investment Officer

Washington State Investment Board (WSIB)

Director’s Report

Betty Lochner
GET Director

Program Statistics

Director's Report

Customer Refund Update

Data: September 1, 2015 - January 31, 2016

- Inbound calls:
  30,072
- Inbound emails:
  4,591
- Estimated number of refund requests received:
  11,761
- Estimated number of refunds processed:
  7,806
- Estimated dollar value of processed refunds:
  $163,923,950

Feasibility Study Update

Questions that have been answered to date:

Question 1:

Beginning in the 2017-18 academic year, what program adjustments will be made to ensure that the total payout value of each account is not decreased or diluted as a result of the initial application of any changes in tuition?

Feasibility Study Update

GET
Guaranteed Education Tuition℠

Answer:

- The GET Committee decided to freeze the payout value at $117.82 per unit indefinitely until the time when one year of resident undergraduate tuition and state mandated fees at Washington State's highest priced public university surpasses $11,782.

- Options were discussed around awarding additional units verses refunding contributions received after July 1, 2015. The GET Committee decided that effective July 1, 2015, the GET program delay new unit sales for a period not to exceed two years, except continued payments on Custom Monthly Plans established prior to July 1, 2015, shall be allowed.

- Effective August 19, 2015, GET will refund the amortization fee paid by customers who have unredeemed units at a purchase price of $163 or greater.

Feasibility Study Update

Question 2:

What is the impact of tuition reductions on the funded status?

Answer:

State Actuary, Matt Smith, provided a preliminary actuarial valuation report regarding GET's funded status on September 1, 2015. Mr. Smith reported that the funded status of the GET program as of June 30, 2015, is 140 percent, up from 106 percent one year earlier.

Feasibility Study Update

Guaranteed Education Tuition℠

Question 3:

What are the alternatives/impacts of removing the state penalty for non-qualified withdrawals?

Answer:

The GET Committee decided to waive all program refund penalties and fees until December 15, 2016, so that customers who are concerned about the tuition policy changes have the opportunity to move their savings into another investment, such as another 529 plan.

Feasibility Study Update

Question 4:

What is the feasibility of creating a 529 college savings plan?

Answer:

Over several meetings, the GET Committee reviewed information from a national 529 expert summarizing options and other states, as well as a marketing analysis. On December 3, 2015, the GET Committee directed GET staff to begin the development of a state-managed direct-sold 529 college savings plan.

Feasibility Study Update

What's Left?

- What is the impact of tuition reductions on future unit prices?
- What are some alternatives of linking GET's payout value from tuition and fees to cost of attendance?

Feasibility Study Update

GET
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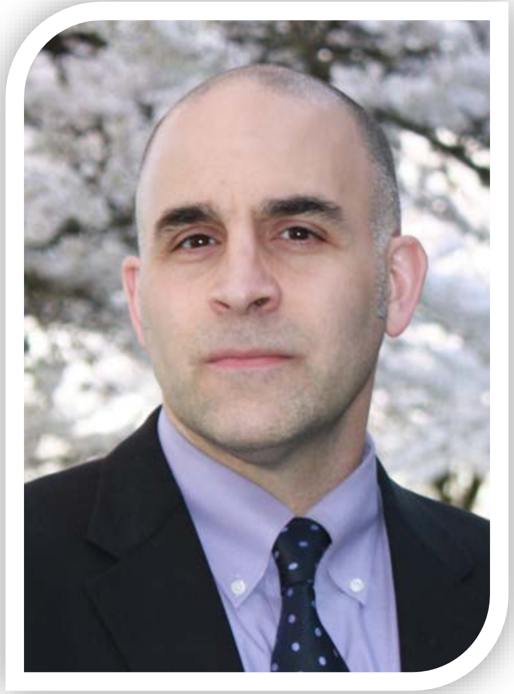
Matt Smith, State Actuary
Office of the State Actuary



What is the impact of tuition reductions on future unit prices?

Feasibility Study Update

Selling future units requires maintaining a delicate balance between “risk” and “affordability.”

- Risk represents the risk the state will need to make contributions to the program
- Affordability represents the affordability of GET unit prices
- Improving one factor will typically increase the impact of the other

Feasibility Study Update

What has changed since the program's last price-setting exercise?

- Tuition reductions
- Minimum payout value established
- Refund of amortization payments
- Temporary window with special refund rules

Feasibility Study Update

How have these changes impacted the program's most recent actuarial measurements?

- Tuition reductions improved funded status
- Minimum payout value and refunds lowered funded status
- Net impact was a significant improvement in funded status measured at June 30, 2015

Feasibility Study Update

How would these changes impact future unit pricing if the program reopens?

- Removal of amortization component lowers future unit price
- Recent and planned tuition reductions could lower future unit prices below prices paid by recent cohorts

Feasibility Study Update

Guaranteed Education Tuition℠

Additional pricing considerations if the program reopens:

- Determine unit price reserve necessary to manage risk from new units sold.
- Continue minimum payout value to protect future purchasers from any future tuition reductions.
- Assess whether initial balance between risk and affordability exists.
- Establish contingency plans to address any imbalance between risk and affordability that may occur in the future.

Feasibility Study Update

Jamie Canup, Attorney / 529 Plan Expert
Partner with Hirschler Fleischer Attorneys at Law

What are some alternatives of linking GET's payout value from tuition and fees to cost of attendance?

Feasibility Study Update

- Cost of Attendance

- Alternative Structures
  - Weighted Average
  - Credit Hours
  - Variation
  - Guaranteed Return
  - Risk Transfer

Next Steps

What would the GET Committee like staff to focus on?

- What does the State of Washington wish to offer and achieve for its citizens when considering what the parameters of a 529 college savings plan should look like?
  - Continue to explore ways to reopen GET without significant modifications?
  - Explore ways to modify GET so that it can be reopened?
  - If modifications should be further studied, what specific models would you like GET staff to focus on?

Public Comment

GET
Guaranteed Education Tuition℠

- 30 minutes
- Sign-up sheet
- 3 minutes per person
- If you would like to submit a written comment, please send your input to: GETInfo@wsac.wa.gov, and include the subject line: “GET Committee Statement”

Questions & Answers

Next Meeting

Wednesday, April 20, 2016
J.A. Cherberg Building
Capitol Campus, Olympia
Senate Hearing Room 1
2 p.m. to 4 p.m.

Guaranteed Education Tuition (GET) Committee Meeting
Thursday, February 11, 2016

J.A. Cherberg Building, Capitol Campus
Senate Hearing Room 1
Olympia, WA 98504
2:00 p.m. – 4:00 p.m.

AGENDA

Call to Order & Welcome

• Approval of the December 3, 2015 Minutes	ACTION	TAB 1
• Chair's Report o Legislative Update	INFO/DISCUSSION	TAB 1
• GET Investment Update *Allyson Tucker, Washington State Investment Board*	INFO/DISCUSSION	TAB 2
• Director's Report o Program Update	INFO/DISCUSSION	
• Feasibility Study Update o Overview to Date o Pricing Alternatives o Next Steps *Betty Lochner, GET Director* *Matt Smith, State Actuary* *Jamie Canup, Hirschler Fleischer*	INFO/DISCUSSION	TAB 3
• Next Steps	DISCUSSION	
• Public Comment		
• Adjournment		

Upcoming meetings:
Wednesday, April 20, 2016
2:00 p.m. – 4:00 p.m.
Cherberg Building, Senate Hearing Room 1
Capitol Campus, Olympia

Thursday, June 23, 2016
2:00 p.m. – 4:00 p.m.
Cherberg Building, Senate Hearing Room 1
Capitol Campus, Olympia

GUARANTEED EDUCATION TUITION (GET) PROGRAM
Committee Meeting Minutes
December 3, 2015
J.A. Cherberg Building, Capitol Campus
Olympia, WA 98504

WSAC staff in attendance:
Betty Lochner, GET Director
Betsy Hagen, Associate Director for GET Operations
Ryan Betz, Associate Director of GET Marketing & Communications
Diana Hurley, GET Contact Center Manager
Matthew Freeby, GET Finance Manager
Kim Porter, GET Project Manager
Dan Payne, GET Marketing & Communications Coordinator
Katie Gross, Special Assistant to the GET Director
Jane Olsen, GET Accountant
Marc Webster, WSAC Senior Fiscal Policy Advisor
Rachelle Sharpe, WSAC Interim Deputy Director
Maddy Thompson, WSAC Government Relations Director
David Mitchell, WSAC Chief Technology Officer
Shakib Kamal, GET Solutions Architect

Guests in attendance:
Matt Smith, State Actuary
Rick Brady, Office of the Attorney General
Allyson Tucker, Washington State Investment Board
Jamie Canup, 529 Taxation Expert, Hirschler Fleischer
Cherie Berthon, Office of Financial Management
Scott Merriman, Office of the State Treasurer
Scott Copeland, State Board for Community and Technical Colleges
Phil Paroian, Washington State Investment Board
Adam Hall, Senate Democratic Caucus
Michael Harbour, Office of the State Actuary
Alan Perry, Milliman
Janet Michaelsen, Citizen
Mike & Pat Mulligan, Citizens
Terry Cays, Citizen
Karin & Denny McKim, Citizens
Catrina Lucero, Washington State House of Representatives
Clint McCarthy, Senate Higher Education Committee, Coordinator
Evan Klein, Senate Higher Education Committee, Counsel

CALL TO ORDER & WELCOME

Gene Sharratt, Chair of the GET Committee and Executive Director of the Washington Student Achievement Council (WSAC), welcomed the Committee members and meeting participants. GET Committee members in attendance were Treasurer James McIntire, David Schumacher, the Director of the Office of Financial Management, Beth Berendt, citizen representative, and Mooi Lien Wong, citizen representative. Wong participated via conference call.

APPROVAL OF THE OCTOBER 7, 2015 MINUTES

Beth Berendt motioned to approve the October 7, 2015 meeting minutes as presented. David Schumacher seconded the motion. The minutes were unanimously approved as presented.

APPROVAL OF THE 2016 GET COMMITTEE MEETING CALENDAR

Berendt motioned to approve the proposed GET Committee meeting calendar for 2016. Schumacher seconded the motion. The 2016 GET Committee meeting calendar was approved as presented.

CHAIR'S REPORT

Sharratt reviewed the legislatively mandated feasibility study and what has been completed to date. Sharratt went over the items of this study that still need to be completed.

DIRECTOR'S REPORT

Betty Lochner, GET Director, updated the GET Committee on the number of refunds received since September 1, 2015 as well as the dollars refunded to date (approximately $62M). Lochner noted that the program has spent close to $100,000 on items linked to the passage of the College Affordability Program.

Lochner informed the Committee that GET's Legislative Advisory Committee (LAC) met two weeks ago. GET staff and the State Actuary, Matt Smith, provided an update on the recent changes made to the GET program. The LAC has not officially created a meeting schedule. Senator Frockt has been elected as the new Chair of this Committee.

GET INVESTMENT UPDATE

Allyson Tucker, Senior Investment Office from the Washington State Investment Board (WSIB), provided an overview of the GET program's investment portfolio. As of September 30, 2015, the account balance was approximately $2.4 billion.

Looking at the month of October, the GET market value at month end was $2.51 billion, up from $2.43 billion at the beginning of the month. This was driven by strong returns in the equity portfolio.

ANNUAL VALUATION OVERVIEW

Matt Smith, State Actuary, mentioned the drafted preliminary results earlier in the year and noted one change since the preliminary draft. The change reflects an updated funded status from 141% to 140.1% due to recent program changes and refunds.

Smith thanked the Chair for highlighting some of the risks and cautions around the actuarial valuation. This report is simply a snapshot in time and is sensitive to a number of economic variables. He also noted that the sensitivity analysis shows how the results would change from the current 'best estimates' if current assumptions are to change. Smith also provided the Committee with data related to a hypothetical scenario with the possible closure of the program. This isn't to speculate the termination of the program but to provide data around a variety of scenarios.

INDEPENDENT ACTUARIAL VALUATION REVIEW

Alan Perry, principal consulting actuary with Milliman, noted they were hired this year to review the State Actuary's experience study and actuarial valuation. Perry noted that Milliman found the actuarial procedures and practices to be of a high quality and in compliance with all major aspects of the applicable actuarial standards. Perry provided an overview of his recommendations. Smith thanked Perry for their work on this.

VALUATION ADOPTION

Marc Webster, Senior Fiscal Policy Advisor with the Washington Student Achievement Council (WSAC) stated that as part of the agency's work with the State Auditor's Office and the Office of Financial Management (OFM), the data behind the actuary's work must always be reviewed. Looking at the review that Milliman provided as well as the experience study provided to the GET Committee last summer by the State Actuary, WSAC has new tools that can assist the program moving forward. Webster stated that the data that lies behind the State Actuary's work as well as Milliman's review needs to be accurate. GET staff and the agency's research team have checked and revalidated the data. Given that, and having reviewed the valuation report, Webster stated that in his judgment, the data is reasonable and accurate to the best of the agency's knowledge.

INFORMATION SHARING – 529 SAVINGS PLANS

Jamie Canup, partner with Hirschler Fleischer, presented information about 529 college savings plans. He noted that there are 101 different 529 plans and of those, 92 are savings plans specifically. The charge given to Canup was to present information related to a direct-sold savings plan run by the state.

Canup discussed investment portfolio options (age-based, static) as well as possible fees (program manager, record-keeper, state, maintenance, etc.) that could be incorporated into a savings plan. Plans can offer a variety of investment options. However, presenting too many options may be overwhelming. Canup made a clear note that a savings program is in an investment with risk, not a guarantee, like a prepaid plan.

Canup gave a few examples of other states' 529 savings plans (Florida, North Carolina, Tennessee, Utah and Virginia) and how they are set up (fee structure, investment options).

Of the 61 direct-sold savings programs, there are 7 that do not charge a state fee. Four of those seven plans have stand-alone bank programs and don't charge a fee. Returns on these options (bank/CD) are very low. Also, some plans don't charge certain fees for residents of their state.

Treasurer McIntire asked for confirmation around the fee structure for a state-run program. Treasurer stated that his understanding is that fees on those portfolio options would vary depending on the customization of the investment options. Canup confirmed this was correct.

Canup noted the importance of marketing a new plan. National program managers do not spend a lot of time on in-state marketing. An in-state option allows for more specified marketing (under-served population, targeted counties, etc.). Age-based portfolios allow customers to choose the investment(s) they want.

Canup noted possible state incentive options (creditor protection, financial aid exclusion, matching funds, scholarships). Canup turned the discussion over to Allyson Tucker of the WSIB.

Tucker stated that the WSIB has been working with the GET program investments since the program's inception. Tucker discussed the design of Washington’s Deferred Compensation Program (DCP), a supplemental savings plan administered by the Washington Department of Retirement Systems, and noted how DCP is structured/designed in a way that could possibly parallel a savings plan. Tucker noted that this information is not to sway the Committee but to provide information around the investment structure that has already been established. WSIB has found that the menu design influences behavior and simplicity in design is essential. Most investors maintain their initial allocation and how the state may choose to channel customers into a savings vehicle is important. Tucker noted that the investment options need to be broad enough to build portfolios of varying risk levels.

Tucker stated that if the GET Committee chooses to pursue WSIB as the investment manager for a direct-sold 529 college savings plan in Washington, there are a few key considerations:

- Legal issues: full investment authority, legal opinion, residency limitations.
- Identification of available investment options, investment procurement options, operational requirements, development of investment policy, analysis of the menu design, and the production of recommendations to the Committee.

David Mitchell, Chief Technology Officer for the Washington Student Achievement Council (WSAC), presented information around the current technological infrastructures in place at WSAC and GET. Mitchell noted that contracted services are often seen as the solution to risk, but if too much authority is delegated to another contractor, risk can increase. GET has a long history of providing in-house services, which has created a great amount of institutional knowledge for WSAC and GET staff members. This is important because staff not only know how things are done, but also why. This helps the program manage its reaction to change and helps maintain a Lean culture.

Existing resources could be leveraged if a savings plan was established. WSAC IT Developers know the staff functions, websites, servers, databases, and tools that have already been created. Established relations with personnel, PRD, AFRS, lockbox, EFTs, etc. are in place. If the Committee chooses to move forward, the IT staff can leverage existing accounts. Automatic processes are already in place and these processes are efficient.

Mitchell noted that Lochner has talked to other 529 administrators nationally, and GET is way ahead of other states in terms of features and usability. Agency staff believe the program is in a leadership position and has a strong working relationship with the state auditors. This shows that the agency has successfully managed risk. Mitchell stated that the program works with College Savings Solutions (CSS), an established vendor used by several states for both prepaid and savings plans. This is housed at WSAC, giving program administrators access for running reports, etc. Establishing a savings plan would keep investment dollars and professional staff here in Washington State.

Mitchell stated that agency staff met with staff from the Department of Retirement Systems (DRS) to discuss record-keeper options.

If a savings plan is established, existing systems could be utilized. Testing would take several months and IT staff would spend more of their time tailoring a web-based system for the savings plan. Mitchell stated that WSAC has the internal IT capacity to launch a new system and could leverage existing infrastructures and staff to keep administrative costs low.

Schumacher asked for a comparison of record keeper options. Staff will work on this research. Schumacher then dismissed himself for another pre-existing meeting.

NEXT STEPS
Ryan Betz, Associate Director for GET Marketing & Communications provided a quick overview of the market analysis GET staff provided. It shows what customers think about investing in a 529 plan, etc. Wong asked if any conclusion could be drawn around strong support for a 529 savings plan. Betz stated that due to the survey and other research, staff believe that if there were some planned incentives, this would be a well-received option for residents.

McIntire commented that if implementation of a savings plan may not launch until the fall of 2017, yet non-penalty refunds are available through December 2016. The difference in timing could create a missed opportunity for the Committee to jump start the savings program.

Betz mentioned the idea of extending the refund deadline to allow existing customers the option to move their funds into a savings plan. Lochner noted that nothing can be done until the legislature authorizes the establishment of a savings plan. Fall of 2017 is an estimated timeframe in regards to the launching of a new plan as risk for project delays are built into this estimate.

Berendt noted her concern around the required legislative authority not only for GET but for WSIB. With the legislative session starting in January, a strategy is needed and ground work needs to be done which can't wait until the legislative session in 2017. Berendt voiced that she is supportive of a state-based direct-sold program, in conjunction with the current prepaid plan.

Sharratt asked if there was a motion regarding next steps. McIntire presented the following motion: *"Based on the recent passage of the College Affordability Program, I move that effective today the GET program begin the development of a state-managed direct-sold 529 college savings plan. Development includes drafting legislation in partnership with the State Treasurer's office and the Washington State Investment Board in order to attain the start-up funds, investment authority, and plan benefits and incentives needed to operate such a program."* Berendt seconded this motion.

Wong asked if the legislature has to approve certain items and Lochner responded that it's up to the legislature to pass a bill to allow us to continue the development of a savings plan. The motion passed.

ADJOURNMENT
Meeting adjourned at 3:08 p.m.

Legislative Update: February 11, 2016

Legislative Advisory Committee to the GET Committee
Prior to session, the Legislative Advisory Committee to the GET Committee convened with its new members and elected Senator David Frockt as Chair and Representative Zeiger as Vice Chair. Other members include: Senator Barbara Bailey, Senator Andy Hill, Representative Steve Bergquist, Representative Ed Orcutt, and Representative Gael Tarleton.

GET Committee Chair (Gene Sharratt) and GET Director (Betty Lochner) presented recent changes to GET and an analysis of 529 savings plan options. State Actuary, Matt Smith, also provided an actuarial update.

529 Savings Plan Legislation
Senators Frockt, Bailey, Braun, and Mullet have drafted SB6601 this session to create a 529 college savings plan in Washington State. Co-sponsor Senator Bailey is the Chair of the Senate Higher Education Committee. Co-sponsor Senator Braun sponsored the College Affordability Program legislation that reduced tuition last session.

This bill provides an oversight role to the GET Committee. The GET Committee would become both the GET Committee and the Savings Plan Committee under this legislation.

This bill also:

- Authorizes a state savings plan as an additional savings option alongside GET.
- Creates a savings plan account under the custody of the State Treasurer.
- Permits the committee to either pursue a state-managed savings plan with investment managed by the State Investment Board, OR to set up a partnership. This partnership would be with another state or through a contract with a non-state, private entity to manage the funds.
- Provides flexibility to respond to customer needs.

The State Investment Board and the State Treasurer offered technical amendments.

Senate Higher Education passed the bill out of committee last week. Senate Ways and Means heard the bill this week (*as of February 8*).

Next Generation Savings Plan Legislation
A bill offered by Representative Kilduff, HB2662, would establish an educational savings account (with an initial deposit of $250) for every child born or adopted in the state. The bill provides that the program would be established through a state 529 college savings plan if a college savings plan is established, or, a traditional savings account (in a bank) may be established if the state does not have a college savings plan and would go alongside a 529 savings program.

The bill authorizes the Student Achievement Council to partner with one or more private organizations to establish and fund the program. The establishment of the program is contingent on funds being available. The bill passed out of the Policy Committee and has been referred to Appropriations (*as of February 8*).

ABLE Legislation
HB2323, sponsored by Representative Kilduff, and SB6210, sponsored by Senator Dammeier, create the Washington Achieving a Better Life Experience program. In December 2014, Congress passed the Achieving a Better Life Experience (ABLE) Act. The law amended IRS Code, removing the tax burden to state-established, exempt qualified ABLE savings programs. Individuals can contribute up to $14,000 annually to eligible beneficiaries' savings accounts. Withdrawals from these accounts will not be taxed so long as the money is spent on qualified expenses, such as housing, education, transportation, health care, and rehabilitation.

The bill establishes a governing board to establish and administer the program: it includes the State Treasurer, the program director for GET, the director of OFM or designee, and four members with demonstrated financial, legal, or disability program experience, appointed by the Governor. These bills have both passed the Policy and Fiscal Committees in both the House and Senate and are now in Rules (*as of February 8*).

Budget Update
The Governor's proposed budget maintains the tuition reductions in the supplemental budget.

GET Prepaid College Tuition Program

Quarterly Report – December 31, 2015

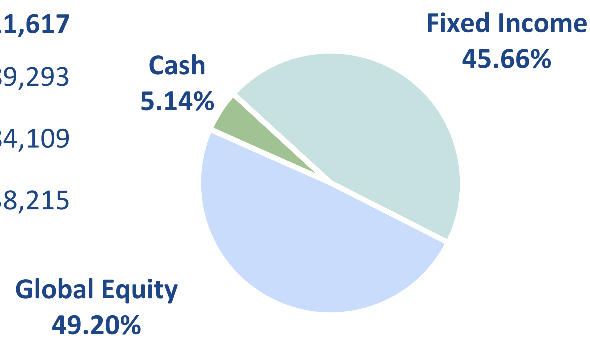
GET Prepaid College Tuition Program

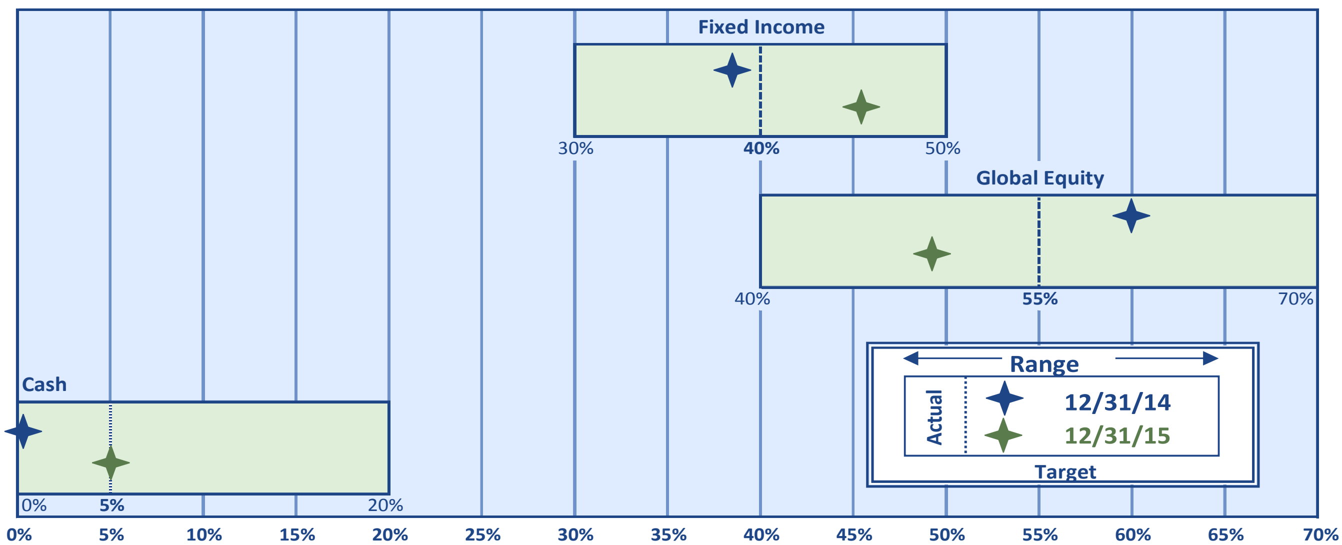
Quarter Ended December 31, 2015

Portfolio Size

Total	**$2,393,411,617**
Cash	$122,989,293
Fixed Income	$1,092,884,109
Equity	$1,177,538,215

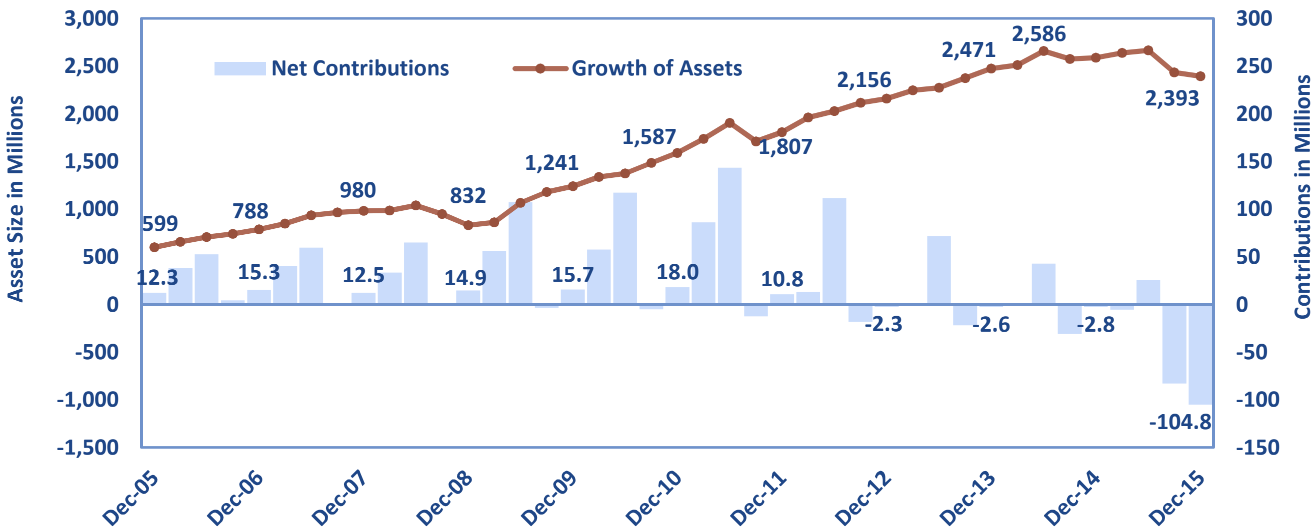
Actual Asset Allocation





Note: For comparison purposes in the chart above, fixed income and TIPs were added together for the prior year.

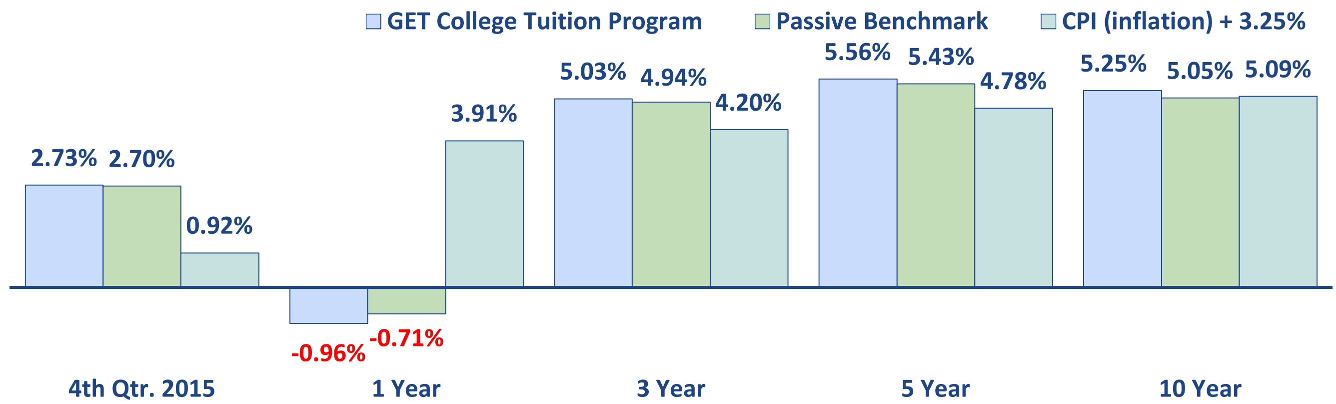
Assets Under Management



GET Prepaid College Tuition Program

Quarter Ended December 31, 2015

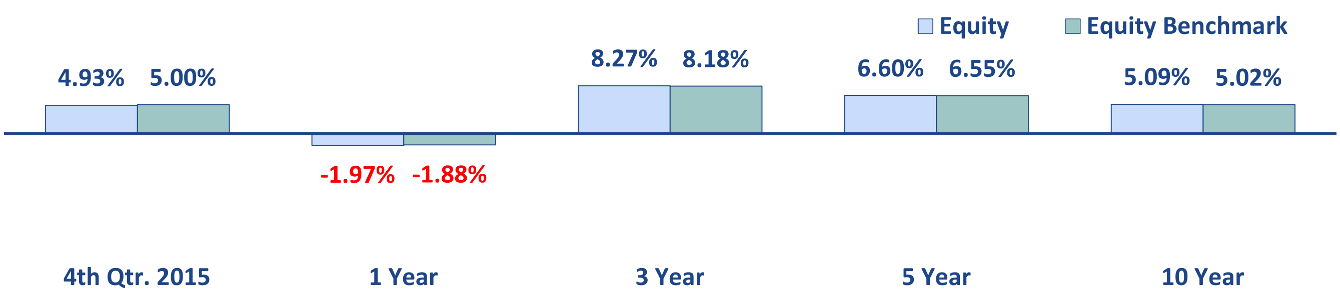
Total Return *



Return Breakdown

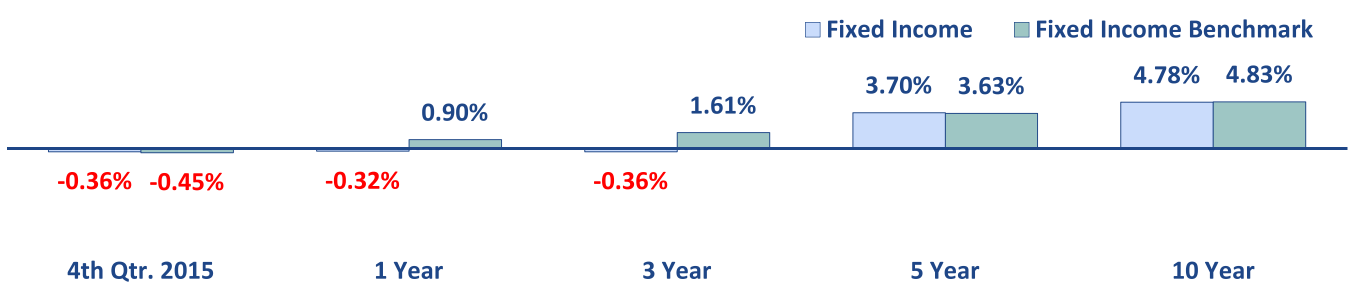
Equity Return *

Benchmark: MSCI ACWI IMI w/U.S. Gross and a historical blended return



Fixed Income Return *

Benchmark: Barclays Capital Intermediate Credit



* The return numbers above are net of manager fees and other expenses that can be directly debited from the account for portfolio management but do not include the WSIB management fee.

HIRSCHLER FLEISCHER
ATTORNEYS AT LAW

TO: Betty Lochner, GET Director

FROM: James W. C. Canup

DATE: February 1, 2016

RE: Alternative Structures for Prepaid 529 Programs

This memorandum is a follow up to my memorandum to you (copy attached) dated August 5, 2015, wherein I addressed the possibility of changing GET tuition payments from being based on tuition and fees to a cost of attendance metric in response to a feasibility study required under Washington State legislation. The issues associated with GET payments based on cost of attendance were identified in that memorandum. This memorandum addresses other possible metrics that GET payments could be tied to as part of the GET committee's response to the legislatively required feasibility study.

In the memorandum of August 5, 2015, I identified other measures used by 529 prepaid plans:

> **Measures used by other 529 Plans**
>
> It is interesting to review what payout metrics typical 529 prepaid plans use. Not surprisingly the vast majority of prepaid plans tie their payouts to tuition and fees. Some prepaid plans pay out the amount of tuition and fees actually charged by the institution covered under the plan, typically only in-state eligible educational institutions (as defined under Section 529). Others payout an amount based on the weighted average public tuition and mandatory fees charged by the type of institution (four-year or two-year/community college). Others tie their payout to the mean weighted credit hour value of the public institution (either four-year or two-year/community college). Some will pay out the actual tuition and mandatory fees up to the weighted average for tuition and mandatory fees at the state's public institutions (four-year or two-year/community college); while others will pay out based on the lower amount of these two measures.
>
> Each of the programs also have different payouts if the beneficiary attends a private school or an out-of-state school (public or private). Some programs provide a payout equal to the weighted average of the public institutions in that state, some provide a set return on investment, and some programs differentiate between in-state private schools and out-of-state schools (public or private) when calculating their payout.

> Regardless, all of these programs calculate their payouts based on some metric based on tuition and mandatory fees. Among the open prepaid plans, only Pennsylvania and Washington have payouts attached to increase credit values, which has given them the moniker guaranteed savings plan (a form of hybrid prepaid plan).

Of course, a prepaid program can provide that it will pay the actual tuition and mandatory fees charged by the in-state public eligible educational institution. This payout can be provided to both beneficiaries who enroll in an in-state public eligible educational institution and to those who either attend private eligible educational institutions or out-of-state public eligible educational institution. This memorandum addresses alternative models in more detail.

Weighted-Average Tuition Models

While many prepaid programs pay out the actual tuition and mandatory fees charged by the public eligible educational institution in that state, other prepaid plans use a weighted-average tuition model (for the type of institution selected, i.e., two-year or four-year institutions) when calculating the payout to an account owner or beneficiary. This weighted-average tuition model can occur under multiple scenarios, including, under certain circumstances, even those plans that pay the actual tuition and fees charged by the public eligible educational institution in that state.

For example, a prepaid plan that would otherwise pay out the actual tuition and mandatory fees if the beneficiary attends an in-state public institution may pay out the weighted-average tuition and mandatory fees of all public institutions in that state when a beneficiary chooses to attend either a private or an out-of-state public eligible educational institution. Sometimes these payments to non-in-state public eligible educational institutions are capped at the lower of (1) the actual tuition and mandatory fees charged by the private or out-of-state public eligible educational institution, or (2) the weighted-average tuition and mandatory fees of all public educational institution institutions in that state.

Other prepaid plans only pay-out the weighted-average tuition and mandatory fees of all public eligible educational institutions in that state. This can be a significant driver in the pricing of the prepaid plan for those states where the various in-state public eligible educational institutions have significant differences in their pricing structure (putting aside the differences between two-year and four-year institutions). By only paying out the weighted-average tuition and mandatory fees of all public eligible educational institutions in that state, the prepaid plan is not on the hook for paying tuition and mandatory fees at the highest cost in-state public eligible educational institution. Of course, then the account owner or beneficiary is responsible for funding any differential to the extent the beneficiary attends an institution whose tuition and mandatory fees are in excess of the weighted-average tuition and mandatory fees of all public eligible educational institutions in that state.

Other Considerations for Tuition Based Models

One of the current issues faced by prepaid plans that use a tuition based model has centered on differential tuition charged within a public in-state eligible educational institution. Many prepaid plans are now specifying that their program only covers tuition and mandatory fees charged for all students attending that public in-state eligible educational institution. The prepaid plan would not cover, for example, differential tuition and fees charged by some schools within an institution or for a specific course of study. This has become a more significant issues as public eligible educational institutions seek to provide differential pricing based on the course of study or school within an institution, for example differential pricing for attending an undergraduate engineering or architecture school rather than the traditional liberal arts college within a specific institution.

Most prepaid plans that use a tuition based model also only cover a maximum number of credit hours per semesters; any credits hours in excess of that maximum number are not covered by the plan. In addition, if a student enrolls for a limited number of credit hours under the maximum amount allowed for that semester under the prepaid plan, there is no reimbursement or credit given for the hours foregone.

Some prepaid programs only pay tuition (whether actual or weighted average) and do not pay any fees, mandatory or otherwise. Other prepaid programs limit the mandatory fees that are covered by the plan. This has been in response to the trend by some public eligible educational institutions to either add to the types of fees they charge and/or to increase fees by more significant percentages than their increases in tuition (sometimes in response to public pressures to limit tuition increases). Therefore, some prepaid programs either do not cover fees at all or limit the nature and type of fees covered under the plan.

Credit Hour Model

A variation on the weighted-average tuition model is a model based on the mean weighted credit hour value at public institutions (either four-year or two-year/community college) in that state. This model ties pricing to credit hours purchased rather than to tuition, whether on a semester or other basis. The prepaid program can then price their offerings on a per credit hour basis rather than on the number of semesters or years selected by the participant. This can also allow for a lower entry point for account holders in order to participate in the state's prepaid plan.

Pricing of course is dependent in this model on whether the actual cost of the credit hours purchased is covered at any in-state public eligible educational institution or whether only a weighted-average credit cost at all in-state public institutions is covered by the program. The same issues as discussed above in the section on weighted-average tuition models applies. The main difference is in the ability to price the program (1) based on credit hours rather than semester or academic years, and (2) without covering any fees, mandatory or otherwise.

Variation on the Weighted-Average Tuition or Credit Hour Models

An alternative to the two models discussed above, is for a prepaid program to match its payout to the lowest tuition or lowest credit hour amount charged by any in-state public eligible educational institution. In essence, the program would be providing a hedge for participants based on the lowest pricing for either semester or credit hours at the time of matriculation of the beneficiary. The account owner or beneficiary would then be responsible for funding the difference between the actual cost of tuition incurred at that institution and the lowest price charged by any in-state public eligible educational institution. However, whether that pricing structure would be attractive to investors is an open question. No prepaid program currently offers this model as its main payout structure, but a few programs do provide a return based on the lowest amount if the beneficiary does not attend an in-state public eligible educational institution.

Regardless of what model is used another consideration is whether to have a differential payment based on whether the beneficiary attends (i) an in-state public, (ii) an out-of-state public, or (iii) in-state private eligible educational institutions. If a differential does exist under a program, it typically provides for lower payouts to eligible educational institutions that are not in-state public institutions. Some programs also differentiate on the payout if the beneficiary attends an in-state private versus an out-of-state public or private institution. Other programs provide the same payout regardless of where the beneficiary is enrolled. In those programs, the account owner knows that the return is the same and is based on an in-state tuition model but that he or she can use those funds at any eligible educational institution.

Guaranteed Return Model

One model used by the Pennsylvania program is a model based on average tuition increases in the school category selected (participants choose from a number of school categories, such as community college, public institutions in Pennsylvania, private institutions, Ivy League universities). Participants select both a tuition level and the number of credit hours for that level to determine the amount they must pay for that year's contract. The participant is counting that the increase in value over time, which is based on tuition increases over that time, will be greater than the amount that the participant would earn had their moneys been invested in the market or in a 529 savings plans. In essence the participant is counting on the fund's earnings to keep up or do better than tuition increases over the time moneys are invested in the program. The Pennsylvania program is not backed by the full faith and credit of the state nor is the program collateralized or guaranteed by another entity or insurance.

If a participant makes a non-qualified withdrawal (i.e., a withdrawal that is not used for qualified higher education expenses) then the return is equal to the greater of (1) the "net earnings rate" of the programs funds or (2) the participant's contributions (less fees). This return is based on the actual returns (or, in some cases, a percentage of the program's actual returns) and is not an unusual return for non-qualified distributions.

Massachusetts has a similar plan that covers actual tuition increases, however, participants purchase special tuition certificates that are backed by general obligation bonds issued by the Commonwealth of Massachusetts, which are backed by the full faith and credit of the Commonwealth of Massachusetts. When the tuition certificates mature, the participants can then use them to pay tuition at the participating eligible educational institutions.

A program could consider offering a prepaid plan that offers a return based on the plans actual investment returns. However, this would in essence be a savings program where the burden of investment decisions would be placed on the program rather than the individual. The participant would then be counting on the ability of the program and its investment advisors to generate a more attractive return than the participant could do on its own.

Alternative to this guaranteed return model based on actual tuition increases is to provide a return based on average tuition increases in the past ten years at the state's public eligible educational institutions rather than a promise to keep up with actual tuition increases for the type of institution selected. This model might work to even out swings in tuition increases (and possibly decreases) over a rolling ten-year period, especially if based on average tuition increases across all in-state public institutions (or a subset of in-state public institutions). Currently, no program is based on this possible model. It might be difficult to explain this model to potential participants so that they understand what they are purchasing. However, it could be an attractive way to handle unexpected spikes in tuition and mandatory fees that occur long after pricing of the prepaid took place.

Risk Transfer Model

A final model to consider is a model that transfers the risk on payouts from the prepaid program from the program to the state higher education system. This model is the model used by the Texas Tuition Promise Fund. Under that program the future cost of tuition is shifted to the state's public universities and colleges under state law. Participants can purchase tuition units at current tuition levels and when their beneficiaries are ready to enroll at a Texas public university or college, those institutions must accept those tuition units as payment for tuition. Market fluctuations in tuition do not affect the value of the tuition units purchased. Participants must select and pay for the amount and type of tuition units (Type I, Type II, and Type III units) depending on the type of in-state institution the participant selects. While the program is not guaranteed by the full faith and credit of the state, Texas law requires all Texas public eligible educational institutions to accept less than full tuition from the Texas program if the program's investment returns fail to keep pace with tuition increases.

This model would require the Washington legislature to enact a law similar to the Texas legislation that requires the Washington state public higher education institutions to accept the value of tuition units at matriculation in full payment of tuition obligations.

Considerations When Evaluating These Alternative Models

Other than the risk transfer model found in the Texas program, the other models presented would require little or no change to the Washington statutes that authorize the creation of GET. In addition, putting aside a model that pays out actual tuition and mandatory fees (as previously existed when the GET program was open), a prepaid program that is based on either (1) weighted-average tuition and mandatory fees (for the type of institution selected) either on a semester or credit hour basis; or (2) average tuition increases in the past ten years (or other measuring period) at the state's public eligible educational institutions (for the type of institution selected) may be models worth exploring. In addition, decisions would need to be made to determine if the program would (a) cover only tuition or tuition and mandatory fees; and (b) pay out the same benefits to beneficiaries who enroll in private or out-of-state public institutions rather than in-state public eligible educational institutions. Care must also be taken to define exactly what tuition and mandatory fees are covered by the state's prepaid program.

Conclusions

There are many alternative structures to consider if the GET Committee and the legislature decide to reopen or redefine GET as a prepaid tuition program. Each of these models described above would need to be reviewed by the State's actuary to determine if a pricing model could be determined and sustained for the long-term. These alternative models described above are presented as a response to the analysis in the prior August 2015 memorandum that addressed using a cost of attendance model for reopening or redefining GET.

If you have any questions, concerning this memorandum or the prior memorandum from August 2015, please do not hesitate to contact me. Thank you.

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MEMORANDUM

TO: Betty Lochner, GET Director

FROM: James W.C. Canup

DATE: August 5, 2015

RE: Cost of Attendance Metric

You have asked that I address the possibility of changing GET tuition payments from being based on tuition and fees to a cost of attendance metric.

I recognize that the newly revised Washington statute requires that GET provide to the legislative fiscal and higher education committee a "list of potential alternatives and impacts for changing the advanced college tuition payment distribution policy from tuition and fees to a cost of attendance metric".

What is cost of attendance?

The first item is to determine what is meant by "a cost of attendance metric". I'm assuming it is a reference to the "cost of attendance" formulation that all higher education institutions that qualify for federal financial aid are required to report to the federal government and others, and which is used in determining federal financial aid. The purpose of calculating a cost of attendance is to determine the amount of financial aid an individual may qualify for at a particular institution.

Cost of attendance is the amount need to cover one year's expenses at an institution of higher learning and typically includes:

- tuition and fees,
- books and supplies,
- room and board,
- transportation,
- loan fees, and
- certain personal costs

These items are typically calculated for a full time student pursuing undergraduate education. The cost of attendance for a student who is less than a half-time student is usually lower and the amount for a graduate student is usually higher.

Each institution is required to determine its own cost of attendance; so the amount can vary greatly across institutions based on the calculated costs specific to each institution.

Some of the items that fall under the rubric of personal costs, may include certain dependent care expenses (if applicable), rental or purchase of a personal computer, expenses associated with eligible study abroad programs, and certain costs related to a disability.

So the first thing to do is determine if the reference in the Washington statute is meant to be the same as the term "cost of attendance" that is used for federal financial aid purposes.

Assuming that is the case, we should confirm that the cost of attendance figure that will apply is the one that will be used by (a) Washington state public institutions for (b) undergraduate students who (c) are full-time students.

If that is not the case, we should determine that cost of attendance means for purposes of a GET distribution.

Cost of attendance versus qualified higher education expenses

Cost of attendance (assuming we have the correct definition) is not the same as "qualified higher education expenses" as defined by Section 529 of the Internal Revenue Code of 1986, as amended (the Code).

Section 529(e)(3)(A)(i) of the Code defines, in part, qualified higher education expenses to mean "tuition, fees, books, supplies, and equipment required for the enrollment or attendance of a designated beneficiary at an eligible educational institution".

This definition is not exactly on point with the term cost of attendance since the items enumerated in Section 529 must be **required** for enrollment or attendance (emphasis added). That is not necessarily the case for calculating cost of attendance figures. In addition, it is not clear whether we should read anything into the addition of the word "equipment" under the Code, which is not part of the list of items included in cost of attendance.

Room and board is a qualified higher education expense under Section 529 of the Code but only if the beneficiary is an eligible student who is at least a half-time student. The cost of attendance figure does permit some room and board costs for a student who is less than a half-time student but such payments are not permitted under Section 529. Under section 529, the allowable costs for room and board are tied to the higher of (I) the allowance for cost of attendance, or (II) if greater, the actual invoice for students residing in housing owned or operated by the eligible educational institution.

It is clear that transportation and loan fees are not included in qualified higher education expenses for purposes of Section 529 but are specifically included in the calculation of cost of attendance.

Computers are an additional item that must be addressed. While they are included in cost of attendance figures, they do not qualify for purposes of Section 529 unless they are required as a condition of enrollment or attendance. Passage of H.R. 529 would change this anomaly.

Disability expenses are another area of confusion. Section 529(e)(3)(A)(ii) of the Code does include “expenses for special needs services in the case of a special needs beneficiary which are incurred in connection with such enrollment or attendance” as qualified higher education expenses. However, no guidance has been provided on what “special needs services” are or who is covered under the term “special needs beneficiary”. So it is not possible to tell if these terms are meant to be synonymous with cost related to a disability used in calculating cost of attendance. In addition, the enactment of ABLE under Section 529A of the Code may have an impact on these definitions. That remains to be seen.

Measures used by other 529 Plans

It is interesting to review what payout metrics typical 529 prepaid plans use. Not surprisingly the vast majority of prepaid plans tie their payouts to tuition and fees. Some prepaid plans pay out the amount of tuition and fees actually charged by the institution covered under the plan, typically only in-state eligible educational institutions (as defined under Section 529). Others payout an amount based on the weighted average public tuition and mandatory fees charged by the type of institution (four-year or two-year/community college). Others tie their payout to the mean weighted credit hour value of the public institution (either four-year or two-year/community college). Some will pay out the actual tuition and mandatory fees up to the weighted average for tuition and mandatory fees at the state’s public institutions (four-year or two-year/community college); while others will pay out based on the lower amount of these two measures.

Each of the programs also have different payouts if the beneficiary attends a private school or an out-of-state school (public or private). Some programs provide a payout equal to the weighted average of the public institutions in that state, some provide a set return on investment, and some programs differentiate between in-state private schools and out-of-state schools (public or private) when calculating their payout.

Regardless, all of these programs calculate their payouts based on some metric based on tuition and mandatory fees (not cost of attendance). Among the open prepaid plans, only Pennsylvania and Washington have payouts attached to increase credit values, which has given them the moniker guaranteed savings plan (a form of hybrid prepaid plan).

Conclusions

It will be important to confirm what is meant by the term “cost of attendance metric”. Assuming it refers to the calculation made for federal financial aid purposes, it is then important to recognize that under Section 529, the term cost of attendance covers different items than qualified higher education expenses.

Only qualified higher education expenses can be paid on a tax-free basis from a 529 Plan, such as GET. So calculating payouts based on cost of attendance may result in taxable distributions to account owners. Clearly, that would not be an intended consequence of moving to a calculation based on cost of attendance. Care will need to be taken to ensure that does not occur. In addition, cost of attendance is different for each institution so the GET payments would need to be tailored to each separate institution or some sort of mechanism would be needed to standardize payments.