

SAVINGS 101

Changes to the rules of 529 plans make them more attractive from a financial aid standpoint

By Paul J. Lim

Few things in life are as complicated as saving for college. Even something like 529 college plans—which were designed to simplify parents' lives—can be confounding once you pore over the fine print.

For starters, there are two different types of 529s: prepaid tuition plans that around 20 states and a consortium of private universities offer; and 529 savings plans, which are tax-deferred investment accounts similar to 401(k)'s.

What's more, within the realm of 529 savings accounts, about 80 different plans are available to parents, with different investment managers, fund choices, account limits, and fees.

Slowdown. The confusion surrounding the system may be one reason that the flow of new money heading into these plans slowed dramatically last year, says Rene Kim, senior vice president at Charles Schwab. After growing 20 percent in 2004, new investments in 529 savings plans were flat in 2005 at \$13.7 billion, according to Financial Research Corp.

But recent developments may simplify families' choices on 529s. Most important, Uncle Sam is leveling the playing field between prepaid tuition plans and 529 savings accounts for financial aid purposes. Money invested in a 529 savings plan is considered a parental asset (assuming a parent, and not a grandparent, opened the account). This benefits financial aid seekers, as the federal government expects only 5.6 percent of parental assets to be used to cover college expenses. Meanwhile, until this year, money held in prepaid 529 tuition plans, which allow parents to lock in future college costs at today's prices, used to be disastrous for financial aid consideration. That's because prepaid accounts reduced aid eligibility dollar for dollar.

Not anymore. Starting July 1, assets in a 529 prepaid tuition plan "will be treated exactly the same as money in a 529 savings plan," says Raymond Loewe, founder and president of College Money, a New Jersey-based college financial planning firm. This means that three of the major types of college savings vehicles—529 savings plans, 529 prepaid plans, and the tax-deferred Coverdell education savings accounts—will all be treated the same in financial aid formulas.

This should go a long way toward simplifying parents' decisions on choosing a plan. Nancy Farmer, president of the Independent 529 plan, a prepaid tuition plan run by a consortium of 255 private colleges nationwide, says that after the rule change was announced, the Independent 529 enjoyed its best March ever in attracting new money.

Big help. Congress has also tweaked other financial aid rules. Now, money transferred from custodial accounts (like Uniform Gifts to Minors Act accounts) to a 529 plan will no longer be considered student assets when cal-

culating financial aid, even though technically it will still belong to the child. And so Uncle Sam will most likely expect only 5.6 percent of it to go toward paying college bills, versus 35 percent if considered the child's money. Starting in the 2007-08 school year, a smaller percentage of student assets will be expected to pay for college in general. Instead of the current 35 percent, the share will drop to 20 percent. "This should be a big help for a lot of families," says Joseph Hurley, founder of the *savingforcollege.com* website.

There's one other change in store for 529 users: more information on the costs and benefits associated with these savings plans. The Municipal Securities Rulemaking Board, which helps regulate 529s, last month indicated that brokers, who sell 80 percent of 529 plans, are required to tell clients that their home-state plans may offer tax breaks and other benefits.

Parents may participate in a 529 sponsored by any state, but going out of state may cost them a tax deduction. The National Association of Securities Dealers fined Ameriprise Financial Services last October for failing to properly supervise 529 sales. Between May 2001 and October 2003, the NASD said, the company sold clients only one plan—the Wisconsin-sponsored 529—even though many investors could have snagged tax breaks by investing in their home-state plans. Selling investors out-of-state plans is permissible. But the MSRB will now require brokers to notify clients about the benefits of their in-state 529 plans.

Of course, parents are still left with the task of studying dozens of 529 plans to choose the one that's best for their family.

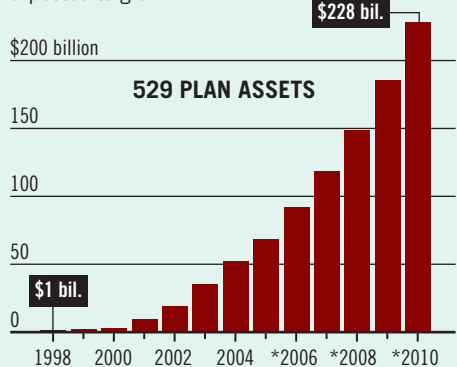
To help them out, the College Savings Plans Network, a clearinghouse for information on state-run college savings plans, has agreed to provide comparative data on competing 529s that parents can consult online, according to the MSRB.

While the CSPN is working to create an online site, parents can visit existing sites, such as *savingforcollege.com*, to plot their strategies to keep up with rising college costs. ●

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SOCKING IT AWAY

The rate of new money flowing into 529 college savings plans slowed last year, but assets are expected to grow.



Source: Financial Research Corp.

*Projected