The 529 Plan Crisis

Parents: The New Dropouts…

Families Flocking To Guaranteed Investments After Consecutive Years Of Market Turmoil

Section 529 Plans, once believed to be the absolute best college savings vehicle on the planet are seeing massive amounts of families dropping their contributions.
According to to Financial Research Corp., a Boston research firm owned by Mercatus Partners LLC, investors were pouring more than $15 billion dollars annually into these plans as recently as 2006 and 2007. However, in 2008 families dropped nearly 70%, all the way down to $5.2 billion, with 2009 even lower at an estimated $4.8 billion.

Why the massive pull-back in contributions to these once insanely popular college investment vehicles?

Families stung with market losses amid one of the worst stock market years in history was one of the big reasons but not the only one. Limited investment choices, fraud, and a little know rule that restricted the number of times a family could make changes to their plan are also to blame.

When section 529 Plans were originally established they were applauded and revered for their tax benefits. Money goes in the plans after-tax but then can be pulled out (including gains) for qualified college expenses on a tax-free basis. The lure of potential tax-free gains coupled with Advisors, the government, Wall Street, and main stream media touting the use of mutual funds inside these plans, sky-rocketed the popularity of these plans.

To the point that families almost never consider the use of any other type of college savings vehicles.

Until now…

In an attempt to bolster investor confidence, states and 529 plan managers have rolled out more conservative options, changed plan managers and tightened oversight of plans' investments. Earlier this month, the Virginia College Savings Plan began offering FDIC-insured savings accounts through BB&T Corp. to investors nationwide. And in October, Colorado's broker-sold Scholars Choice College Savings Program added new portfolio options, each investing in zero-coupon U.S. Treasury bonds. Oregon replaced OppenheimerFunds as its plan manager with TIAA-CREF and hired a third-party investment manager to oversee its investments.

But at this point, it is to late. Smart families have moved on. They are realizing that banking their kids college education on investments that have little to no guarantees are a bad option. Armed with an open mind about where to put their hard earned college savings dollars, families have looked at several options.

Real Estate is one area that has lured many investors over the years. The idea of steady returns backed by property that can be seen and managed individuality has not performed well in the past few years as well. In fact however, real estate is quite possibly the hardest hit of all market sectors that last two years.

Looking for a much more conservative approach, many families have sought the use of bond funds outside of their section 529 plans. Bonds are considered to be safer investments plus investors wouldn't have to worry about any of the restrictive 529 plan rules. However, gains on these funds would be taxable with some exceptions (municipal bond funds). But as thousands of families found out in Oregon, bond funds can cause massive losses. Parents there lost 36% in what was considered a low-risk bond fund managed by Oppenheimer. Unfortunately Oregon is not the only state to suffer massive losses in these accounts. Attorney Generals in three separate states are going after Oppenheimer to make amends for this unprecedented account downfall.

Even with the steady returns touted in bond funds, investors are getting blindsided by hidden management fees. Fidelity portfolio holding bonds would have seen a $10,000 investment grow to $11,660 at the end of a five-year period ended September. By contrast, the same investment in one low-cost, Vanguard tax-exempt muni-bond fund would have grown to $12,209 over the same period. The Fidelity portfolio has annual expenses of 0.69%, compared with 0.20% for the Vanguard tax-exempt fund.

Even with drastically lower management fees, bond funds are not staying pace with rising college inflation. Nor do they offer any guarantees that the money will be there as so many unsuspecting families found out the hard way.

One type of savings plan that many smart families are re-discovering is a properly funded – high cash value permanent life insurance plan. These plans, which have long been used by major banks including 5 of the 6 largest banks in the world: – Citigroup, JP Morgan Chase, HSBC Holdings, Bank of America, and the Royal Bank of Scotland to store their Tier-1 capital.

Tier-1 bank capital is the safest of a banks holdings. These major banks buy and hold billions of their earnings and deposits in cash value life insurance. Why would they do this? Quite simply, banks are in the money business. They employ the smartest economists, analysts, and money managers in the world to help make sure that the banks money is working as hard as it can with the maximum amount of safety. Banks buy an enormous amount of cash value life insurance because it provides immeasurable economic benefits, financial stability, and safety – even superior to what the banks do themselves.

If it is good enough for the biggest and best performing banks in the world than it is probably a good place to store your hard earned savings.

Here are three reasons why properly designed high cash value permanent life insurance plans are growing in popularity…

Because your funds are sitting in the cash value account of a life insurance policy, they do not count against you in the calculations for financial aid. These funds are not currently reported as assets on the Free Application for Federal Student Aid (FAFSA). This means that your chances for scholarships and financial aid are greatly increased.

The money is guaranteed to be there when you need it. There are certain guarantees built into each specially designed life policy that insure that whatever money you put into the plan for college is guaranteed to be there whenever your child is ready to head off to college. (This one reason alone should help you sleep better at night).

Any withdrawals from a properly designed cash value life plan is tax-free for any use, including college. So whether your child(ren) go to college or not, you can access the money tax-free without any restrictions.