

**SmartMoney.com - March 3, 2011**

<http://online.wsj.com/article/SB70001424052748704005404576176863808903094.html>

SMARTMONEY

MARCH 3, 2011

## **529 Plans Offer Free Cash**

By **ANNAMARIA ANDRIOTIS**



*Getty Images*

Battered during the recession, some state 529 college savings plans have developed the ultimate pitch to lure investors: Free money! With cash incentives, more states are now encouraging parents to save for kids' college costs – and to help the state's bottom line at the same time.

The bonuses aren't huge, but parents are likely to find them compelling. Less than a month ago, Virginia launched a program that offers up to \$2,000 for high school students who qualify academically and financially. For new parents in Rhode Island, there's a new \$100 bonus if they start a 529 plan within the child's first year, and a bill in the Oregon state legislature seeks to do the same. Experts expect other states to follow suit, and the federal government is doing its part as well, with a series of proposals in Congress that make saving in a 529 plan potentially more lucrative. "States want to see these plans grow," says Mark Kantrowitz, founder of FinAid.org.

The states have their own motives behind these programs. As states have been cutting funding to public colleges, they're trying to soften the blow of tuition

increases, says Joe Hurley, founder of SavingforCollege.com, which tracks 529 plans. And in some cases, states may be working hard to repair a plan's tarnished reputation, says Laura Lutton, a director for Morningstar's Fund

Research group, which oversees and grades 529 plans. During the market downturn, Oregon's 529 plan lost 25% and faced a huge public outcry; turnover among the chief investment officers at Rhode Island's plan earned it Morningstar's lowest ranking.

Officials in both states deny any connection. "My interest is independent of those problems – but if [this makes] people more confident and willing to invest so much the better," says Tobias Read, the Oregon state representative who is sponsoring the initiative. And Peter Kerwin, chief of program development at Rhode Island's 529 plan, says the new incentive was introduced before the state received its ranking.

And if their efforts work, states stand to profit. More money in the plans means the states collect more administrative fees, and any money that's left over after covering the program costs, may be directed back to state coffers if the state allows for it, says Lutton. (Reps from Virginia and Rhode Island say their states don't.) Longer-term, states are hoping for a domino effect: More students save more money to go to college, graduate with less debt, get better jobs, and boost state income taxes. Or so says Oregon's Read, who noted that Oregon's income tax revenue has dropped over the past decade and that the proposed incentive could reverse that trend and reduce demand on government services.

For families, these incentives may be attractive – and the timing is good. The markets are up, which has made investing for college more palatable for parents; for those who are still nervous, nine states have added certificates of deposit or savings account options. The plans are also getting cheaper: Fees have been dropping for more than two years. The annual fees for direct-sold plans averaged 0.59% in December – or \$59 on every \$10,000 invested -- down from about 0.71% a year earlier, according to the Financial Research Corp., an industry research group.

There may be another benefit to opening a 529 plan, though it's nothing the states can claim credit for. Studies show that parents who use 529 plans save more for college. Of those families who invest with a 529 plan, nearly all save more money than those who save without, according to the College Savings Foundation. Meanwhile, 46% of families who don't use a 529 plan have saved nothing at all.

To be sure, in the grand scheme of things, the incentives are small, says Andrea Feirstein, managing director of AKF Consulting Group, which advises states that administer 529 plans. For one thing, \$100 is a drop in the college tuition bucket.

For another, says Lutton, the free money could deter parents from comparison

shopping and make them blind to fees or poor performance. Furthermore, the cash isn't as rewarding as many parents might hope: like the rest of the money in a 529 plan, it can only be used for tuition and qualified educational expenses. In the long run, 529 plans are proving to make good politics – and that may be good for parents and students. Last month, a bipartisan bill was introduced in

Congress that would give parents more flexibility with the investments in 529 plans, encourage employers to match employee contributions, and extend the retirement saver's credit to 529 plans. Given the country's larger budget problems, the bill, currently in the Ways and Means Committee, is unlikely to move quickly through Congress, says Feirstein. But, she says, it is a sign investors can expect more changes to come.

#