Texas college savings plan flunked

Texas' 529 college savings program ranked at the bottom of its class; new manager takes a seat

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Texas Comptroller Carole Keeton Rylander seemed excited at a February 2002 meeting where the state was about to choose the financial manager for its college savings plan.

Texas had hired a consultant and sought bids for the 529 plan, named after the tax code that lets families sock money away for college with tax-free growth. One bidder, Atlanta-based Enterprise Capital Management Inc., promised to spend $2 million on marketing in the first year and won the favor of the consulting firm hired to evaluate the four bidders.

"Enterprise knocked the ball out of the park on the marketing stuff," Ms. Rylander said, and the firm was chosen unanimously.

But Enterprise actually struck out on the marketing, judging by the number of Texas families that were helped.

In five years, Enterprise signed up about 20,000 families with just over $200 million in assets; by contrast, Virginia's CollegeAmerica 529 plan manages nearly $28 billion in assets.

Texas families were turned off, in part at least, by the plan's low returns and high costs. In the three-year period ending Dec. 31, 2006, Enterprise finished dead last in total performance among similar plans around the country, according to SavingForCollege .com. The fees it charged were among the highest.

The 529 debacle represents another chapter in Texas' struggles to help families pay for college. With its original prepaid tuition plan shut to new applicants in 2003, the 529 plan was the state's sole offering for families looking to save for college.

"They underperformed way too dramatically for way too long a period," said Dallas financial planner William Taylor, who pulled his clients out of the Texas plan about a year ago. "The expenses were high for what you were getting.

"It seems like they were not making the best decisions on who should be managing the assets," said Mr. Taylor, managing partner at Cypress Wealth Management.

Enterprise, whose contract with Texas was its only 529 business, didn't bid to renew its five-year contract last year and exited the 529 industry. A division of AXA Financial Inc., Enterprise declined to comment about its performance.

An analysis of Enterprise's plan shows that the fees charged contributed substantially to the poor returns that Texas families received.

For every $100 of income that the Texas plan generated for the four years ended Aug. 31, 2006, only $94 was reinvested in the plan, said Steven Bankler, a San Antonio accountant who examined the plan for *The Dallas Morning News*.

Mr. Bankler measured how much investors had to pay in fees to get $100 in returns. The figures tally the success of the investing strategy as well as the expenses.

For every $100 of income, an average of $6 went for expenses, such as investment management and advertising, Mr. Bankler said. "That seems high to me."

The year ended August 2006 was the worst under Enterprise's management, he said. That's when an average of $8.56 in generated income went for plan expenses and $91.44 was reinvested.

Fee structure

Mr. Bankler questioned Enterprise's fee structure. The company charged a 1 percent asset management fee to scour the universe of mutual funds and build the best portfolios for investors. But the funds it chose were largely its own, which generated additional fees known as expense ratios.

"This is a fund of funds, so the management company also got income from the underlying funds," said Mr. Bankler, who is a certified forensic accountant, certified public accountant and personal financial specialist.

"Enterprise lived up to its agreement to keep the funds balanced," Mr. Bankler said. But there seems to have been no monitoring of the underlying funds to see whether they were suitable investments or determine whether they were performing well, he said.

"For those kinds of fees, they should be doing that as well."

Despite its size, Texas hasn't attracted the country's top 529 plan providers to its program. When Texas first asked financial firms to bid, none of the 10 biggest 529 managers responded.

In 2001, Watson Wyatt Investment Consulting evaluated bids from Brinson Advisors (owned by UBS Americas Inc.), Dreyfus Services Corp., MFS Investment Management (a subsidiary of Sun Life Financial) and Enterprise.

Dreyfus, despite tying for first with Enterprise in Watson Wyatt's scoring system, withdrew from the bidding in February 2002 after the state had begun talks with Enterprise.

Watson Wyatt and the losing bidders either declined to comment on the decision or didn't return calls seeking comment.

Officials with the Texas Prepaid Higher Education Tuition Board, which oversees the 529 plan, have struggled to explain what went wrong with the Enterprise plan.

Asked why there was a lack of interest, board member Michael Gollob of Gollob, Morgan, Peddy & Co. in Tyler said Enterprise and other companies involved in the bidding had complained about low commissions paid to investment professionals who would sell the plan. He added that he wasn't particularly involved in the discussions to choose the plan manager.

Ms. Strayhorn, whose last name was Rylander in 2002 and who, as state comptroller, was chairwoman of the board, didn't return calls for comment. Neither did any other board members.

Allen Spelce, spokesman for current Comptroller Susan Combs, said the Enterprise contract was signed on Ms. Strayhorn's watch, and the lawyers who worked for her are gone.

"When we took over, the decision had already been made – that Enterprise had decided not to rebid," Mr. Spelce said. "We moved ahead at that point to finding a successor to Enterprise and rebidding the contract."

Choice of two

When the state looked again for a plan manager in 2007, only two companies bid for the job – OFI Private Investments Inc. and UPromise. Both companies manage 529 plans in multiple states.

OFI offered to market the Texas plan traditionally, through investment advisers, while UPromise planned a grass-roots approach – letting grocery shoppers build their accounts with a percentage of the purchase price of certain products.

The state chose OFI, a subsidiary of Oppenheimer Funds Inc., to expand its 529 plan.

"Texas is a great state," said Raquel Granahan of OFI, adding that OFI officials were surprised that Texas' college savings plan had only $200 million in assets. "We can raise the assets and the number of accounts for Texas residents while we're the program manager. It hasn't been marketed the way the state had wanted it to be."

TRYING FOR BETTER MARKS

Texas has revamped both of its college tuition savings plans. More details are available at www.texastomorrowfunds.org. Here is an overview:

TEXAS COLLEGE SAVINGS PLAN

Formerly the Tomorrow's College Investment Plan, the program has a new provider, OFI Private Investments Inc., a subsidiary of Oppenheimer Funds Inc.

Known as a 529 plan after the section of the tax code that authorizes it, the plan lets families invest after-tax dollars that grow tax-free. No taxes are owed on withdrawals as long as the money is used for higher education.

OFI offers a selection of portfolios based on a child's age, with more aggressive investment strategies the younger the child is. The underlying mutual funds are run by Oppenheimer, its affiliates and Dreyfus Funds. Portfolio management fees range from 0.53 percent to 0.77 percent.

OFI took over management of the plan and its $200 million in assets on Nov. 19. Through Jan. 31, OFI has brought in $11.9 million in new contributions, said Allen Spelce, spokesman for Comptroller Susan Combs.

OFI replaces Enterprise Capital Management, whose offerings ranked Texas' plan as the worst in the nation for investment returns and among the highest for fees, according to Savingforcollege.com.

Pamela Yip

TEXAS TOMORROW FUND II

The Texas Tomorrow Fund, which guaranteed a future college education at today's prices, was a popular choice for families when enrollment began in 1996. But the program was closed to newcomers in 2003 because of soaring tuition costs at state colleges and universities.

State officials hope families will be as enthusiastic when a scaled-back version premieres Sept. 1.

The costs of a contract will be considerably higher, and the state will no longer guarantee contracts as it did for the 158,000 young Texans who were enrolled in the original program.

Parents will have three choices in purchasing tuition contracts, with the most expensive for flagship universities such as the University of Texas at Austin and Texas A&M University. A midprice contract would be available for other universities and senior colleges, and a lower-price contract would be offered for community colleges.

Contracts would be purchased in units, with one unit equaling 1/100th of the tuition for one year of college. For example, a unit at a flagship school could cost around $120, while a unit at a community college could run about $55. Exact prices have not been determined.

Colleges and universities – not the state – will be responsible for absorbing any additional costs if Tomorrow Fund II assets don't cover tuition in the future.

Terrence Stutz