Prior to 2001, when the first broker-sold 529 plans were introduced, financial advisors typically recommended traditional investment products such as Roth IRAs or mutual funds to their clients saving for college. Since then, the landscape has changed dramatically and advisors now recognize that 529 plans can be a key tool to help clients reach their goals. Today, there are over 30 advisor-sold plans that offer a wide range of commission-based investment options. Yet brokers aren’t the only ones recommending 529 plans. In recent years, the financial services industry has seen a movement toward fee-based Registered Investment Advisers (RIAs), who assist families with selecting and managing no-load 529 plan options.

Advisors, whether working for a broker-dealer or RIA, need to recognize the growing impact these once modest accounts can have on their business. In 2002, the average account balance across all 529 plans was just over $9,500. As of December 2015, that figure had risen to over $20,190, a 113% increase. With college costs rising twice as fast as any other household expense, 529 average account balances should continue to grow.

Families can likely expect to pay much more than the average household income if they want to send their newborn child to a four-year private college in 18 years. Although scholarships and grants will still exist to help cover some of the cost, parents are understandably worried about being able to pay for college. In fact, college costs are the number one household concern among parents. So much so that 52% of parents say saving for their children’s education is more important than saving for their own retirement.

With college costs rising twice as fast as any other household expense, 529 average account balances should continue to grow.

More than ever before, parents and grandparents are seeking out financial professionals to assist them in planning for college, and advisors need to be prepared. In fact, the 2016 Savingforcollege.com Annual Survey found that 36% of parents and grandparents who were starting to save for college intended to work with a financial advisor. The top reason to work with an advisor was “I need help to understand my college savings options and create a plan.” This chapter will examine how you can incorporate 529 plans into discussions with your clients, and how to leverage these vehicles to create opportunities to grow your practice.

How to begin the initial discussion

You don’t have to limit your 529 plan discussions to families with young children. While this group is obviously the most suitable, you may also have clients saving for college for nieces, nephews, grandchildren or even themselves. There is no one type of client that is the perfect fit for a 529 plan because anyone can open an account and name almost anyone as the beneficiary.

Once you’ve determined that your client can use help with educational planning, the next step is to discuss which savings vehicle is their best option. This e-book focuses on how to proceed if you and your client determine that a 529 plan is the recommended choice.
INTRO

SHOULD I ALWAYS RECOMMEND AN IN-STATE 529 PLAN?

Currently, 31 states and the District of Columbia offer residents a tax deduction or credit for 529 plan contributions. However, all but five of these states require clients to invest in their home state’s plan in order to receive the tax break. Some states will also disregard the account balance of students with in-state 529 plans when determining eligibility for state-funded financial aid. As an advisor, it is your obligation to make your client aware of these benefits. In fact, the Municipal Securities Rulemaking Board requires anyone giving financial advice regarding 529 plans to notify clients if investing in another state’s plan will cause them to lose out on these perks.

That is not to say that investing in an out-of-state plan is never prudent. Obviously if your client resides in a state that does not afford a tax benefit or lives in a state with no income tax, you should be looking at all plans available. Sometimes an out-of-state plan may be the best option even when the in-state plan does offer special tax benefits. The key is to properly weigh the pros and cons for your client to ensure they are maximizing their savings potential.
529 plans are complex investment vehicles and contain certain attributes that won’t be found elsewhere in the investing space. There are over 100 different plans, so the question becomes: How do I compare them all? Savingforcollege.com offers a convenient 529 plan comparison tool with detailed information on every plan in one place.

The comparison tool allows you to build a customized list of plans based on criteria that you select. If you’re working with a client who has a couple of plans in mind, you can view a list of all plans by state, click on your choices, and generate a side-by-side comparison. If you don’t know the names of the plans you want to research, you can create a list of plans based on features that your client is looking for. The tool also allows you to filter your results by direct-sold, broker-sold or prepaid plans.

Check out the 529 plan comparison tool on Savingforcollege.com

Savingforcollege.com also offers detailed investment options pages that can help you select a 529 plan and investment portfolio for your client. You can find information on asset allocations, expense ratios, and historical performance for the investment options offered by each 529 plan on these pages.

View investment options on Savingforcollege.com
Attributes such as investment management, fees and expenses, contribution limits and resident benefits all need to be considered when making a recommendation to a client. Sure, a state may afford your client a tax deduction, but if the plan’s fees are 50 basis points higher than another, how much is that deduction actually worth? The in-state plan could also have limited investment options or lagging performance compared to its competitors. So let’s look at a detailed example to see how all of these features might come into play.

**EXAMPLE**

You are a registered representative working for a broker-dealer firm. You and your client, Bob, have decided that a 529 plan is the best way to save for his 3-year old child’s college education. Bob has great expectations for his son and wants to save for a 4-year private school as well as a graduate degree. Bob currently lives in Georgia, which offers residents a tax deduction up to $2,000 if they invest in an in-state plan. However, the plan does not have many investment options and it also has a very low maximum lifetime contribution amount (currently $235,000). Given the future cost of college, you determine that Bob conservatively needs to save around $500 a month in order to save for dual degrees.

During the discussion, you make the following recommendations after getting approval from your firm: Bob should put $167 a month into the Georgia Path2college 529 plan. The plan’s fees are actually quite low and this contribution schedule will still allow him to take maximum advantage of the $2,000 state tax deduction each year. However, you explain to him that the plan has a limited menu of investment options as well as a low contribution ceiling. Even if Bob were to contribute the maximum amount allowed, he might not be able to save enough for two degrees.

You suggest that Bob put the other $333 a month into a broker-sold, out-of-state plan that offers a bevy of investment options. It allows you as an advisor to place him into investments you feel can beat the rising cost of education. You will also be able to monitor the account just as you do with Bob’s other investments.

The example above is a good way to provide added value to a client. You’ve helped him maximize his state tax deduction and demonstrated your knowledge of the markets by recommending the out-of-state plan. Remember, 529 plans are one of the few investments which clients can open themselves (usually at no cost), so be wise with your investment choices if you suggest a broker-sold plan.
SPECIAL CASES

MILLENIAL CLIENTS

Nearly 20% of parents who are looking to open a 529 plan are between 25 and 34 years old. There is a projected $30 trillion transfer of wealth coming from Baby Boomers to this younger generation coming, so it is critical for financial advisors to begin to attract millennial clients. However, millennials do not operate like previous generations. They are skeptics of the financial services industry in the aftermath of the 2008 financial crisis and having seen their parents lose vast sums of their wealth.

Studies have shown that this skepticism has caused millennials to shy away from many financial products traditionally offered through advisors. However, they do seem to have a keen interest in saving for their children's college education. Many of them are feeling the burden of student debt and are committed to saving in order to reduce their children's dependency on loans.

Helping young families understand and invest in 529 plans can be critical to forming new relationships and securing future business, but you must be careful with your approach. According to a Pew Research paper from 2014, as a generation, millennials are about half as likely to trust people as Baby Boomers. They believe in themselves and with unlimited access to information, they are confident that they can handle their own investments. Here are a few key points on how to handle millennials in the college savings space.

Growing your practice with 529 plans

BE STRAIGHTFORWARD

Over 23% of millennials have earned a bachelor’s degree or higher, making them the most educated generation in history\(^1\). You can expect everything in your conversations to be researched and scrutinized, so always be direct and truthful when discussing any financial product or plan. When discussing 529 plans, simply list out the pros and the cons. Overhyping them as an investment will only hurt your credibility.

PROVIDE OPTIONS

Millennials are independent thinkers who do not appreciate being told what to do. When presenting a college savings strategy, be sure to provide multiple options that include different plans, contribution amounts and investments and outline the pros and cons of each. Allow the client to review the different scenarios and involve them in the decision making process.

EDUCATE

Millennial clients will also want to know why each plan option is being presented. Remember, they will do their own research so if they don’t understand why you’ve selected certain 529 plans it can lead to confusion. What’s more, discussing the reasoning behind your selections might reveal valuable information about your client’s investment preferences. For example, when you explain why you chose a foreign equity fund for their 529 portfolio, you may find out that they are more interested in socially responsible investments. Having this discussion will allow you to create specially catered advice, which is of utter importance to a generation that demands mass customization.

Demonstrating your expertise and gaining the trust of this sceptical generation will give you access into other areas of their financial lives, which they currently may be handling on their own. For example, becoming a parent is a life-altering event, which opens the door to cross-sell products such as life insurance. Not only is the millennial generation incredibly underinsured, they are twice as likely to buy insurance online instead of through an agent\(^2\). In fact, a study was conducted by public relations agency Edelman gauging how the public views the trustworthiness of major industrial sectors. What topped the list? Technology. Dead last? Financial Services. As we see more and more clients purchasing financial services products online, an opportunity exists for advisors to prove their trustworthiness and reclaim the business.

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\(^1\)Hyder, Shama. Here’s What You Need To Know About Millennials. Forbes, 4 Mar. 2014.

\(^2\)Gallup. “Insurance Companies Have a Big Problem with Millennials” 5 Mar. 2015.
SPECIAL CASES

GRANDPARENTS

72% of grandparents feel it’s important to save for their grandchildren’s higher education. Those already saving plan to give a median of $25,000 to all of their grandchildren and 35% are planning to give $50,000 or more. This demographic can be a lucrative one for any advisor providing college planning services. 529 plans are a great investment for grandparents, but there are some important things to consider.

On the surface, grandparent-owned 529 plans work just the same as any other one. They can use any state’s 529 plan, enjoy tax-free gains when the funds are used for qualified higher education expenses, and may be eligible for state tax deductions on their contributions. Ownership of the funds also remains with the grandparent, which means all distributions will be made at their discretion. It’s when we dig a little deeper we see some additional advantages as well as some hidden disadvantages.

Most advisors should already be offering estate planning advice to older clients, so 529 plans are a perfect way to kill two birds with one stone. Contributions to a 529 plan are treated as gifts to the beneficiary for tax and generation-skipping transfer tax purposes, and deposits up to $14,000 ($28,000 for a couple) per grandchild per year will qualify for the annual gift tax exclusion. Accounts can also be “Superfunded” by contributing 5 years worth of gifts at once (per grandchild).

8 Id.
Mr. and Mrs. Smith have eight grandchildren. They express an interest in saving for their college educations. You advise them that 529 plans are a great, tax-advantaged way to save for college: they can be the account owner; they can easily name successor owners; and funds remain in their name. They are thrilled with your advice, but become overjoyed when you inform them that by opening up a 529 account for each of their grandchildren, they can remove $1.12 million from their estate in 1 day ($140,000 contributed to eight 529 plans).

A topic that warrants a discussion with any grandparent thinking of investing in a 529 plan is the potential effect on Medicaid. Elderly clients might rely heavily on this government benefit, so it is your duty as an advisor to explain the possible pitfalls. Account owners retain control of funds within a 529 plan even after the beneficiary turns 18. This retained ownership means that money in a 529 is a countable asset for Medicaid purposes. If something were to happen and your client needed nursing home care, all money within a the plan would need to be exhausted before Medicaid would pay the nursing home bills. Exhausting this account means not only liquidating a dedicated college fund, but also subjecting your gains to taxes and a 10% penalty. However, there is a possible solution to this problem.

You can suggest your client transfer ownership of the account to the child’s parents, but you must inform them that this is considered a transfer of assets, which will trigger a Medicaid penalty period. This period is determined by how much you transfer and what Medicaid determines the average private pay cost for a nursing home to be in your state. So, if your client transfers a 529 plan with $50,000 in it, and Medicaid determines the average monthly cost of a nursing home in his state is $5,000, he will be ineligible for 10 months ($50,000/$5,000).
One of the most crucial topics you’ll want to discuss with grandparents is the impact on the student’s financial aid eligibility. The funds in a grandparent-owned 529 plan are not reported as assets on the Free Application for Federal Student Aid (FAFSA). However, withdrawals used for the beneficiary’s qualified higher education expenses will be treated as the student’s unearned income. This will have to be recorded on the grandchild’s FAFSA application the following year and can reduce their aid package by up to 50% of the distribution amount. (Note: Beginning with the 2017-18 school year, instead of using prior year income as “base year” income, the FAFSA will use prior-prior year income.)

FORTUNATELY, THERE ARE WAYS TO PLAN AROUND THIS.

- If the family is not planning on applying for financial aid, or is phased out due to their income, this is not a problem.
- Change ownership of the plan to the parent before the child applies for financial aid. Be sure your client’s plan allows for a change of ownership, as not all do. If the plan does not, you can roll over the assets to a plan that does and transfer ownership at that time. Just be careful if the client has been claiming tax deductions for contributions to a current plan. Some states may require recapture tax on out of state rollovers or ownership changes. Additionally, remember to balance this with the potential Medicaid penalty discussed above.
- Wait until the student’s final year of college to take a distribution from the grandparent-owned account. Since the beneficiary will not need to apply for any more financial aid, there will be no negative impact.
COLLEGE PLANNING

As tuition costs and the need for a college degree increase, so will your clients’ expectations. Helping families save for college requires much more than simply recommending an investment vehicle like a 529 plan and telling them how much to contribute. There are many ways you can provide assistance, beginning with the application process. In fact, a study released by Fidelity stated that over a quarter of parents saving for college expect their advisor to help their child decide on a major. This is an opportunity for you to present yourself as an objective third party who can provide valuable insight and go beyond the normal expectations of an advisor.

With students graduating with an average debt load of $30,000, finding scholarships and grants to bring costs down has become more important than ever. Just because a student isn’t a star athlete or academic genius doesn’t mean they can’t get a scholarship to college. Talk with your client about other possibilities – are they involved in any extracurricular activities? Does your company offer scholarships? Is the family part of a minority ethnic group? These are all common ways to find tuition money.

And don’t worry if you’re dealing with an upper-income family. According to Sallie Mae’s 2014 How America Pays for College report, high-income families paid around 20 percent of their college expenses with scholarship money. What’s more, 38 percent of scholarships were awarded to families with annual incomes over $100,000.
SCHOOL SELECTION DIALOGUE

When helping a family choose the proper higher education institution, you need to consider both the family’s financial situation and the child’s needs. Clients whose children are getting a full ride to their top choice are not the norm, and would likely not need advice on college financing. But for those who do need to cover some of the costs, it’s your job to present a set of options that both fit their budget and provide their child with an appropriate environment to foster success.

If your client’s children are young, you won’t need to focus on a specific school. Instead, simply ask whether they would like to save for a four-year private or public institution and help calculate the future cost of tuition. However, as the student gets closer to college, school selection becomes of critical importance. A dialogue about how they would like to approach paying for tuition, room & board, etc. is vital. Of course, some clients will be willing to pay whatever is required out-of-pocket. But other parents (although they may have the financial means) will want their kids to have ‘some skin in the game’ and are comfortable with some student loans. And you’ll also likely encounter families who do not have the means to pay for full tuition, and do not want their child taking out excess loans. These clients will need help narrowing down their search to more affordable schools.

This dialogue should also involve the future college attendee, as he or she should have some input in the decision. There is no single school that is perfect for everyone. You’ll want to get a better idea of things like whether the student would feel more comfortable at a small or large school, or if they want to attend a school with a historically good basketball or football team. Academic-driven students, for instance, might want to narrow their search to schools that foster the best environment for their future major. And of course, admission requirements such as SAT/ACT scores, GPA and class rank also need to be factored into this search.
Once you have a better overall picture of your client’s situation and the type of school they are interested in, you can begin researching the costs. If the family already has specific colleges in mind, you can start by finding out the true price of attendance of each. Some advisors may have their own proprietary technology for this research, but those who don’t can reference the college’s net price calculator.

The Higher Education Act of 1965 (HEA) was amended in 2011 to require each postsecondary institution that participates in Title IV federal student aid programs to include a net price calculator on their web site. These calculators use institutional data to provide estimated net price information to current and prospective students based on the each child’s situation as well as the school’s availability of funds. Advisors can input the family’s financial information and receive the true cost of attendance at each school. You may find that the school with the highest sticker price may be cheapest to attend after all grants and scholarships are accounted for.

When presenting the costs of different schools to a client, you may also want to include a breakdown of how much the student’s loan payments would be after graduation. This can help them to weigh the pros and cons of each choice. For example, their top choice school might cost another $250 a month in loans after graduation compared to their second choice school.
FINANCIAL AID

AGI TACTICS

Another extremely valuable service you can provide to your clients is to increase their financial aid eligibility. One way to achieve this is to keep a handful of tactics up your sleeve that can lower their adjusted gross income (AGI). Colleges calculate how much a family can afford to spend on higher education before they award an aid package. When a family’s AGI is reduced, their Expected Family Contribution (EFC) will also go down. Simply put, the lower a family’s EFC, the more aid they will be eligible for.

REAL ESTATE

Becoming a landlord can be a great way to bring in monthly income, while adding $0 to your AGI. This is because real estate, in most cases, allows for a depreciation deduction. If your client were to bring in net rental income equal to the depreciation deduction you get (e.g., $8,000 in income after expenses and a $8,000 deduction), there will be no effect on the family’s AGI.

CAPITAL GAINS & LOSSES

Selling stocks and bonds may have an effect on a family’s AGI if the sale triggers a capital gain or loss. For instance, you’ll want to keep a close eye on transactions that occur from January of the student’s junior year of high school until their junior year of college (when the family would be applying for financial aid). If the client sells a stock or bond that results in a capital gain, it will be reported as income on the following year’s FAFSA. However, some strategically timed losses can help. If the sale triggers a capital loss, it would reduce AGI and could increase financial aid eligibility.
EXAMPLE

Bob has money invested in the stock market. Some of his positions are up, and some are down. With his child attending college soon, you advise him to just sell off the down positions triggering a $10,000 capital loss. Not only will he pay less in taxes this year, you’ll reduce his AGI on the FAFSA by $3,000 each year for the next three years and by $1,000 in his child’s senior year (capital losses can be carried forward). This could lead to thousands of dollars more in federal aid for his child, taking some of the pain away from that $10,000 loss.

SOCIAL SECURITY

If you have clients who are age 62 or older and have a child applying for financial aid you should encourage them to delay taking social security. Although they will currently forego monthly income, it will lower their AGI and increase the student’s aid eligibility.

IRA CONVERSION

There are times when converting a pretax IRA to a Roth IRA makes sense for your client, but if they have a child applying for need-based aid; you might want to encourage them to wait. Converting to a Roth will trigger income that needs to be reported and lower their potential aid package.
IF YOU HAVE A CLIENT WHO PLANS TO APPLY FOR FINANCIAL AID, YOU HAVE ONE OF THE BEST TOOLS FOR DETECTING CONCEALED ASSETS: THE FAFSA.

One of the most difficult aspects of a financial advisor’s job is getting a complete picture of a client’s finances. Many times clients will ‘hide’ or fail to mention certain blocks of their wealth for a number of reasons. If you have a client whose child is going to be attending college soon and they plan on applying for financial aid, you have one of the best tools for detecting these concealed assets: the FAFSA.

Helping a family complete the FAFSA is an important part of the college planning process. As an advisor, you can provide valuable insights on how to leverage certain tactics that can lead to a more lucrative award. But in order to do so, your clients will have to provide documents such as their most recent federal income tax returns, W-2s and other records of money earned, bank statements, records of investments, and records of untaxed income. Families who were previously hesitant to reveal this information should be much more cooperative when their financial aid eligibility depends on it.

In fact, the penalties for providing false or misleading information on the FAFSA include, but are not limited to, fines of up to $20,000, up to five years in jail, and repaying the financial aid received by the student. Some universities may suspend or expel a student for providing false information as well. The result of all this is usually a cooperative, truthful client giving you their complete financial picture, allowing you to provide better advice and cross-sell other products they may need.
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