Fall 2022

THE PROMISE OF 529 PLANS:

Increasing college savings for all Illinois Families

GUGLIELMO BRISCESE
SABRINA LIU
JESSE ORR

UCHICAGO URBANLABS INCLUSIVE ECONOMY LAB

EXECUTIVE SUMMARY

Higher education is widely recognized as a critical tool to for creating equity and achieving economic security, especially for children in lower-income households.

Due to the rapidly increasing cost of college and cuts to public funding for state universities, this goal of achieving higher education is increasingly out of reach for many middle- and low-income families.[1] College Savings Accounts, also known as 529 plans, are a useful tool for bridging this gap. Such accounts are offered by 49 states and the District of Columbia, and provide families with a low-cost, tax-advantaged vehicle for saving. Despite the potential impact and broad availability of these plans, relatively little is publicly known about their take up and usage.

Few studies exist of 529 take up at the national level. The few national studies that have been conducted imply that a relatively low percentage of US families save in 529 plans and those who do tend to be wealthier than others.[2] Moreover, trends in 529 take up reflect wider trends in inequality related to ownership of retirement and other savings accounts.[3]

In Illinois, the Illinois State Treasurer's Office administers the state's two 529 College Savings Plans – Bright Start and Bright Directions. Since 2015, the Illinois State Treasurer's Office has worked to expand the number and diversity of Illinois families saving for college. Over recent years, the State Treasurer's Office has reduced barriers to entry to the plans, for example by making the 529 program available in Spanish, investing in multicultural and multilingual marketing and outreach, enabling ITIN holders to open accounts, and greatly reducing the costs for families to participate. However, opportunities still exist to reach many more families.

EXECUTIVE SUMMARY CON'T

The University of Chicago Inclusive Economy Lab ("IEL") is partnering with the Illinois State Treasurer's Office to test additional efforts to expand access to college for Illinois families by improving participation in the 529 program and helping account owners make the most of their savings plans.

Our research partnership has included extensive analysis of available administrative data as well as survey research with representative samples of Illinois parents and existing 529 account owners. **Early insights from the Inclusive Economy Lab's analysis include:**

- The number of Illinois children with a 529 plan has increased over time, but remains less than 15 percent;
- Despite investments by the State Treasurer's Office to reach economically and racially diverse families throughout the state, residents of wealthier communities in Illinois are still at least five times more likely to hold 529 accounts;
- Among families with low or moderate income, while initial awareness of 529 plans is lower, interest in opening an account is high once families are aware of the benefits;
- Total program assets are concentrated in a small number of accounts, with the top 10 percent of account contributors owning up to 50 percent of assets; and
- Many 529 account owners could improve their saving strategies to maximize the benefits of their 529 plans.

These features make the Illinois 529 plans a high-quality and low-cost tool to help reduce educational inequalities in the state.

The Illinois State Treasurer's Office has sought to increase the economic, racial, ethnic, and geographic diversity of families participating in the 529 program through the elimination of account opening fees, providing Spanish-language materials and marketing, and implementing the Illinois Children's Savings Account program, which will provide a $50 seed deposit to all parents with children born or adopted in Illinois on or after January 1, 2023. The Illinois State Treasurer is committed to increasing the take up rate in lower- and middle-income communities and communities of color and has therefore partnered with the Inclusive Economy Lab to research, test, and amplify these efforts.

BACKGROUND

Even though the returns to a postsecondary degree remain high, the immediate cost of attending college can be a major barrier for students from middle- and low-income backgrounds. The challenges of navigating the confusing mix of federal, state, institutional, and private financial aid options leave many students unable to afford college (Partnership for College Completion, 2019) and a forthcoming report from the Inclusive Economy Lab finds that college costs play a primary role in determining whether and where Chicago Public School students attend college. Further, students who enter college, even those with the support of federal aid, confront a wide array of financial challenges, including paying for tuition, books, or living expenses (Goldrick-Rab, 2016). Facing mounting debt, low-income students may feel pressure to work more and take time away from studying (Welbeck et al., 2014), while others may drop out in response to high tuition bills (Stinebrickner & Stinebrickner, 2008). Expanding take up and savings in 529 plans for middle- and lower-income households could play a role in reducing these barriers.

Named after section 529 of the IRS Code, 529 plans are state-established college savings accounts that allow a contributor either to prepay a beneficiary's qualified higher education expenses at an eligible educational institution or to contribute to an account intended to pay postsecondary educational expenses. In 2001, the Economic Growth and Tax Relief Reconciliation Act made earnings on these plans completely tax-free (with this provision becoming permanent in 2006). Today, 49 states and the District of Columbia offer 529 plans, and many of them offer income tax deductions for contributions.[4]

In Illinois, the Treasurer serves as the trustee and administrator of two 529 college-saving plans: Bright Start, a direct plan that allows individuals to sign up and manage their savings independently, and Bright Directions, which is a plan accessible through a financial advisor.

Both plans share several defining features:

- Contributions are tax deductible for Illinois taxpayers (up to $10,000 for individuals and $20,000 for joint filers per year);
- Earnings accrue free of federal and state taxes;
- Withdrawals are tax free for qualified education-related expenses[5]; and
- Assets in 529 plans have a minimal effect on federal financial aid (only 5.64 percent of their total amount are reported as a parental asset in the FAFSA calculation).
- Accounts have no minimum balance, no minimum contribution amount, and no annual account fee.
- Anyone can contribute to a 529 plan, and account owners can change the beneficiary or transfer funds to other 529 plans if needed. Total fees in the programs can also be very low. For example, savers selecting the Bright Start Index Age-Based Portfolio (the default choice for Bright Start savers) pay a total fee of approximately 12 cents on every $100 they contribute.

These features make the Illinois 529 plans a high-quality and low-cost tool to help reduce educational inequalities in the state.

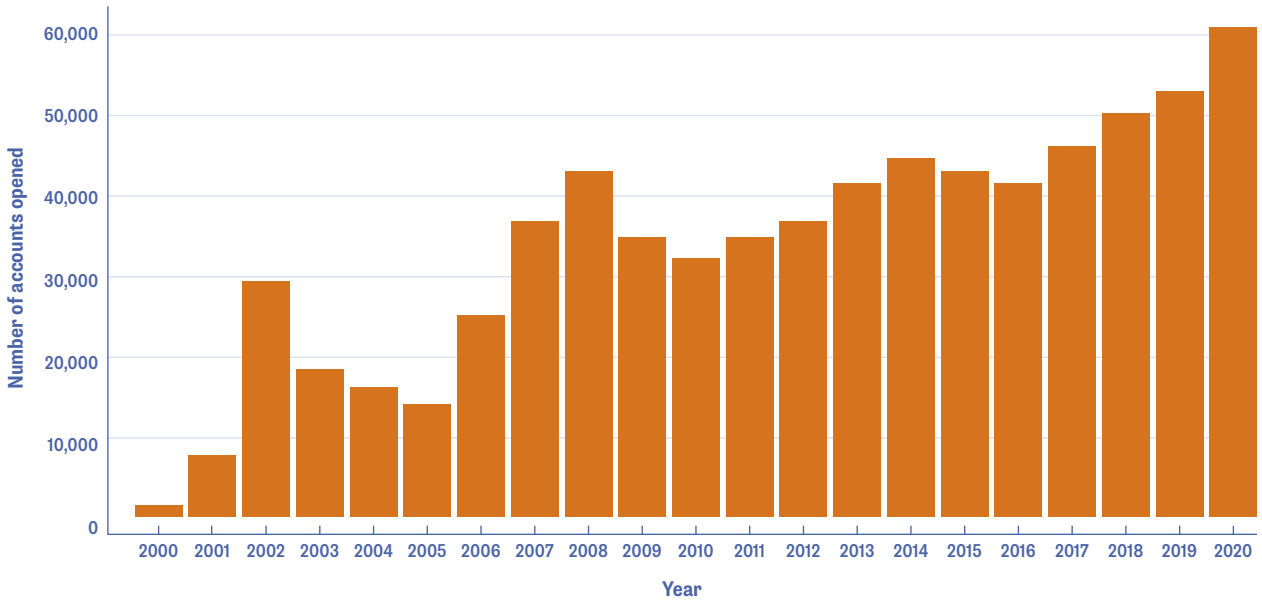
The Illinois State Treasurer's Office has sought to increase the economic, racial, ethnic, and geographic diversity of families participating in the 529 program through the elimination of account opening fees, providing Spanish-language materials and marketing, and implementing the Illinois Children's Savings Account program, which will provide a $50 seed deposit to all parents with children born or adopted in Illinois on or after January 1, 2023. The Illinois State Treasurer is committed to increasing the take up rate in lower- and middle-income communities and communities of color and has therefore partnered with the Inclusive Economy Lab to research, test, and amplify these efforts.

INCREASING TAKE-UP OF 529 SAVINGS PLANS AMONG UNDER-REPRESENTED FAMILIES

Key Findings #1: The number of Illinois families owning 529 plans has increased over time but remains a small share of eligible households.

College savings plans have been available in Illinois since the late 1980's.[6] Each year, the Illinois Treasurer's Office invests millions of dollars in multi-lingual, multi-cultural marketing and outreach to notify Illinois families about the program including, at different times, television and online advertising, community outreach, free online webinars, and direct mail to families. The Inclusive Economy Lab has conducted extensive analysis on the program's de-identified, aggregate, administrative data and found that participation in the program has increased substantially over time, from less than 10,000 accounts opened in the program's first year to more than 60,000 new accounts opened in 2020, bringing the total cumulative number of accounts to 712,000 by 2020. In recent years, both Bright Start and Bright Directions have consistently grown faster than the national average for 529 plans.[7] Despite the increasing trend, in 2020 the share of Illinois children with a 529 plan under their names remained lower than 15 percent[8], which based on informal communication with the College Savings Plan Network it appears to be in line with estimates of national take up rates for 529 plans.

Figure 1. Number of new 529 accounts opened per year in Illinois



INCREASING TAKE-UP OF 529 SAVINGS PLANS AMONG UNDER-REPRESENTED FAMILIES

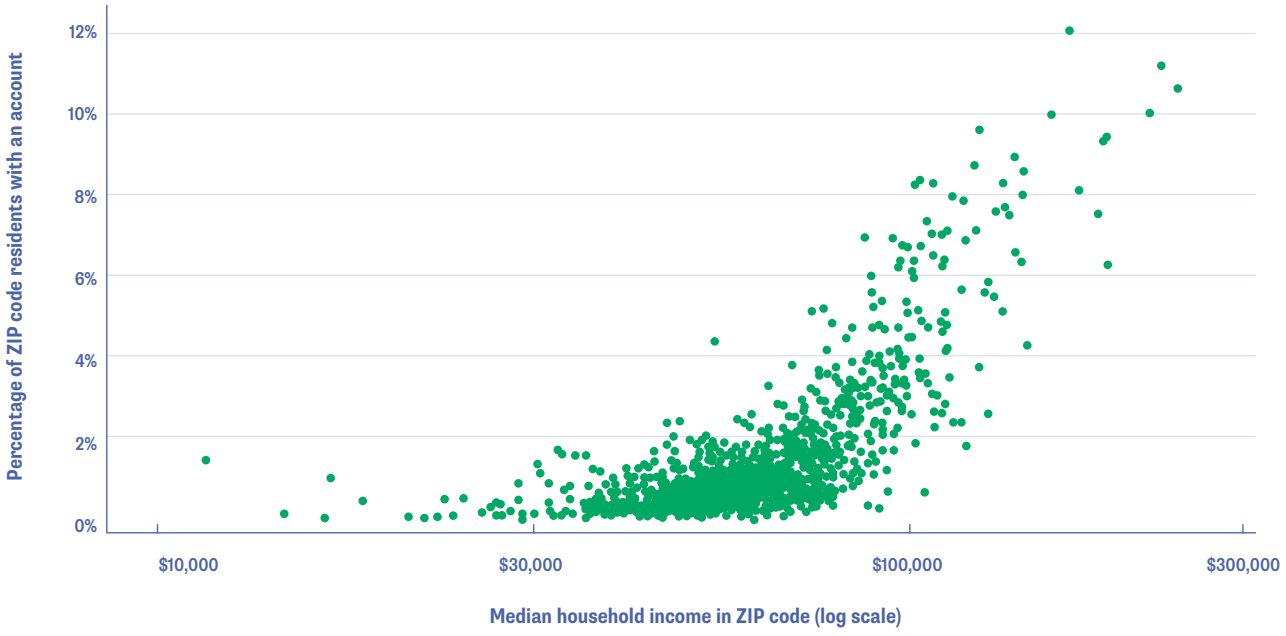
Key Finding #2: Families residing in higher income areas in Illinois are more likely to hold 529 accounts

Across all zip codes in Illinois, a minority of families own a 529 account. However, in 2020, take up of 529 plans was substantially higher in ZIP codes where the median household income was at least $100,000 than in ZIP codes with lower median incomes. Analysis by the Inclusive Economy Lab found that more than 10 percent of residents in ZIP codes with a median household income above $200,000 had an account, compared to less than 2 percent of residents of ZIP codes with a median household income of $30,000 or less.

In addition, a geographic analysis found that account ownership is highest in the northern and western suburbs of Chicago, which tend to be areas where residents are predominantly wealthier, more educated, and white. Similar disparities exist also in the take up of other financial products, such as household mortgages (Woodstock Institute, 2015). While zip code information is an imperfect proxy for race and ethnicity, there is sufficient evidence to suggest that the vast majority of account holders in Illinois have been opened by owners residing in zip codes where most of the population is white. In an effort to incentivize a greater geographic and economic diversity of families to save, in early 2023 the Illinois State Treasurer is launching the Illinois Children's Savings Account (IL CSA) program, through which the family of any child born or adopted in Illinois will receive a free $50 initial deposit in their college savings account.

Notes: *The graph shows the zip code's household median income (on the x-axis) and the percentage of ZIP code residents with an account (on the y-axis) using 2000-2020 529 data and 2020 Census data.*

Figure 2. Relationship between ZIP code median income and 529 plans take-up rates



INCREASING TAKE-UP OF 529 SAVINGS PLANS AMONG UNDER-REPRESENTED FAMILIES

Key Finding #3: Awareness of 529 plans is lower among lower- and middle-income families, but interest in opening a plan is high once families are aware.

To better understand what factors influence participation in 529 programs, the Inclusive Economy Lab partnered with faculty members at the University of Chicago Booth School of Business to conduct a survey on a representative sample of 1,013 households with children aged 17 or less in Illinois.

The survey found that:

- Most families hope their children will pursue post-secondary education, and a majority have begun saving to cover educational expenses across income groups. Approximately 55 percent of families with a household income of $60,000 or less indicated that they are saving for college compared to 73 percent of families with a household income between $61,000 and $125,000, and 85 percent of those with an income above $125,001.
- Program awareness is correlated with income: less than 50 percent of families with a household income below $60,000 had heard of 529 plans compared to more than 80 percent of families with an income above $125,001.
- Once the program was briefly explained to families who never heard of 529 plans, almost all families expressed interest in opening an account regardless of income.

INCREASING SAVINGS RATES AMONG 529 SAVINGS PLAN OWNERS

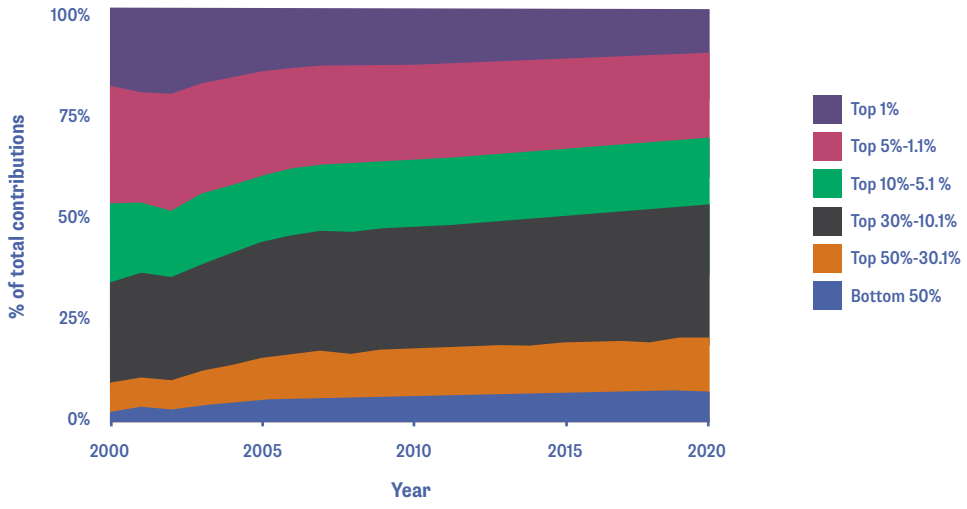
Ownership of a 529 savings account can help families save more regularly for their children's college, but many families may not take full advantage of these accounts due to saving strategies that don't seem to maximize the plan benefits as a result of inaccurate estimates of the future cost of college and/or the average savings rate among peers. **Indeed, preliminary findings from our analysis of program administrative data show that differences in savings among account owners are large, although disparities have decreased over time.**

Key Findings #4: The distribution of 529 assets remains highly unequal despite improvements in recent years

Total asset values in 529 plans in Illinois in 2022 reached $17 billion.[9] However, assets remain concentrated in a small number of accounts. In 2005, the top one percent of contributors to 529 accounts had saved approximately 15 percent of all assets in the program. These top savers were presumably owners with higher disposable income and accounting knowledge who were among the first to reap the benefits of these plans. Over the years this balance has improved: in 2020, the top one percent of contributors accounted for about 10 percent of total assets, but assets remain concentrated in a small share of accounts (see Figure 3). Further analysis by the Inclusive Economy Lab found that, among the roughly 120,000 individuals who owned an account for at least one year at some point over the past 20 years, about 45 percent saved less than $10,000 by the time they closed their account, and 25 percent saved less than $3,000. These differences in savings rates pose a key question: are account owners saving different amounts due to differences in income, or do different account owners display different behavioral biases and expectations?

Notes: *The graph shows the share of total assets under management in the Illinois 529 program in any given year owned by account owners.*

Figure 3. Distribution of 529 assets among contributors



INCREASING SAVINGS RATES AMONG 529 SAVINGS PLAN OWNERS

Key Findings #5: Account owners can improve their savings strategies.

In November 2021, the Inclusive Economy Lab and the Illinois State Treasurer's Office surveyed a representative sample of 3,370 account owners to complement the preliminary analysis on the administrative data to better understand the extent to which saving disparities in the program can be explained by financial constraints versus behavioral biases in saving behaviors.

Findings from the matched administrative and survey data show that account owners tend to underestimate the future costs of college, thus underestimating what share of those costs can be covered by their 529 savings. IEL analysis also revealed that many account owners adopt saving strategies that might prevent them from reaching their saving goals in the future. For example, about a third of account owners set up automatic transfers to avoid forgetting and contributing regularly. In the months immediately after setting up automatic transfers, owners start saving substantially more than they used to, but over the years many tend to forget to adjust the frequency and amount of their contributions, locking themselves into a self-imposed default for several years, which leads them to save less in the long run than their counterparts who do not set up automatic transfers.[10] IEL analysis on the matched survey and admin data also shows that owners who set up automatic transfers are not significantly different from those who don't on any dimension of income, financial literacy, or ability and willingness to increase savings amounts. These behavioral patterns are not unique to 529 plans; a well-established literature has extensively documented how individuals' biases affect savings and how low-cost interventions can often yield large benefits (see Carrera et al., 2022, and Carroll et al., 2009).

DISCUSSION

The analyses described above provide the foundation for continuing efforts by the State Treasurer's Office to expand and diversify the number of families saving for future education. In the coming months, the State Treasurer's Office will work closely with the Inclusive Economy Lab and faculty at the University of Chicago Booth School of Business on a series of evidence-based and data-driven initiatives to increase participation rates in 529 plans, improve savings behaviors among existing account owners, and in the future explore the potential impact of savings incentives, seed investments or matches for less affluent families.[11] Targeted awareness campaigns, complemented with simple incentives to overcome the first hurdle of opening an account, could have a significant effect in broadening the pool of families opening a 529 account. Research has shown that removing small administrative frictions can often have a large effect on participation in programs like 529 plans. Similarly, while the Illinois State Treasurer's Office already offers free online tools and tips to existing account owners to help them choose the best saving strategy for their goals, further study may help identify which tools work best and for whom. The Inclusive Economy Lab will collaborate with the Treasurer's Office to implement an additional online randomized control trial to provide better tailored advice to account owners and encourage them to adjust savings strategies when necessary.

TO LEARN MORE

The learn more about our research partnership with the Illinois State Treasurer's Office, please contact Guglielmo Briscese at gubri@uchicago.edu.

To learn more about the work of the University of Chicago Inclusive Economy Lab, please contact Carmelo Barbaro at cbarbaro@uchicago.edu or visit inclusiveeconomy.uchicago.edu.

To learn more about the Illinois State Treasurer's Office and its College Savings programs, please contact John Mitchell at jmitchell@illinoistreasurer.gov or visit illinoistreasurer.gov/Individuals/College_Savings

REFERENCES

Bettinger, Eric P., Bridget Terry Long, Philip Oreopoulos, and Lisa Sanbonmatsu. "The role of application assistance and information in college decisions: Results from the H&R Block FAFSA experiment." The Quarterly Journal of Economics 127, no. 3 (2012): 1205-1242.

Carrera, Mariana, Heather Royer, Mark Stehr, Justin Sydnor, and Dmitry Taubinsky. "Who chooses commitment? Evidence and welfare implications." The Review of Economic Studies 89, no. 3 (2022): 1205-1244.

Carroll, Gabriel D., James J. Choi, David Laibson, Brigitte C. Madrian, and Andrew Metrick. "Optimal defaults and active decisions." The quarterly journal of economics 124, no. 4 (2009): 1639-1674.

Dynarski, Susan, C. J. Libassi, Katherine Michelmore, and Stephanie Owen. "Closing the gap: The effect of reducing complexity and uncertainty in college pricing on the choices of low-income students." American Economic Review 111, no. 6 (2021): 1721-56.

Goldrick-Rab, Sara, Robert Kelchen, Douglas N. Harris, and James Benson. "Reducing income inequality in educational attainment: Experimental evidence on the impact of financial aid on college completion." American Journal of Sociology 121, no. 6 (2016): 1762-1817.

Partnership for College Completion, "Priced Out: Black Students On Illinois' Disinvestment In Higher Education & What Can Be Done About It", Report

Selingo, Jeffrey J. "Moving the Needle on FAFSA Completion: How Changes to Federal Financial-Aid Policy Can Broaden Access to Higher Education." National College Access Network (2017).

Stinebrickner, Ralph, and Todd Stinebrickner. "The effect of credit constraints on the college drop-out decision: A direct approach using a new panel study." American Economic Review 98, no. 5 (2008): 2163-84.

Welbeck, Rashida, John Diamond, Alexander Mayer, and Lashawn Richburg-Hayes. "Piecing Together the College Affordability Puzzle: Student Characteristics and Patterns of (Un) Affordability." MDRC (2014).

Woodstock Institute. "Her Longer Road Home: Disparities in Mortgage Lending to Women in the Chicago Region". (2015)

1 https://www.salliemae.com/content/dam/slm/writtencontent/Research/HowAmericaPaysforCollege2021.pdf

2 https://www.gao.gov/products/gao-13-64 and https://treasurer.nebraska.gov/news/default.aspx?story=511

3 https://www.census.gov/library/stories/2022/08/who-has-retirement-accounts.html

4 There are two types of 529 plans: prepaid tuition plans and education savings plans. All fifty states and the District of Columbia sponsor at least one type of 529 plan. In addition, a group of private colleges and universities sponsor a prepaid tuition plan. Five states currently have a state income tax but do not offer a deduction for contributions: California, Hawaii, Kentucky, Maine, and North Carolina.

5 Expenses the IRS counts as qualified education spending are tuition and related fees, room and board, books and supplies, special services, computers and related equipment, various expenses related to participation in an apprenticeship program registered with the US Department of Labor, and up to $10,000 of repayment of a student loan. Room and board expenses are limited to the lesser of the room and board allowance in a school's cost of attendance measure, or the actual amount paid to student housing. 529 funds cannot be used to pay for insurance, sports expenses or monthly health dues, electronics, smartphones and tablets, transportation and travel cost, and repayment of student loans. If 529 account withdrawals are not used for qualified higher education expenses or tuition for elementary or secondary schools, they will be subject to state and federal income taxes and an additional 10 percent federal tax penalty on earnings.

6 See https://www.collegesavings.org/history-of-529-plans/

7 Source: College Savings Plan Network

8 Source: https://www.census.gov/library/visualizations/interactive/adult-and-under-the-age-of-18-populations-2020-census.html

9 In 2016, total asset values in 529 plans across the U.S. was $275 billion. Source: https://www.brookings.edu/research/a-tax-break-for-dream-hoarders-what-to-do-about-529-college-savings-plans/

10 Additional analysis shows that owners who set up automatic plans are not different from other owners on any important dimension such as income, saving goals, or financial literacy.

11 A number of states already offer an opening contribution or match to new owners. Connecticut, Rhode Island, and West Virginia offer a one-time contribution of $100 to every child born in the state; Maine and North Dakota offer a $200 matching donation. Colorado, Kansas, Louisiana, Maryland, North Dakota, and Tennessee offer matching grants between $200 and $500 based on income eligibility.