

## **I. Introduction**

The Office of the State Treasurer (“OST”) continues to prepare for implementation of the Delaware ABLÉ Act (“ABLE”). This has included further research and analysis of the issues and working with our colleagues in the ABLE sphere. Since our May 8 memo important developments in the areas of federal regulations, costs of an ABLE program, and use of ABLE programs have occurred. This memo updates you on these developments and shares our thoughts on where ABLE stands in the fall of 2015.

We continue to believe ABLE can be implemented in Delaware but regulatory and cost headwinds may be greater than originally anticipated. The proposed federal regulations for ABLE are much more onerous than states expected and what Congress intended. As states attempt to budget for ABLE, it is becoming clear there will be some launch costs and it presently appears unlikely third party financing will materialize. Preliminary survey data with respect to how ABLE accounts will be used are better than expected but show that challenges will remain in making ABLE viable.

## **II. Federal regulations**

Since our last memo, the Internal Revenue Service (“IRS”) has released (on June 19) proposed regulations (the “Regulations”) for ABLE. The public comment period for the Regulations ended on September 21. On October 14, the IRS held a public hearing in Washington D.C. on the Regulations. A transcript of that hearing will be made available plus a summary from CSPN but as of this writing neither have been produced. The release of final Regulations had been expected by the end of 2015 but that is now unlikely. At this time, we are hopeful that final Regulations will be issued in the spring of 2016.

Given the uncertain timing of the final Regulations, many states, both independently and through the National Association of State Treasurer’s College Savings Plan Network (“CSPN”), are requesting advance guidance from the IRS regarding “threshold” issues vital to determining the viability and design of ABLE programs. In discussions with CSPN, the IRS has indicated its preliminary willingness to address those issues; however, the Social Security Administration (“SSA”) has controlling authority over other Regulations that CSPN is seeking to change. Based on its first meeting with SSA officials on September 17, CSPN has reported that the SSA does not appear amenable to relaxing its requirements. While further meetings between CSPN and both the IRS and SSA are planned, uncertainty over the resolution of such issues is likely to continue into 2016.

CSPN’s regulatory subcommittee has identified three major problems with the Regulations: (i) eligibility certification and recertification, (ii) tracking distributions and qualified expenses, and (iii) collection and retention of taxpayer identification numbers (“TINs”). Discussions with our peers, both in person at the August ABLE conference in Chicago and via e-mail and telephone over the summer, suggest that the views of the CSPN regulatory subcommittee reflect the consensus of state administrators. While the federal ABLE Act was modeled on Section 529 of the Internal Revenue Code, which governs college savings plans, the ABLE Regulations are more administratively complex with more cumbersome obligations placed on the states. We

are working with CSPN and our sister states to seek relief from the IRS and SSA regarding the most onerous provisions of the Regulations and more closely conform the states' responsibilities under ABLER with the comparable obligations under the 529 college plan rules.

### **Certification and Recertification Eligibility**

*A qualified ABLER program must specify the documentation that an individual must provide, both at the time an ABLER account is established for that individual and thereafter, in order to ensure that the designated beneficiary of the ABLER account is, and continues to be, an eligible individual.<sup>1</sup>*

ABLER Regulations shift the burden to determine participant eligibility from the U.S. Treasury, as envisioned by the federal ABLER Act, to the states. This provision would require state programs to collect and retain sensitive medical information and to make determinations with respect to medical data to determine participant eligibility. CSPN has argued that state agencies are not equipped to make such determinations as most ABLER programs are housed in departments and divisions with financial, not medical, expertise. In Delaware's case, the eligibility determination requirement would create a significant administrative burden given the need to ensure strong controls are in place to prevent unauthorized access to medical files. Moreover, OST lacks expertise to make eligibility decisions based on medical reports and health records. This burden would be compounded further if the IRS requires states to make annual recertifications involving eligibility determinations with respect to the length of particular disabilities and the likelihood of cure or recovery.

CSPN has proposed a sensible solution to this problem: "self-certification." Self-certification would require that states receive only a representation from the account owner regarding eligibility based on a doctor's diagnosis. Violations would be enforced via penalty of perjury or another applicable "enforceable obligation" under state law. CSPN notes that state agencies are not required to screen 529 college plan accounts for eligibility. Under the 529 college framework, account owners are responsible for ensuring eligibility with the IRS on the front and back end. States have no role in 529 eligibility determinations as states rely on self-certification. Unless self-certification is approved, ABLER would create an administrative burden on states well beyond what 529 programs require.

### **Tracking Distributions and Purpose**

*A qualified ABLER program must establish safeguards to distinguish between distributions used for the payment of qualified disability expenses and other distributions, and to permit the identification of the amounts distributed for housing expenses as that term is defined for purposes of the Supplemental Security Income program of the Social Security Administration.<sup>2</sup>*

Regulations call for ABLER programs to track three types of distributions or withdrawals that must be reported to the SSA: qualified, qualified housing and non-qualified expenditure.

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<sup>1</sup> Regulations §1.529A-2(d)(1)

<sup>2</sup> Regulations §1.529A-2(h)(1)

Tracking distributions and matching them with qualifying expenditures would impose a significant administrative burden on ABLE administrators. CSPN acknowledges the need to provide monthly reports on the amount of distributions, but objects to the requirement that particular expenditures be identified and tied to specific distributions. CSPN notes that a single distribution may cover a variety of expenses requiring substantially more accounting than simple recording of withdrawals. Moreover, account distributions can be drawn in anticipation of a qualified expenditure rendering any such accounting dependent on an expression of intent by the account holder or further and subsequent verification of the use of such monies. This type of detailed tracking would add significantly to states' administrative burdens.

CSPN has proposed the elimination of the requirement to identify and classify distributions and match them with qualifying expenditures. If not wholly eliminated, CSPN has suggested an alternative proposal to allow account owners to self-certify (under the penalty of perjury) the particular uses and amounts of distributions at the time of withdrawal. Since compliance with the Supplemental Security Income program ("SSI") is predicated on what a distribution is spent to purchase, the SSA has expressed an unwillingness to accept only monthly distribution data from the states (which SSA then would need to cross-reference with the monthly self-reporting expenditure data that it receives from beneficiaries). Effectively, the SSA wants to pass that administrative burden to the states. CSPN plans to continue to work with the SSA, but as of now it appears that states would be required to track and match both participant distributions and eligible expenses.

Tracking of distributions and matching of expenses as required by the Regulations is another point of difference between ABLE and college 529 programs. Currently, 529 programs have no requirement to track and make determinations respecting qualified expenses; the only obligation is to report distributions from accounts to the IRS. Notably, 529 programs originally were required to verify whether distributions were used for qualified expenses, but due to the administrative burden it placed on states and vendors, Congress revised the statute in 2001 to shift the burden to document qualified expenses from states to the account owner. CSPN's current argument for revising ABLE's regulations follows this precedent.

### **Collection and Retention of TINs**

The third major concern of CSPN with the Regulations is the requirement that ABLE administrators collect TINs for all contributors to an ABLE account at the time of contributions. The proposed regulations call for ABLE programs to track the "name, address, and TIN of the designated beneficiary of the ABLE account" and the "name, address, and TIN" of any contributor.<sup>3</sup> The IRS seeks TINs in order to police cases where contributions in excess of statutory limits were made and have to be returned to the contributor. CSPN argues that such requirements are unnecessary if state systems can prohibit excess contributions from being deposited into accounts in the first place. Technology already exists for state 529 programs to do just that and the same programs can be utilized by ABLE plans in a like manner.

CSPN proposes requiring collection of TINs only when an ABLE program lacks the technology to prohibit excess contributions. If there is a technical error resulting in a rare excess

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<sup>3</sup> Regulations §1.529A-5(2)(i) and §1.529A-5(2)(ii)

contribution, CSPN argues that the cost of incurring collection of TINs for every contribution outweighs the enforcement benefits. (Note that contributions can come from multiple individuals and are commingled in a single account.) Here again, the Regulations impose greater administrative burdens than the rules governing college 529 programs. Under 529 college regulations, states which collect TINs for only the account owner and beneficiary, not for every contributor.

### **III. Costs**

Costs of designing, implementing and administering ABLE consist primarily of marketing, consulting and legal fees, staffing and personnel costs, IT investments and fees for third-party record-keeping. Precise start-up and recurring costs of Delaware's ABLE program will be difficult to forecast until the Regulations become final and an implementation path is determined. What is fairly certain at this point is that such costs will be greater than comparable costs incurred by the State in designing and running its 529 college program due to the greater regulatory burdens associated with ABLE. In addition, the prospect for reimbursement of such costs will be lesser owing to the low likelihood that assets accumulated in ABLE programs will be of a scale to incent meaningful vendor participation.

For purposes of generating preliminary cost estimates for Delaware's ABLE plan, we have collected estimates for both implementation costs and recurring costs for ABLE programs from approximately a dozen states. These data are set out in a table and attached as [Appendix I](#). Scaling the estimates to Delaware's population and rounding to the nearest \$1,000, produces a median estimate of \$49,000 and a mean estimate of \$111,000 for initial start-up costs. Recurring cost estimates exhibit slightly less variation in medians and means, ranging from a low of \$68,000 to a high of \$97,000, respectively.

The disparity between median and mean estimates reflects the wide range of estimates for both start-up costs and recurring costs. A large part of this variance is simply due to the lack of certainty around the Regulations. In speaking with a number of states, we have concluded that most of the reported costs estimates are very preliminary and likely reflect an understatement of actual costs. This is borne out by classifying the estimates into two groupings. The first group of estimates were made by fiscal offices for purposes of budgeting ABLE costs before the publication of the Regulations. The second group are estimates made by the state agencies that will administer ABLE programs after publication of the Regulations. Estimates made by the former group tend to be lower than those issued by the latter group based on what states now perceive to be a fairly burdensome set of Regulations.

A second meaningful source of variance in estimates arises from decisions that states are making regarding plan design and their current 529 college "footprint." Some states which are leaders in the 529 college arena, such as Virginia and Florida, are seeking to build on their substantial infrastructure to be leaders in collecting plan assets for ABLE from outside their borders. Other states that have less investment in their 529 plans and outsource much of the administration of such plans to third party vendors, such Vermont and South Dakota, are assuming that they will pursue a similar model for ABLE. Still other states with lower ABLE cost estimates may be expecting to contract administration out to another state (like Virginia or Florida) or joint

venture with a group of states to mitigate ABLE expenses. We believe that the lower estimates, understate likely ABLE costs due to the tepid interest expressed by vendors and the uncertain nature of states' capacity to contract out or participate in a joint venture.

The other relevant set of data to evaluate for potential ABLE costs is the actual 529 college plan implementation costs. We have collected such data from thirty state programs, scaled the amounts to account for population differences, adjusted the figures for inflation using 1998 dollars and rounded to the nearest thousand. These expenses are presented in a table attached as Appendix II. Based on that methodology, the mean and median total actual costs (for both state and vendor expenses) for 529 college plan implementation were \$305,000 and \$460,000, respectively. Delaware's 529 implementation cost was reported at only \$110,000, but this figure does not include costs borne by the vendor as part of the start-up. These actual cost figures are three to four times the launch estimates provided above for implementing ABLE.

The discrepancy between implementation estimates for ABLE and 529 actual costs cannot be fully explained. One possible rationale for the divergence assumes that states will be able to leverage both their learning curves from their 529 implementation as well as their existing 529 college plan infrastructures to support ABLE implementation. A second explanation may be that states are assuming that the much smaller base of ABLE eligible participants relative to 529 eligible participants will result in fewer start-up expenses. A final explanation and perhaps the most likely is that estimates generally tend to be set at levels that are overly optimistic, particularly in times of budget shortfalls.

In forecasting Delaware's ABLE implementation costs, we are putting greater weight on actual 529 college implementation costs as opposed to other states' ABLE estimates. We believe this more conservative approach is supported both by Delaware's specific situation as well as the general differences between ABLE and the 529 college program. In the first instance, Delaware's implementation costs are likely to be high as the State currently outsources administration of its 529 program to a third party vendor through the Department of Education ("DOE") and has almost no existing state infrastructure.<sup>4</sup> DOE personnel were also not part of the 529 college plan launch and therefore even if the Office of the State Treasurer could coordinate design of ABLE with DOE, there is very little learning curve to leverage.

General plan differences also suggest that ABLE will be more expensive to implement than college 529 programs. As discussed above, the current ABLE Regulations are clearly more administratively burdensome to administer than the 529 college program. Though there will likely be a fraction of the number of participants in the ABLE program than are enrolled in the college 529 program, the start-up costs will not be greatly impacted by the ultimate number of participants. Rather, the complexity of the "design and build" out of the ABLE platform will most significantly impact costs of implementation. Due to the regulatory burden and relatively small participant base, vendor support of ABLE is currently anticipated to be very low. This indicates that little if any reimbursement of state implementation costs can be expected by third parties. Even the "soft support" derived from the learning curve of current 529 vendors may not support ABLE implementation if vendors decline any role in the program's implementation.

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<sup>4</sup> Delaware's 529 program is supported by a fraction of the time of 1 FTE; Virginia by way of contrast has approximately 100 FTEs for its 529 program.

Our forecast for Delaware’s ABLÉ implementation costs therefore adheres to the higher range of the estimates above and the lower end of the average of the actual 529 implementation costs. We are preliminarily estimating start-up costs for ABLÉ at \$200,000 – 250,000. Similarly, we are assuming that recurring costs will also comport to the higher end of the ABLÉ estimates and we are using a working estimate of \$100,000 - \$125,000. Finally, note that we have not attempted to build our own cost model at this time using third party bids. Due to the present uncertainty surrounding ABLÉ Regulations and because precise costs will be greatly influenced by the model for ABLÉ that Delaware ultimately adopts, we do not think that such an exercise would have merit at this time. We have, however, broken down the estimated ranges above into plausible levels of expenditures and presented that data in a table attached as Appendix III.

#### **IV. Use of ABLÉ Accounts & Plan Asset Model**

Use of ABLÉ accounts by participants will have an immense impact on the character and scale of plan assets, and therefore the potential viability for states to recoup their costs of administering ABLÉ programs. Lacking any concrete data, state administrators generally have assumed that there would be a mix of those who use ABLÉ as a long term investment vehicle and those who use it as a de facto checking account. In the former instance, the 529 college program was invoked as a comparable model for ABLÉ plans. However, as one of the main benefits of an ABLÉ account was to provide exemption for plan assets from federal means testing, there was a competing vision that accounts might be used as short term vehicles akin to health savings accounts, with regular contributions and offsetting drawdowns. As discussed in a prior memo, account balances that cannot be invested in long term vehicles will not generate sufficient return against which fees can be levied to cover program costs, a crucial determinant for calculating the amount of state resources that ABLÉ will require on a continuing basis.

Since our last memo two surveys were completed that provide limited guidance on the issue of account use and balances. The first survey was commissioned by Florida’s 529 program and the second was done by the National Disability Institute (“NDI”). The results of the surveys confirm a mix of short and long term use of ABLÉ accounts and suggest that account balances may level off in the range of \$15,000 - 25,000. (As a point of reference, 529 college savings account balances averaged a little more than \$20,000 at the end of 2014.)

Of the nearly 1,000 responses across the U.S. to the NDI survey, 50% of respondents indicated that they planned to keep money in their account for at least five years and 40% said they would contribute at least \$5,000 per year. These responses suggest that half of the ABLÉ population plans to use ABLÉ accounts as a savings vehicle and amass account balances of at least \$25,000 before beginning withdrawals. The Florida survey data is comparable as to use of account but significantly less bullish with respect to the level of account contributions. While nearly 60% of the 200 respondents indicated that they would keep funds in an account for six years or more, only 17% said that they would invest at least \$5,000 per year, with nearly half reporting contributions between \$1,000 and \$4,999 and the balance under \$1,000. These responses indicate that account balances might only reach as much as \$15,000 prior to withdrawals, but suggests a

clear intent to use ABLE as a savings vehicle (i.e., only 5% of respondents indicated that they would use ABLE for immediate needs).

In light of the survey data we have updated our asset model to take into consideration the information on account usage. Previously, we had assumed comparable usage by all account holders. We now assume that 60% of participating accounts will be used for long term investing with an average length of six years until withdrawals begin. We also assume annual contributions will average \$5,000 per year over that six year time horizon. We exclude from the model account balances for the remaining 40% of ABLE participants on the assumption that such account balances will net to zero over the course of any given year and will be invested in short term money market accounts that do not generate reimbursable fee income. Finally, as the surveys did not provide information sufficient to model withdrawals, we assume that participants end contributions six years after enrolling and maintain account balances. While this might provide for some upward bias to our 10-year account balance projection, the model does not incorporate investment gains, which would bias the ending balance downwards.

As no data has been introduced via the surveys that would alter our model’s assumptions about the eligible population or participation rate, we have left those estimates unchanged. We have, however, altered our initial projections of the pace of “on-boarding” participants from a level build over five years to front-end weighted loading over four years. This change does not alter our out-year projection after the first decade of the program, but does reflect what we believe to be a more likely trajectory in getting to a steady state base of assets.

Year	Long Term Accounts		Annual Contributions				Total Contributions	Total Assets
	New Accounts	Total Accounts	Cohort 1	Cohort 2	Cohort 3	Cohort 4		
1	480	480	\$2,400,000	N/A	N/A	N/A	\$2,400,000	\$2,400,000
2	360	840	\$2,400,000	\$1,800,000	N/A	N/A	\$4,200,000	\$6,600,000
3	240	1,080	\$2,400,000	\$1,800,000	\$1,200,000	N/A	\$5,400,000	\$12,000,000
4	120	1,200	\$2,400,000	\$1,800,000	\$1,200,000	\$600,000	\$6,000,000	\$18,000,000
5	0	1,200	\$2,400,000	\$1,800,000	\$1,200,000	\$600,000	\$6,000,000	\$24,000,000
6	0	1,200	\$2,400,000	\$1,800,000	\$1,200,000	\$600,000	\$6,000,000	\$30,000,000
7	0	1,200	\$0	\$1,800,000	\$1,200,000	\$600,000	\$3,600,000	\$33,600,000
8	0	1,200	\$0	\$0	\$1,200,000	\$600,000	\$1,800,000	\$35,400,000
9	0	1,200	\$0	\$0	\$0	\$600,000	\$600,000	\$36,000,000
10	0	1,200	\$0	\$0	\$0	\$0	\$0	\$36,000,000

## V. Conclusion

Despite considerable challenges, ABLE implementation remains feasible. What the specific program design will be, and in turn what the precise costs will be, are heavily dependent on how burdensome the final federal regulations are. The biggest constraint on being able to determine how an ABLE program could or should look is regulatory uncertainty. We hope the picture is clearer by the end of the year, even if only informally, although preferably via a statement of advance guidance, even though the official final regulations may not be released until this time

next year. OST will continue to monitor developments in the regulatory sphere and work with our colleagues and CSPN to improve the regulations.

Once there is some degree of clarity with respect to federal regulations we can begin to in earnest assess potential plan models and have a better idea of what the costs of launching and maintaining ABLE may be. OST will continue to keep you informed about any material developments during the implementation process.

## Appendix I

### 529(a) Implementation and Recurring Cost Estimates<sup>5</sup>

State	Implementation Cost	Cost (Scaled to Delaware)	Recurring Cost	Recurring Cost (Scaled to Delaware)
Alabama	\$150,000-\$250,000	\$29,000-\$48,000	\$100,000-\$200,000	\$19,000-\$38,000
California	\$333,000	\$8,000	\$330,000	\$8,000
Florida	\$3,400,000	\$160,000	\$2,000,000	\$94,000
Maryland* <sup>6</sup>	\$1,400,000	\$219,000	\$1,200,000	\$188,000
Minnesota	\$73,000	\$13,000	\$98,000	\$17,000
Montana*	\$22,000	\$20,000	\$1,000	\$1,000
Nebraska*	\$270,000	\$135,000	\$135,000	\$68,000
North Dakota*	\$25,000	\$32,000	\$50,000	\$64,000
Pennsylvania	\$1,500,000	\$110,000	N/A	N/A
South Carolina	\$600,000-\$1,000,000	\$115,000-\$192,000	\$600,000	\$115,000
Tennessee	\$171,000	\$24,000	N/A	N/A
Utah*	\$67,000	\$22,000	N/A	N/A

<sup>5</sup> For purposes of consistency and simplicity all numbers are rounded to the nearest thousand.

<sup>6</sup> Estimates issued by a state's fiscal office are denoted by an asterisk; other estimates produced by ABLE administrative agencies.



Washington	\$441,000	\$59,000	\$665,000	\$89,000
Virginia*	\$4,954,000	\$557,000	\$3,413,000	\$383,000

## Appendix II

### 529 Actual Implementation Costs<sup>7</sup>

State	529 Launch State Costs (2015 dollars)	Total 529 Launch Costs (2015 dollars)	Total 529 Costs Scaled to Delaware (2014 populations)
Alabama	\$732,000	\$4,884,000	\$945,000
Alaska	\$0	\$659,000	\$837,000
Arizona	\$127,000	\$127,000	\$18,000
California	\$2,826,000	\$2,826,000	\$68,000
Colorado	\$4,392,000	\$5,856,000	\$102,000
<i>Delaware</i>	<i>\$110,000</i>	<i>\$110,000</i>	<i>N/A</i>
Florida	\$0	\$6,487,000	\$305,000
Illinois	\$0	\$1,757,000	\$128,000
Iowa	\$878,000	\$878,000	\$265,000
Kentucky	\$761,000	\$761,000	\$161,000
Louisiana	\$1,107,000	\$1,107,000	\$223,000
Maryland	\$7,566,000	\$7,566,000	\$1,184,000
Massachusetts	\$2,777,000	\$2,777,000	\$385,000
Michigan	\$6,332,000	\$6,332,000	\$598,000
Mississippi	\$4,648,000	\$4,648,000	\$1,453,000
Nevada	\$0	\$1,757,000	\$580,000
New Jersey	\$944,000	\$944,000	\$99,000
New York	\$1,318,000	\$1,318,000	\$62,000
Ohio	\$6,588,000	\$6,588,000	\$532,000
Oklahoma	\$285,000	\$285,000	\$69,000
Pennsylvania	\$4,784,000	\$4,784,000	\$350,000
Rhode Island	\$293,000	\$293,000	\$259,000
South Carolina	\$586,000	\$586,000	\$113,000
Tennessee	\$1,651,000	\$1,651,000	\$236,000
Texas	\$23,406,000	\$23,406,000	\$812,000
Utah	\$66,000	\$66,000	\$21,000
Virginia	\$8,052,000	\$10,980,000	\$1,234,000
Washington	\$2,946,000	\$2,946,000	\$350,000
West Virginia	\$2,929,000	\$2,929,000	\$1,479,000
Wisconsin	\$2,465,000	\$2,853,000	\$464,000

## Appendix III

<sup>7</sup> For purposes of consistency and simplicity all numbers are rounded to the nearest thousand.

**Itemized Projected Costs**

<b>Category</b>	<b>Recurring</b>	<b>Initial</b>
Records Administrator	\$37,000	\$30,000
Construction of IT platform	\$0	\$40,000
Consulting	\$10,000	\$40,000
Investment Manager	\$10,000	\$23,000
Legal	\$0	\$32,000
Communications	\$3,000	\$15,000
Staff	\$50,000	\$50,000
Banking services	\$10,000	\$20,000
Accounting/Auditing	\$5,000	\$0
<b>Total:</b>	<b>\$125,000</b>	<b>\$250,000</b>