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MEMORANDUM

To:	The Honorable Representatives Melanie George Smith & W. Charles "Trey" Paradee
Cc:	Michael L. Morton, Controller General
From:	Ken Simpler
Sent:	May 8, 2015
Subject:	**ABLE LEGISLATION**

I. Summary

The Office of the State Treasurer ("OST") continues to gather data concerning implementation of the ABLE Act ("ABLE") in Delaware. This memo updates our March 25 memo to the Office of the Controller General (the "March Memo") based on our research and work since that time. In the intervening weeks, we have spoken directly to half a dozen state ABLE representatives, read numerous published reports from a variety of third party organizations and analyzed fiscal notes from a dozen states. Additionally, we have had discussions with the ABLE analyst at the Joint Committee on Taxation, the U.S. Senate staffer responsible for the legislation, a national expert on 529 programs and five financial industry experts.

Based on our review, we have revised downward our preliminary projections set out in the March Memo, and we are now forecasting significantly smaller numbers of ABLE participants and long-term assets under management. Our current view is that ABLE can be implemented in Delaware, but that its smaller scale poses major hurdles and may require coordination with the state's current 529 plan administration. Ultimately, the administrative feasibility of ABLE in Delaware will be dictated by the aggregate amount of assets invested in the plan. Attempting to forecast the future level of investment is difficult at this time due to uncertainty surrounding both the number of eligible enrollees and their participation rates in the plan, how enrollees will use their accounts, and what final federal regulations will stipulate. This memorandum provides our best guidance as to these matters at this time.

II. Update to the March Memo

In our original forecast provided to the Controller General's office, we forecast (i) a universe of 16,000 Delawareans eligible to participate in ABLE, (ii) a participation rate of 40% and (ii) an average account balance of $16,250 at stabilization. This analysis suggested that Delaware's ABLE plan would accumulate what was deemed to be a critical amount of assets to attract outside management by year 5 of the program. Our current forecast suggests that Delaware's stabilized asset base will not exceed this level and will fall well below our original forecast.

<u>Eligible Participants</u>

Relying on estimates from the Department of Health and Social Services, we originally forecast Delaware's disabled population as 5% of total population. We adjusted this figure downward to adjust for disabled individuals rendered ineligible for ABLE by virtue of developing their disability after age 25. This resulted in a forecast of 16,000 ABLE-eligible Delawareans. We have modestly revised this eligible population upwards to 20,000 Delawareans based on analysis of a variety of estimation methods developed by other states.

Participation Rate

Originally, we anticipated a participation rate of 40% of eligible Delawareans which when applied against the former population estimate of 16,000 yielded a participation group of 6,400. To be conservative, we rounded that figure down to 6,000 participants at stabilization. The original participation figure was based on two estimates of enrollees by Virginia and North Dakota. Since that original forecast, both states have scaled back estimates of participation rates. Moreover, other states and outside groups have conducted additional participation analyses that suggests a range of 40% is unrealistic. Other states have forecast participation from a high of 20% to a low of 3%. We agree with the more conservative range of estimates. Modeling Delaware's participation rate using this more recent feedback and comparing ABLE potential participation to the historical high water mark of Delaware's 529 participation rate yields an estimate closer to 10%. This is only a quarter of the participation rate assumed in our prior model and, even with the higher eligible base of participants now projected, lowers our forecasted ABLE participating population to 2,000 from 6,000.

Plan Assets

In addition to the dramatic decrease in forecasted plan participants, which alone would reduce forecast ABLE assets under management by two-thirds, better understanding of the use of ABLE accounts suggests even greater downward revision to investment assets. While not completely settled, the majority of analyses of ABLE plans concludes that the plans will be used very differently than traditional 529 plans. Rather than being employed as savings accounts, most analysts now conclude that ABLE participants will use plans more akin to checking accounts. Unlike those opening and funding traditional 529 education accounts for saving over a protracted period for the targeted goal of funding college tuition, ABLE participants are more likely to use plans to shield current assets from inclusion in disability benefit calculations for various federal programs, most prominently the Supplemental Social Security Income program ("SSI"). Moreover, the amounts invested in ABLE accounts are likely to be used to meet ongoing chronic needs of the disabled beneficiary as opposed to savings toward a long term goal. These new assumptions about the use of ABLE suggest that the plans may be better compared to health savings accounts (HSAs) as opposed to 529 education accounts.

The average account balance estimates relied upon for our forecast in the March Memo were as high as $33,000. We projected a figure of roughly half that, or $16,250, in our model. Based on the revised analyses of the use of ABLE accounts, we have revised that figure downward by half again. This revision is based on an average HSA balance of $2,356 adjusted upwards for the greater variety of expenses that can be covered by an ABLE account. Our current figure of $8,125 accounts for the fact that ABLE balances will be added to but also drawn down annually. Emphasis, however, is placed on the fact that this estimate is subject to great uncertainty as the ultimate use of ABLE accounts is not fully known at this time. Using the revised figure, we are projecting steady state aggregate assets under management of roughly $16,250,000 vs. an original forecast of nearly $100,000,000 after four years.

Our revised model is presented below. Our original report and projections are attached for comparison as Exhibit A.

Year	Number of New Accounts	Average Annual Account Contribution	Cumulative Accounts	Annual Deposits	Total Assets under Management
2016	500	$8,125.00	500	$4,062,500	$4,062,500
2017	500	$8,125.00	1,000	$8,125,000	$8,125,000
2018	500	$8,125.00	1,500	$12,187,500	$12,187,500
2019	500	$8,125.00	2,000	$16,250,000	$16,250,000

III. Third Party Administrators

Revised estimates suggesting a low number of eligible participants, lower participation rates among those who are eligible, and great uncertainty as to the level of funding of ABLE accounts has caused many states, particularly smaller states and those without a meaningful 529 plan administrative staff to doubt whether they will have enough assets to attract a third-party administrator to their ABLE programs. Conversations with potential plan administrators confirms these concerns.

We have spoken to Fidelity, who administers both the Delaware College Savings Plan ("DCSP") and Delaware's 457(b) deferred compensation plan, as well as several of the State's 403b vendors. All are concerned as to whether they can profitably administer ABLE due to the projections for very modest amounts of assets to accumulate in these plans. A prime purpose of the federal ABLE law was to allow disabled individuals to accrue assets without failing the federal means-test for SSI and other federal assistance programs. Under SSI's test, inclusion of all assets can result in a suspension of benefits for individuals with a total of $2,000 in their bank account and other instruments, such as retirement savings accounts. ABLE allows $100,000 in ABLE assets to be accumulated before the means test is breached. The intent of this exclusion was to have ABLE used as an alternate savings account. Increasingly, however, those studying ABLE view it as more likely that ABLE's exclusion of assets from SSI may result in ABLE accounts being used as checking accounts for the wide range of recurring expenses that are ABLE-eligible. In this view, some modest sums will accrue in these accounts, but the regularity of withdrawals will generally offset the accumulation of assets and therefore the investment base on which plan administrators depend for their profits may be inadequate to attract them to ABLE plans.

There is also concern among plan vendors about the nature of plan assets. College and retirement are long term goals which, in most cases, encourage participants to use stock and bond mutual funds. These are investment products that are predictably profitable for the investment firms and that attract vendors to the administration of 529 and deferred compensation plans. If ABLE accounts are treated by beneficiaries as alternate checking accounts (as opposed to savings accounts), it is more likely that the assets in which such funds will be invested will not be stock and bond mutual funds but rather cash and money market accounts. Investment firms cannot make sufficient, if any, profit on such products in the current environment.

Last, investment firms are worried about the frequency of withdrawals from ABLE accounts if they are, in fact, more akin to HSA accounts than 529 college or deferred compensation plans. As plan sponsors must document and report such expenditures to both the Social Security Administration and Internal Revenue Service, administrative cost and complexity of ABLE plans could easily eclipse any profitability of such plans.

From the perspective of third party providers, the low profits and high costs of ABLE plans are a potential "lose-lose." So far we have only found one vendor that has agreed to partner with a state (Florida) to administer ABLE. That vendor focuses on the record-keeping component of plans leaving potentially meaningful administration with the state. In general, there is a consensus among investment firms that service the 529 college plans to defer meaningful evaluation of ABLE plan administration until final regulations are issued by the IRS.

IV. Our Options

If ABLE plans are not sufficiently profitable for third party vendors to fully administer, Delaware and comparable states, have two options for ABLE administration. The first is to run the program in-house, ideally leveraging the state's current 529 and deferred compensation plan bases. The second is to contract with another state or to form a joint venture with a group of states to run Delaware's ABLE program.

<u>In-House Administration</u>

In the first instance, it is possible that ABLE could be administered in-house with modest third party support. Under this scenario, Delaware could handle many of the administrative functions in-house and use the state's existing deferred compensation plan and 529 plan administrator, Fidelity Investments, for selective support. Two complications for this approach are the current separation of 529 and deferred compensation administration in Delaware and the care that would need to be taken in not having one group of participants/beneficiaries support another.

Most states locate 529 plan administration with their State Treasurer's office. Delaware currently administers this plan out of the Department of Education (albeit the plan was founded in and originally administered in the Treasurer's office). Staffing for this plan at DOE is exceptionally modest with just one person providing part-time support to the DCSP.[1] Virtually all administration is handled by Fidelity. Conversely, deferred compensation plans are handled out of the Treasurer's office with significant activities managed by three full-time staff and other administrative tasks handled by Fidelity and other outside vendors.

The variation in the administration of Delaware's 529 and deferred compensation plans derives from greater complexity in administering withdrawals from deferred plans, more significant ERISA-like sponsor responsibilities for the deferred plans and the integration of the deferred plans savings options with the State's payroll system. In addition, deferred compensation plans are uniquely available to state employees and are supported to a greater extent than the State's 529 plans which are open to all Delawareans as well as citizens of other states.

Though still uncertain due to lack of final regulations, ABLE's administration could be significantly more complex than both traditional 529 plans and even deferred compensation plans. ABLE eligibility criteria are not yet fully spelled out but are more stringent than both plans. In addition, expenditures are likely to be substantially more frequent and can be applied to a greater variety of qualifying uses. Record-keeping may also be more burdensome as the Federal reporting requirements mandate each State track their plan's deposits and distributions of beneficiary assets and report them to the Social Security Administration to ensure ABLE account assets do not exceed the $100k balance limit. This level of complexity coupled with relatively low asset balances are the reasons third party administrators have so far shied away from ABLE administration and why some state-level administration may be likely.

Notwithstanding third party provider reluctance to administer ABLE, Delaware could leverage both its internal administrative staff and joint asset bases across 529 and deferred compensation plans with Fidelity to provide a platform for administering ABLE. Delaware's current base of 529 assets totals roughly $632 million and the state's deferred compensation plan balances aggregate to $950 million. This level of assets is sufficient to "entice" Fidelity to support Delaware's ABLE plan so long as there is some meaningful oversight by state-level staff.

While Delaware should certainly avail itself of its scale of relationship with Fidelity, care needs to be taken to ensure that one group of beneficiaries/participants is not subsidizing another. Clearly, different plan assets could not be commingled and segregation would also need to apply to credits from the various plans. That said, proportionate amounts of credits could be applied to overhead, and the overall amount of such credits might be maximized by centralization of the management of such programs.

Administering ABLE in-house augurs for administrative efficiencies by coordinating Delaware's 529, deferred compensation and ABLE plans with one vendor, particularly through one agency. This coordination might be managed between the Governor's office and the Office of the State Treasurer, but action by the General Assembly may be required to address the ongoing role of all three plans and coordinate and/or consolidate the responsibilities of the various boards charged with oversight of such plans.

[1] Delaware is at a distinct disadvantage in administering ABLE to states that took a more hands-on approach to their college 529 plans and now have the infrastructure to leverage their ABLE programs. For example, Virginia has 100 positions supporting its 529 program and is contracted by other states to help administer their 529 plans. As a result, Virginia can leverage its existing 529 infrastructure and economies of scale to absorb ABLE. In contrast, Delaware completely outsourced its 529 plan and has 0.1 FTE's working on the program at DOE.

Contract Out or Joint Venture

A second option for Delaware's ABLE plan would be to contract with another state, or a group of states, to run our program or to form a joint venture to administer the plan. A variety of smaller states and/or those with limited 529 plan architecture are already discussing the creation of consortiums or joint ventures to administer ABLE. The states that are most likely to lead groups of states are those with large 529 infrastructures, such as Virginia, Florida, and Pennsylvania. Other groups of smaller states have also begun discussing joint ventures. We are following and participating in such discussions without committing to our ultimate administrative course. The terms and conditions of any such contracting, participating or joint venturing will likely need to await final federal regulations.

V. Conclusion: Timing, Costs and Headcount

The earliest an "in-house" ABLE program could be adopted in Delaware would likely be in the middle of 2016. Virginia, the 529 leader, is targeting a spring 2016 launch of its program and other states could join the Virginia plan thereafter. Florida, another 529 leader, is targeting a July 2016 launch. That timetable might be elongated should Delaware consider a joint venture with other states, and could potentially be shortened if the state opted to engage an early leader, like Virginia or Florida, to administer Delaware's plan.

Among states, there is no consensus on the net costs for ABLE administration. Of ten estimates for initial costs adjusted to Delaware's size, the range is from approximately $6,000 to as high as $550,000; half of these estimates exceed $100,000. For long-term costs, estimates range from an annual expense of $0 to $380,000 with several projections in excess of $100,000. Only four states have projected revenue credits, all of which are initially quite small. One state estimated $0, two roughly $25,000 and one $49,000. Long-term estimates of revenue credits suggest increases commensurate with plan size, but the range of such estimates is also wider, with a high six years out of $560,000 and a low of $24,000. Finally, staff positions forecast to date range from a high of 17 in Virginia (which plans to follow its 529 model of attracting significant outside investment) to none in the case of states that plan to contract out to other states. In the middle of these extremes are states such as Washington, Pennsylvania and Florida, which project support staff of seven, 2-3 and one, respectively.

Ultimately, the timing of the implementation of Delaware's ABLE plans as well as the staffing and net costs associated with such launch will be determined by the option we elect to pursue – in-house or outsourced, and, in the former case, whether we are able to coordinate or combine our current 529 and deferred compensation plan administration. While there is no doubt that ABLE can be implemented in Delaware, the administration of the program is not without substantial uncertainty and complexity. Potential costs could be too great given Delaware's size if synergies between current 529 and deferred compensation plans cannot be realized. How Delaware might contract with or joint venture with other states is difficult to assess at this time but discussions are ongoing if only exploratory. At present, material progress on our ABLE analysis will need to await the release of federal regulations. We will plan to provide further analysis at that time.

Appendix

The following sources have provided direct discussions, reports, briefs and papers informing our current report on Delaware's ABLE program:

National Association of State Treasurer's ABLE Act Working Group.
Mary Busse, Managing Director of Greater Disclosure, a firm that consults on 529 plans. Mary also is the chair of the National Association of State Treasurer's working group on ABLE.
Kathleen McGrath, Director of Pennsylvania's 529 program.
Chris McAgee, General Counsel to Virginia's 529 program.
Jennifer McCloskey, Chief Policy Advisor to U.S. Senator Bob Casey (D-PA).
Will Thompson, Deputy Executive Director of the Florida 529 program.
Chris Hunter, Deputy Executive Director of the National Association of State Treasurers.
Shana Payne, Director of the Delaware Higher Education Office.
Deborah Gottschalk, Chief Policy Advisor to Secretary Landgraf.
James Barnhardt, Director of North Dakota's 529 program.
Aaron Butz, ABLE's analyst at the Joint Committee on Taxation.
National Disability Institute.
National Down Syndrome Society.
Virginia Department of Planning and Budget.
Maryland Department of Legislative Services.
Nebraska Fiscal Legislative Office.
Missouri Committee on Legislative Research, Oversight Division.
New Mexico Legislative Finance Committee.
Montana Governor's Office of Budget and Program Planning.
New Hampshire Department of Treasury.
Utah State Legislature.
State of Washington's Office of Financial Management.
Nevada Governor's Council on Developmental Disabilities.
Social Security Administration.
Minnesota Department of Revenue.
Keith Burnhardt, Fidelity Investments.
Tim Rouse, Voya Investments.
Ronan Burke, American Funds.
Al Siracusa, MetLife.
Kansas Treasurer's Office.
Elizabeth Fontaine, Assistant Executive Director of the Massachusetts Educational Financing Authority.
Anna Scimemi, Director of College Savings Programs at the Massachusetts Educational Financing Authority.
Brandon Nowak, KeyBank.

Exhibit A

March 25, 2015 Memo to the Controller General's Office

I. Summary

Implementation and administration cost for a Delaware ABLE program could vary greatly depending upon the number of individuals who will be eligible to participate in the program as well as the assets invested in the program. Low participation and fund balances would likely necessitate proprietary management of the program by OST (and higher direct expenses) whereas higher participation and fund balances would provide a base on which to pay third party expenses and/or costs of administration by OST.

One means of mitigating costs would be to "couple" Delaware's new ABLE offering with the state's existing 529 plan using the same plan administrator, Fidelity. At present, it is not clear, however, if Fidelity will seek to act as an administrator for ABLE plans given the uncertain size of the assets available for management (i.e., lack of significant market opportunity). In the alternative, small states like Delaware may seek to contract with a larger state to allow their citizens to enroll in the larger state's program. What cost sharing or fees might arise from such a relationship is unclear, but presumably very little expense would be borne by the contracting state.

Based on the best available information and subject to a variety of assumptions set out below, OST believes that all or substantially all expenses related to implementation and administration of a new ABLE program could be reimbursed out of returns on plan assets after roughly four years assuming an asset base at that time of nearly $100,000,000. Depending upon the degree of fiduciary responsibility to be asserted by Delaware as the plan sponsor and subject to review of final federal regulations, OST would require at least one additional FTE and as many as three FTEs to implement and administer the plans.

II. Introduction

The Office of the State Treasurer ("OST") has been asked to provide analysis of the costs associated with (i) implementing and (ii) administering the Achieving a Better Life Experience Act ("ABLE") 529(a) program in Delaware. The analysis set out below provides a fairly wide range of high and low cost estimates due to the lack of final federal regulations regarding ABLE and limited time frame in which OST has had to undertake this analysis. In relying on these cost projections for consideration of the merits of passing Delaware legislation to effect an ABLE program, legislators should be apprised of the preliminary and uncertain nature of the projections.

III. Plan Size: Eligibility, Enrollment and Assets

According to DHSS, approximately 5% of the Delaware population has disabilities covered by ABLE. However, for purposes of ABLE eligibility, a potential applicant must have developed his/her disability before attaining the age of 26. Moreover, federal regulations are still being drafted to determine and potentially limit the types of disabilities that ABLE will cover. Using DHSS data and adjusting for the eligible age group and uncertainties of the ultimate federal guidelines, OST estimates that approximately 1.7% of the population, or approximately 16,000 Delawareans, will be <u>eligible</u> to participate under the ABLE program.

Actual enrollment of the eligible population in Delaware is very hard to gauge as no strong in-state proxies exist. Delaware's 529 plan has 31,000 enrollees, but eligibility is not limited – anyone can have a 529 account. Assuming, however, that program enrollees are drawn from the youngest quartile of the population yields a 529 enrollment rate of roughly 12.5%. Applying that estimate to the 16,000 ABLE-eligible Delawareans results in an enrollment of just 2,000 participants. However, Delaware's 529 offering is not particularly robust in terms of participation when measured against other states. Aggressive promotion and early adoption of such plans directly affects enrollment.

Based on estimates from Virginia and North Dakota, two other states that have conducted preliminary assessments of eligibility and enrollment, Delaware's enrolled population could be as high as 11,000 and as low as 6,000. This suggests enrollment rates of nearly 70% to just under 40% of Delaware's projected 16,000 ABLE eligibles. OST assumes the lower end of this range, or 6,000 participants, for purposes of the remainder of this analysis.

In terms of size of assets, ABLE legislation limits annual contributions to $14,000 per annum. Virginia estimated an average annual contribution of $6,000 and North Dakota $7,000. The Delaware 529 plan generates an average annual contribution of just $1,200. However, there is reason to believe that ABLE accounts would receive larger annual contributions because of the much broader range of items for which such funds can be utilized. OST has no data on average net worth of eligible participants that would enable analysis of "ability to pay." OST uses the VA/ND mean of $6,500 for purposes below.

IV. Model and Conclusion

Assuming an annual average Delaware ABLE contribution of $6,500 and a projected maximum enrollment population of 6,000 (achieved after four years of initial plan implementation) total estimated contributions would be as follows:

Year	Number of New Accounts	Average Annual Account Contribution	Cumulative Accounts	Annual Deposits	Total Assets under Management
2016	1,500	$6,500.00	1,500	$9,750,000	$9,750,000
2017	1,500	$6,500.00	3,000	$19,500,000	$29,250,000
2018	1,500	$6,500.00	4,500	$29,250,000	$58,500,000
2019	1,500	$6,500.00	6,000	$39,000,000	$97,500,000

Investment time horizons for withdrawal of funds are not known and are not taken into consideration for purposes of this analysis as they are assumed to be well outside the four-year roll-out period.

Based on the foregoing projection and a remittance to the State of roughly 25 basis points on fund assets, OST believes that ongoing expenses could be covered and implementation costs recovered in roughly four years from plan implementation. Depending upon the degree of outsourcing of the plan administration, OST projects the need for at least one additional Financial Investment Program Specialist (PG 15) to support an existing OST Financial Investment Program Manager under a "light footprint." Should Delaware seek to manage the program "in-house", OST would require three additional staff members: one Financial Investment Program Manager (PG 18) and two Financial Investment Program Specialists (PG 15).