JLARC
JOINT LEGISLATIVE AUDIT
AND REVIEW COMMISSION

October 15, 2024

Defined Benefit 529 Surplus Funds
2022 JLARC Review

SFAC Workgroup on
DB529 Surplus Funds

Study motion

- Review of Defined Benefit 529 surplus funds
  - Statutory/legal restrictions on use of funds
  - Amount of funds that could be removed while maintaining actuarial soundness
  - Options for using funds to support higher education access and affordability

Study mandate: Motion approved by Commission, July 6, 2021

Primary research activities

- Contracted with consultants
  - Actuarial firm (GRS)
  - Investment firm (Callan)
  - Law firm (McGuireWoods)
- Structured interviews
  - Staff at Virginia529, State Council of Higher Education for Virginia, and other state agencies
  - Other states’ Prepaid529 savings programs
- Analysis of student financial aid data

In brief

The Defined Benefit 529 (DB529) fund has substantially more assets than needed to pay all obligations to contract holders.

Over $1 billion in actuarial surplus funds ($1.3B identified in 2022 report) could be withdrawn from the DB529 fund over 5 years and returned to contract holders and/or used to support higher education access and affordability programs.

An independent committee, and not the Virginia529 board, should oversee the withdrawal of surplus funds.

Dedicated higher education fund could be established to fund access and affordability programs.

In this presentation

Background

Availability of Defined Benefit 529 Surplus Funds

Potential Uses of Defined Benefit 529 Surplus Funds

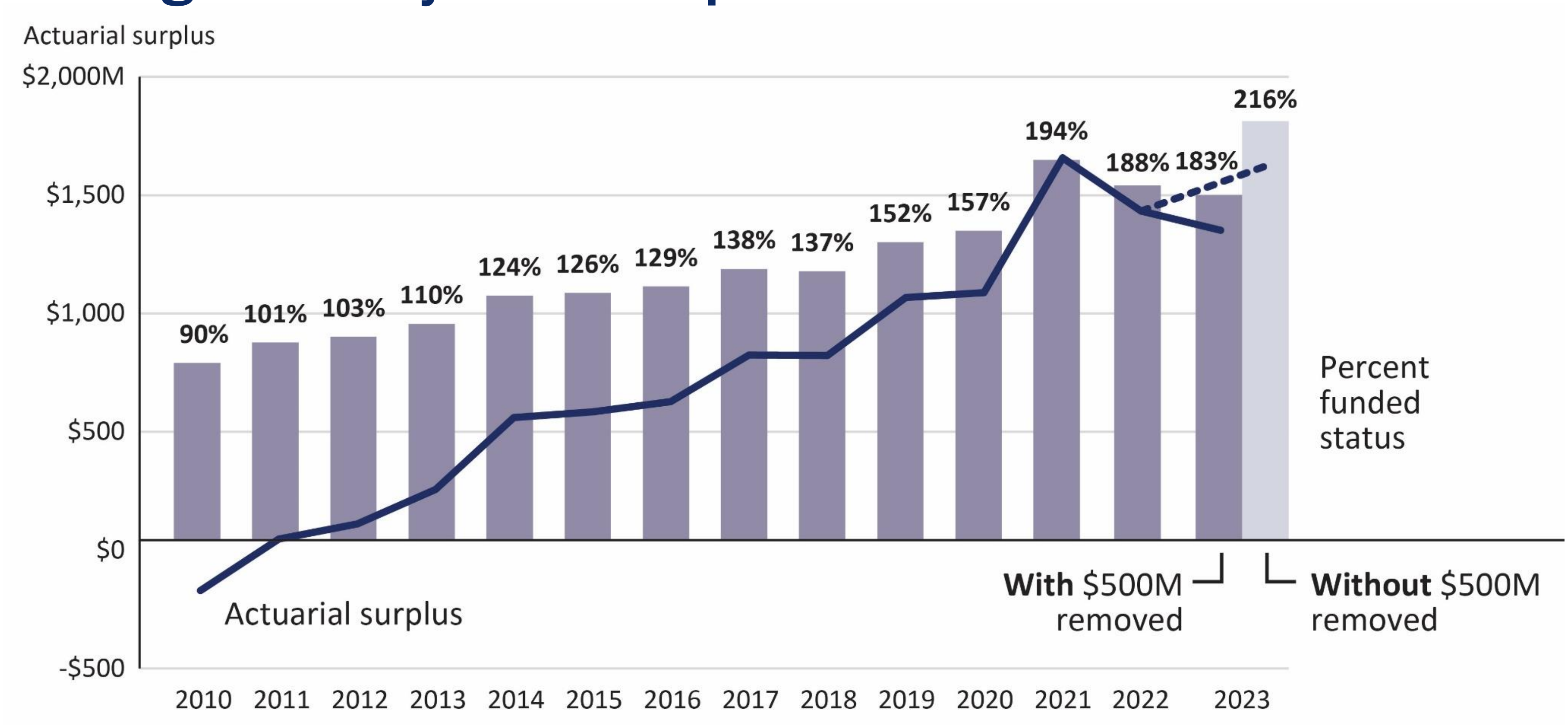
Virginia529 administers 2 defined benefit college savings programs

- Legacy Prepaid529
  - Closed to new participants in 2019 but continues to pay benefits to existing participants
- Tuition Track Portfolio (TTP)
  - Opened in 2021
  - Pays the same weighted-average tuition benefit regardless of college attended
- Programs combined into single Defined Benefit 529 (DB529) fund for actuarial and investment purposes

DB529 fund receives revenue from investment income and contract holder payments

- Most revenue is from investment income ($624 in FY21) vs. contract payments ($28M in FY21)
- DB529 fund previously received administrative fee proceeds from Virginia529 college savings programs
  - Virginia529 allocated $353 million to DB529 fund (FY04–19)
  - Nearly 90 percent of fee proceeds were from national CollegeAmerica program

Funded status and actuarial surplus grew significantly over the past decade



- FY23 funded status would be 216% without board allocation of $500M to Access fund

In this presentation

Background

Availability of Defined Benefit 529 Surplus Funds

Potential Uses of Defined Benefit 529 Surplus Funds

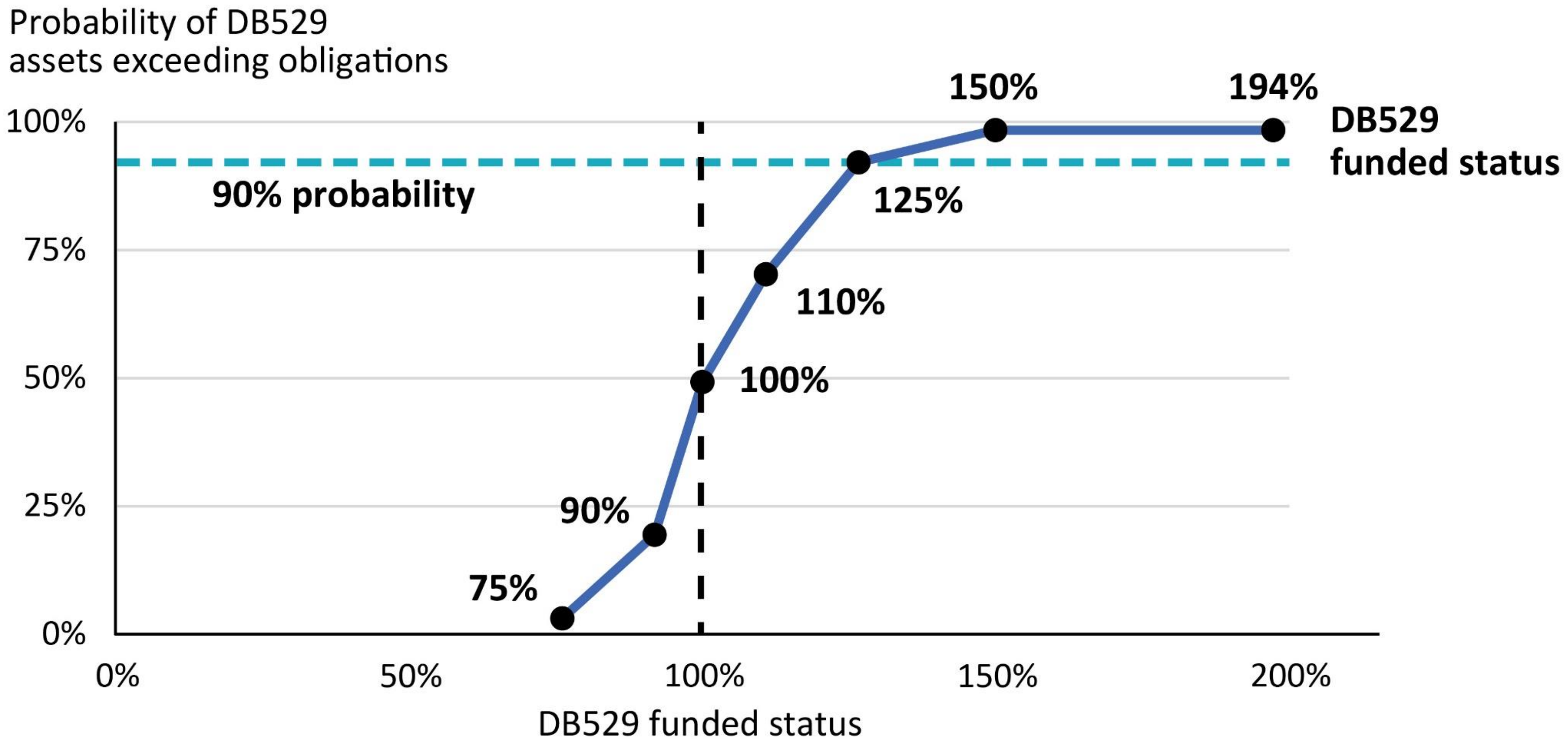
DB529 fund needs to maintain sufficient funded status and liquidity

- Sufficient funded status to ensure enough assets to pay all obligations to contract holders
  - Funded status is ratio of assets to obligations
  - Higher funded status means greater probability of sufficient assets
- Sufficient amount of funds in liquid assets to make benefit payments to contract holders
  - Independent investment consultant recommended enough liquidity to make at least 10 years of payments

Finding

The funded status of the DB529 fund is higher than needed to pay all future obligations to contract holders.

Independent actuary says 125 percent is a reasonable funded status for DB529 fund



Based on analysis by Virginia529's actuary of 2021 valuation using investment return and tuition increase assumptions at that time.

Finding

Over $1 billion in surplus funds could be withdrawn from the DB529 fund over 5 years while maintaining (i) a funded status of at least 125 percent for the Legacy Prepaid529 and TTP programs (ii) and sufficient liquidity in the DB529 fund.

$1.3 billion estimated in 2022 JLARC review based on 2021 actuarial valuation of DB529 fund.

TTP = Tuition Track Portfolio

Over $1 billion in surplus funds could be removed over 5 years using realistic assumptions

- Maintains 125 percent funded status through FY44
- Assumes 5.5 percent annual investment return
  - Virginia529 board has since increased the return assumption to 5.75 percent annually; a higher return will increase the surplus funds available.
- Assumes 6 percent long-term tuition growth
  - 6 percent approved by Virginia529 board
  - Somewhat higher than tuition growth (5 percent) over last 15 years

$1.3 billion estimated in 2022 JLARC review based on 2021 actuarial valuation of DB529 fund.

$900 million could be removed using moderately conservative, less likely assumptions

- Maintains 125 percent funded status through FY44
- Assumes 4.5 percent annual investment return
- Assumes 7 percent long-term tuition growth

$900 million estimated in 2022 JLARC review based on 2021 actuarial valuation of DB529 fund.

Removing surplus funds over 5 years protects actuarial soundness and liquidity of DB529 fund

- 5-year timeframe allows more gradual decline in funded status
  - Protects DB529 fund against solvency problems if large decline in investment returns occurs
- 5-year timeframe maintains ability to make 20+ years of benefit payments

Recommendation

The General Assembly may wish to consider directing in statute the removal of DB529 surplus funds

- in annual increments over at least 5 years, and
- up to an amount that maintains a funded status of at least 125 percent for the DB529 programs through FY44 based on the investment return and tuition increase assumptions approved by the Virginia529 board.

Finding

Annual reviews of scheduled surplus fund withdrawals by an independent committee would allow withdrawals to be reduced or paused if needed to maintain the funded status and liquidity of the DB529 fund.

Annual withdrawals of surplus funds should be reviewed by independent committee

- Review updated actuarial and investment modeling to ensure additional withdrawals remain prudent
- Withdrawals could be reduced or paused if modeling projects
  - Funded status below 125 percent <u>or</u>
  - Liquidity for less than 10 years of benefit payments
- Reviews would allow flexibility to respond to significant market declines or tuition increases

Independent committee could monitor DB529 fund over long term

- Committee could continue monitoring DB529's status in the future to determine whether additional surplus funds should be withdrawn
- Substantial surplus may continue accumulating over long term even after planned surplus funds are withdrawn
  - Less than $1 billion plus is withdrawn in near term
  - Investment returns consistently higher than assumed rate
  - Tuition growth consistently lower than assumed rate

Recommendation

The General Assembly may wish to consider

- establishing an independent committee to review and approve annual withdrawals of surplus funds based on updated actuarial and liquidity modeling, and
- directing the committee to meet at least every 2 years after planned surplus funds are withdrawn to determine whether additional surplus funds can be withdrawn.

In this presentation

Background

Availability of Defined Benefit 529 Surplus Funds

Potential Uses of Defined Benefit 529 Surplus Funds

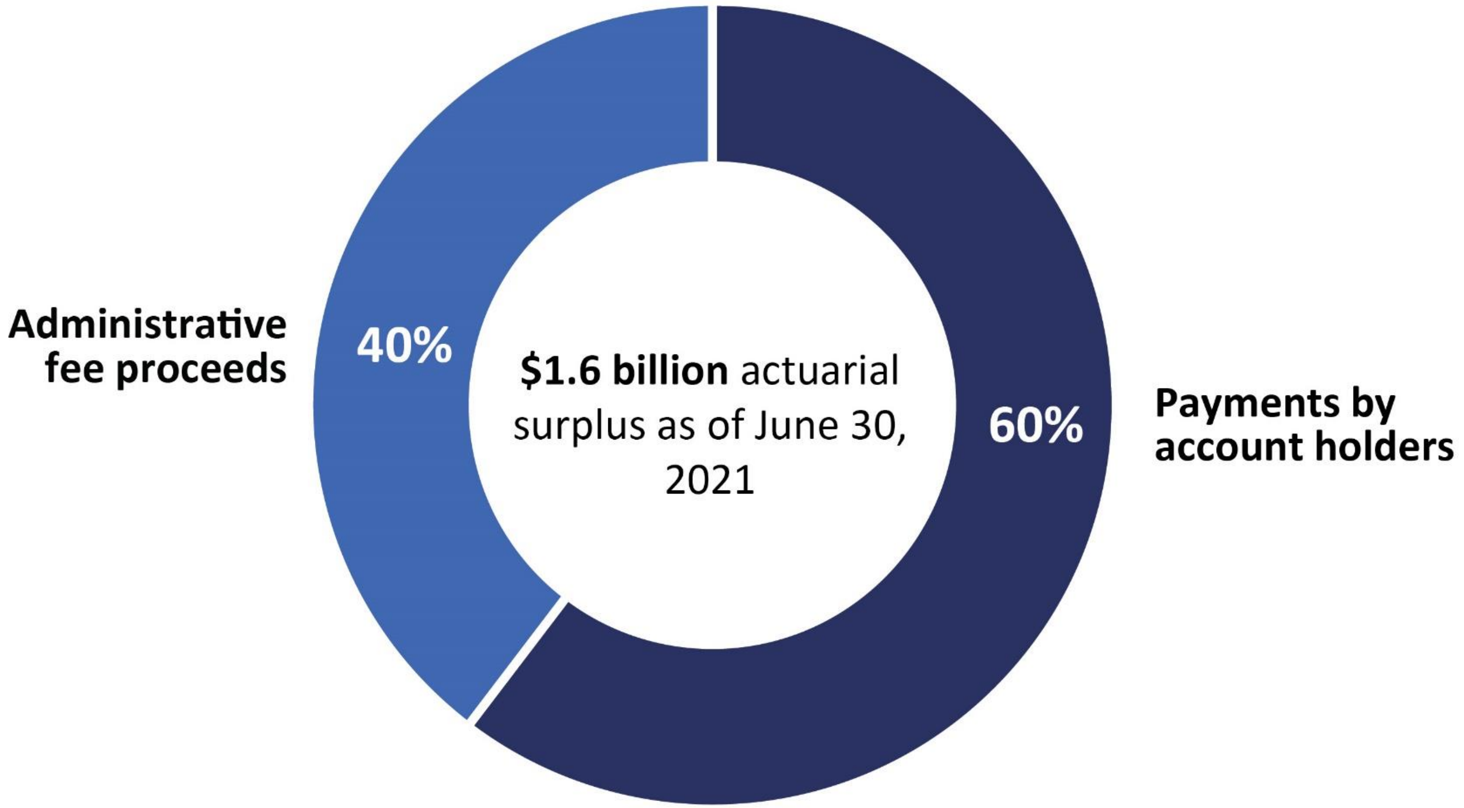
Higher education access and affordability most appropriate use of DB529 surplus funds

- Surplus funds could potentially be used for variety of purposes
- However, sources of surplus funds are directly related to higher education access and affordability
  - Payments by account holders
  - Administrative fee proceeds from college savings programs
- Opportunities to improve access and affordability are forgone if surplus funds are left in DB529 fund

Finding

DB529 surplus funds could be used in proportion to the revenue sources of the surplus.

Actuarial surplus derives from account holder payments and administrative fee proceeds



Includes investment earnings on sources of actuarial surplus funds.

Option

The General Assembly could direct that

- 60 percent of removed surplus funds are returned to Legacy Prepaid529 account holders, and
- 40 percent of removed surplus funds are used to support higher education access and affordability programs.

Findings

If $1.3 billion in surplus funds were removed from the DB529 fund (estimated in the 2022 report), $780 million (60 percent) could be returned to account holders.

Options

The General Assembly could direct that DB529 surplus funds designated for Legacy Prepaid529 account holders be returned to account holders

- whose beneficiaries attend institutions with below-average tuition,
- whose contracts were priced above average tuition, or
- in the same amount for each Prepaid529 contract they purchased.

The General Assembly could direct funds be returned to account holders but give the Virginia529 board discretion to determine how to return the funds.

Finding

If $1.3 billion in surplus funds were removed from the DB529 fund (estimated in the 2022 report), $520 million (40%) could be used to fund higher education access and affordability programs.

Options

The General Assembly could direct that DB529 surplus funds designated for higher education access and affordability programs be used to

- provide additional grants for low-income students,
- pilot a new state financial aid progression bonus program,
- establish a state emergency financial aid program, or
- provide additional support services to at-risk students.

Findings

Creating a dedicated higher education fund with DB529 surplus funds would provide a long-term funding source for access and affordability.

Dedicated fund assets could be made available to the DB529 fund to address any concerns about its solvency or liquidity.

SCHEV is the most appropriate entity to allocate dedicated fund assets, and Virginia529 is the most appropriate entity to manage dedicated fund assets.

SCHEV = State Council of Higher Education for Virginia

Dedicated fund would provide flexibility and long-term funding for access and affordability

Dedicated fund lifespan	Annual funding (millions)
20 years	$39
In perpetuity	$16

- Dedicated fund could be managed similar to an endowment
  - Would allow state to assist many more students and adapt to changing higher education needs, but would provide a smaller amount of funding in initial years

Based on $520M identified in 2022 JLARC report as derived from administrative fee proceeds.

SCHEV is most appropriate entity to allocate dedicated funds within statutory guidelines

	SCHEV	Virginia529	New entity
Mission and staff expertise in access and affordability	◕	◑	●
Sufficient independence from surplus removal process	●	○	●
Minimal administrative complexity and cost	●	●	○

- SCHEV could create an advisory committee to examine options and make recommendations to council

SCHEV = State Council of Higher Education for Virginia

Dedicated fund assets could remain in DB529 fund and be managed by Virginia529

- Dedicated fund assets must be invested in multiple asset classes to provide sufficient investment earnings
- Virginia529 staff have experience managing investments across all asset classes
  - Other state agencies (Treasury, VRS) are not good alternatives
- Dedicated fund assets could be made available to DB529 fund to address any solvency concerns

VRS = Virginia Retirement System

Recommendations

The General Assembly may wish to consider directing that

- DB529 surplus funds designated for higher education access and affordability programs be used to create a dedicated higher education fund.
- SCHEV allocate dedicated fund assets within statutory guidelines established by the General Assembly.
- Virginia529 manage dedicated fund assets, which remain with DB529 funds but are accounted for separately.

SCHEV = State Council of Higher Education for Virginia

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