An Introduction to 529 Plans - Investor Bulletin

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The SEC's Office of Investor Education and Assistance is issuing this Investor Bulletin to provide investors with background information on 529 plans. Please also see our companion Bulletin (https://www.investor.gov/additional-resources/news-alerts/alerts-bulletins/investor-bulletin-10-questions-consider-before) *for a few questions to consider before opening a 529 plan account.*

What is a 529 plan?

A 529 plan is a tax-advantaged savings plan designed to encourage saving for future education costs. 529 plans, legally known as "qualified tuition plans," are sponsored by states, state agencies, or educational institutions and are authorized by Section 529 of the Internal Revenue Code.

There are two types of 529 plans: education savings plans and prepaid tuition plans. Most education savings plans are available to everyone, but a few have residency requirements for the saver and/or beneficiary. Prepaid tuition plans typically have residency requirements. One exception is a prepaid tuition plan sponsored by a group of private colleges and universities.

The person who opens the 529 plan account is called the account holder or the saver. The person the account is opened for is called the beneficiary or the student. The account holder and the beneficiary can be the same person.

What are the differences between education savings plans and prepaid tuition plans?

Education Savings Plans. Education savings plans let a saver open an investment account to save for the beneficiary's future qualified higher education expenses (https://www.investor.gov/introduction-investing/investing-basics/glossary/qualified-higher-education-expenses) . Qualified higher education expenses include tuition and certain expenses for post-secondary education and recognized post-secondary credential programs. Withdrawals from education savings plan accounts can generally be used at any college or university, including sometimes at non-U.S. colleges and universities, or at a recognized post-secondary credential program. Education savings plans can also be used to pay for other education-related expenses. These include up to $20,000 per year per beneficiary for tuition and certain expenses at any public, private, or religious elementary or secondary school; certain expenses required for participation in registered apprenticeship programs; and qualified education loan repayments up to $10,000 total per beneficiary.

A saver may typically choose among a range of investment options, which often include various mutual fund (https://www.investor.gov/additional-resources/general-resources/glossary/mutual-funds) and exchange-traded fund (https://www.investor.gov/additional-resources/general-resources/glossary/exchange-traded-fund-etf) (ETF) investments and a principal-protected bank product. Education savings plans also may include static fund portfolios and age-based portfolios (sometimes called target-date (https://www.investor.gov/additional-resources/general-resources/glossary/target-date-fund) portfolios). These portfolios include a combination of different types of ETFs and/or mutual funds and are designed to help diversify the risk in the account. Typically age-based portfolios automatically shift funds into more conservative investments as the beneficiary gets closer to college age, but static fund portfolios will keep the same mix of investments. If you are using a 529 account to pay for elementary or secondary school tuition, you may have a shorter time horizon for your money to grow. You may not feel comfortable taking on riskier or more volatile investments if you plan on withdrawing the money soon. Therefore, you may consider different investment options depending on when you plan to use the money that is invested.

All education savings plans are sponsored by state governments, but only a few have residency requirements for the saver and/or beneficiary. State governments do not guarantee investments in education savings plans. Education savings plan investments in mutual funds and ETFs are not federally guaranteed, but investments in some principal-protected bank products may be insured by the FDIC. As with most investments, you can lose money in an education savings plan.

Prepaid Tuition Plans. Prepaid tuition plans let a saver or account holder purchase units or credits for the beneficiary to use in the future at participating colleges and universities. The saver is essentially pre-paying future tuition and mandatory fees at the current prices of tuition and mandatory fees. The participating colleges and universities are typically public, in-state institutions in the state that sponsors the plan. Prepaid tuition plans are not as flexible as education savings plans because the credits can only be used for future tuition and mandatory fees at certain schools. If the beneficiary does not attend a participating college or university, they can typically still receive money from the plan to help pay for college tuition and mandatory fees, but the amount is determined by the particular plan.

Most prepaid tuition plans are sponsored by state governments and have residency requirements for the saver and/or beneficiary. Prepaid plans are not guaranteed by the federal government. Some state governments guarantee the money paid into the prepaid tuition plans that they sponsor, but some do not. If your prepaid tuition payments aren't guaranteed, you may lose some or all of your money in the plan if the plan's sponsor has a financial shortfall. In addition, if a beneficiary doesn't attend a participating college or university, the prepaid tuition plan may pay less than if the beneficiary attended a participating college or university. It may only pay a small return on the original investment, depending on how the plan calculates your return.

What fees and expenses will I pay if I invest in a 529 plan?

It is important to understand the fees and expenses associated with 529 plans because they lower your returns. Fees and expenses will vary based on the type of 529 plan (education savings plan or prepaid tuition plan), whether it is a broker- or direct-sold plan, the plan itself and the underlying investments. You should carefully review the plan's offering circular to understand what fees are charged for the plan and each investment option.

Education Savings Plans. Education savings plans may charge an enrollment/application fee, annual account maintenance fees, ongoing program management fees, and ongoing asset management fees. The asset management fees will depend on the investment option you select. Investors that purchase an education savings plan from a broker are typically subject to additional fees, such as sales loads or charges at the time of investment or redemption and ongoing distribution fees.

Prepaid Tuition Plans. Prepaid tuition plans may charge an enrollment/application fee and ongoing administrative fees.

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What restrictions apply to an investment in a 529 plan?

There will likely be restrictions on any 529 plan you may be considering. Before you invest in a 529 plan, you should read the plan's offering circular to make sure that you understand and are comfortable with any plan restrictions.

Investments. Education savings plans have certain pre-set investment options. It is not permitted to switch freely among the options. Under current tax law, an account holder is only permitted to change his or her investment option twice per year or when there is a change in the beneficiary.

Withdrawals. With limited exceptions, you can only withdraw money that you invest in an education savings plan without incurring taxes and penalties for qualified higher education expenses or the other expenses discussed above. One exception is that you can rollover funds in a 529 account into a Roth IRA account for the same beneficiary with some restrictions, which are explained above.

Beneficiaries of prepaid tuition plans may only use their purchased credits or units at participating colleges or universities. If a beneficiary doesn't attend a participating college or university, the prepaid tuition plan may pay less than if the beneficiary attended a participating college or university. It may only pay a small return on the original investment, depending on how the plan calculates your return.