

Date: March 20, 2023
To: Maryland House Appropriations Committee
From: Elliott Stern (ebstern@gmail.com), Maryland 529 account holder, Potomac, MD
Re: Maryland House Bill 1290, Higher Education – Maryland 529 Program – Reform

Concerns

I'm writing to express my concerns about the Maryland Prepaid College Trust (MPCT) situation. While I feel empathy for the frustrated MPCT account holders, the account holders and the Maryland taxpayers are fortunate that the program remains able to pay all advertised and contractually promised tuition benefits without invoking the Legislative Guarantee.

I support the pre-November 2021 MPCT account holders in their objective, but that's not my motivation for submitting this testimony.

Senate Bill 959 seeks to dissolve the MPCT. Despite the current challenges facing the MPCT, I believe a prepaid plan is a valuable offering within the Maryland 529 program. The new, post-November 2021 prepaid contract terms correct fundamental flaws inherent in the original prepaid contract design; flaws the Maryland 529 Board sought to fix in response to the 2019 Legislative Audit. Many Marylanders have demonstrated their preference for a defined tuition benefit over the investment-based options in the Maryland College Investment Plan. Simultaneously, the unfortunate reality is that many Marylanders do not have the financial literacy or discipline to meet their objectives using the Maryland College Investment Plan (MCIP).

While the MPCT situation created under the direction of the Maryland 529 Board must be addressed and resolved, it's not a reason to dissolve the Prepaid College Trust. It's not a reason to deprive Maryland families of the newer, better designed, less complicated prepaid tuition option. Please do not dissolve this program.

And a plan

I ask that the new post-November 2021 prepaid contracts -- those using the 10-year Treasury note rate and ledger system accounting for minimum benefits, rollovers, and refunds -- be

shielded from the complications affecting the pre-November 2021 contracts. Within the MPCT investment pool, segregate the aggregate value of contributions and earnings associated with the outstanding original contracts. Address the problems with the old contracts using their own values to the extent possible. Permit the new contracts to continue on as a sound, functional prepaid plan.

For the outstanding original (pre-November 2021) contracts, I request that account holders be given a final time-bounded rollover window, perhaps 3 months, to conduct rollovers pursuant to their original contract terms at the then-current investment returns. The account holders would have the option to rollover funds (1) into a new or existing MCIP account, (2) into a new post-November 2021 prepaid contract for the same beneficiary and Projected Enrollment Year, or (3) to any other 529 account as permitted by IRS regulations.

Following this one-time rollover window, each account's remaining funds would be automatically rolled over into a new MCIP account and invested in the Enrollment-Based Portfolio closest to the beneficiary's Projected Enrollment Year. Through this method and by the end of the window, all pre-November 2021 contracts will cease to exist.

This strategy represents a compromise, preserving a Maryland 529 prepaid option while giving pre-November 2021 MPCT account holders an exit path with their investment returns intact. The MPCT surplus should be sufficient to support this strategy. The 2022 actuarial soundness valuation letter contained within the 2022 Maryland 529 Annual Report assumed a 6% interest rate applied "for periods both before and after November 1, 2021." The same letter calculated the Trust's funded ratio to be 140.0%.

Please do not deprive Maryland residents of a low risk, defined benefit, prepaid tuition option. Thank you for your consideration.

On the following pages, please find conditions and assumptions I used for the above; followed by a story I wrote to help my 11-year-old understand the design flaws in the original MPCT contract.

Conditions and Assumptions

As the above plan was formulated, I kept the following conditions, and assumptions in mind:

- The purpose of the MPCT, per the Enabling Legislation, is that "the prepaid contract will cover the average in-State tuition costs at public institutions of higher education in the State at the time that the benefits are exercised". It is not the MCIP. [MD. Education Code Ann. § 18-1903 (2021)]
- Per the Enabling Legislation, the Trust's fiduciary duty is "Solely in the interest of the participants". The "participants" are recognized collectively. The fiduciary duty is not to each participant individually. The MPCT contract terms must not permit transactions contrary to this duty (i.e. if the "100% investment earnings" rollover provision jeopardizes MPCT solvency) [MD. Education Code Ann. § 18-1907 (2021)]
- In the "Changes to the Contract" clause of the MPCT Contract Article IX, retroactive adverse changes are permitted to assure compliance with Enabling Legislation.
- The MPCT should operate as a deferred, fixed index annuity pegged to the Maryland in-state Weighted Average Tuition.
- Avoiding taxpayer bailouts of MPCT, via the Legislative Guarantee, takes priority over issuing rebates.
- Clawbacks of past distributions are not feasible.

Explaining the original MPCT contract design flaws to my 11-year-old

I wrote the following to help my 11-year-old understand the design flaws inherent in the pre-November 2021 MPCT contract design. The former contract design presented a risk to taxpayers and participants. Prepaid account holders and Maryland taxpayers were lucky that investment returns outpaced tuition for the last 20 years. Given another 20 years, the original contract design would have accelerated depletion of Trust surpluses and prompted greater need for the Legislative Guarantee.

[Hypothetical MPCT edutainment informational video]

Narrator: I'm going to illustrate how the Maryland Prepaid College Trust actually worked prior to November 2021.

But first, let's learn what coins are made of! No really, this is going to be helpful. I promise.
<https://www.usmint.gov/learn/kids/coins-life/coin-composition>

Now that you understand "clad coins", we can begin.

Are you worried about rising tuition rates?

Scared that a stock market crash or poor investment returns could wipe out your college savings at the wrong time?

Have I got a deal for you!

The Maryland Prepaid College Trust will let you lock in future college tuition at today's prices.

How can we do this? Tokens! Actual metal tokens like you'd use in a pinball machine.

Here's how it works:

- * In exchange for your prepaid contribution amount, MPCT will mint a special token stamped with your name.

- * For security reasons, MPCT will hang onto the token so it doesn't get lost or used at the arcade.

- * Each token can be redeemed for 1 semester tuition at any in-state Maryland university, or for the Maryland Weighted Average Tuition at out-of-state or private universities.

- * When it is time to redeem the token, just tell the school you have an MPCT token.

- * Upon receiving a token redemption request from the school, we'll destroy the token and send the in-state or WAT tuition. Easy peasy!

Check out the disclosures and sign up today!

That's really all you need to know if you're not interested in hearing about the complicated technicalities of token production.

But if you're curious, stick around and I'll tell you how we use tokens to transform today's dollars into tomorrow's tuition payment.

Still here? Let's talk tokens!

When you send in the contribution to purchase a token, we use the funds to purchase 10 different precious metals in a very specific proportion at current market rates. We keep supplies of all 10 metals on-hand, so we can mint your coin right away.

Using the "clad coin" technique you learned about earlier, we press those metals together with extremely high pressure, and then stamp it with your name. Then it's off to the vault for one to twenty years until your school's redemption request arrives.

[15 years in the future]

Welcome back! Your school's MPCT token redemption request just arrived, so let's go get your token from the vault.

Since this token is not legal tender, we can't simply send it to the school. Instead, we melt it down and separate each precious metal individually. The metals go back into our on-hand supply and your contractually guaranteed tuition payment, in-state or WAT, is sent directly to the school.

What happens if the value of your token's metals are worth less than the cost of tuition? I'm glad you asked! That's part of the extra value we offer.

If that were to occur, we will sell some of the metals in our on-site supply (i.e. from MPCT surplus) to make sure your tuition gets paid.

And if our on-site supply is empty? Well that shouldn't happen. We try very hard to make sure we always have some extra precious metals available, but we have a plan for that too. The Maryland General Assembly has granted us a Legislative Guarantee. That means they'll ask the Maryland taxpayers to lend us the funds for the tuition shortfall.

Any more questions? Yes, in the back. If the token's metals are worth more than tuition. Uh huh.

As I said before, when your token is redeemed, the token is melted; the metals go back into our supply; and the tuition is sent to your school.

So you'd like to keep the token if the metals are worth more than tuition? That's very clever, but for security reasons the token never leaves our facility. We don't send them to the schools or to the named owners.

Yes, I understand you'd prefer to keep any token's value in excess of tuition so you can use it for other educational expenses. Yes, I understand that your contribution purchased those metals. Still, the answer is no. The extra metal must remain within the facility and return to the supply (i.e. increase the MPCT surplus).

You see, retaining the excess value (surplus) when precious metal values rise is what ensures we can make up for tuition shortages when precious metal values fall. This is how all the token owners help protect each other so everyone receives their tuition as promised (i.e. self-insuring program).

If token owners kept the excess value (surplus) in good times, we would *always* need taxpayer assistance in bad times. At some point, the taxpayers might even stop helping us. Whomever owned a token when that happened would be in trouble!

Ok, any more questions? You said the MPCT disclosure said something about rollovers. Right. So I forgot to mention that since we don't advertise it. Most people don't read the contract as closely as you do.

So we at the Maryland Prepaid College Trust deal with tokens and precious metal commodities, but our friends at the Maryland College Investment Plan deal with stocks, bonds, and precious metal commodities.

If you request a rollover from the MPCT to the MCIP, we will melt your token, return the metals to the MPCT supply, and then send 100% of the current market rate value of your token's metal to the MCIP, keeping none of the excess value in the MPCT surplus.

Why don't we advertise that if it's such a great deal? For one, the process is more complicated. To calculate the rollover value, we have to precisely weigh the metals and check the current precious metal prices. That requires a manual review and most people don't know they have to request it.

But the biggest reason we don't advertise it is because it would put the whole operation at risk. Recall what I said about token owners protecting each other? Rollovers are used almost only when it benefits the token owner; otherwise they'd take the larger tuition payment. Rollovers deprive the remaining token owners of the MPCT surplus-based protection they might need when it is their time to redeem. If the Maryland Legislature understood the risk posed by these surplus-draining rollovers, they might shut us down!

Let's dig into this a bit more. Our token's specific metal proportions can be thought of as equivalent to an MCIP Fixed Portfolio. If you purchase a token just to rollover when metal prices are high, then you really should have used the MCIP Precious Metals Fixed Portfolio. They use the same proportions we do and would get the same investment return.

Why not use the MCPT to get the insurance when needed and keep the gains when not needed? Because that loophole will probably get fixed when it's least convenient for you. Not to mention it feels wrong, unfair, and contrary to the purpose of a prepaid plan.

That said, I suppose you're correct. MPCT has honored the 100% investment earnings rollover provision for more than 20 years. If you're comfortable investing in the MCIP Precious Metals fund, or made comfortable by having the Legislative Guarantee plus the mutual token insurance provided by former less diligent participants who didn't understand the rollover strategy, then I guess you can use the MPCT that way. Still feels wrong to me. I hope your decision to use MPCT to harvest rollover gains doesn't come back to bite you.

[End scene]

While the MCIP Precious Metals portfolio was invented for the token analogy, the MPCT Comprehensive Investment Plan has a peer in the MCIP Balanced Portfolio.

MPCT Comprehensive Investment Plan:

Equity 31%

Private equity 10%

Real assets 15%

Fixed income 44%

6.0% return since 1/1999 inception as of 6/2021

MCIP Balanced Portfolio:

Equity 60%

Fixed income 40%

7.23% return since 11/2001 inception as of 9/2021

For MPCT, the largest undisclosed and unanticipated risk was the Maryland Legislature. Specifically, by freezing or capping in-state tuition increases, the Legislature adversely affected the MPCT Weighted Average Tuition payments for private and out-of-state schools. The Contract "Risk Factors" section never contemplated that risk.

"Free Our Interest Now, Maryland529" Press Conference - Spencer Fell

<https://www.youtube.com/watch?v=uZTqy6BxBw>

Starting around 59:00, Mr. Fell claims that MPCT was not a contract or guarantee program; it was an investment.

I don't believe MPCT was intended to be an investment plan, that was the purpose of MCIP. But MPCT operated as an investment plan via the rollover provision.