TESTIMONY of Cheryl Moss Herman
HB 1290, Maryland 529 Program Reform
Before the Maryland House Appropriations Committee
March 21, 2023

To Members of Maryland House Appropriations Committee:

Much has happened since the January 19, 2023 briefing to this Committee.

There have been two Maryland 529 Board resignations, including one on January 20, 2023 - the day following the Appropriations Committee briefing, a number of Maryland 529 updates that continued the “all is well, we have the problem solved” message, followed by a notice to account holders in early March that the 1099-Q we each received in late January is likely wrong. And there has been a fair amount of media attention that does not paint the Maryland 529 organization or the State of Maryland in a good light.

There was a Senate briefing on the Maryland 529 in late January, and three bills introduced related to the Maryland 529 Prepaid Trust issues (SB 0475 and HB 1290 that was cross-filed with SB 0959). The latter two transfer the Maryland 529 to the State Treasurer’s office, dissolve the Maryland 529 Board, and begin a wind-down of the Maryland Prepaid College Trust (the “Trust”). There have also been two legislative hearings in the Senate at which dozens of account holder testimonies and cries for help were heard.

There should be no doubt among Committee Members that all is not well and the problem is not solved.

There should also be no doubt that we need your intervention to solve it.

I urge you to approve HB 1290, with important amendments that remedy the harm caused to account holders.

Moving the 529 from an independent agency to the Treasurer’s office will help if concrete steps are taken to improve transparency and accountability, but FIRST there must be resolution of the harm to account holders caused by detrimental reliance on program officials and contractors – and by breach of contract.

While Maryland 529 will tell you that the Trust pays in semesters – it is important that you know that these benefits have a monetary value. The monetary value must be calculated – according to contract terms – not only for distribution benefits directly for 529 qualified education expenses, but also for the opportunity to conduct a rollover or refund. Both the FAFSA value and the 1099-Q information reported to the Internal Revenue Service are monetary values.

The challenge that I face is that due to a late 2022 “reinterpretation” of the Trust Disclosure by the Maryland 529 Board, that the monetary values for semester Minimum Benefits that were shared with me by Maryland 529 Executive Director by phone and on Maryland 529 leadership in May 2022 were wrong. These estimates were consistent with my end-of-year 2021 Annual Statement refund/FAFSA value.

I relied on that information to make important financial decisions and choices with my now college freshman daughter. I received my manual calculation and the difference in monetary value for me is almost $50,000. That’s $50,000 that I will need to find “elsewhere” to pay for her four-year college expenses, including but not limited to tuition, fees, housing, board, and books.

How is this late 2022 change consistent with the mission of the Maryland 529? It’s not. And it’s not consistent with our contracts either.

Understanding the dramatic impacts account holders are experiencing is critical. Please consider HB 1290 and amendments to yield a timely and equitable solution that mitigates harm caused by the State to account holders and shapes the future of the Maryland 529.

In YOUR actions, YOU must recognize the harm caused to Maryland college students and their families by state agency actions through detrimental reliance on information provided directly and repeatedly by Maryland 529 leadership and agents, and by breach of contract in detrimentally changing rollover terms.

On the latter, HB 1290 MUST be amended to require the Trust to honor its contract terms regarding rollovers. Accounts with students in college or about to go to college should be prioritized.

Following the June 1, 2023 transfer of the Maryland 529 to the State Treasurer’s office, the Treasurer shall grant and apply all Trust account holders a 6% earnings rate, compounded monthly, on account balances from the date of contribution to the date of the transfer.

This is consistent with the June 25, 2021 approval by the Maryland 529 Board that the rate of return for minimum benefits, rollovers and refunds each be to be the Trust's since-inception rate of return as of June 30, 2021 -- 6% -- for balances held PRIOR to November 1, 2021. Contributions received on/after November 1, 2021 would receive the 10-year Treasury Note rate. These rates and calculation changes were to go into effect on November 1, 2021. They were accurately reflected in our end-of-year 2021 Annual Statements that became binding on March 1, 2022.

Prior to this change, the calculation used for a rollover or refund used MPCT's since inception rate of return to attribute earnings to the balances in an account. According to Maryland 529, this has been between 5% and 6% in the seven years prior to 2022. However, those account holders who were requesting Minimum Benefits, had their benefits calculated as contributions made under their contract plus a rate of return equal to a monthly rate of return of a U.S. Government Security with a constant maturity of one year minus 1.2%, with a floor of 0%. From November 2008 to June 2017, the rate of return associated with the Minimum Benefit calculation was 0%.

A driver for the June 2021 change was consistency and fairness -- for the Trust to align calculations for Minimum Benefit with calculations for rollovers and refunds so that an account was not worth more when it was rolled over or refunded than it was when it was used as intended.

Restoring the 6% also eliminates the violation of contract Article IX. Article IX of our contract states that the board cannot retroactively modify contracts in a manner adverse to beneficiaries, and that any such change requires prompt notification so account holders could cancel their contracts. The late 2022 reinterpretation was both detrimental to account holders AND was not properly noticed.

To aid in implementation, I believe that the current program manager, Intuition CSS, should conduct the correct earnings calculation for account holders. Intuition produced the December 2021 end-of-year statement with the refund/FAFSA values. I do not believe that the plan can be migrated successfully to another platform in a financially responsible and timely manner.

In addition to the restoration of investment earnings at 6%, with prioritization for those with students in college in 2022 and 2023, I ask that HB 1290 be amended to establish a damage claims process for those who incurred extraordinary expenses due to the inability to access 100% of their funds in those years.

Funding for the restoration of the 6% investment earnings should first come from Maryland Prepaid College Trust itself. The Maryland 529 2022 Annual Report indicated the Trust had $1.2B in assets, which includes a $355.6M surplus.

In addition to these monies, the Trust held a separate operating surplus that is invested in a Money Market Mutual fund (Wells Fargo). That fund held $13,321,779 as of June 30, 2022 and should be available immediately to help with some of the transition expenses, including hiring experts to execute the remedies proposed and migrate the program to the Treasurer's office.

Consider access to the Governor's Rainy Day Fund (estimated to be at $2.9 B at the end of FY 2023) to cover extraordinary expenses incurred by some due to the detrimental reliance on information provided by the Trust. Additionally, in the case of liquidity shortcoming by the Trust, the State could provide a loan to the Trust to cover account holder requests (there is precedent to this as the State provided start up loans to the Maryland 529 for Trust and ABLE plans).

Together, the reinstatement of the 6% earnings and a damage claim fund would serve to remedy much of the current harm.

As the Trust is wound down, the Work Group should explore FUTURE enhancements to accountability, transparency, and efficiency of the 529. It should begin as soon as practicable after enactment, and conclude its work soonest, by September 2023 is preferable but not later than December 2023, to allow the findings to be considered during the next legislative session.

The Work Group should have subpoena power; the current "hide the ball" is unacceptable. The Workgroup results should be made public contemporaneously with transmittal to the Governor. The statute of limitations for contract disputes should be extended for one year beyond when the Work Group report is made public.

Due to previous actions that lacked transparency, I ask that the bill require notification to all account holders regarding 529 transfer to Treasurer be mailed, emailed, and stated on 529 website within 15 days of enactment of the bill. I also ask that shortly after the transfer to the Treasurer, that an additional notification be made that includes contact information and a schedule for future actions such as timelines for filing claims, for rollovers or refunds, and for damages.

Additional enhancements could include a new statement after the reinstatement of the 6% earnings and annually thereafter until the account is terminated or transferred. A clear appeals process would also be an enhancement; none exists today.

I also ask that upon enactment of the Bill, the Maryland 529 Prepaid College Trust should be closed to new contracts. The rationale for this is that it will be challenging to implement the transfer to the Treasury and process new contracts simultaneously. It also avoids increasing liability for such contracts.

We need a timely and equitable solution that honors Trust contract terms. The current situation is not acceptable. The principles of consistency and fairness that were the basis for the June 2021 equalization of the interest rate calculation should carry forward to discussions about future actions and solutions this legislative session.

I stand ready and willing to sit down with you, the Treasurer, the Governor's office, and the Maryland 529, to forge a fair and whole solution that helps the Maryland 529 meet its intended objectives.

For additional background, I am sharing with you below the testimony I prepared for SB 0475 and provided to the Senate Education, Energy, and the Environment Committee for its February 22, 2023 hearing. I think it is important you all see the same information regarding how we got to this unacceptable place.

My February testimony describes in detail my engagements with Maryland 529 regarding my two Maryland Prepaid Trust accounts, the information about calculation methodology used and expected semester minimum benefits that I received from Maryland 529, including from its former Executive Director, and the impact of the late 2022 policy change that account holders were alerted to on January 6, 2023.

Thank you for allowing me to share my views.

Respectfully,
Cheryl Moss Herman

Attachment: Testimony of Cheryl Moss Herman, SB 0475, February 22, 2023

ATTACHMENT:

TESTIMONY of Cheryl Moss Herman Regarding
SB 0475, Workgroup on the Maryland 529 Prepaid College Trust Program
Before the Maryland Senate Education, Energy, and the Environment Committee
February 22, 2023

Good Afternoon, Chair Feldman, Vice Chair Kagan, and Members of the Committee. My name is Cheryl Moss Herman. I am a resident of District 15, represented by Senator Feldman, but live close enough to the district line that my children attended elementary, middle, and high schools that were in Senator Kagan's District.

I am here today to share my views on SB 0475, which I support, but with significant amendment towards an equitable and timely solution to the harm caused to Account Holders from across Maryland by the missteps, mistakes and mismanagement of the Maryland Prepaid College Trust.

I purchased Prepaid accounts for both of my daughters, now young adults, in 2001 and 2004 and paid off each account over a number of years. I assure you that I understood the terms of what I purchased, including the actuarial projections of Trust investment earnings and of future college tuition costs used for price setting.

I also understood the changes proposed in 2021 and spent a great deal of time trying to understand the value of my younger daughter's account as she was selecting colleges in Spring, 2022. The difference between the Minimum Benefits estimate provided to me in May, 2022 and the recently received "Manual Report" is over $50,000, or a decline in benefits of almost $6,000 per semester. That is why I am here today.

The recent chapter for the Maryland Prepaid College Trust (MPCT) began on June 25, 2021, when the Maryland 529 Board approved the rate of return for minimum benefits, rollovers and refunds to be the Trust's since-inception rate of return as of June 30, 2021 -- 6% -- for balances held PRIOR to November 1, 2021. Contributions received on/after November 1, 2021 would receive the 10-year Treasury Note rate. These rates and calculation changes would go into effect on November 1, 2021.

The November 1, 2021, date of the change coincided with the transition from self-management of the MPCT to management by a third-party Program Manager, Intuition.

Prior to this change, the calculation used for a rollover or refund used MPCT's since inception rate of return to attribute earnings to the balances in an account. According to Maryland 529, this has been between 5% and 6% in the seven years prior to 2022. However, those account holders who were requesting Minimum Benefits, had their benefits calculated as contributions made under their contract plus a rate of return equal to a monthly rate of return of a U.S. Government Security with a constant maturity of one year minus 1.2%, with a floor of 0%. From November 2008 to June 2017, the rate of return associated with the Minimum Benefit calculation was 0%.

A driver for the change was consistency and fairness -- for MPCT to align calculations for Minimum Benefit with calculations for rollovers and refunds so that an account was not worth more when it was rolled over or refunded than it was when it was used as intended.

In August 2021, MPCT announced to Account Holders the transition of operations to Intuition and provided Account Holders with a supplement that amended the prior December 2020 Disclosure Statement that had also been amended in April 2021. The changes, as noted above, would become effective on November 1, 2021.

The amended Disclosure language for says:

> "For Accounts in existence on October 31, 2021, contributions in your Account prior to October 31, 2021 will earn 6% on balances, compounded monthly, until Benefits are withdrawn, or your Contract is terminated.
>
> Contributions made on or after November 1, 2021, will accrue regular interest each year, compounded monthly, at a rate equal to the 10-year Treasury note rate. The Treasury note yield applicable to the Account contributions will be updated annual with the June 30th number."

For seven semesters, I successfully used my in-state benefits for my older daughter, a 2022 graduate of the University of Maryland - College Park. However, after the August 2021 changes to the disclosure went into effect on November 1, 2021, I realized we had value in the account above what would be needed for the final tuition payment. I called Maryland 529 to find out how to preserve that value and was told three different things – from the value will disappear when the final (8th) semester is paid to it will be available for an additional ten years. I was also advised each time that the most secure way to preserve the value would be to roll it over to the Maryland College Investment Plan(MCIP). Instead of rolling the dice on the what would preserve the value, I executed a rollover to MCIP.

The MPCT initiated the rollover as I requested and canceled my account on February 25, 2023. By mid-March, concerned that the money had not appeared in my MCIP, I began daily calls to both MPCT and MCIP to find the money. One day, the check from MPCT with my funds arrived at my home by mail, with a note from MCIP that the check was made out improperly and therefore rejected.

That’s right. The MCIP rejected the check from MPCT – both are part of the same organization, Maryland 529.

I did not see anything improper about the check. After a number of phone calls, I returned the check to MCIP and it was deposited into my daughter's MCIP account. I was told that the "documentation" for the check was the issue. When I received the paperwork from the Prepaid, I could see why: the rollover of about $14,000 had earnings of over $29,000 reported for it. That. Can't. Be.

It seems that my first account may have been one of the "canary in the coal mine" accounts. I was told that Maryland 529 staff was noticing discrepancies in the application of interest that required a programming fix. It was shared that the new earnings calculation was not only being applied to monies that remained in the account, but also to historical balances that had been distributed. That seems consistent with the account statement I was provided at the time of the rollover.

Additionally, a background document provided by Maryland 529 to the General Assembly in summer 2022 corroborates this error. It describes the calculation issue (page 4), "…the new earnings calculation, which increased the interest rate payable under the Minimum Benefit calculation, was not being applied to just the balances held in an account as of the transition date, as called for by the disclosure Statement, but rather to historical account balances that had long-since been distributed. As such, funds were being distributed with earnings calculations that were attributable not to the basis portion of that same distribution, but on past balances no longer held by the Trust."

Upon discovery of the programming error, MPCT froze the application of earnings on accounts in April, 2022 while they investigated and attempted to correct what they described as a "technical error" that occurred during the November 2021 transition to a third-party program manager, Intuition. The freeze also resulted in all FAFSA (Federal application for financial aid) values now being displayed in an account's online portal at the level of contributions only.

During the Spring of 2022, many Account Holders, myself included, relied on the balances shown on the end-of-year 2021 statement and estimated calculations done for them by MPCT upon request when making financial choices related to their student's college education. For many, including me, this information played directly into their affordability calculations and the choice of in-state versus out-of-state colleges.

My second account, for my then high school senior, showed a FAFSA value of more than $85,000 with the added earnings per the 2021 policy change. I reached out to the Prepaid Trust multiple times from December, 2021 through February, 2022 to try to ensure I knew the balance of monies I saved for my daughter's college education. I received confirmation of the end of year FAFSA value and its relationship to the Minimum Benefit multiple times in that timeframe.

But by the end of April, 2022, with college decisions looming, the MPCT representatives refused to share the value of the Minimum Benefit for my own Prepaid account with me. This information was key to learn before my daughter had to make her college section by May 1. This is when I reached out to my legislative delegation for help.

The availability of these funds were a critical part of our discussions that resulted in her deciding to attend an out-of-state university.

Thanks to intervention from Senator Feldman's office, I was provided a phone estimate on April 21, 2022 by Ms. Traci Ornella of Intuition -- in time to consider the financial implications as my daughter selected a college. The estimate was for over $87, 000 with a semester Minimum Benefit of almost $11,000 per semester. During that phone call, and subsequent calls, we also talked about the methodology for calculating the Minimum Benefit, with the 6% interest applied to contributions from the time they were made until the monies were withdrawn. During the April 21 call, I asked for the estimates in writing.

On May 18, 2022, I received a phone call from the then MPCT Executive Director, Erin Layton, during which the Minimum Benefit estimate was confirmed. We also discussed the 6% since contribution methodology for calculating earnings. Ms. Layton shared that she was approving a letter to be sent to me with my requested Minimum Benefit estimates. [That letter also addressed new calculations for the rollover of my older daughter's account that was completed in Feb/March 2022 that initially had an incorrect interest calculation.]

On May 19, 2023, I received the letter from Ms. Ornella, as approved by Ms. Layton and discussed with me the day prior. Both of the phone calls (Ornella and Layton) included estimates that calculated interest from the time of contribution as well as specific discussions of how the earnings were calculated at 6% on contributions from the time of contribution until dispersed. The May 19, 2022 estimated amount is similar to the end of calendar year 2021 statement FAFSA value. As noted above, it included an estimated Semester Minimum Benefit of almost $11,000 per semester - a significant amount above the approx. $5300 per semester weighted average tuition benefit.

It is important to note that neither the freezing of interest application or the change in the online FAFSA account value were shared broadly with Account Holders for months. Maryland 529 notified Account Holders of the April, 2022 suspension of interest earnings on August 29, 2022 – a full four months after that suspension was initiated and as Account Holders were filing for benefits for Fall 2022 tuition and qualified education expenses. Unless an Account Holder reached out specifically for an estimate of benefits or a rollover or refund, or inquired about the change in the online FAFSA value (long after most had filed the FAFSA form), the interest calculation freeze was not widely known.

I was not yet concerned about the 'technical issue' for my younger daughter's account because it was described as only affecting accounts that had prior distributions and each and every call I had included a discussion of the earnings methodology that was to be applied to my account.

The initial target for the recalculations to be completed was June, 2022. However, MPCT hired auditors in that timeframe and elected to have the recalculations reviewed by the auditors, pushing the new deadline to August, 2022. That was later revised to September, 2022.

For those Account Holders with students attending out-state-colleges in Fall 2022, this meant that Account Holders were only able to access the weighted average tuition (WAT), not the greater of WAT or Minimum Benefit, as described in the Disclosure. It also posed issues for Account Holders who counted on their excess benefits for other qualified education expenses and those whose students were graduating and will not have costs against which to take future distributions.

In September, 2022, Mr. Savia became the new Executive Director (the third in as many months) and during a Board meeting and a Townhall, acknowledged that the interest calculation issues were on-going and promised an update by October 31, 2022. He also established a process for identifying and prioritizing manual calculations of accounts thought an Account Support Request form.

On November 7, 2022, Maryland 529 informed Account Holders that on October 27, 2022, the Board voted on “a number of initiatives” aimed at providing accurate account values. The communication specifically noted a change from a “net contribution” method to a ledger balance method. Account Holders do not know what other “initiatives” were discussed and voted on at that meeting.

The November 7, 2022 Maryland 529 update also provided a projected timeline, which had the manual recalculations 100 % complete by the third week of December. This timeline should have allowed Account Holders to access their semester Minimum Benefit for Fall 2022 before the end of tax year 2022.

A December 12, 2022 Update from Maryland 529 said, in part, “The manual calculation process is underway and work remains ongoing to test and validate an automated process for the calculation across all Accounts. Our next step is to contact each Account Holder who submitted an Account support request form to advise on next steps.” The update directs Account Holders to FAQs on the Maryland 529 website, which included the prior timeline with the third week of December as the target completion date for manual calculations.

As far as we are aware, no manual calculations were completed and earned interest made available in 2022. This means that Minimum Benefits for Fall 2022 were not available in calendar year 2022, which would have enabled the matching of expenses and distributions in the same calendar year for tax purposes.

On January 6, 2023, an MPCT update introduced a new implementation approach where the 6% earnings are only applied to balances in your account on Oct 31, 2021. That update says, in part, "In the process of distributing these additional earnings (which ironically stem from an increase to percentage of attributable earnings effective November 1, 2021), the calculation was inaccurately reported and had to be corrected in compliance with the Board approved Disclosure Statement (which has always been publicly posted on our website at: https://maryland529.com/Portals/0/Files/MPCT_Disclosure_Statement.pdf).”

Additional explanation is provided via a slide deck linked to the update: Prepaid College Trust Public Update_1.6.23.pdf (maryland529.com). Page 12 indicates that for contributions made prior to Nov 1, 2021, the interest rate at the time (which was effectively zero from November, 2008 to June 2017) would be applied and the 6 % would be applied to balances in place on Oct 31, 2021 and, for these accounts – those that were in existence on October 31, 2021 -- thereafter.

This January 6, 2023 methodology change yields drastically different account values for Account Holders than shown on the 2021 end-of-year statements. Each Account Holder will not realize tens of thousands of dollars of earnings that they were previously expecting and counting upon. I also believe it is not consistent with the intent of the Board in June 2021 as it decreased the value for rollovers and refunds, which may not be allowed by the contract.

Based on discussions many Account Holders, including me, had with MPCT leadership and contractors and estimates received along the way, this change in approach is an unwelcome surprise. It is also surprising given the reference to interest calculations described in the Actuarial Soundness report included in the Maryland 529 2022 Annual report [2022_MD529_AnnualReport_FINAL.pdf (maryland529.com)]. On page 18, the actuaries who reviewed the actuarial soundness of the MPCT say the following (italics added for emphasis):

> "Beginning November 1, 2021, the same interest crediting will be used in calculations performed for the Minimum Benefit, rollovers and refunds. *Interest will be credited on contract payments made to the Trust prior to November 1, 2021 at the since inception rate of return as of June 30, 2021 (6.00 percent) for periods both before and after November 1, 2021.*"

The actuaries conducting the soundness report understood that the 6% was to be applied to contract payments before and after Nov 2021 – and – the assumptions in their report were included in the Annual Report and not disputed by comment or footnote.

Importantly, the actuaries determined that MPCT is actuarially sound if the 6 % interest is applied to contributions made prior to November 1, 2021 from the time of the contribution.

The January 6 update has confused matters considerably. I and hundreds of Marylanders relied on the 2021 information to make financial decisions related to our students' college education.

For me, the difference between the greater than $87,000 estimate I received by phone on April 21, 2022 as my family was making college choice, which was confirmed by Ms. Layton on May 18, and as approved by Ms. Layton, in writing by Intuition, on May 19, 2022 and the manual calculation reports I received on January 23, 2023 (and inexplicably again on January 31 and February 8) is over $50,000. That is, the Minimum Benefits calculated by the January 6, 2023 methodology is over $50,000 less than the estimate previously provided – or about $6,000 per

<u>semester less. College decisions were made on the initial estimate, causing us to have to find $6,000 per semester elsewhere.</u>

Changing the rules retroactively in the “middle of the game” presents significant hardships related to college funding that are contrary to the objective of the Maryland 529.

This is unacceptable to me -- and should be unacceptable to you. As a State-legislature backed program, both transparency and accuracy should be paramount.

Account holders relied on this Maryland state agency to help them plan for college. This state agency failed me and thousands of others from across the state. Our families and our students deserve better. We need your full engagement soonest to make this right.

Those principles of consistency and fairness that were the basis for the June 2021 change in the interest rate calculation should carry forward to discussions about current status and future actions and solutions this legislative session.

I stand ready and willing to sit down with you, the Governor’s office, and the Maryland 529, to forge a fair and whole solution that helps the Maryland 529 meet its intended objectives immediately.

Thank you for allowing me to share my views.

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