MISSOURI'S 529 COLLEGE SAVINGS PLAN

CLINT ZWEIFEL
MISSOURI STATE TREASURER

August 19, 2015

FROM: Nicole Hackmann
Director of Banking and Investments

RE: 2014 Annual Program Review

Section 166.450 of the Revised Statutes of Missouri (RSMo) requires an annual review of the Missouri Higher Education Savings Program ("MOST") by the Director of Investments of Treasurer Zweifel's Office and the reporting of the findings to the Missouri Higher Education Savings Program Board ("Board"). The statute requires a review of five areas:

- Board administration
- Financial status
- Investment policy
- Participation rate
- Continued viability

Therefore, in accordance with these requirements, I am pleased to present the following findings from my review for calendar year 2014.

I. Board Administration

Ascensus Broker Dealer Services, Inc. (formerly Upromise Investments Inc.) assumed responsibility as program manager and Ascensus investment Advisors, LLC (formerly Upromise Investment Advisors, LLC) (together "Ascensus College Savings"), assumed responsibility as recordkeeping and servicing agent, for both the Direct and Advisor Plans on June 3, 2006. On February 7, 2011, the Board entered into another contract with Ascensus College Savings, following a Request for Proposal ("RFP") process. The new contract extends to June of 2016. As the Board is aware, we have issued a Request for Proposals for Program Management Services and responses are due August 28, 2015. The Board and Treasurer Zweifel's Office continue to work closely with Ascensus College Savings and monitor its management of the programs. In addition, the Board met quarterly during 2014, as required by law.

II. Financial Status

Following is a review of the financial status of our major partners and a summary of the investment performance of the investment options within the MOST Plan.

A. Financial Status of MOST Partners

Ascensus College Savings is part of Ascensus. Ascensus is the largest independent retirement and college savings services provider in the United States, helping over 6 million Americans save for the future. With more than 30 years of experience, the firm partners with financial institutions to offer tailored solutions that meet the needs of financial professionals, employers, and individuals. Ascensus specializes in recordkeeping, administrative, and program management services, supporting over 43,000 retirement plans and 3 million 529 college savings accounts. It also administers more than 1.5 million IRAs and health savings accounts.

The investment manager for the Direct Plan, The Vanguard Group, remained a strong franchise. Vanguard is the world's largest mutual fund company and one of the world's largest investment management companies. Vanguard manages more than $3.3 trillion in global assets, including more than $20 million investors. The firm offers more than 173 funds to U.S. investors and more than 124 additional funds in non-U.S. markets. Within the 529 market, Vanguard is the largest provider of investments with $63.2 billion representing approximately 25% of the market.

The distributor for the Advisor Plan is DeAWM Distributors, Inc (formerly known as DWS Investments Distributors, Inc.). DeAWM is home to the full range of active, passive, alternative and private wealth management functions of Deutsche Bank. With approximately $1.2 trillion of assets under management (as of March 31, 2015), DeAWM is one of the world's leading investment organizations, offering traditional and alternative investments across all major asset classes as well as customized wealth management solutions and private banking services to high-net-worth individuals and families..

B. Performance of MOST Underlying Funds

Overall, 2014 had a solid performance from fixed income, with the exception of inflation indexed paper, and a more lackluster performance from equity. All but one of the fixed income funds showed positive results for the year while around 75% of the equity funds showed positive results. Equity funds showed results ranging from -5.51% to +13.35%, while the fixed income results ranged from -1.11% to 8.91%. The negative results in funds can be attributed to low inflation and poor performance in growth and international equity sectors.

The one-year returns of the funds in the Direct Plan, excluding the Interest Accumulation Portfolio ranged from -5.77% (Vanguard International Growth Portfolio) to +12.34% (Vanguard Total Stock Market Index Portfolio). The returns for all options in the Advisor Plan were similar with a range of -6.61% for the lowest one year return (T. Rowe Price International Growth & Income) and +12.75% (Deutsche Equity 500 Index) for the best performer. Underlying fund performance was similar in that the plan showed mixed returns for the year. Funds with an international fixed income component generally outperformed those with only a domestic exposure – the reverse was true for underlying funds with an international equity component.

Treasurer Zweifel's office is responsible for monitoring the relative performance of each of the underlying investment alternatives versus an established benchmark. This effectively measures the contribution that the investment manager's expertise has on participants' returns. During calendar year 2014, absolute returns were mixed and relative performance for all but one of the funds (Advisor) can best be described as at or below benchmark for the period. While Index funds are expected to be at or below benchmark, depending on the extent to which they stray from exact matching of the index, actively managed funds are expected to exceed those benchmarks, however by and large, the actively managed funds missed those benchmarks this year. To summarize, the investment managers' overall contribution to participants' returns was negative, albeit modestly. As of year-end, two advisor funds were on the Watch List for negative intermediate-term performance results, three advisor funds were on the Watch List for short-term performance results, and one advisor fund was on the Watch List for Qualitative Watch (PIMCO). All passive (index tracking) funds performed satisfactorily, and experienced low tracking error of returns versus their relevant indices.

III. Investment Policy

The Missouri Higher Education Savings Program Board adopted a formal investment policy, governing program investments, in mid-2007. The policy establishes objectives for structuring the investment options in the Direct and Advisor Plan, formulates policies for selecting appropriate investment managers and the use of specific investment vehicles, and establishes an investment performance process for underlying funds in the Plan. The policy is an important statement by the Board in terms of defining its fiduciary responsibilities and standards for Treasurer Zweifel's office staff and MOST partners. The policy was modified in 2008 to allow the Director of Investments, rather than the Board, to make the decision to place or release a fund to/from "WATCH" status. The Board again modified the investment policy in August 2011 to provide that the formal review period for a fund would be three consecutive quarters (as opposed to two consecutive quarters) when looking at benchmark performance evaluation for the Watch List. "Beta" and "Alpha" measures were also added to the review process for funds when determining Watch List eligibility and quarterly performance, as well as the elimination of the "value of active management" measurement criteria. The investment policy was reviewed but not changed during 2014.

IV. Participation Rate

Following is an examination of the participation rate of the MOST program. By examining the participation rate for the program, we can attempt to gauge the relative success the program has had in reaching the state's residents and encouraging them to increase college savings—the original goal of the IRS section authorizing these programs. The relative success or failure of states' various 529 programs rests on many different factors including the effectiveness of marketing efforts, availability of a state tax deduction, demographic and economic conditions, cost structure and the abilities and resources of states' partners to attract and retain assets. However, one facet that has remained a constant is the competition for assets among states' program managers, which remains fierce.

A. Growth of Plan in 2014

The MOST Plans experienced growth in both assets and accounts during the year. The asset growth in 2014 is due to both investment returns and increased contributions, while the positive change in number of accounts is primarily the result of plan marketing, increased awareness, and popularity of the program.

Combined Plan assets grew by a rate of 8.57% as compared to a 17.29% growth rate last year, ending the year at approximately $2.472 billion as compared to year-end 2013 at $2.277 billion. Growth was experienced in both the Advisor (9.24%) and the Direct Plans (8.50%) although the majority of the absolute dollar growth was again accounted for in the Direct Plan. Both plans grew at a lower rate than the two prior years which saw Advisor Plan growth at 21.48% and 19.98% respectively, and Direct Plan growth at 16.88% and 14.76% for years 2013 and 2012.

For the past three years, plan growth in MOST has been driven by market returns and to a lesser extent, account growth.

Contributions during the period once again outpaced withdrawals, also contributing to the positive asset growth. Total combined contributions for both plans equaled $270.0 million, while withdrawals were $217.6 million. Contributions increased by $3.8 million in 2014 versus $13.1 million in 2013 and $26.2 million in 2012. While the rate of growth in contributions has slowed, they are still increasing year over year, which should be expected as the economy continues to recover and the cost of higher education increases.

The number of accounts grew by a rate of 3.9%, the rate of growth decreasing from a year earlier (4.7%), resulting in a total of 148,427 combined accounts at year-end. The rate of growth for the Advisor Plan was 0.8% and the Direct Plan was 4.3%. Roughly 88% of account holders are Missouri residents, an amount relatively unchanged in 2014.

B. Comparison of MOST Participation to National Trends

Nationally, assets in 529 Plans on average have grown significantly over the past decade, but at a decreasing rate. Similar to Missouri, levels plummeted in 2008 due primarily to the financial market performance, but accounts have continued to grow signaling that popularity and awareness across the country is on the rise. Overall, the growth trends for Missouri's MOST Plan, both in respect to assets and accounts, have consistently mirrored the national rates over the past several years.

In 2014, while still positive, MOST asset and account growth has somewhat lagged behind the national rates. MOST assets increased by 8.60%, slightly behind the national rate of 9.71%. MOST accounts increased by 3.9% as compared to the national rate of 5.2%.

V. Continued Viability

The MOST program remains a viable college savings program. In Ascensus College Savings' eight and one-half years of program management we have experienced strong trends in asset and account growth despite the market turmoil that plagued much of this period. We also saw an upswing in the number of new beneficiaries enrolled in the plan, which shows growth of new customers, and much better participation in the Advisor Plan among Missouri-based brokers over the past year.

The performance of the Plan throughout the economic downturn and subsequent recovery has been resilient. The fact that participants weren't required to make non-qualified withdrawals on a large scale during this period is promising. As a result, the majority of participants should have experienced almost full recovery of their college savings account balances. The economic environment remains challenging, but the view in regard to a sustainable recovery and financial markets stability is one of optimism. With this outlook, we should expect to see growth in all aspects of the plans continue. Increased competition in the 529 marketplace requires innovation and a commitment to excellence to ensure MOST continues to grow.

Missouri's MOST 529 Plan remains not only viable, but well positioned for growth as one of the premiere plans in the country.