



Annual Evaluation of the

CONNECTICUT HIGHER EDUCATION TRUST

For the Period Ending December 31, 2019

Submitted to:

The Committees on Education and Finance, Revenue
& Bonding of the Connecticut General Assembly

Statutory Requirements

This *Annual Evaluation of the Connecticut Higher Education Trust* (“CHET” or “Trust”) is jointly submitted by the Connecticut State Treasurer’s Office and the Executive Director of the Office of Higher Education to the Committees on Education and Finance, Revenue and Bonding of the Connecticut General Assembly, pursuant to Section 3-22e(b) of the Connecticut General Statutes.

Pursuant to Section 3-22k of the general statutes, the annual audited financial statements for CHET are included in the Annual Report of the Treasurer, which is transmitted to the Governor and members of the General Assembly on December 31st of each year. The audited financial statements also are transmitted to the CHET Advisory Committee pursuant to Section 3-22e of the general statutes.

The members of the CHET Advisory Committee as of the annual 2019 meeting, held on April 12, 2019, were:

Shawn T. Wooden, State Treasurer
Melissa McCaw, Secretary, Office of Policy and Management
Keith M. Norton, Acting Executive Director, Office of Higher Education
State Rep. Robert Sanchez, House Chair, Education Committee
State Sen. Douglas McCrory, Senate Co-Chair, Education Committee
State Sen. Eric C. Berthel, Senate Co-Chair, Education Committee
State Rep. Kathleen M McCarty, Ranking Member, Education Committee
State Sen. Kevin D. Witkos, Ranking Member, Finance, Revenue and Bonding Committee
State Rep. Christopher Davis, Ranking Member, Finance, Revenue and Bonding Committee
State Sen. John Fonfara, Senate Co-Chair, Finance, Revenue and Bonding Committee
State Rep. Jason Rojas, House Chair, Finance, Revenue and Bonding Committee
Patrick Torre, Vice President of Finance, University of New Haven
Margaret A. Malaspina, Director of Financial Aid, Capital Community College
Julie Savino, Executive Director, University Financial Assistance, Sacred Heart University
Rose Ellis, Dean of Administration, Norwalk Community College

Background and Program Management

CHET is a qualified state tuition program established pursuant to Section 529 of the Internal Revenue Code. Connecticut’s authorizing statute was unanimously approved by the Connecticut General Assembly and signed into law by the Governor in 1997 (Public Act No. 97-224, the “Act”). The program began operating on January 1, 1998. While the Trust is considered an instrumentality of the State, the assets of the Trust do not constitute property of the State and the Trust is not construed to be a department, institution or agency of the State.

The Act designates the State Treasurer as the Trustee of CHET. The assets of CHET are privately managed by professional money managers under the supervision of the State Treasurer. TIAA-CREF Tuition Financing Inc. (“TFI”) serves as program manager for CHET Direct pursuant to a contract that expires in March of 2020.

In August of 2010, the State Treasurer entered into a management agreement with The Hartford Financial Services Group, Inc. to offer an advisor-sold plan. The contract for CHET Advisor runs through August of 2019. In July 2019, the State Treasurer exercised the option in the management agreement to extend the contract with The Hartford Financial Services Group to extend the contract through August 31, 2020.

In August 2019, the State Treasurer exercised the option in the management agreement to extend the term of the contract to August 31, 2020.

CHET DIRECT

As of December 31, 2019, CHET Direct had 132,374 unique accounts with \$3.50 billion in assets. This compares to 125,952 accounts and \$2.95 billion in assets on December 31, 2019, representing increases of 5.1% and 18.8% for accounts and assets respectively, and reflects account redemptions as account owners withdrew funds to pay college costs for beneficiaries. Since inception, more than \$2.27 billion has been withdrawn for beneficiaries.

Investment Options

CHET Direct gives investors the opportunity to invest in age band portfolios that will rebalance automatically as a child ages. Investors can select from conservative, moderate or aggressive age bands, depending on their investment risk tolerances. These options are designed for investors who wish to make deposits and leave the investment decisions to investment managers. For those investors who wish to be more active in their asset management, CHET Direct also offers individual options covering different asset classes.

Age Band Options

The three CHET Direct age-based options consist of nine portfolios for each option, allowing for a smoother transition for the investor as the child grows.

The existing age bands for the conservative, moderate and aggressive options are:

- 0-4 years
- 5-8 years
- 9-10 years
- 11-12 years
- 13-14 years
- 15 years
- 16 years
- 17 years
- 18 years and over

Individual Options

There are 11 individual options that are either actively or passively managed across different asset classes.

Actively managed:

- Active Global Equity Option
- Active Fixed-Income Option
- High Equity Balanced Option (a blend of equity and fixed income)
- Social Choice Option (large cap U.S. equities)
- Principal Plus Interest Option (a life insurance funding agreement)
- Global Tactical Asset Allocation Option
- Money Market Option

Passively managed:

- Global Equity Index Option
- U.S. Equity Index Option
- International Equity Index Option
- Index Fixed-Income Option

Underlying Funds

Both the age band and individual portfolios have underlying funds that span asset classes. There are 23 total underlying funds used in the CHET Direct options. A total of twenty-two institutional mutual funds (from TIAA-CREF, Blackrock, DFA, Harding Loevner, State Street, T. Rowe Price, Templeton, Metropolitan West, and GMO fund families) underlie the investment options. The Principal Plus Interest Option is invested through a funding agreement with TIAA-CREF Life Insurance Company. Some options use multiple underlying funds.

Administrative and Program Fees

CHET Direct's administrative and program management fees are competitively ranked in the bottom quartile of fees charged by providers in the 529 industry. The Principal Plus Interest Option does not disclose a program management fee. The total asset-based fees of the other investment options range from 0.18% to 0.98%, depending upon which option is selected. There is an annual state fee of 0.01% of the average daily net assets of the Trust to pay for expenses related to oversight of the Trust.

In June of 2018, TFI, the CHET Direct Plan manager, advised the Treasurer, trustee of CHET, that 33 CHET account holders had online access to their accounts established by unauthorized individuals that resulted in withdrawals of approximately \$1.4 million. Of this amount, more than \$442,000 was recovered or stopped. TFI fully restored the accounts of all impacted CHET accounts and provided holders and beneficiaries with two years of identity fraud protection services, identity restoration services and \$1,000,000 in identity theft insurance coverage. Federal, state and local law enforcement agencies are conducting a coordinated investigation. Following these incidents, TFI implemented system enhancements, additional internal controls, and extra manual reviews aimed at preventing fraudulent activity. The Treasurer's Office is closely monitoring these security initiatives. In addition, at the Treasurer's request, TFI retained an independent auditor to review this incident and make any further recommendations.

Investment Performance

CHET Direct earned a Bronze Star rating from Morningstar in October 2019. This award reflects Morningstar's conviction in CHET Direct's ability to outperform its peer group over a full market cycle of at least five years. Five different factors are evaluated for this rating: Process, Performance, People, Parent and Price.

Performance of Age Band Options

CHET Direct's age-based portfolios are allocated to aggressive, moderate and conservative investment styles. The six age-based portfolios in the aggressive options earned returns between 23.98% to 11.81% for the one-year period ending December 31, 2019. In the moderate option, portfolios returned 22.49% to 8.35%. Annual returns for the same period in the conservative option were between 17.46% and 4.52%.

Performance of Individual Options

The active options, which include global equities, fixed income, and short-term investments, had returns for the year ending December 31, 2019. Returns, net of investment management fees, ranged from 26.19% for the Active Global Equity Option to 2.03% for the Money Market Option. The index options annual returns ranged from 30.76% for the US Equity Index Option to 8.33% for the Index Fixed Income Option. The Principal Plus Interest Option had a return of 2.16% for the period.

CHET-Direct Marketing and Promotion

- The Treasurer's Office worked closely with TFI to develop and execute a robust multichannel marketing plan to promote CHET, strengthen public awareness, and increase understanding of the importance of saving for a college education. The Treasurer's Office and TFI remain committed to promoting the benefits of saving for college early to families of all backgrounds and cultures throughout Connecticut. In addition to broad-based marketing to the core target market, CHET also incorporated an outreach effort to low- to moderate income individuals to ensure that all Connecticut residents have the knowledge and access to save with CHET. Further, over the past two years, TFI expanded outreach

and marketing to the state's Latino and African American constituents through targeted events, community influencers and social media.

Key highlights include:

- CHET Baby Scholars continued as a flagship program, providing college savings accounts for newborns in Connecticut. The program was initially funded in 2014 with \$4,400,000 from the Connecticut Student Loan Foundation. By December of 2019, just \$3.16 million was distributed to accounts for Connecticut's newborns. Two key partnerships helped the Treasurer's Office promote this initiative. The first, with the Connecticut Department of Public Health, featured CHET Baby Scholars on the Connecticut birth certificate application. The second was with Read to Grow, an organization that staffs volunteers in CT hospitals to meet with new parents about the importance of reading to their children from an early age.
- The CHET Advance Scholarship program was again offered to high school seniors and freshmen. During 2019, 100 high school freshmen and 100 high school seniors won scholarships of up to \$2,523 in the sixth year of the CHET Advance Scholarship program. The winners hail from all eight counties in Connecticut. Since 2013, the Treasurer's Office has awarded \$3.0 million in scholarships to 1,200 students through the CHET Advance Scholarship program, at no cost to the State.
- CHET also continued the annual Dream Big! essay and drawing competition for elementary and middle school students, ensuring that the programs reach families with children of all ages from birth to college-age. In 2019, 48 winners were selected from 2,300 entries, with the total awarded at \$26,000. Total prize money awarded since inception in 2008 is \$291,800 across 820 students.
- TFI partnered with a data-driven marketing agency, Epsilon, to execute core direct and digital marketing for CHET. Over the course of 2019, TFI continued to implement an onboarding program for all new account owners, followed by monthly communications to stay in contact with existing CHET account owners. TFI also built an automated outreach program for individuals who inquire about CHET, whether online, via phone, at an event or any other activity, to follow up and encourage the opening of an account. Lastly, TFI significantly expanded outreach to prospects across the state through digital and direct marketing programs.
- CHET continued to partner with GiftofCollege.com to offer individuals an innovative way to gift money to a CHET 529 plan. GiftofCollege.com is a gift registry for college savings 529's that lets friends, family, and employers contribute to a recipient's 529 plan account both online and with gift cards.
- In 2019, CHET continued to execute on a reenergized social media, public relations and mass media plan. The refreshed local plan resulted in a shift to direct TV, a more robust social strategy and increased media interview opportunities for the Treasurer's Office staff

representing CHET. Integrated advertising and direct marketing campaigns ran throughout the year, focusing on tax time, graduation time, back-to-school and year-end contributions. CHET's advertising and direct marketing efforts served to increase CHET's brand awareness among state residents. The campaigns focused on the value of saving for college and the specific benefits of Connecticut's 529 college savings program

CHET ADVISOR

CHET Advisor was established in 2010 with Hartford Funds, a subsidiary of The Hartford, Inc. ("Hartford Funds") serving as program manager. As of December 31, 2019, CHET Advisor had 28,916 program accounts with \$678 million in assets. Accounts grew by 5.7% and assets by 25% from previous-year levels. Over the same time period, qualified withdrawals totaled \$56 million, up 19%, for qualified educational expenses. Marketing in this plan is focused on educating financial advisors who then work with their clients to open CHET Advisor accounts.

Program Offerings

While CHET Advisor offers similar investment options to CHET Direct, the structure of an advisor-sold plan is different by its nature. This plan offers three different share classes (A, C and E) and has different fee structures for each share class. Share classes are structured to include compensation for the financial advisor.

Share classes and fee structure are as follows:

- Class A: Under the Class A fee structure, there is an up-front sales charge of up to 5.5%, which is reduced as the total value of all savings plan accounts of the account owner grows above certain levels.
- Class C: Under the Class C fee structure, there is no up-front sales charge. However, withdrawal of any contribution that has been in the account for twelve months or less will be charged a contingent deferred sales charge equal to 1% of the amount withdrawn. Class C shares that have been held for four years or longer are automatically converted to Class A. The shares that roll into Class A will not pay any Up-Front Sales Charge. Thereafter, contributions that have been in an account for at least four years, together with any earnings associated with those contributions, automatically transfer to the Class A fee structure within approximately a month of the four-year anniversary of the Account holding such shares.
- Class E: This class is available only to certain groups associated with Hartford Funds. Under the Class E fee structure, there is no up-front or contingent deferred sales charge.

Under all CHET Advisor asset classes, there is an additional state administrative fee of 0.01% to pay for expenses related to the oversight of the Trust.

Investment Options

CHET Advisor provides investors with the opportunity to invest in age-band portfolios that rebalance automatically as a child ages. This option is designed for investors and their financial advisors who wish to have their asset allocation decisions made and automatically updated for them over time. For those investors who wish to take a more active role in their asset management with their financial advisors, CHET Advisor offers individual options covering different asset classes.

Age Band Options

The CHET Advisor offers nine age-band portfolios to smooth the investor glide paths.

The existing age bands are:

- 0-3 years
- 4-6 years
- 7-9 years
- 10-11 years
- 12-13 years
- 14-15 years
- 16 years
- 17 years
- 18 years and over

Individual Options

CHET Advisor also offers two types of individual funds for investors: static and individual portfolios.

Static portfolios are designed for different investment risk tolerances. The four static portfolios are comprised of different, specific proportions of equity, fixed income, and other investments. The Checks and Balances Portfolio was removed in February 2019 based on feedback from the CHET consultant, Aon.

Static Portfolios:

- Conservative
- Growth
- Aggressive Growth
- Balanced

The other individual portfolios allow an active investor to choose among twelve asset-specific funds to create a customized portfolio of equity, fixed income, and capital preservation assets.

Individual Portfolios:

Equity Portfolios

- Small-Cap Growth

- Mid-Cap
- International Opportunities
- Growth Opportunities
- Dividend & Growth
- Equity Income
- Core Equity

Fixed Income Portfolios

- Inflation
- Total Return
- World Bond

Mixed Asset Portfolio

- Balanced Income

Capital Preservation Portfolio

- Stable Value

Underlying Funds

There are 16 funds that are used as underlying funds to the age-based and static portfolios, 14 of which are offered as individual options. Some options use multiple underlying funds. As of December 31, 2019, several CHET Advisor funds were actively managed by Wellington Management Company, the sub-advisor to The Hartford, in addition to Schroders for emerging markets, Invesco for Stable Value and BlackRock/iShares for two passive equity funds. The underlying annual distribution fee for Stable Value Class C portfolio was reduced from 1% to 0.25% in February 2019.

Investment Performance

CHET Advisor's nine aged-based (Class A) portfolios produced positive returns between 27.04% and 5.91% for the one year period ending December 31, 2019. The static portfolios (Class A) generated returns of between 27.08% and 10.78% for the one-year period ending December 31, 2019.