

**Minutes of the Connecticut Higher Education Trust (CHET)
Advisory Committee Annual Meeting
Thursday, December 3, 2009**

Members Present:

Denise L. Nappier, Connecticut State Treasurer
James Blake, Executive Vice President, Southern Connecticut State University
R. Chuck Lockert, Designee (representing Sen. Thomas P. Gaffey, Senate Chairman, Education Committee)
John Mengacci, Undersecretary for Policy Development and Planning, Office of Policy and Management (representing Secretary Robert Genuario)
Julie Savino, Dean of Student Financial Assistance, Sacred Heart University
Dave Williams, Designee (representing Rep. Vincent Candelora, House Ranking Member, Finance, Revenue & Bonding Committee)
Margaret Wolf, Director of Financial Aid, Capital Community College

Absent:

Hon. Michael P. Meotti, Commissioner, Department of Higher Education
Sen. Eileen Daily, Senate Chairman, Finance, Revenue & Bonding Committee
Rep. Andrew Fleischmann, House Chairman, Education Committee
Sen. Thomas J. Herlihy, Senate Ranking Member, Education Committee
Rep. Kevin Witkos, House Ranking Member, Education Committee
Rep. Craig A. Miner, House Ranking Member, Finance, Revenue & Bonding Committee
Rep. Chris Perone, House Vice Chair, Finance, Revenue & Bonding Committee
Sen. Andrew W. Roraback, Senate Ranking Member, Finance, Revenue & Bonding Committee
Rep. Cameron Staples, House Chairman, Finance, Revenue & Bonding Committee
William Lucas, Vice President, Finance and Administration, Fairfield University

Others Present:

Howard G. Rifkin, Deputy Treasurer, Office of the State Treasurer
Linda Hershman, Assistant Deputy Treasurer and Chief of Staff, Office of the State Treasurer
Pamela Bartol, Assistant Investment Officer, Office of the State Treasurer
Meredith Miller, Assistant Treasurer – Policy, Office of the State Treasurer
Bettye Jo Pakulis, Executive Assistant, Office of the State Treasurer
Pam McNulty, Regional Director and Program Manager, TIAA-CREF
Cynthia Steer, Chief Research Strategist and Managing Director, Fixed Income, Rogerscasey
Kathleen Tunson, Program Manager, Education Savings, TIAA-CREF
Maykala Hariharan, Roger S Casey

Call to Order

Mr. Rifkin called the meeting to order at 1:40 pm (EST), followed by a roll call of attendees. Mr. Rifkin announced voting on the minutes of the December 5, 2008, meeting of the Connecticut Higher Education Trust (“CHET”) Advisory Committee (“Committee”) annual meeting would be deferred until the end of the meeting.

Program Updates

Mr. Rifkin began the meeting with an announcement that the Office of the Connecticut State Treasurer (“Office”) had put out a Request for Proposals (“RFP”) for a Program Manager for the CHET program. The RFP asked for proposals to continue a direct-sold plan and to implement an advisor-sold plan and there were five responses to the RFP. The proposals were reviewed by Office Staff and Rogerscasey, which was hired to analyze the asset

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allocation assumptions and the underlying fund offerings. While not public at the time, Mr. Rifkin noted that the Office had chosen to continue its relationship with TIAA-CREF Tuition Financing, Inc. (“TIAA-CREF TFI”) as Program Manager for the direct-sold program and was in negotiations with TIAA-CREF TFI on the contract. The Office also entered into discussions with one of the other respondents to the RFP to simultaneously create an advisor-sold plan and expected to begin contract negotiations in January 2010.

Mr. Mengacci asked if the options under the direct-sold plan and the advisor-sold plan would be the same.

Mr. Rifkin responded that the options would be different.

Mr. Rifkin reported on three major updates to the Office’s contractual relationship with TIAA-CREF TFI. First, Mr. Rifkin announced a number of changes to the direct-sold plan. He noted the Office was revisiting TIAA-CREF TFI’s asset allocation approach to the age-band models with Rogerscasey and that CHET will be offering three age-band investment options, as opposed to the two currently offered. The three tracks will cover conservative, moderate, and more aggressive investment options. He also noted there had been some concerns about asset allocation between international and domestic securities.

Mr. Rifkin continued that there may be the opportunity to have a couple of non-proprietary, non-TIAA-CREF TFI funds in the age-band options, which would mark a change in the business approach by TIAA-CREF TFI. The fees in the age-band investment options would likely fall 35 to 40 percent from the current fees because the investments would be indexed, resulting in lower costs.

Mr. Rifkin announced that there would be a bundle of stand-alone offerings in the direct-sold plan which also would be a blend of best-in-class TIAA-CREF TFI funds and best-in-class funds that are not managed by TIAA-CREF TFI. The fees would depend on the type of investment strategy (e.g. passive or active).

Mr. Rifkin noted that these changes will make it one of the most competitive – if not the most competitive – direct-sold plans in the country.

Second, Mr. Rifkin continued that TIAA-CREF TIF also has committed to establishing an annual scholarship fund pursuant to the new contract. While the structure of the scholarship was still under consideration, the total funds offered would be around \$250,000 per year until the contract expires.

Mr. Rifkin noted that the third major update was the commitment by TIAA-CREF as a company (“TIAA-CREF”) and TIAA-CREF TFI to reach out to the growing Latino community. Pursuant to this commitment, TIAA-CREF TFI would produce disclosure documents in Spanish. The commitment is part of TIAA-CREF’s overall business approach, but the company is starting its company-wide effort with CHET.

Mr. Rifkin announced that the current CHET contract ends March 13, 2010. He continued in the Spring the Office would be re-launching the CHET direct-sold program with the aforementioned enhancements.

Mr. Rifkin noted that it was unclear what the name of the advisor-sold plan would be, but it would not include TIAA-CREF funds. Rather, it would include funds chosen by the administrator. The Office did have conversations with TIAA-CREF about the advisor-sold plans and the company was comfortable with the approach. The advisor-sold plans would provide an alternative to individuals who prefer to work with a financial advisor to map out their entire portfolios. However, because it is an advisor-sold plan, the fees will be higher than the direct-sold plan and these fees may include loads. TIAA-CREF and the new administrator of the advisor-sold plans are committed to work cooperatively with the Office to ensure the marketing approach provides clear and comprehensive information to the consumer.

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Mr. Mengacci sought to clarify whether an administrator would be selected for the advisor-sold plan, while the plan would be sold exclusively through the administrator's advisors.

Mr. Rifkin responded that the likely administrator of the advisor-sold plan employed advisors that work directly for the company, and advisors independent of the company but with whom the company has a business relationship. Mr. Rifkin estimated there would be 1,500 advisors throughout the state that currently have some affiliation with the administrator and would be able to sell the CHET plan. The advisor-sold plan would only be offered in Connecticut; out-of-state individuals would not be able to purchase the CHET plan.

Mr. Mengacci suggested the marketing of the advisor-sold plan would be a challenge.

Mr. Rifkin noted that Connecticut would not be the only state offering both a direct-sold plan and an advisor-sold plan. This gives Connecticut the opportunity to learn from the experiences of other states that offer both plans.

Ms. McNulty also said that, from a marketing perspective, the plans were distinctive. When an individual is purchasing a plan through a financial advisor there is a one-on-one relationship with the advisor. Thus, marketing for the advisor-sold plan likely would concentrate on the advisor, who would then offer the program to the consumer. Conversely, marketing for the direct-sold plan is broad-based.

Mr. Mengacci asked if the purpose of offering the advisor-sold plan was to extend the reach of the CHET program.

Mr. Rifkin answered in the affirmative, as the addition may preclude individuals from seeking 529 plans in other states.

Mr. Mengacci asked if individuals can switch from the direct-sold plan to the advisor-sold plan (or vice versa); noting that it would appear the investment options would be different.

Mr. Rifkin answered individuals may roll-over their accounts once a year, but if they did so from the direct-sold plan to the advisor-sold plan, the fees would likely be higher.

Mr. Rifkin said in the direct-sold plan, seventy-five percent or more participants are invested in one of the age-band options. The reverse would be true in an advisor-sold plan—assets would more likely be invested in stand-alone funds because individuals would have the help of an advisor in making asset allocation decisions.

Mr. Rifkin noted that when 529 plans first started, the goal was to offer tax-advantaged investment options that kept up with education cost inflation. Over time, provisions in the tax code were amended, which created what essentially is a tax-advantaged bundle of mutual funds.

Mr. Mengacci asked if the ability to switch between investment options in the advisor-sold program would be governed by the administrator's policies.

Mr. Rifkin replied that it would not be governed by the administrator's policies; rather, it would be determined by the Internal Revenue Service ("IRS") code's 529 provisions.

Recap of YTD 2009 Statistics and Overall Performance

Ms. McNulty proceeded with a PowerPoint presentation¹ ("Presentation") of YTD statistics of the participation in, and overall performance of, CHET. She noted the statistics for the meeting covered the period from October 31,

¹ CHET Advisory Committee 2009 Annual Meeting, PowerPoint Presentation, 3 December 2009.

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2008, to October 30, 2009 (“YTD 2009”); previous year statistics cover the period from October 31, 2007 to October 30, 2008 (“YTD 2008”).

Ms. McNulty continued that 2009 was still a difficult year for the capital markets, especially considering the dip in consumer confidence. However, although CHET was not as successful in terms of participant and asset growth versus the previous year, given the market conditions, Ms. McNulty was pleased with the overall results. The average new CHET contributions for the year were in about \$3,000 increments versus about \$5,000 last year. Although people were not investing as much when opening account, over 6,900 new net accounts opened in YTD 2009.

As of October 30, 2009, there were 88,203 CHET accounts with \$1.14 billion in assets. As of December 2, 2009, assets grew to \$1.18 billion. Although assets did dip below \$1 billion in 2008 as the markets fluctuated, assets generally remained above \$1 billion. The average new account size as of the end of YTD 2009 was \$3,853. Qualified withdrawals increased in YTD 2009 from \$52.8 million compared to \$48.6 million in YTD 2008 as the program, which has been around for ten years, continues to mature and beneficiaries who enrolled at a young age are reaching college age, showing that individuals are using the funds for education expenses. Non-qualified withdrawals increased as well in YTD 2009 due to continued market pressure from \$3.0 million in YTD 2008 to \$5.3 million. However, rollovers decreased from \$7.5 million in YTD 2008 to \$4.4 million in YTD 2009. Ms. McNulty noted that the investment options haven’t changed much over the last fiscal year, as options such as the guaranteed option, fixed income and an attractive money market option have offered account holders a sense of security.

Mr. Mengacci asked if TIAA-CREF had done any analysis on which option over time would have been the most advantageous for account holders.

Ms. McNulty replied that such analysis had not been done. Ms. McNulty noted that on the pension side of TIAA-CREF, a 50/50 asset allocation tends to perform in the long-run. However, current market volatility generates some uncertainty for the future.

Mr. Mengacci noted it would be interesting to see what a \$10,000 investment would have yielded over time in each option.

Ms. McNulty replied one of the challenges in conducting such an analysis for a 529 plan is that although each year TIAA-CREF does conduct asset allocation studies, there have been instances when ratings for a particular fund in a particular asset class was adjusted, it makes it difficult to generate a long-term perspective. However, each year TIAA-CREF does tweak asset allocations for maximum yield.

Ms. Steer commented that with the vast majority of CHET participants invested in the age band options, it would be very difficult to generate an analysis of long-term yields. Diversification as a strategy has worked over the last twenty years—the “set-it-and-forget-it” asset allocation strategy is not really working very well going forward. Another faulty convention over the past 25 years is the lack of premium paid for liquidity, which is currently under active discussion: how much liquidity is needed, what the components would be, and at what point is it relevant.

Ms. McNulty noted that all of the aforementioned factors are being taken into consideration in the re-design of the CHET program.

Ms. McNulty continued with the presentation, reporting of the total assets in the program as of the end of YTD 2009, 58.9 percent was invested in a managed asset allocation option; 13.6 percent of the total assets fell into the principal plus interest option; 16.6 percent was invested in a high equity option; 4.3 percent was invested in an equity index option; 3.5 percent was invested in an aggressive managed allocation option; 2.0 in fixed income; 0.9

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percent in a money market; and 0.2 percent in a social choice option. Of note is the percent of contributions over YTD 2009, which really identifies investor behavior as the market fluctuated. For example, at the end of YTD 2008, 12.6 percent of contributions were allocated to the principal plus interest option, versus 21.2 percent at the end of YTD 2009, indicating more conservative investor behavior. Similar was the 100 percent fixed income option, a bond portfolio, where the percent of contributions increased from YTD 2008 at 3.1 percent to 6.2 percent in YTD 2009. The percentage of contributions in the money market option, which increased from 1.3 percent in YTD 2008 to 3.0 percent in YTD 2009, also indicates conservative investor behavior even though rates are relatively low. However, the largest percentage of contributions is still going into the managed allocation option.

Ms. McNulty also noted the rebalances by investment option also was of some interest given the high degree of market uncertainty. Over the two-year period beginning in YTD 2008, most rebalances went into the principal plus interest option (45.0 percent in YTD 2008 and 39.7 percent in YTD 2009), followed by the managed allocation option (18.3 percent in YTD 2008 and 23.9 percent in YTD 2009). To put the percentages in perspective, \$20.3 million went into the principal plus interest option in YTD 2009 versus \$17.6 million in YTD 2008; for the managed allocation option, from YTD 2008 to YTD 2009, rebalances increased from \$7.1 billion to \$12.2 billion. Individuals do not have to rebalance all of their investments—partial rebalances are permitted.

Ms. McNulty noted at the inception of the CHET program, all options were age-based. Expanding the available options gives direct investors more choice.

Ms. McNulty continued internet use has been a useful tool for direct investors, from opening new accounts to managing existing accounts. About 60 percent of account holders are registering online, which is about steady. Internet mail requests accounted for about 22 percent of new account enrollment. Individual requests through the phone center total 12 percent. Bulk requests, which are typically through employers or CHET events, are about 3 percent of overall enrollments. About 3 percent are from business reply cards, which was part of a marketing effort by CHET.

Ms. McNulty continued as of the end of YTD 2009, performance was positive overall whereas last year was mostly negative. When the 65 basis points for fees are subtracted from the total, some of the options did not meet their benchmarks. A few funds—the inflation-linked bond fund, the international equity index fund, and the real estate securities fund—performed below benchmark over the short-term. Long-term performance is tracking much closer to the benchmarks. New investment options will likely have some different underlying funds, and diversification—especially in the age-based funds—really helps returns relative to the benchmark. Returns are posted monthly on the website. Of note is that the managed allocation option uses the same underlying funds.

Ms. Steer also noted within the age-based funds, there might be some confusion because funds in the lower age bands appear to underperform the higher age bands. This is driven by the asset allocation strategy for the various age band options.

Ms. McNulty said the performance of the lower age band funds is to be expected, as they have higher exposure to real estate and the stock market. As the age bands approach 18 years old, investments are weighted more heavily in the bonds and money market funds.

Mr. Lockert asked if more contributions are invested in inflation-linked bonds.

Ms. McNulty replied it is a very popular option as a component in the age band options.

Mr. Lockert opined he liked the inflation-linked bond option in the 529 plan because of anticipated inflation.

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Ms. McNulty noted the underlying asset allocations for each of the options are listed in the disclosure materials, both hard-copy and on the website. The only option with a single underlying fund is the social choice option through a social choice equity mutual fund. Each of the other options is a blend of TIAA-CREF mutual funds.

Ms. McNulty continued with program updates. On the federal level, the definition of “qualified expenses” has been expanded to include computers, software, and computer peripherals; however, the change is not permanent. Previously, computers were a qualifying expense only if having one was a condition of enrollment. The most questions fielded by CHET are on what constitutes a qualifying expense because it is broadly worded legislatively and because individuals are required to provide documentation of qualifying expenses on their own.

Mr. Mengacci asked what documentation individuals are required to provide and how the information is verified.

Ms. McNulty replied that CHET generally advises account holders to keep their receipts. Very few account holders have reached the maximum account balance of \$300,000, so there aren’t a lot of people who would likely use assets accumulated through CHET as an estate planning technique.

Ms. Steer asked if the majority of the CHET account funds went to the colleges.

Ms. McNulty replied yes, especially for tuition and possibly room and board. But, Ms. McNulty also noted that account holders should keep receipts for other expenditures.

Marketing, Outreach and Public Relations

Ms. McNulty credited the marketing activity—which was very robust for YTD 2009—with the volume of new enrollments given the market conditions.

Ms. Tunson reported there are many parents who have heard about CHET but are not sure how the program operates. The purpose of the marketing effort is to educate consumers from all income groups about the benefits of CHET. In YTD 2009, developments included increased community outreach, the redesign of CHET promotional materials, and an overall integrated marketing approach.

Ms. Tunson said the foundation of the marketing approach is based on five primary time frames, which include tax time (New Year’s Eve to April 15), post-tax time, and year-end gift giving (the highest contribution time during the year). Targeted audiences include prospective account holders, current account holders, individuals making inquiries into the program, and employers. Many of the targeted outreach efforts also include low- to moderate-income families and the Hispanic population.

Ms. Tunson reported that the partnership with local marketing agency Adams & Knight was extended into YTD 2009. With the agency’s assistance, CHET has expanded its outreach, public relations, and pre- and post-outreach, post-event media follow-up. CHET also has expanded its partnership with Ethnic Marketing Solutions, a local agency focused on Hispanic marketing.

Ms. McNulty also noted in 2010, TIAA-CREF is planning to hire a bilingual public relations consultant to expand outreach opportunities in the Hispanic community. CHET is currently using a translation service.

Ms. Tunson continued there were five primary promotional efforts over the course of the year, including the CHET Dream Big! promotion. The promotion is an expansion of the CHET Challenge promotion. Entries for the competition increased from about 300 in 2008 to over 1,800 in 2009.

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Mr. Mengacci asked how individuals would be selected to receive scholarships from the \$250,000 pool set up by TIAA-CREF.

Ms. McNulty said the firm was still working with the state, because it is a state-based scholarship program, to choose recipients.

Ms. Tunson continued by noting the college fair promotion, which was a spin-off of the CHET Dream Big! competition, was a new promotion through the Hartford Greater Hartford Classical Magnet School. The purpose of the promotion was to educate parents about college and the college process, and to encourage parents to save early for students.

Ms. Tunson reported CHET also introduced a statewide summer reading program promotion through a partnership with the Connecticut State Library. Parents and children had to go to their local library and participate in a state-sponsored summer reading program in order to participate in the CHET reading promotion. The program received about 2,700 entries, and winners will be announced over the next few weeks.

Ms. Tunson continued the CHET Challenge Kick-Off competition was still underway. CHET partnered with four schools throughout the state for the competition, and awards consist of monetary prizes.

Ms. McNulty noted CHET was trying to expand the competition to colleges and universities.

Ms. Tunson continued by highlighting some of the community events held throughout the year, including several women's expos.

Ms. Tunson continued that CHET is undertaking a Hispanic marketing initiative, including providing Spanish language materials in the market.

Ms. Tunson continued by noting employer outreach also is a focus of CHET's marketing approach, as employees can open a CHET account with as little as \$25, or \$15 with an employer-based automatic deduction. The Spanish-speaking consultant is expected to help with the employer marketing effort.

Ms. Tunson continued that "financial influencers" also are a major focus of CHET marketing efforts.

Ms. McNulty reported that CHET had marketed in the past in publications for Certified Public Accountants, which was a good way to promote the state tax deduction.

Ms. Tunson continued that the number of press releases have increased with Ms. Pakulis's and Ms. Hershman's involvement. Last year also provided great opportunities for on-air interviews, one of which featured Ms. McNulty. CHET also has developed four primary print ads, which have run throughout the state. A new series of ads is planned for 2010. With respect to radio and television, CHET produced eleven television spots that ran during the year-end gift-giving time period. Radio ads also focus on college costs and are run on English and Spanish language stations.

Ms. Tunson continued one of the foundations of the CHET marketing efforts involved developing a tool for individuals seeking to educate themselves about the CHET program. The CHET site features a webcast with Connecticut Treasurer Denise L. Nappier, who discusses the features and benefits of the program and investing basics.

Ms. Tunson continued that CHET uses a number of different mediums to reach consumers. Direct mail and email continue to be the most targeted efforts. Banner advertising also is very effective. Search engine marketing is the

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most effective effort overall. When individuals respond to an ad, they are directed to a more aggressive marketing process that was developed to include an initial mailer and email, and then a thirty-day follow up.

Ms. Tunson reported that marketing to existing account holders seeks to motivate them to continue to invest and automate investments. Outdoor marketing is a new marketing strategy, including billboards and buses.

Other Comments on Market Conditions

Mr. Lockert noted the market has been flat for the past ten years. Generally, the economy lags the market. But the upside is the relatively low number of withdrawals, taking everything into consideration.

Mr. Rifkin noted that the tax-advantaged status of plans, coupled with the state tax deduction, has made CHET an attractive investment option.

Additional Questions

Mr. Mengacci asked if TIAA-CREF had determined what the replacement rate needs to be because of the uptick in withdrawals as the beneficiaries reach college age.

Ms. McNulty replied on the payroll deduction alone, CHET brings in about \$500,000 per month, which is a very steady result. Ms. McNulty said she would include more information on the replacement rate in the following year's annual meeting materials.

Approval of Minutes

Mr. Rifkin asked for a motion to accept the minutes from the December 5, 2008, Committee meeting. Mr. Mengacci so moved, and Mr. Lockert seconded. The minutes were unanimously accepted.

Adjournment

There being no further business, Mr. Rifkin adjourned the meeting at 3:02 pm (EST).