



Annual Evaluation of the  
**CONNECTICUT HIGHER EDUCATION TRUST**

For the Period Ending December 31, 2016

Submitted to:

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

June 30, 2017

## **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 2016 meeting, held on November 22, 2016, were:

Denise L. Nappier, State Treasurer  
Gayle Slossberg, Senate Chair, Education Committee  
Andrew M. Fleischmann, House Chair, Education Committee  
Antonietta “Toni” Boucher, Senate Ranking Member, Education Committee  
Gail Lavielle, House Ranking Member, Education Committee  
John Fonfara, Senate Chair, Finance, Revenue and Bonding Committee  
Jeffrey Berger, House Chair, Finance, Revenue and Bonding Committee  
L. Scott Frantz, Senate Ranking Member, Finance, Revenue and Bonding Committee  
Christopher Davis, House Ranking Member, Finance, Revenue and Bonding Committee  
Benjamin Barnes, Secretary, Office of Policy and Management  
Keith M. Norton, Acting Executive Director, Connecticut Office of Higher Education  
Rose Ellis, Dean of Administration, Norwalk Community College  
Margaret Malaspina, Director of Financial Aid, Capital Community College  
Patrick Torre, Vice President of Finance, University of New Haven  
Julie Savino, Executive Director of University Financial Assistance, Sacred Heart University

## **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. In December 1999, Treasurer Denise L. Nappier contracted with TIAA-CREF Tuition Financing Inc. (“TFI”), as program manager for CHET.

In 2009, Treasurer Nappier issued a request for proposals for management of both the existing direct-sold program and for a new advisor-sold program. In 2010, the Treasurer entered into a management agreement with TFI to continue offering the CHET direct-sold plan for a contract period ending in March 2015. In October 2014, Treasurer Nappier exercised an option in the management agreement to extend the contract with TFI an additional five years through March 2020.

On August 31, 2010, Treasurer Nappier entered into a management agreement with The Hartford Financial Services Group, Inc. to offer an advisor-sold plan for a contract period ending in August 2017. That plan was launched in October 2010. To differentiate the plans, they were re-branded as “CHET Direct” and “CHET Advisor.”

## **CHET DIRECT**

As of December 31, 2016, CHET Direct had 111,698 unique accounts with \$2.58 billion in assets. This compares to 104,296 accounts and \$2.36 billion in assets on December 31, 2015, representing increases of 7.1 percent and 9.3 percent for accounts and assets respectively, and reflects account redemptions as account owners withdrew funds to pay college costs for beneficiaries. Since inception, more than \$1.42 billion has been withdrawn for 39,584 beneficiaries.

## **Investment Options**

CHET Direct gives investors the opportunity to invest in age band portfolios that will re-balance 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***

CHET Direct is in the process of shifting from six age bands to nine, which is expected to be finalized during the third quarter of 2017. The existing age bands for the conservative, moderate and aggressive options are:

- 0-3 years
- 4-7 years
- 8-11 years
- 12-14 years
- 15-17 years
- 18 years and over

The new age bands will be:

- 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:

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

Passively managed:

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

## ***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, TCW, 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, and are currently the lowest in the program's history. The Principal Plus Interest Option is not assessed a program management fee. The total asset-based fees of the other investment options range from 0.18% to 1.12%, depending upon which option is selected. Approximately 97% of CHET Direct assets are subject to an expense ratio of under 0.50% and almost one-quarter of assets are subject to an expense ratio under 0.30%.

Since inception, program management fee reductions for CHET Direct have been negotiated by the Treasury seven times, from 1.55% to the current fee level of 0.12% on the average daily net assets of the Trust (plus the cost of underlying fund expenses.) With the 2010 contract renewal, effective November 2010, the fee structure changed from a flat fee (unitary pricing for all Options) to a non-unitary structure which is in line with industry standards. The new fee structure includes a breakdown of program management fees, state administrative fees, and underlying mutual fund fees. A table with the history of CHET Direct program management fee reductions is provided below:

2006: All prices reduced to new all-in cost of 0.70%
2006: All prices reduced to all-in cost of 0.65%
2010: All-in price reduced to 0.60%
2010: New pricing structure, Cost of Funds (COF) + 0.20% (+0.01% State Admin Fee)
2011: Fee reduction to COF + 0.18% (+0.01% State Admin Fee)
2013: Fee reduction to COF + 0.15% (+0.01% State Admin Fee)
2016: Fee reduction to COF + 0.12% (+0.01% State Admin Fee)

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.

## **Investment Performance**

CHET Direct was one of 20 plans nationally to earn a Bronze Star rating from Morningstar. 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 positive returns of between 4.40% to 7.49% for the one year period ending December 31, 2016. In the moderate option, portfolios returned 3.52% up to 6.85%. Annual returns for the same period in the conservative option were between 2.23% and 6.07%.

### ***Performance of Individual Options***

The active options, which include global equities, fixed income and short-term investments, all had positive returns for the year ending December 31, 2016. Returns ranged from 10 basis points for the money market fund to 13.39% for the social choice option. The index options had positive annual returns: 7.17% for global equities and 2.28% for fixed income. The global tactical asset portfolio had a return of 3.18% for the period.

## **CHET-Direct Marketing and Promotion**

Each year, the Connecticut State Treasurer's Office works closely with TFI to develop and execute a holistic, multi-channel marketing plan to promote CHET, strengthen public awareness, and increase understanding of the importance of saving for a college education. The Treasury and TFI are 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 incorporates an outreach effort to low- to moderate-income individuals to ensure that all Connecticut residents have the knowledge and access to save with CHET. Also, TFI employs a full-time, bilingual Field Consultant to ensure outreach and connection with Connecticut's growing and diverse Hispanic population.

Key highlights for 2016 include:

### ***CHET Baby Scholars***

CHET Baby Scholars provides college savings accounts for newborns in Connecticut, and is funded with \$4,400,000 from the Connecticut Student Loan Foundation. By December of 2016, just over 4,700 families had signed up and \$1.1 million had been distributed to accounts for Connecticut's newborns. During 2016, CHET partnered with the Department of Public Health to add CHET Baby Scholars to the Connecticut birth certificate application, providing information to new families about the program. Once that program was in place, enrollment rates jumped from approximately 5% to 7% of new births in Connecticut.

### ***CHET Dream Big! Competition***

The Dream Big! drawing and essay competition continued to be one of CHET's flagship events and key awareness drivers for CHET. The 2016 competition resulted in over 3,700 entries from across Connecticut. Schools in over 75% of Connecticut's 169 cities and towns participated. The contest asked children in kindergarten through third grade to draw a picture that answers the question, "What do I want to do after I go to college?" Fourth through eighth grade students were asked to write an essay responding to the question, "How will I change the world after I go to college?" The competition motivated parents to think about how to save for college education

to support their children's dreams. In 2016, there were 48 winners: 4 grand prize winners received a \$1,000 contribution to a CHET account and 44 students received \$500 CHET contributions. Significant efforts were made to reach schools in underserved districts such as Bridgeport, Waterbury, Hartford and New Haven.

### ***CHET Advance Scholarship***

In 2016, the CHET Advance Scholarship program was offered to high school seniors and freshmen, with 100 scholarships going to each group for a total of 200 scholarships awarded. To ensure that this scholarship opportunity reached students with the greatest need, half of the scholarships went to students in the state's underperforming schools. For all schools, seniors students received \$2,500 for immediate use as they entered college the following fall. Freshmen were encouraged to save with an initial scholarship of \$2,000, with an opportunity for an additional \$500 match if they save at least \$500 in their own individual CHET account by the time they graduate from high school. CHET's plan managers, TFI and The Hartford, provide exclusive funding for this program.

Overall CHET has achieved a substantial presence in Connecticut:

- Between *CHET Dream Big! Competition* and *CHET Advance Scholarship*, CHET reaches students/families/administrators in every grade (K-12) in every school in Connecticut, including public and private and home-schools. Outreach via the Connecticut school system is one of the best ways to ensure we are reaching all students/families across the state.
- Events targeting low- to-moderate-income communities were scheduled throughout the year to ensure that the CHET message was reaching Connecticut's under-served populations.
- CHET Direct also partnered with other community-based organizations and agencies specializing in promoting financial literacy and economic empowerment, including the annual Latinas in Power Symposium, YWCA Money Conference for Women, college financial planning nights at local high schools, and company benefit fairs.
- In 2016, CHET created a new direct-response television ad, with a \$50 match offer for new accounts opened. The offer ran three times during the year throughout the state, and drove new accounts along with continued increase in awareness to help ensure Connecticut residents know about and take advantage of the CHET state-sponsored, tax-advantaged, college savings vehicle.

### **CHET ADVISOR**

The CHET Advisor Plan was established on October 1, 2010, with The Hartford Financial Services Group, Inc. ("HFSG") serving as program manager. As of December 31, 2016, CHET Advisor had 24,479 program accounts with \$421,342,676 in assets. This compares to 21,877 accounts and \$347,254,477 in assets from a year earlier. Accounts grew by 12 percent and assets by more than 21 percent from previous-year levels. Over the same time period, 842 account owners withdrew \$25.9 million 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 percent, which is reduced as the total value of all savings plan accounts of the account owner grows above certain levels. In addition, there are ongoing asset-based fees equal to an annual charge of approximately 0.69 percent to 1.42 percent of the total value of each account, depending on investment options selected.
- 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 percent of the amount withdrawn. In addition, there are ongoing asset-based fees equal to an annual charge of approximately 1.44 percent to 2.17 percent of the total value of each account, depending on investment options selected.
- Class E: This class is available only to certain groups associated with Hartford Life Insurance Company (the parent company of HFSG). Under the Class E fee structure, there is no up-front or contingent deferred sales charge. There are ongoing asset-based fees each year of approximately 0.44 percent to 1.17 percent of the total value of each account, depending on investment options selected.

Under all CHET Advisor asset classes, there is an additional state fee of 0.02 percent 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 make deposits and have their assets professionally managed. 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***

CHET Advisor is in the process of shifting from five age bands to nine. This process is expected to be implemented during the third quarter of 2017. The existing age bands are:

- 0-8 years
- 9-13 years
- 14-15 years
- 16-17 years



- 18 years and over

The new age bands will be:

- 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 offers two types of individual funds for investors: static and individual portfolios. Static portfolios are designed for different investment risk tolerances. The five static portfolios are comprised of different proportions of equity, fixed income and other investments.

#### ***Static Portfolios:***

- Conservative
- Growth
- Aggressive Growth
- Balanced
- Checks & Balances

In addition to the static options, there are another 12 individual funds for investors to choose to create their own customized mix across equity, real assets, fixed income and money market assets.

#### ***Individual Portfolios:***

Equity Portfolios

- Small-Cap Growth
- Mid-Cap Value
- International Opportunities
- Growth Opportunities
- Capital Appreciation

- Dividend & Growth
- Equity Income

#### Alternatives Portfolio

- Global real asset

#### Fixed Income Portfolios

- Inflation
- Total Return
- World Bond

#### Money Market Portfolio

- Money Market

### ***Underlying Funds***

There are 17 funds that are used as underlying funds to the age-based and static portfolios, 12 of which are offered as individual options. Some options use multiple underlying funds. At December 31, 2016, all CHET Advisor funds were actively managed by Wellington Management Company, the sub-advisor to The Hartford.

### **Investment Performance**

CHET Advisor's five aged-based portfolios produced positive returns between 3.98% and 7.59% for the one year period ending December 31, 2016. The static portfolios generated returns of between 5.62% and 8.24% for the one year period ending December 31, 2016.

### **2017 Changes to CHET Direct and CHET Advisor Investments**

As part of ongoing efforts to offer high-performing 529 plans to residents of the State of Connecticut, changes in investment products and allocations, along with fee reductions, have been approved by the Treasurer and currently are being implemented in both the CHET Direct plan and the CHET Advisor plan.

In 2017, there will be changes to the CHET Direct program that involve reallocation of funds among portfolios as well as the replacement of existing investment products. The strategy is to improve performance through higher returns, lower fees and further risk diversification. The money market fund and short-term bond fund will be replaced with a funding agreement with TIAA Life that offers a significantly higher interest rate. The number of age bands will be expanded from six to nine, mitigating some risk from re-balancings during adverse market conditions. A high yield fund will be added to the age-based options. Index funds will replace some actively managed funds thereby significantly reducing manager fees. A REIT index will replace an actively managed real estate fund in the age-based options. Two actively managed mid-cap equity funds will be replaced with a mid-cap index fund in both the active global equity option and the high equity balanced option. Asset allocation analysis based on market conditions and outlook is a normal part of portfolio re-balancings, and changes in weightings will occur in a number of portfolios.

The objectives for modifications made in the CHET Advisor plan were to improve performance through changes in products, fee reductions and diversification of risks. As noted above and consistent with the expansion of age bands in CHET Direct, CHET Advisor will move to nine age bands from the current five. This will smooth the equity step-downs to minimize market timing risk. Many proprietary funds will be replaced with third party funds that had better investment performance and/or lower fees and to introduce low-cost index funds. Products in equities, fixed income, global real assets and short-term strategies will be replaced in various options. In addition to significant fee reductions related to the switch to new external fund managers and index funds, administration and share class fees also will be reduced.