

2019 Morningstar Webinar for College Savings Plan Network



Madeline Hume, Analyst, Multi-Asset and Alternative Strategies, Manager Research
Leo Acheson, Associate Director, Multi-Asset and Alternative Strategies, Manager
Research

November 21, 2019

Morningstar Coverage of 529 College Savings Plans

- Morningstar's goal: Ensure that college savers and plan selectors have access to analysts' qualitative opinions on a broad spectrum of plans
- Coverage is not determined by quantitative screens on performance or limited to only a "best of breed" universe
- Analyst evaluate 529 plan assets under management as one gauge of investor interest
- We also cover new and/or small plans if investor interest merits doing so or if college savers would otherwise benefit from learning more about a plan (ex. Rhode Island College Bound Saver Direct-Sold)

Morningstar Ratings for 529 College Savings Plans

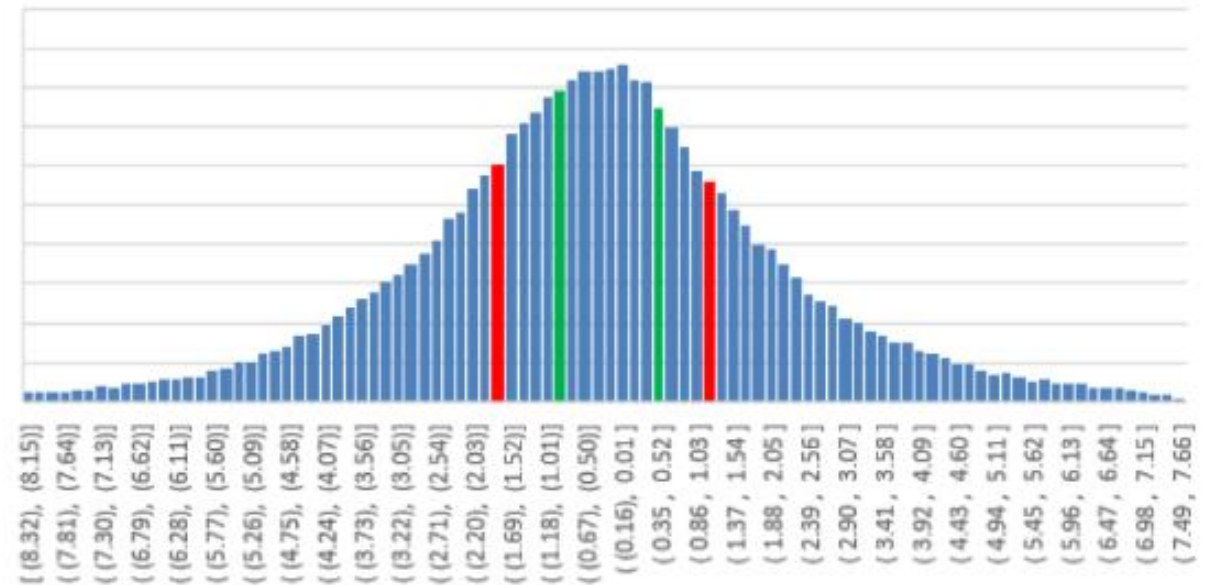
- 5 Pillars:
 - Parent: State and investment manager oversight that puts investors first
 - Process: A sensible and repeatable process for designing the plan's investment options
 - People: High-quality managers and investment resources underlying a plan's investment options
 - Price: Competitive expense ratios
 - Performance: Strong risk-adjusted performance over the long-term
- 3 possible scores: Positive, Neutral, and Negative
- The scores across these five pillars contribute to the overall rating. Ratings vary based on our conviction
- We assign ratings to 529 college savings plans at the plan level



Morningstar Analyst Ratings for Mutual Funds

- 3 Pillars (High, Above Average, Average, Below Average, Low)
 - Parent: Stewardship that puts investors first
 - Process: A sensible and repeatable objective, and portfolio construction that is consistent with this objective
 - People: A stable and experienced team aligned with investor interests
- The scores across these three pillars are transformed into a potential for outperformance. After deducting fees, we assign an analyst rating based on the fund's net-of-fee potential for outperformance relative to the category's benchmark and peers.
- We assign ratings to funds at the share class level.

Large Blend: Distribution of Rolling 36-mo. Pre-Fee CAPM Alphas
Jan. 2000 - Dec. 2018; excludes top and bottom percentiles of distribution



 **Gold**
 **Silver**
 **Bronze**

Neutral **Negative**

FAQs on Morningstar Analyst Ratings for 529 College Savings Plans

- Why don't you take tax benefits into account?
 - To allow for greater comparability between plans.
- Is there a formula for analyst ratings?
 - The pillar scores inform the overall analyst rating, but the analyst has discretion over the proposed overall rating.
- Who ultimately assigns the rating?
 - The analyst presents his or her conclusions to a committee composed of leaders on the multi-asset and alternatives team.
 - Only when the committee is satisfied with the soundness of the judgments expressed in each area is the final rating approved.
- Are you considering changing the 529 college savings plan ratings in response to the changes to mutual fund ratings?
 - Yes. We're constantly re-evaluating our ratings, and our mutual fund ratings reflect our best-thinking on what drives a fund's outperformance.

Data Collection

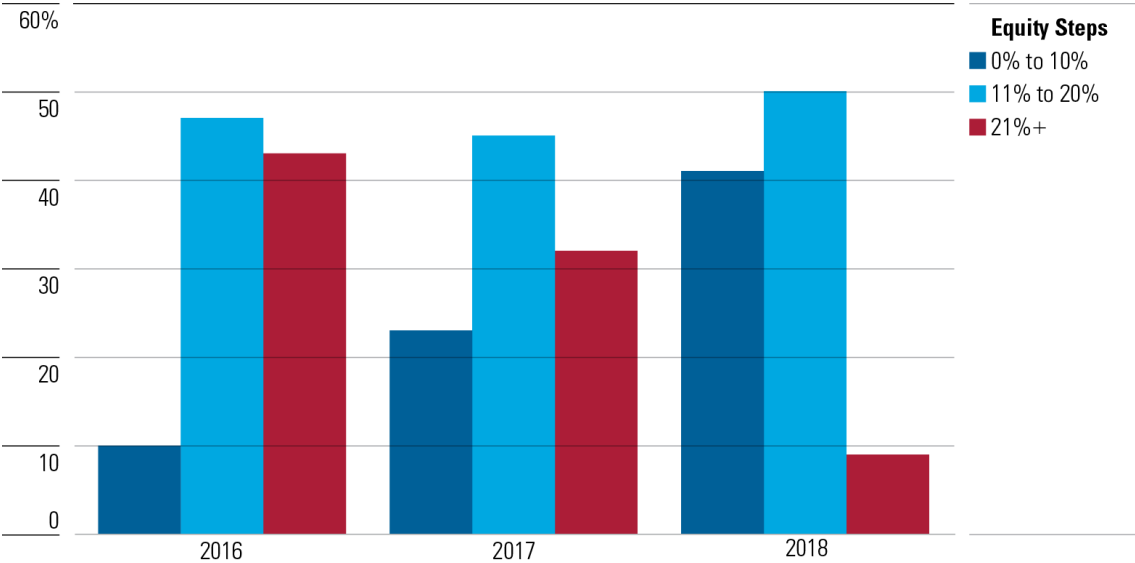
- Morningstar's data team is responsible for the collection of information from plans
- Our data team relies on program descriptions and surveyed data from program managers
 - To provide information to our data team, reach out to 529data@morningstar.com
- Data works with manager research to update unresponsive or out of date program management contacts
- For many of the investments we rate, like target-date funds, Mexican pensions, 529 plans and HSA plans, manager research supplements our research with qualitative information through a Request for Information (RFI).

In-Depth: Parent Pillar

- Goal: determine if the state and its partners are strong stewards of their 529 plans.
- Is the overseer stable, and isolated from political churn?
 - MEFA provides solid oversight and the same people have been overseeing the plan for more than 15 years.
 - I think one main benefit is still the fact that the team hasn't been vulnerable to political disruptions.
- Have they chosen strong partners?
 - Fidelity receives a positive Parent rating from Morningstar analysts.
 - Fidelity continues to build out its asset-allocation effort and the 529 plans should benefit. Plus, Fidelity applies the exact same approach to all four plans, so in a way all states benefit from each other's oversight.
- Do they, with their investment consultant if applicable, act as a check on the investment manager?
 - MEFA also enlists a consultant for an added view.
- How do they respond to industry changes?
 - State passed a state tax benefit of \$1,000 per year per individual or \$2,000 per married couple filing jointly, taking effect January 1, 2017 through the 2021 tax year. This was passed with strong advocacy from MEFA, as well as the state's university presidents.

Asset Allocation Steps are Narrowing...

- Through 2018 and into 2019, plans continued to reduce the size of the steps a participant moves through as they age.
- Currently, progressive plans change Morningstar Categories as participants age, making it difficult to build up a long-term track record.

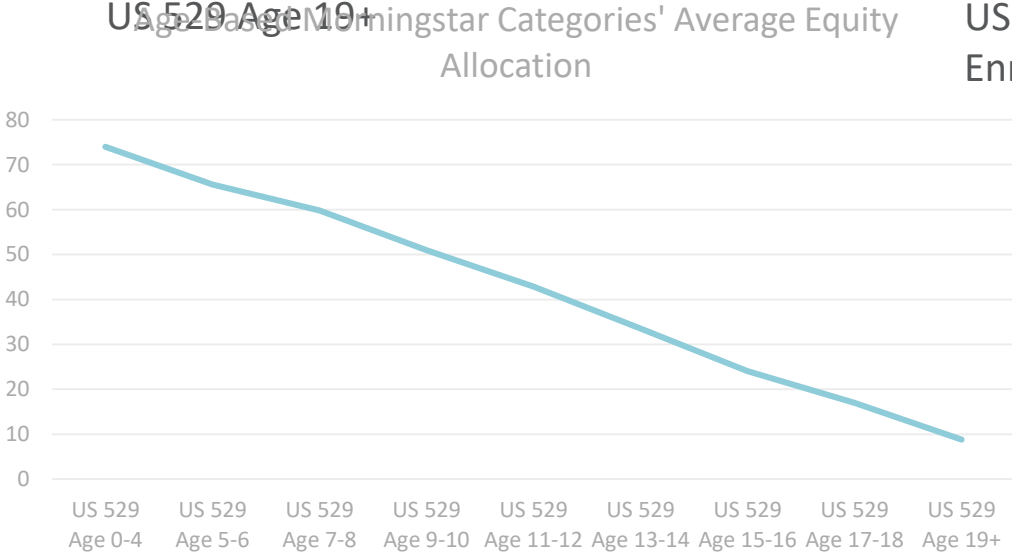


Data as of December 31, 2018.

So, We Debuted New Categories

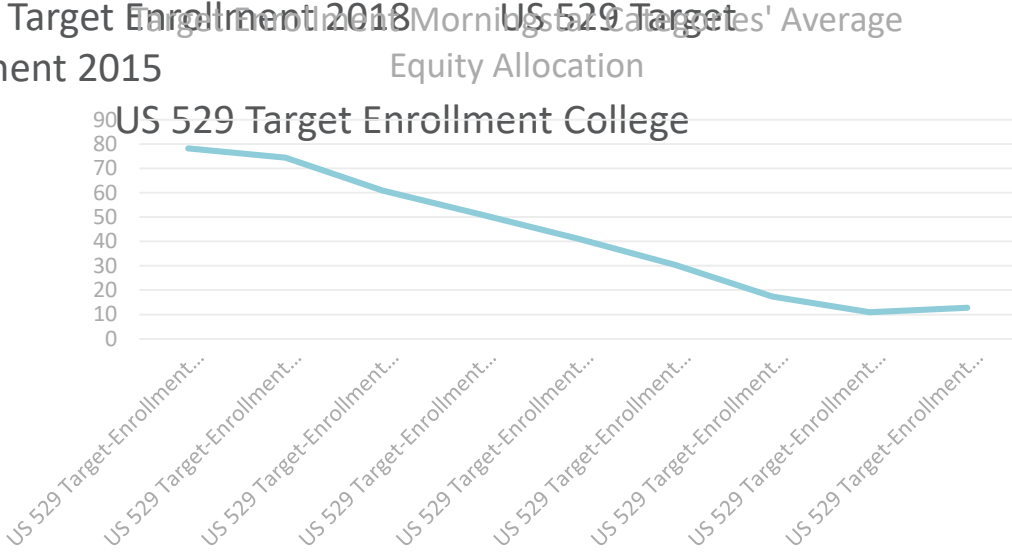
Age-Based Fixed Categories:

- US 529 Age 0-4
- US 529 Age 5-6
- US 529 Age 7-8
- US 529 Age 9-10
- US 529 Age 11-12
- US 529 Age 13-14
- US 529 Age 15-16
- US 529 Age 17-18
- US 529 Age 19+



Target Enrollment Categories:

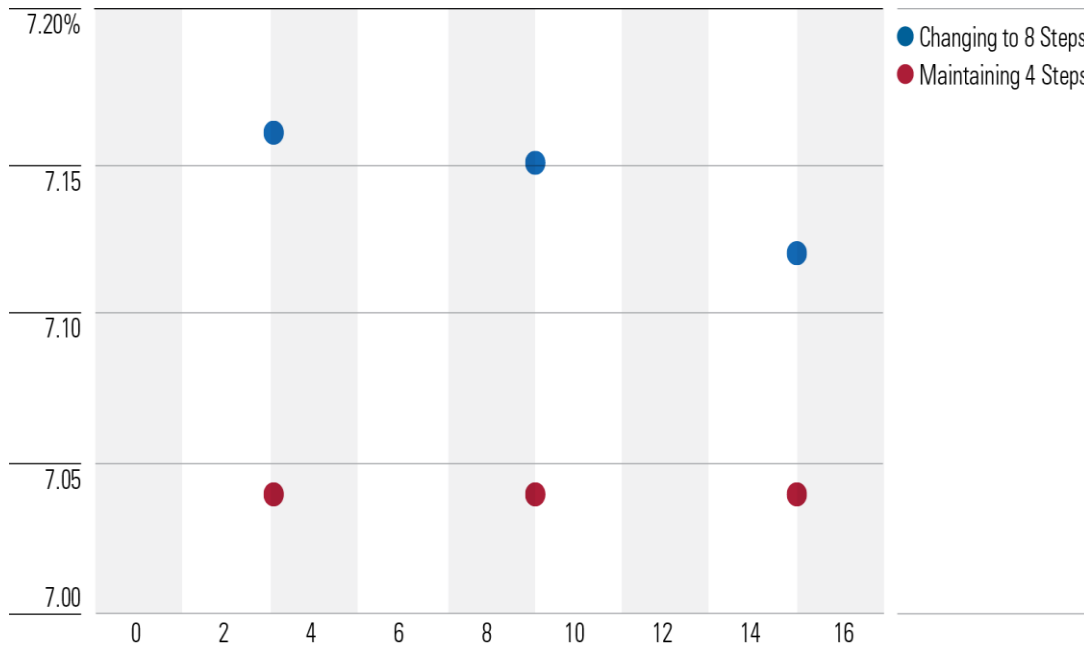
- US 529 Target Enrollment 2039+
- US 529 Target Enrollment 2036
- US 529 Target Enrollment 2033
- US 529 Target Enrollment 2030
- US 529 Target Enrollment 2027
- US 529 Target Enrollment 2024
- US 529 Target Enrollment 2018
- US 529 Target Enrollment 2015



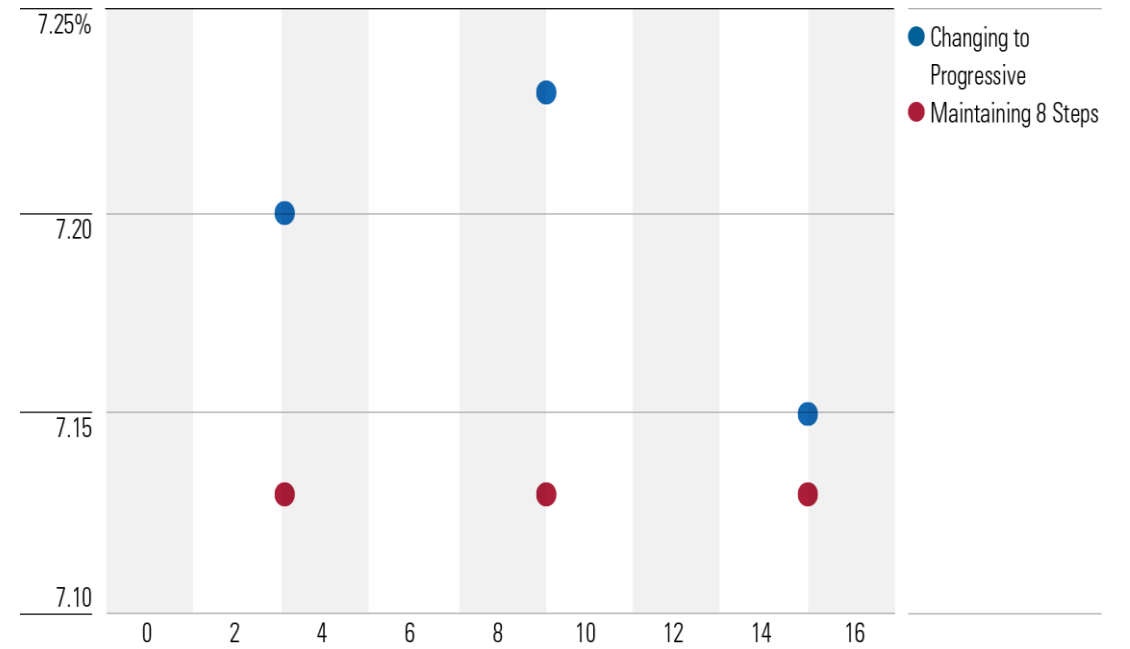
Data as of October 31, 2019.

Narrower Steps are Good for Investors, to a Point

Money-Weighted Returns of Investors After Moving from Four Steps to Eight



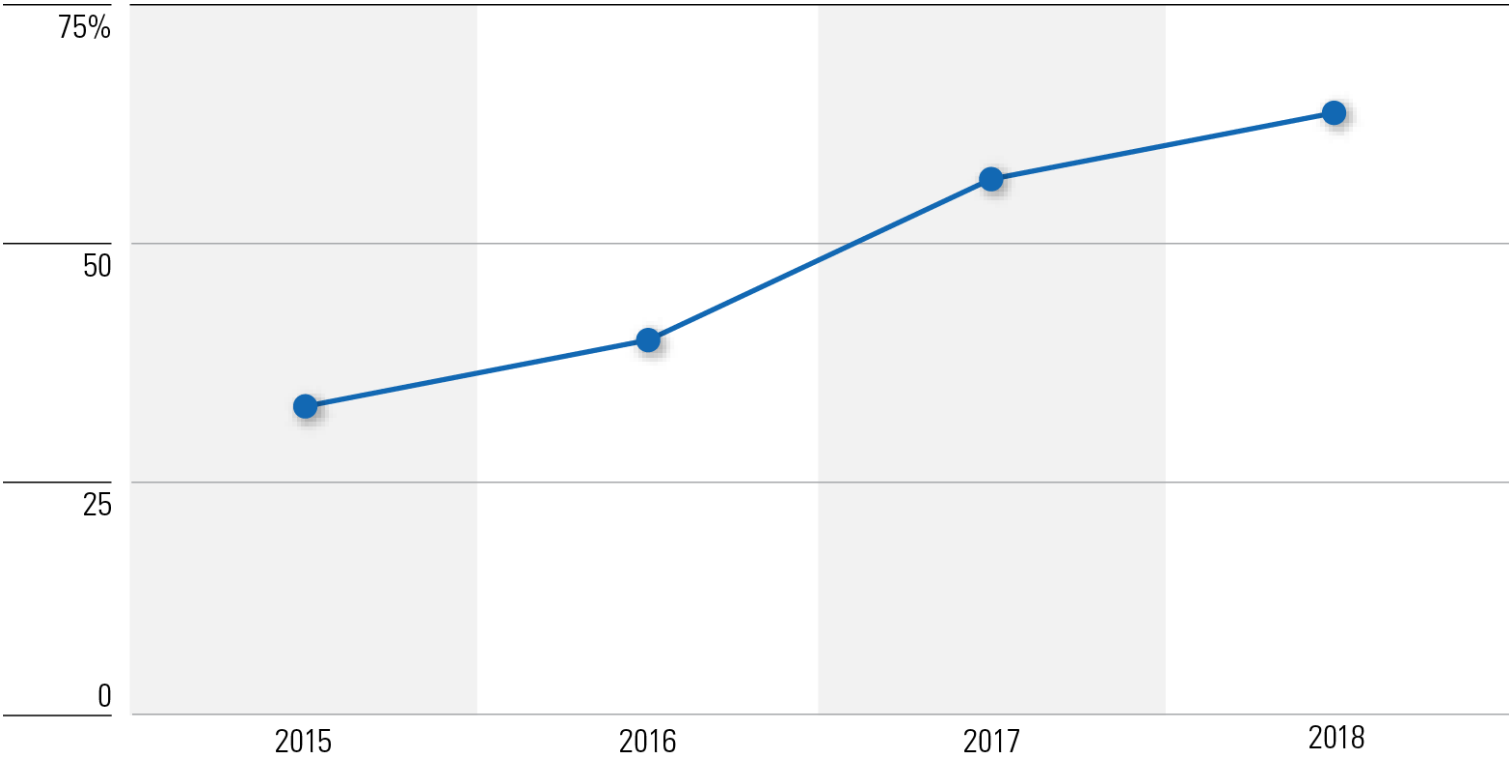
Money-Weighted Returns of Investors After Moving from Eight Steps to Progressive



Data as of December 31, 2018.

Quality of Underlying Investments Has Improved

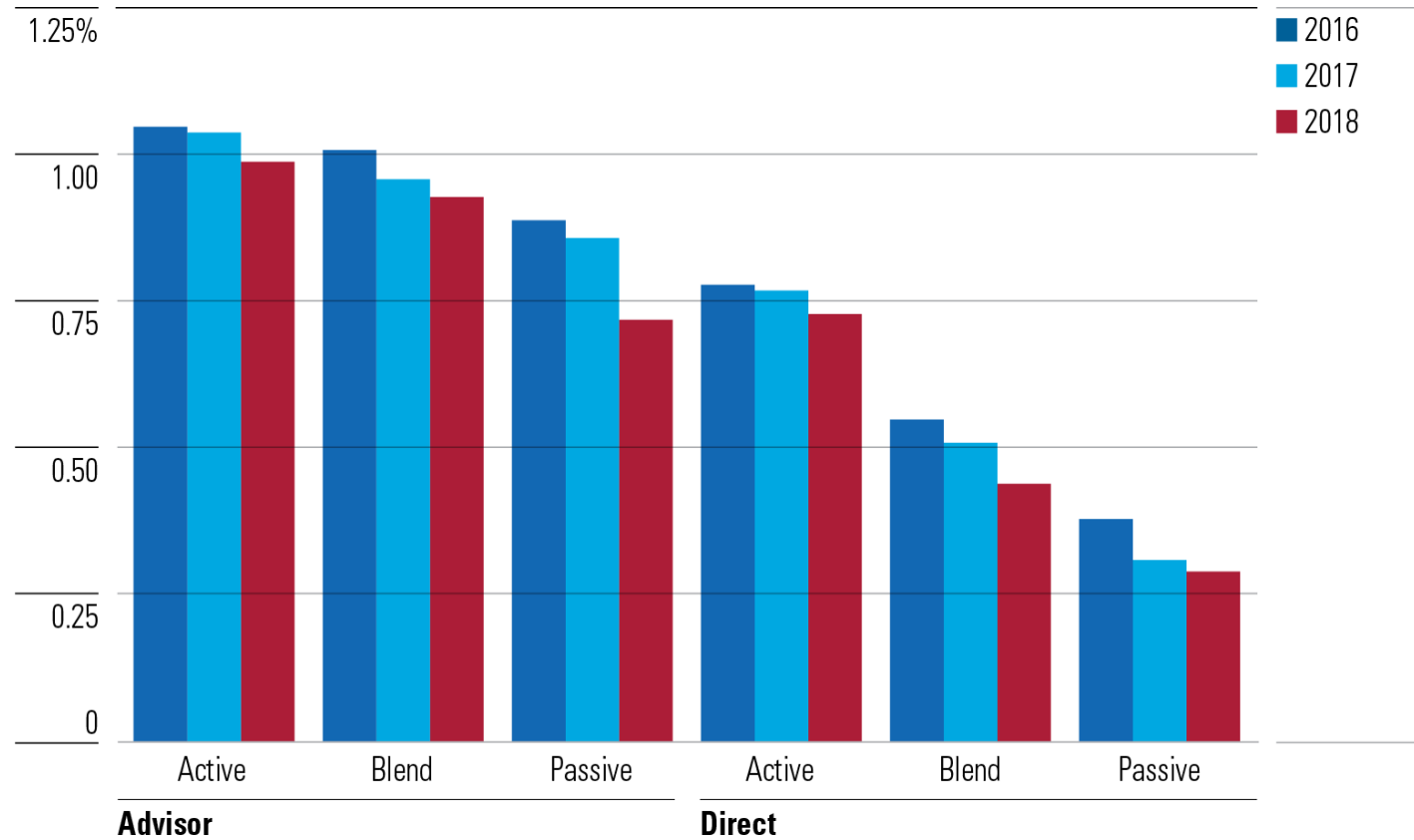
Average Percentage in Medalists of 529 Age-Based Portfolios, 2015-2018



Data as of December 31, 2018.

Fees Have Come Down

Average Expense Ratio of Age-Based Track, by Sales Channel and Underlying Investment Type



Data as of December 31, 2018.

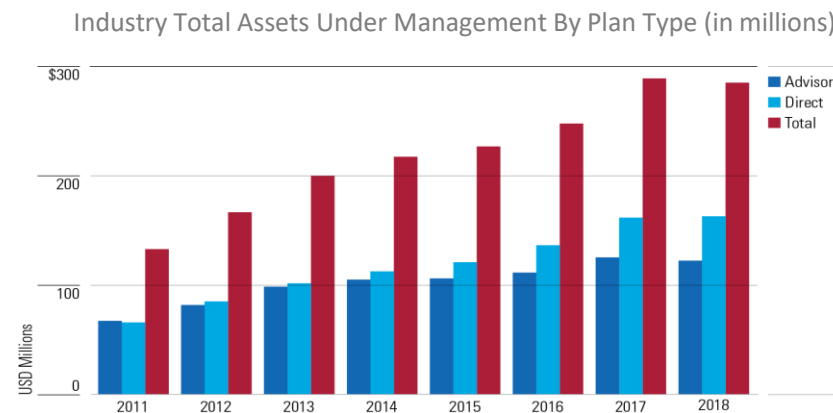
Drivers of Growth and Consolidation

Growth

- Increased awareness of 529s
- Greater flexibility to use savings in a 529 college saving plan for other educational expenses (K-12 education, student loans, etc.)
- College tuition inflation driving up contributions to meet the rising costs of college

Consolidation

- Aging beneficiaries and, in certain states, aging populations
- For advisor-sold plans, the rise of fee-based compensation structures

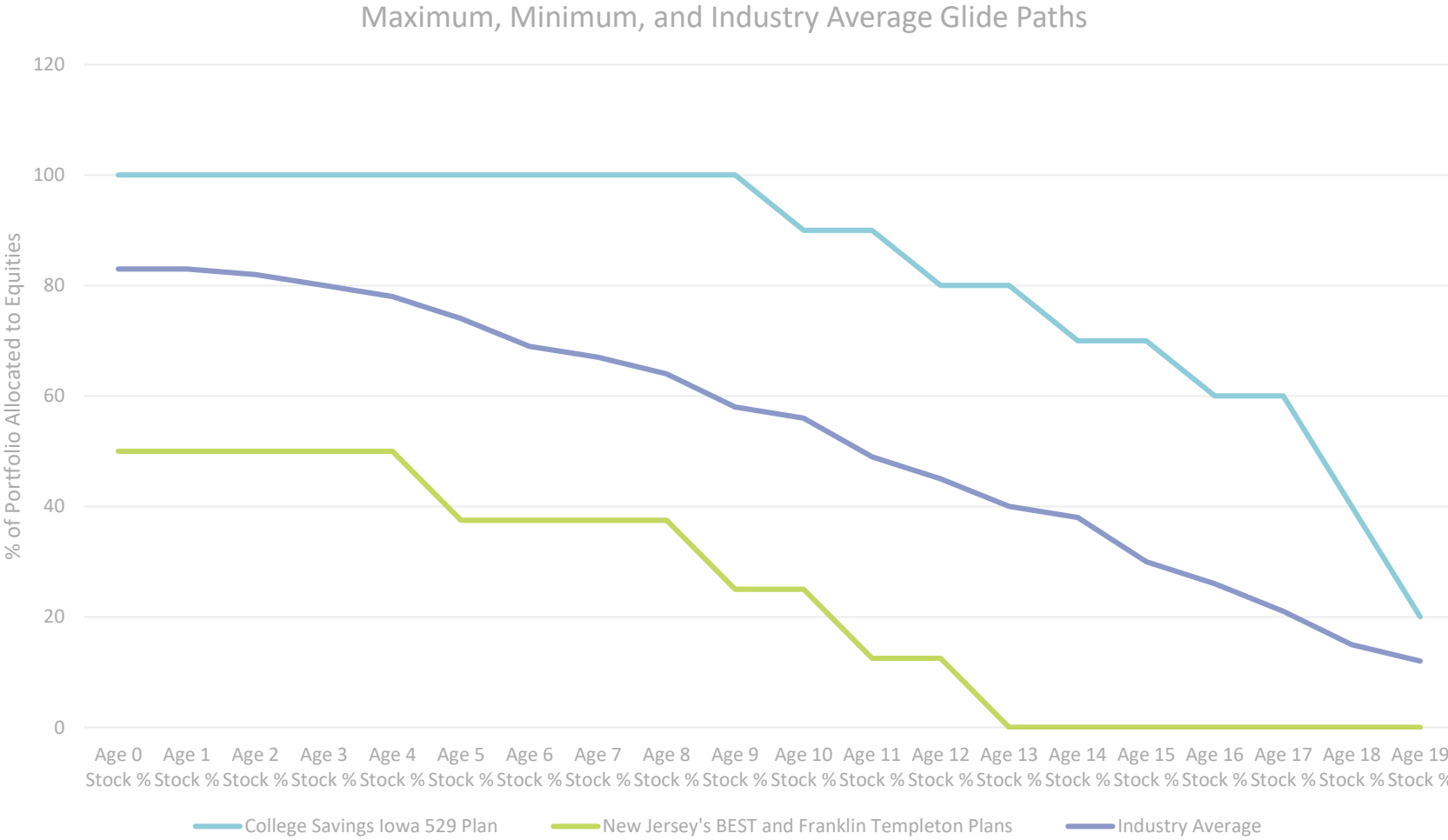


Data as of December 31, 2018.

QUESTIONS?

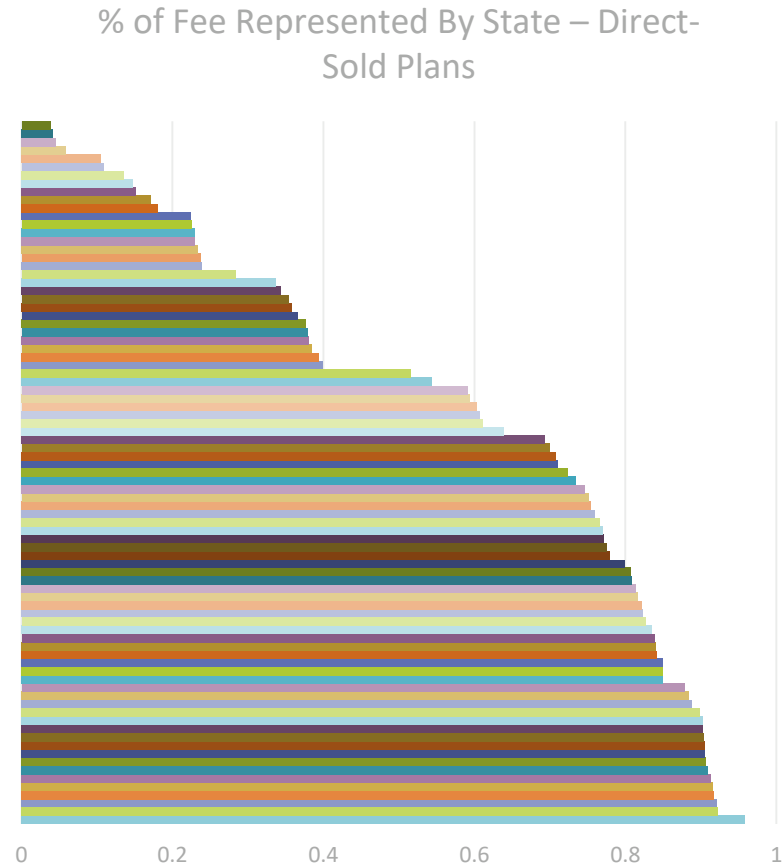
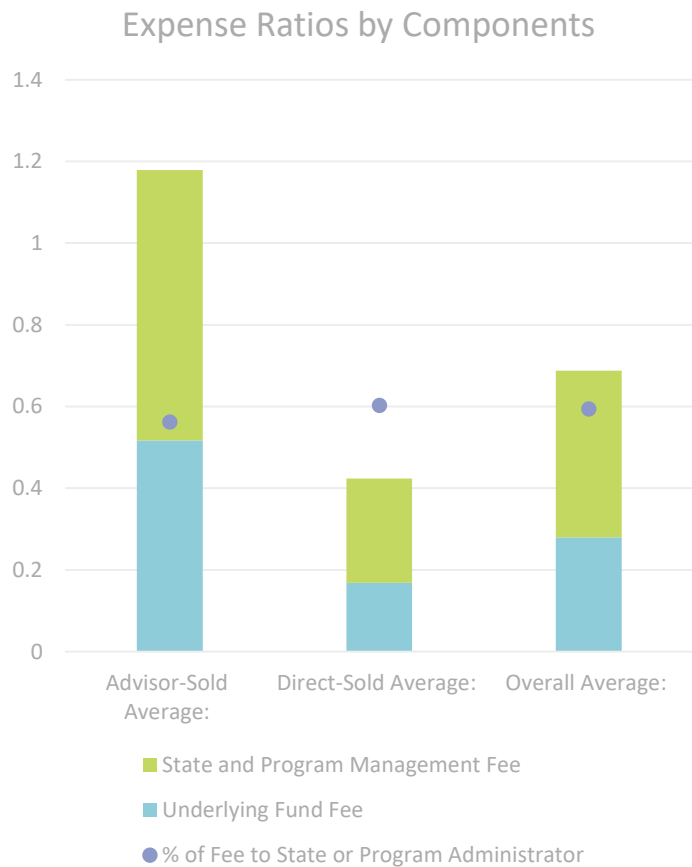
APPENDIX

A Diverse Array of Solutions



Data as of December 31, 2018.

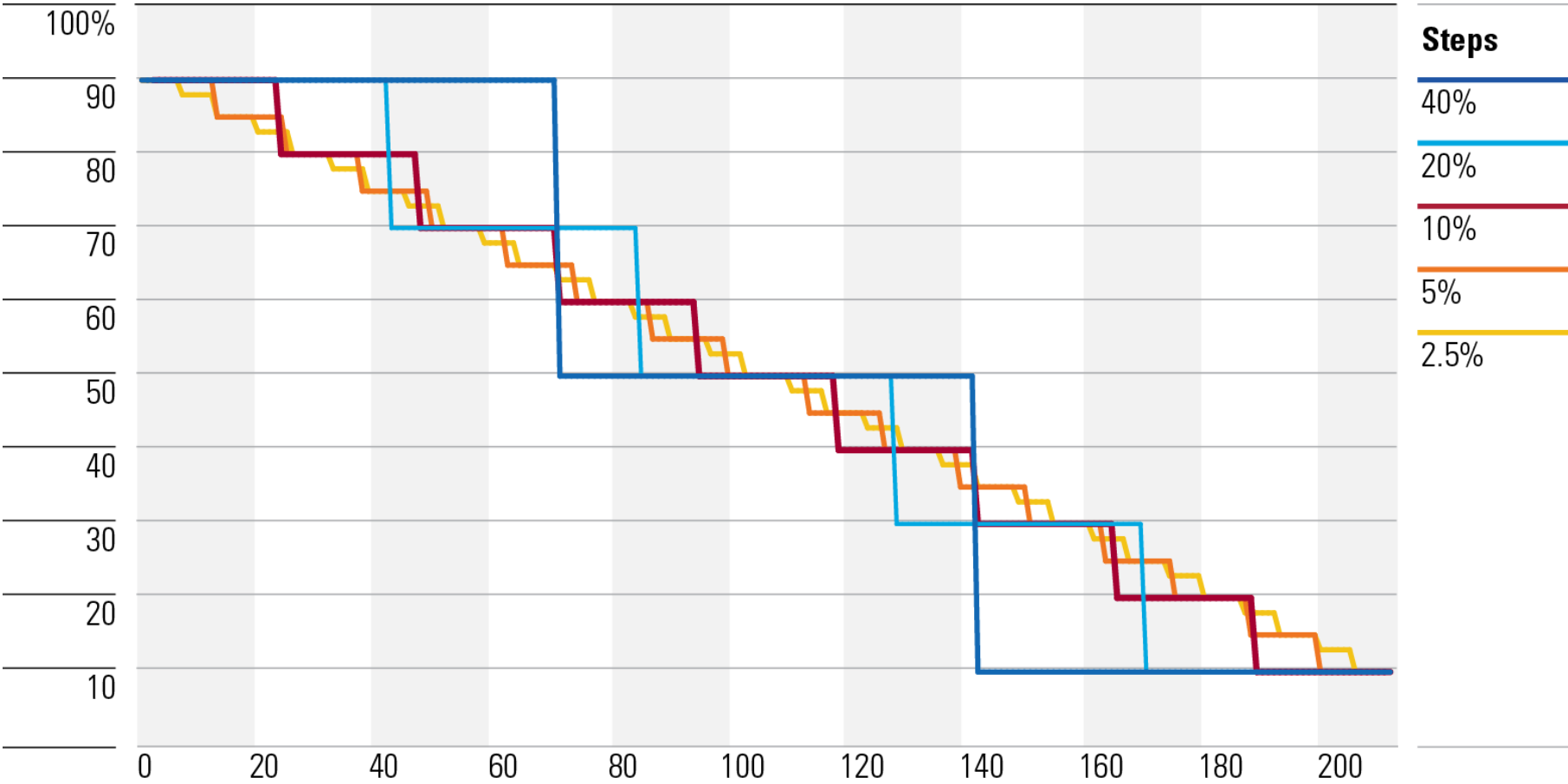
What's Under the Hood of Expense Ratios



- On average, Direct-Sold plans offer cheaper Age-Based portfolios than Advisor-Sold plans.
- However, Direct-Sold plans aren't necessarily a bargain, because more of that fee goes to states and program managers.
- Participants must weigh the greater state and program management fee they might pay in-state against the potential tax benefits.

Data as of December 31, 2018.

Age-Based Tracks with Various Step Sizes



Data as of December 31, 2018.