
DECEMBER 7, 2021

**AGENDA ITEM 1
INFORMATION ITEM**

SCHOLARSHARE INVESTMENT BOARD

Fiduciary and Investment Training for Board Members

Background

The Fiduciary and Investment Training prepared for the ScholarShare Investment Board's (SIB) members will be presented by SIB's consultants, AKF Consulting Group and Meketa Investment Group, Inc., and will outline various items that include:

- AKF Consulting Group: Fiduciary and Governance Training
 - Foundations of the Board's Duties
 - Fundamentals of Fiduciary Duties
 - Good Governance Practices

- Meketa Investment Group, Inc.: Investment Training
 - The Framework: Policy Statements
 - The Line-Up: Investment Portfolios

Presenters

Andrea Feirstein, Managing Director, AKF Consulting Group
Mark Chapleau, Senior Consultant, AKF Consulting Group
Eric White, Principal, Meketa Investment Group, Inc.

California ScholarShare Investment Board

Fiduciary and Governance Training

December 7, 2021

Today's Discussion

Slides

- **Foundations of the Board's Duties** 3 - 10
- **Fundamentals of Fiduciary Duties** 11 - 25
- **Good Governance Practices** 26 - 31

Appendix 1: Checklist - Common and Best Practices

Appendix 2: Statutory and Regulatory Sources

Section 1

Foundations of the Board's Duties

Sources of Fiduciary Duties

- **Fiduciaries are held to extremely high standards of conduct**
- **A variety of sources together establish the fiduciary duties of Board members and otherwise provide guidance:**

State Law

Common Law

Federal Law

Program Documents

- **ScholarShare Code Sections (Golden State Scholarshare Trust Act)**
- **ScholarShare Regulations**

- **Restatement of Trusts**

- **Internal Revenue Code**

- **Program Disclosure Statement and Participation Agreement**

Fiduciary Sources

- **California Code Sections authorizing and establishing ScholarShare are primary sources**
- **Additional sources**
 - **Fiduciary law is based on common law of trusts**
 - **Created hundreds of years ago and developed over time by case law**
 - **General Trust Law**
 - **Trust Components**
 - **Settlor creates the trust**
 - **Trustees govern the operations of the trust**
 - **Beneficiary receives benefits (usually money) from the trust**
 - **Restatement of Trusts**
 - **Incorporates the Prudent Investor Rule (1992)**

Common Law Underpinnings

- **Common Law**
 - **Duty of Care**
 - **Duty of Loyalty**
 - **Duty of Obedience**

- **Duties Derived from Common Law**
 - **Duty of Prudence**
 - **Duty of Loyalty**
 - **Diversification**
 - **Adherence to Program Documents (Duty of Obedience)**
 - **Prohibited Transactions**

Federal Guidance on Fiduciaries

- **529 Plans may look at other Federal laws for Guidance:**
 - **Public retirement plans rely upon ERISA for fiduciary standards**
 - **Unregistered funds and separate accounts may look to the Investment Company Act of 1940 standards for governance**
 - **A combination of both may provide appropriate governance guidance for the ScholarShare Investment Board**
- **ERISA on Fiduciaries:**
 - **Fiduciary status is based on the *functions performed for the plan, not just a person's title.***
 - **Fiduciaries are held to a “prudent expert standard”**
 - **Fiduciaries include the trustee, investment advisers, municipal advisors and any individuals exercising discretion in plan administration**
 - **Attorneys, accountants and actuaries are not fiduciaries when acting in their professional capacity**

Investment Company Act of 1940 Governance Standards

- **Directors of investment companies and public companies generally share common responsibilities**
- **Examples of duties specific to investment company directors:**
 - **Approve timing of Net Asset Value calculations and procedures for valuation of securities**
 - **Approve trading practices and procedures**
 - **Approve investment objectives and policies**
 - **Monitor credit quality and valuation of money markets**
 - **Approve distribution plan of open-ended funds pursuant to Rule 12b-1**

Federal Securities Law Foundation

- **California's Golden State Scholarshare Trust Act establishes a municipal trust:**
 - ScholarShare participants open 529 accounts
 - Contributions are invested in units of the trust, which are “municipal securities”
- **Securities Act of 1933:**
 - Municipal securities are exempt from registration
- **Securities Exchange Act of 1934:**
 - Municipal securities are exempt from most reporting requirements
- **Trust Indenture Act of 1939:**
 - Provisions do not apply to municipal securities
- **Investment Company Act of 1940 and Investment Advisers Act of 1940:**
 - Provisions do not apply to instrumentalities of a State or agents “acting in the course of official duty”
- **Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010:**
 - Advisers to municipal entities are subject to varying degrees of oversight by FINRA, the MSRB and applicable Bank Regulators

Importance of the '33 and '34 Acts Together

- An exempt issuer does not have to register securities or sales of securities
 - Interests issued by municipal trusts are exempt from registration
- BUT anti-fraud provisions of both Acts *always* apply:
 - Section 17(a) – Fraudulent Interstate Transactions ('33 Act)
 - Section 10(b) – Manipulative and Deceptive Devices ('34 Act)
 - Rule 10b-5 – Employment of Manipulative and Deceptive Devices ('34 Act)
- “10b-5” Anti-Fraud Standard:
 - “It is unlawful to make *any untrue statement of a material fact or to omit to state a material fact necessary in order to make the statements made, in light of the circumstances under which they were made, not misleading*”

Section 2

Fundamentals of Fiduciary Duties

Who is a Fiduciary?

- **Board members are the highest level fiduciaries with the broadest responsibility**
- **Others may be fiduciaries, too, by contract or by virtue of the work they perform**
- **Some internal (executive) staff are fiduciaries**
- **Test is whether they have discretion**
- **Investment managers and consultants are usually fiduciaries but not all outside service providers such as auditors and attorneys**
- **Test is whether a person has discretion and control over the administration of the plan or management of the assets (not performance of ministerial tasks)**
- **A breach of fiduciary duty can lead to serious consequences such as personal liability and reputational risk of the Program causing an erosion of stakeholder confidence**

Fiduciary Duties

- The most important duties for ScholarShare fiduciaries are those of loyalty, prudence and Program Document adherence
- **Duty of Loyalty**
 - Unwavering commitment to stay focused on the interests of the participants in the Program
- **Duty of Prudence**
 - Requires expertise and more than a good faith attempt to try to do the right thing
 - *“The Board... shall discharge their duties as fiduciaries...by investing with the care, skill, prudence and diligence...that a prudent person would use...”*
- **Duty of Obedience (i.e., to follow Program Documents)**
 - Follow the Golden State Scholarshare Trust Act and ScholarShare Regulations

Fiduciary Duties, cont'd

- **Other fiduciary duties flow from the key fiduciary duties of loyalty, prudence and adherence:**
 - **Duty to diversify**
 - **Flows from the duty of prudence**
 - **Considers diversifying investment choices unless not prudent**
 - **Duty to refrain from prohibited transactions**
 - **Duty to delegate**
 - **Board is the ultimate fiduciary for the Program**
 - **Duty of prudence allows delegation but not abdication**
 - **Appropriate monitoring not able to be delegated**

Duty of Loyalty

- Also known as the “Exclusive Benefit Rule”
 - *"The assets of the trust, including the program fund, shall at all times be preserved, invested, and expended solely and only for the purposes of the trust and shall be held in trust for the participants and beneficiaries..." § 69991 of the Golden State Scholarshare Trust Act*
- Interpretation of loyalty
 - When creating policies or making other decisions for the Program, Board members can “only wear one hat ”
 - Courts have held that a trustee may not wear a second hat as a representative of an entity that may have appointed him or her to the fiduciary position
 - Board members are not to balance interests of outside parties
 - Board members are not to act in their own self-interest

Duty of Loyalty, cont'd

- Each Board member has a fiduciary duty that is owed to all beneficiaries of the trust
- There will be those who expect you to represent them and be their advocates when you serve on the Board, but
 - No fiduciary duty is owed to whoever appointed you
 - No fiduciary duty is owed to the local business community
 - No fiduciary duty is owed to taxpayers of the State
 - No fiduciary duty is owed to the Legislature or Executive Branch
- Regardless of how one comes to serve on the Board, the fiduciary duty is the same for each member

Duty of Loyalty, cont'd

- **Duty to pay only reasonable Program expenses also flows from the duty of loyalty**
 - **Paying expenses from trust assets is a fiduciary decision**
 - **Expenses must be reasonable and necessary for the administration of the trust**
 - **Not incurred “but for” trust administration**
 - **Reasonable does not mean the least costly**

Duty of Loyalty, cont'd

- **Duty of Loyalty also encompasses the laws relating to conflicts of interest**
 - **Even the appearance of a conflict of interest must be avoided**
 - **If avoidance is not possible, conflicts must be disclosed promptly and managed**
 - **Recusal from votes and not taking some actions might be necessary**
- **Bottom line – fiduciary duty takes precedence over other duties**
- **Laws are complex so it is important to check with legal counsel if there is any doubt as to whether a conflict of interest exists**

Duty of Prudence

Prudent: exercising sound judgment in practical matters; cautious in conduct; sensible; not rash ---- Webster's Dictionary

*The test of prudence is one of **conduct** and not a test of the **result** of performance of the investment. The focus of the inquiry is how the fiduciary acted in his selection of the investment and not whether his investments succeeded or failed. ---- Donovan v. Cunningham*

- Variety of terms
 - Prudent investor: comes from the Uniform Prudent Investor Act, adopted in nearly all states and follows modern portfolio theory
 - Prudent expert: the ERISA standard, which is the highest standard of care; this is the recommended standard:
 - The “prudent expert standard” requires a fiduciary to act:
“With the care, skill, prudence, and diligence under the circumstances then prevailing that a prudent man acting in a like capacity and familiar with such matters would use in the conduct of an enterprise of like character and with like aims...” ERISA 404(a)(I)(B)

Duty of Prudence, cont'd

- **Duty of prudence requires more than a good faith attempt to do the right thing:**
 - **Understand facts and what is being voted on**
 - **Investigate options, review information on what others are doing**
 - **Seek expert advice**
 - **Delegation mitigates risk as long as delegation process was prudent**
- **A good process is more important than a good outcome:**
 - **Best defense to potential liability**
 - **Board members are judged by the “prudence” of their process**
 - **Written documentation is critical**
- **Delegation still requires an ongoing duty to monitor**
- **Law requires prudence, not perfection!**

Duty of Obedience

- **Trustees have a duty to follow the written terms of a trust without deviating from any requirements**
- **For all fiduciaries, the duty is often stated as the duty to follow “Program Documents”**
- **For ScholarShare, the enabling statute is the primary Document (e.g., Article 19 - -- the Golden State Scholarshare Trust Act). Other federal and state laws and regulations may also be applicable.**
- **“Program Document” also includes other documents that the Board has formally adopted (e.g., the ScholarShare Program Disclosure Booklet)**
 - **Regulations, Policies and Procedures (e.g., the Investment Policy Statement), etc.**
 - **Open meetings and open records laws are usually incorporated by reference and thereby become part of the Program Documents**

Fiduciary Liability

- **Laws governing public fund fiduciaries may impose liability for breach of duty; sovereign immunity laws may apply in some cases**
- **When fiduciaries delegate responsibility the liability is shifted**
 - **Oversight is still required**
 - **The delegation must continue to be prudent**
- **Consequence of breach of duty**
 - **Personally liable to make good any losses to the Program resulting from the breach and to restore any profits which have been made through use of Program assets**
 - **Other equitable or remedial relief as a court may deem appropriate**
 - **Liability usually not relieved in bankruptcy**
- **Attorney-client privilege may run to the Program rather than to an individual fiduciary**

Co-Fiduciary Liability

- **Co-fiduciary liability means “you are your brother’s keeper” or “the duty to squeal”**
- **Liability can result if a fiduciary enables, knowingly participates in, or knowingly undertakes to conceal a breach by another fiduciary**
- **For liability to attach, you must have actual knowledge of an action that you know to be a breach**
- **A fiduciary has a duty to speak up and take reasonable steps to prevent or halt a co-fiduciary’s breach**
- **Resignation from the Board is usually not sufficient**

Mitigating Fiduciary Liability

- **Initial orientation and continuing education on fiduciary responsibility**
- **Clear understanding of fiduciary duty and common examples where fiduciary duties exist**
- **Thorough, detailed and disciplined decision-making process with clear documentation of actions and rationale**
- **Obtain expert advice from legal counsel, staff and others, as appropriate**
- **Prudent delegation and diligent oversight – critical to understand what authority has been delegated and what has been retained**
- **Good Board governance policies including clearly defined roles and responsibilities, accountability, and a commitment to continual oversight**

Summary of Board Member's Responsibilities

- **Act in the interest of ScholarShare beneficiaries**
- **Carry out duties prudently**
- **Follow ScholarShare Program Documents**
- **Diversify Program investments**
- **Pay only reasonable Program expenses**
- **Seek the assistance of an independent expert if the Board member does not possess the education, experience or skill necessary to carry out his/her duties**
- **Understand the subject matter in order to question or challenge advice**
- **Do not abdicate fiduciary duties**

Section 3

Good Governance Practices

Good Governance

- **Governance is the structure, manner, and process by which a Board exercises authority or control**
- **Good governance begins with understanding of fiduciary duty**
- **Good governance policies and practices can help Boards meet fiduciary responsibilities**
- **Governance is not:**
 - **Management**
 - **Day-to-day operations**
 - **Tactical decisions**
 - **Staff functions**
 - **Details of policy implementation**

Essential Elements of Good Governance

- **Accountability**
- **Transparency**
- **Adherence to laws, rules and policies**
- **Effectiveness and efficiency**
- **Inclusiveness – engaging in participatory processes**
- **Maintaining clear distinction between roles of the Board, the Executive Director and the staff**
- **Future focus that has an outward vision rather than internal preoccupation**

Processes for Governance

- **Procurement Processes:**
 - Delineate appropriate roles for Board and staff in –
 - Development and approval of RFPs
 - Evaluation of responses
 - Final approval of contracts
 - Staff should ensure open and fair solicitations
 - Recommendations should reflect weighted criteria that bidders understand
 - If sole source procurement, basis for closed process should be clear
- **Establishment of Performance Benchmarks:**
 - Administration and operations
 - Marketing costs and results
 - Investment policies and performance targets
- **Investment Policy Statements and Monitoring Criteria:**
 - Establish roles, responsibilities and process
 - Also defines selection criteria and monitoring procedures
 - Ramifications for underperformance should be clear

Processes for Governance, cont'd

- **On-going Reviews:**
 - **Monthly investment results to key staff and independent Investment Consultant from Investment Manager**
 - **Quarterly reports to the Board from Program Manager (including the Investment Manager) and the independent Investment Consultant**

Summary

- **All Board members are fiduciaries and have strict legal requirements they operate under**
- **Board members may delegate certain duties but cannot abdicate their overall fiduciary responsibility**
- **The duties of prudence and loyalty are most important**
- **The duty to follow the law and Program Documents is critical as well**
- **Seek advice about fiduciary issues when in doubt**
- **There are serious consequences when fiduciary duties are breached**
- **A culture of good governance adds both tangible and intangible value**

Appendix 1

Checklist – Common and Best Practices

Checklist – Common and Best Practices

- **Prepare for all meetings**
- **Diligently attend all Board and assigned committee meetings**
- **Act in good faith and in the best interest of participants and beneficiaries in all decision making**
- **Be familiar with and abide by all applicable laws, regulations and Program Documents**
- **Delegate, where appropriate, to experts pursuant to a prudent process**
- **Establish and document prudent processes**
- **Periodically review policies and procedures to ensure consistency and relevancy**
- **Differentiate Board policies from management policies**
- **Take actions consistent with the mission and policies of the Program**

Checklist – Common and Best Practices, cont'd

- **Perform continual oversight – applies to Board and staff**
- **Institute reporting tools and procedures that facilitate oversight:**
 - **Internal Sources examples –**
 - **Executive Director Reports**
 - **Internal Audit**
 - **Risk Management Dashboard**
 - **External Sources examples –**
 - **Investment Manager(s) and Investment Consultant**
 - **External Auditors**
 - **Custodian Bank**

Checklist – Common and Best Practices, cont'd

- **Clearly define and enumerate roles and responsibilities between the Board and staff**
- **Regular review of efficiency and effectiveness of the Program's goals**
- **Assess performance and actions of staff and service providers (e.g., Program Manager and Investment Managers, consultants and auditors)**
- **Benchmark operations to similar programs and best practices**
- **Develop and maintain comprehensive charters for the Board and committees**
- **Obtain independent expert advice**

Checklist – Common and Best Practices, cont'd

- **Require transparency and accountability**
- **Communicate with all stakeholders in a timely, accurate and transparent manner**
- **Maintain confidentiality of participant and beneficiary information**
- **Offer orientation and continuing education on relevant topics**

Appendix 2

Statutory and Regulatory Sources

Uniform Prudent Investor Act (“UPIA”)

- Reflects changes in investment practice since the late 1960s, specifically with regard to modern portfolio theory
- Establishes that standard of prudence applies to any investment in the context of the total portfolio, rather than to individual investments
- Allows trustees to delegate investment management functions, subject to appropriate safeguards (such delegation was expressly forbidden by the former trust law)
- Fosters a greater degree of diversification in investment portfolios and allows for derivatives, commodities and futures:
 - Despite these investments individually having a relatively higher degree of risk, they could potentially reduce overall portfolio risk and boost returns when considered in a total portfolio context.
- uniformlaws.org

Securities Act of 1933 (the “33 Act”)

- Exempts issuers of municipal securities from registration (Section 3(a)(2))
- “Truth in securities” has two basic objectives:
 - Requires that investors receive financial and other significant information about securities being offered
 - Prohibits deceit and misrepresentation in the sale of securities
- <https://www.sec.gov/answers/about-lawsshtml.html#secact1933>

Securities Exchange Act of 1934 (the “34 Act”)

- Created the SEC and empowers it to register, regulate and oversee:
 - Brokerage firms, clearing agencies and transfer agents
 - Self regulatory organizations (“SROs”) including Financial Industry Regulatory Authority (“FINRA”) and the Municipal Securities Rulemaking Board (“MSRB”)
- Establishes periodic reporting requirements for registered entities or transactions
 - Municipal securities generally are exempt from reporting requirements (Section 3(a)(29))
 - BUT some initial and ongoing disclosures apply (Rule 15c2-12)
- Identifies and prohibits deceitful conduct
- Grants the SEC disciplinary powers over regulated entities and the persons associated with them
 - SROs are essential to the entire process (municipal broker-dealers may not contravene any rules of the MSRB (Section 15B))
- <https://www.sec.gov/answers/about-lawsshtml.html#secact1933>

Trust Indenture Act of 1939

- Applies to debt securities – including bonds and interests in publically offered trusts
- Requires a trustee to protect and enforce the rights of bondholders and rights must be included in a trust indenture
- Municipal trusts are exempt based upon '33 Act exemption (Section 304(a)(4)(A))
- <https://www.sec.gov/answers/about-lawsshtml.html#secact1933>

Investment Company Act of 1940 (the “40 Act”)

- **Regulates companies that engage primarily in investing, reinvesting and trading in securities**
- **Focus of the Act is to provide the public with information about a fund and its objectives, and about the investment company structure and operations**
- **Explicitly not applicable to government entities or officers or employees “acting as such in the course of his official duty” (Section 2(b))**
- **<https://www.sec.gov/answers/about-lawsshtml.html#secact1933>**

Investment Advisers Act of 1940 (the “Advisers Act”)

- Firms that provide advice about securities investments must conform to regulations designed to protect investors:
 - Advisers with more than \$100 million in client assets must file Form ADV with SEC
 - If assets > \$25 million but < \$100 million, adviser registers with state
- Does not apply to states or subdivisions or to officers or employees “acting as such in the course of his official duty” (Section 202(b))
- <https://www.sec.gov/answers/about-lawsshtml.html#secact1933>

Dodd-Frank Wall Street Reform and Consumer Protection Act ("Dodd-Frank")

- Amends Section 15B ('34 Act) to require registration of municipal advisors and imposes fiduciary duty on them
- "Municipal advisor" is any person that provides advice to or on behalf of a municipal entity regarding municipal securities, including advice with respect to the structure, timing, terms and similar matters concerning such issues
- Excludes registered Investment Advisers, attorneys offering "legal advice", engineers and accountants
- Act also creates the Consumer Financial Protection Bureau
- <https://www.sec.gov/answers/about-lawsshtml.html#secact1933>

Municipal Securities Rulemaking Board (“MSRB”)

- **Established by Congress in 1975:**
 - **Mission is to protect investors, municipal entities and obligated persons, and to promote a fair and efficient municipal market**
 - **Operates Electronic Municipal Market Access (“EMMA”) to promote transparency and provide widespread access to information**
- **MSRB rules are intended to:**
 - **Prevent fraudulent or manipulative practices**
 - **Promote just and equitable principles of trade**
- **Has no enforcement powers – its rules are enforced by:**
 - **FINRA for securities firms**
 - **Office of the Comptroller of the Currency, the Federal Reserve, or the FDIC for banks**
 - **SEC for municipal advisors, securities firms and bank dealers**
- **Bottom line: jurisdiction is over securities firms, municipal dealers and municipal advisors, NOT municipal issuers**
- **msrb.org**

AKF Legal Disclosure

Pursuant to Municipal Securities Rulemaking Board (“MSRB”) Rule G-42, on Duties of Non-Solicitor Municipal Advisors, Municipal Advisors are required to make certain written disclosures to clients and potential clients which include, among other things, Conflicts of Interest and Legal or Disciplinary events of AKF and its associated persons.

Conflicts of Interest

Compensation

AKF represents that in connection with the issuance of municipal fund securities, AKF receives compensation from its client issuers for services rendered on an hourly, retainer or fixed fee basis. Consistent with the requirements of MSRB Rule G-42, AKF hereby discloses that such forms of compensation may present a potential conflict of interest regarding AKF’s ability to provide unbiased advice regarding a municipal fund security transaction. This potential conflict of interest will not impair AKF’s ability to render unbiased and competent advice or to fulfill its fiduciary duty.

Other Municipal Advisor Relationships

AKF serves a wide variety of clients that may from time to time have interests that could have a direct or indirect impact on the interests of other AKF clients. For example, AKF serves as Municipal Advisor to other municipal fund securities clients and, in such cases, owes a regulatory duty to such clients just as it will with the entity receiving this proposal, if hired. These other clients may, from time to time and depending on the specific circumstances, have competing interests. In acting in the interests of its various clients, AKF could potentially face a conflict of interest arising from these competing client interests. AKF fulfills its regulatory duty and mitigates such conflicts by dealing honestly and with the utmost good faith with all clients.

If AKF becomes aware of any potential or actual conflicts of interest after this disclosure, AKF will disclose the detailed information in writing to the client or obligated person in a timely manner.

Legal or Disciplinary Events

AKF does not have any legal events or disciplinary history on its Form MA and Form MA-I, which includes information about any criminal actions, regulatory actions, investigations, terminations, judgments, liens, civil judicial actions, customer complaints, arbitrations and civil litigation. You may electronically access AKF’s most recent Form MA and each most recent Form MA-I filed with the Securities and Exchange Commission at the following website: www.sec.gov/edgar/searchedgar/companysearch.html. If any material legal or regulatory action is brought against AKF, AKF will provide complete and detailed disclosure to its clients, thereby allowing each client to evaluate AKF, its management and personnel.



ScholarShare Board Investment Training

Meketa Investment Group

December 2021



ScholarShare Board Investment Training

Table of Contents

1. The Framework: Policy Statements

- Investment Policy
- Monitoring Procedures

2. The Line-Up: Investment Portfolios

- Asset Allocation and Diversification
- Building Portfolios

**The Framework:
Policy Statements**

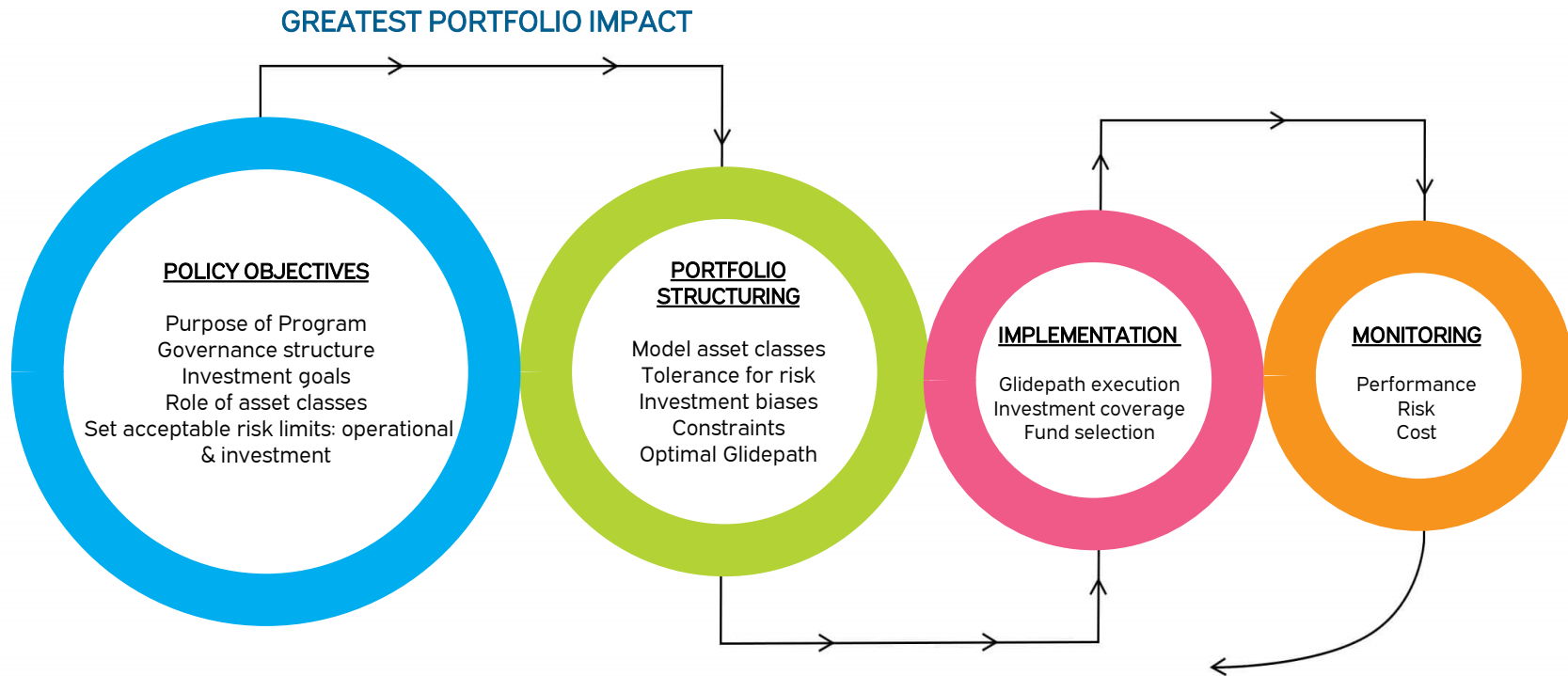


Program Structure Goals

- 1 Offer a range of options across the risk spectrum – utilizing high quality funds
- 2 Diversified options should provide broad based capital market exposure
- 3 Efficient from a risk-return perspective; meet or exceed the rate of college tuition inflation
- 4 Identify/remove unintended biases
- 5 Cost conscious



The Framework





Elements of an Investment Policy Statement

Specifies Program's Guiding Principals





Evaluating the Program

Approach and Understanding of Investment Design

- Overall appropriateness of investment options – rational capital markets exposure
- Review portfolio's effectiveness at generating returns relative to the risks incurred

Due Diligence and Risk Management

- Overall risk oversight
- Underlying fund evaluation
- Asset allocation / risk analysis

Appropriateness of 529 Investment Menu

- The number and quality of the investment options
- Broad based capital market exposure
- Investment biases
- Reasonableness of cost relative to investment structure



Monitoring Procedures

- The Monitoring Procedures are designed to aid in making the best decisions on behalf of participants.
- Since Programs are mostly comprised of retail mutual funds or exchange traded funds as the underlying components, performance data is easily accessible.
- The key element to developing the Monitoring Procedures is to pre-determine a level of underperformance that is unacceptable.
 - To accept actively managed funds is to accept periods of relative underperformance (beyond portfolio management fees).
 - It is important to establish a level of underperformance where the fund no longer meets expectations.
- The Monitoring Procedures then provide for predetermined steps to address funds that do not exhibit material improvement.



Manager/Fund Monitoring

The evaluation process should exhibit several key features

- Objectivity
- Balance between short-term issues and long-term objectives
- Biases of client

While the process might be fluid, a systematic documented approach is essential

- Incorporate quantitative and qualitative aspects of managers/funds' practices
- Understanding the role of the manager/fund in the Program
- Clear time period of review



Manager/Fund Monitoring

Quantitative Review

Formulaic criteria focused on

- Relative performance versus a benchmark/peer group over various time periods

Understand underperformance

- Is investment style out of favor?
- What are the biases of the investment strategy?
- Do the portfolio characteristics reflect its stated investment style?
- Is the benchmark/peer group an accurate representation of the fund's opportunity set?
- Is the underperformance consistent with expectations?

Qualitative Review

Non-performance issues

- Has there been a change in ...
 - People – PM/Analysts
 - Process
 - Philosophy
 - Organizational Structure

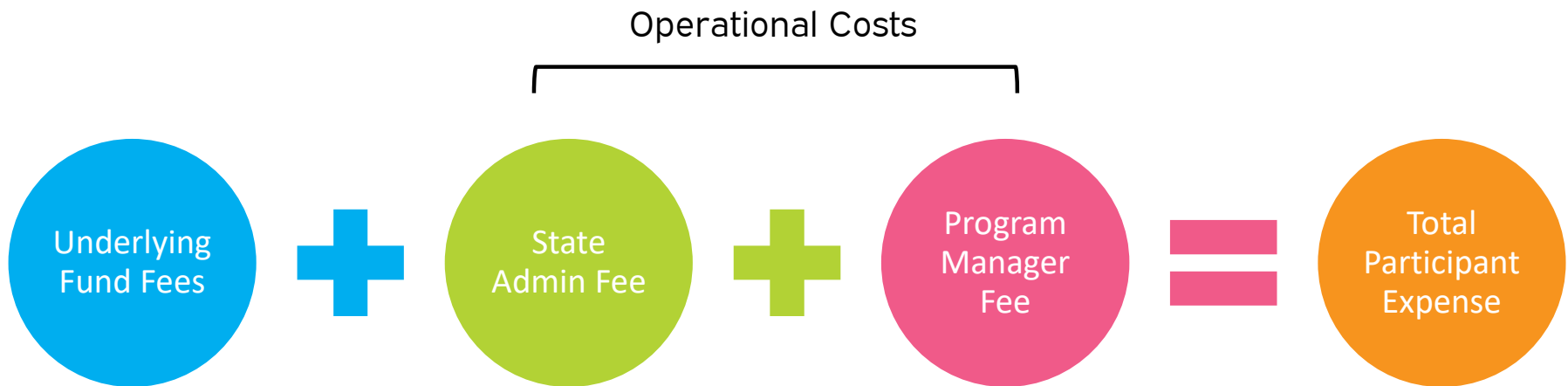
Implications of change/event

- Is the change a positive or negative?
- How will it impact the management of the fund?
- How will it impact the firm/team culture?
- Will it be a distraction to the investment process?



529 Portfolio Fee Components

- Evaluate how competitive fees are versus peers



**The Line-up:
Investment Portfolios**



The Line-up

Investment Menu (Similar to 401k Plans)

- **Age- / Enrollment-based Options (most common choice of participants)**
 - Diversified options that de-risk over the investment horizon
 - **Static Options (Risk-based)**
 - Asset allocation remains the same over time
 - **Stand Alone (Individual) Options**
 - Invests in a single fund
- **FDIC Option**
 - Savings account
 - **Stable Value Option**
 - Protects against decline in yield and loss of capital

Conservative
Options



Asset Allocation and Diversification

What's the difference?

Asset Allocation

The portion, or percentage, of each asset class that an investor has in their portfolio. For example, 60% stocks and 40% bonds.

Diversification

A risk management practice to reduce the impact of any one investment, by investing in a mix of assets that move up and down under different market conditions.

Different, but related.



Asset Allocation and Diversification

Asset allocation is one of the most important decision an investor makes

- Asset allocation decisions dominate the risk and return in investment results
- Impact of other decisions like manager selection is minimal
- Awareness of risk embedded in an asset allocation is critical

A properly developed (diversified) asset allocation ...

- Combines risky assets (stocks) with less risky assets (bonds & cash)
- To meet a return target while minimizing their risk (volatility)

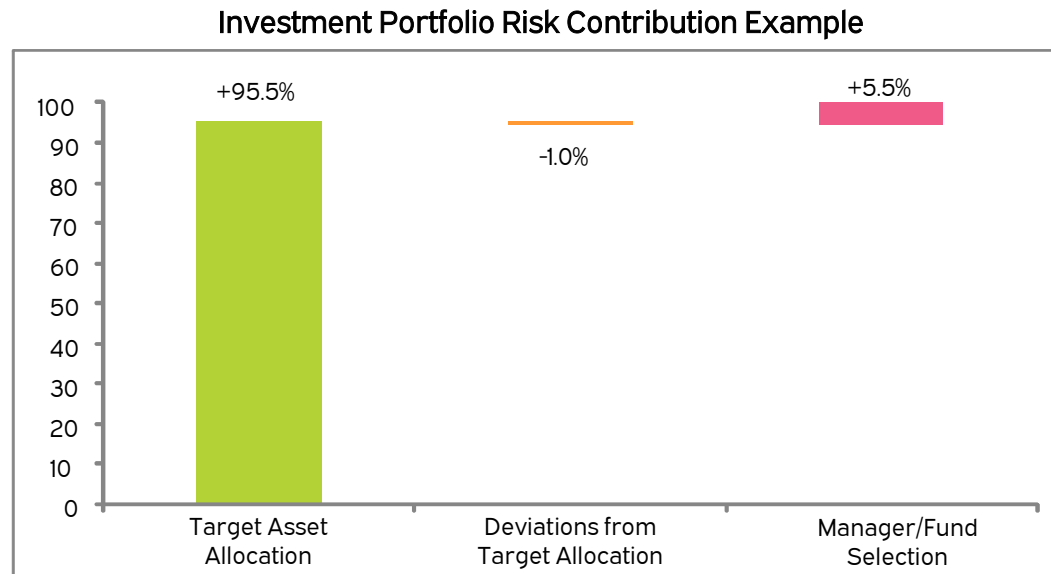
Volatility

How much a portfolio's overall value fluctuates up and down.



Impact of Asset Allocation and Diversification

The Plan determines the asset allocation for participants in age-based and static 529 Portfolios.





Asset Allocation and Diversification

Overview of Asset Classes

- The investable universe is largely composed of just two broad asset classes.
- Historically, these major asset classes have not moved up and down at the same time.

Equity

Stocks

- Ownership in publicly traded companies
- Categorized by style, market capitalization, and geography
- Role: Growth

Fixed Income

Bonds

- Essentially loans that the investor (lender) makes to an entity (borrowers)
- Role: Protection and income generation

Cash Equivalents

- Short term, highly liquid, low risk debt instruments
- Role: Capital Preservation



Asset Allocation and Diversification

Investable Universe

- 529 Plans are limited to public markets
- Representing approximately 90% of the investable universe
- Equity and Fixed Income asset classes can be broken into numerous sub-asset classes
- Each sub-class has its own inherent risk and return potential

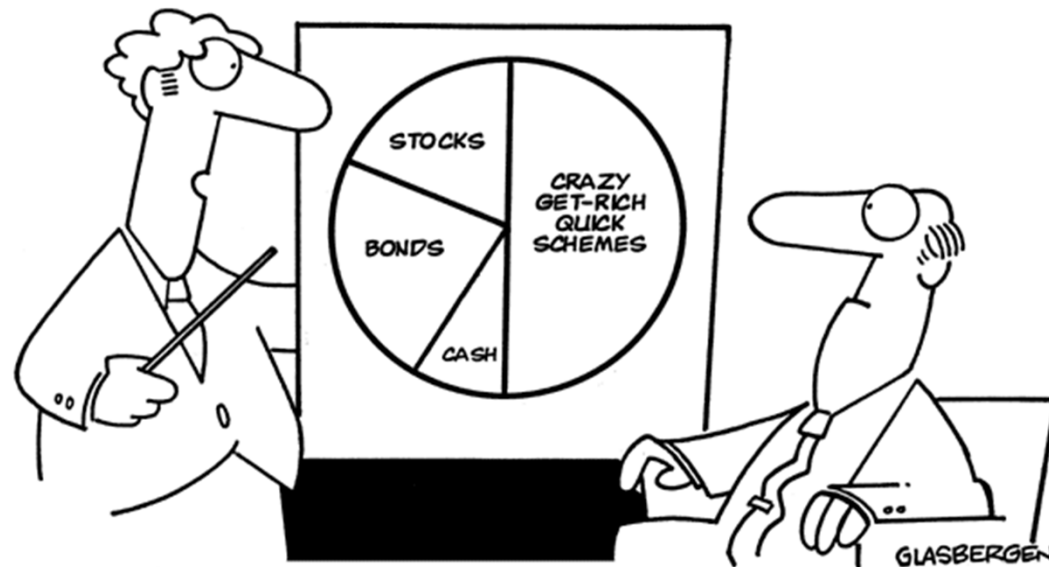
Asset Class	Market Size (USD, Trillions)	% of Global Investable Universe
US Equity	43.1	22.8
Non-US Equity (Developed)	32.4	17.1
Non-US Equity (Emerging)	9.7	5.1
Public Real Estate Equity	4.6	2.4
Commodities	2.1	1.1
US Bonds	25.3	17.9
Bank Loans	1.6	0.8
Non-US Bonds (Developed)	33.9	13.4
Emerging Markets Bonds	8.8	4.6
Inflation-Linked Bonds	3.3	1.7
Money Market/Cash Equivalents	4.5	2.4
Private/Illiquid Markets		
Private Equity	4.5	2.4
Private Debt	0.9	0.5
Infrastructure	0.5	0.3
Natural Resources, Energy, Timberland and Agriculture	0.2	0.1
Private Real Estate	10.2	5.4
Hedge Funds	3.8	2.0
Total	189.4	100.0

Data Sources: MSCI, Bloomberg, BIS.org, LaSalle Accessing the Real Estate Universe in 2021, Preqin, NCREIF, Investment Company Institute



Asset Allocation and Diversification

- Why not just invest in the asset classes which have the highest expected long-term returns?



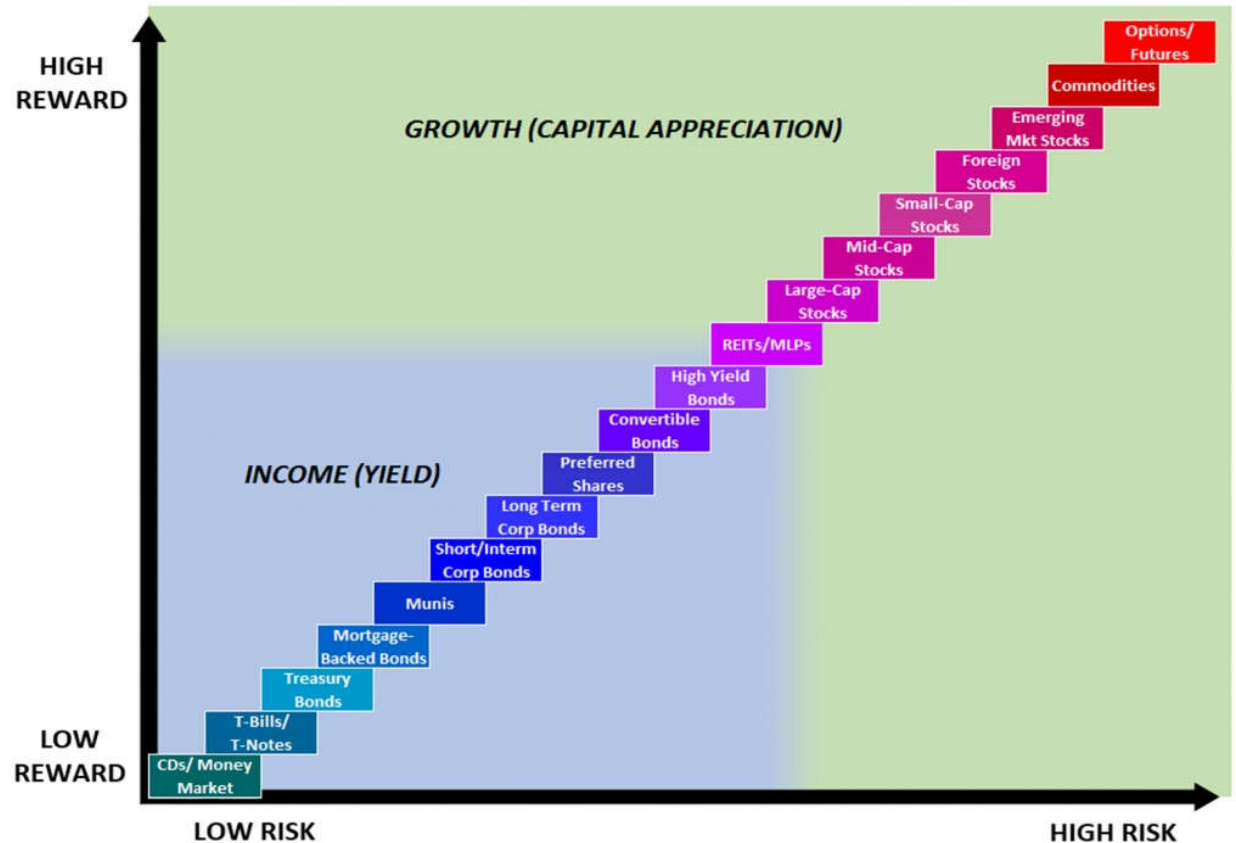
“I’d like you to consider a bold new strategy...”



Asset Allocation and Diversification

Risk (Volatility)

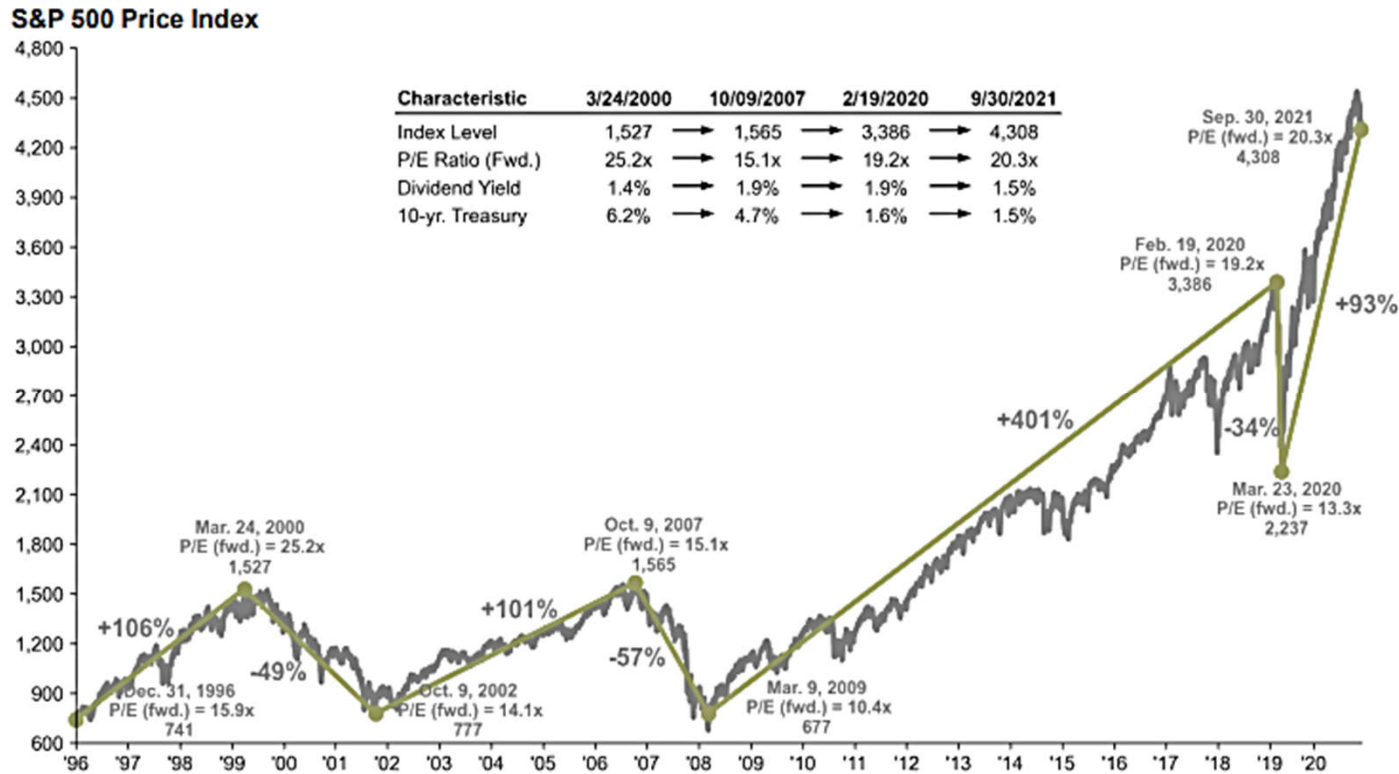
- There exists a tradeoff between volatility and return
- Historically, stocks have significantly outperformed other asset classes
- But with significantly greater volatility





Asset Allocation and Diversification

Potential volatility of risky assets: US equities fall $\approx 50\%$ 2x in the last 20 years

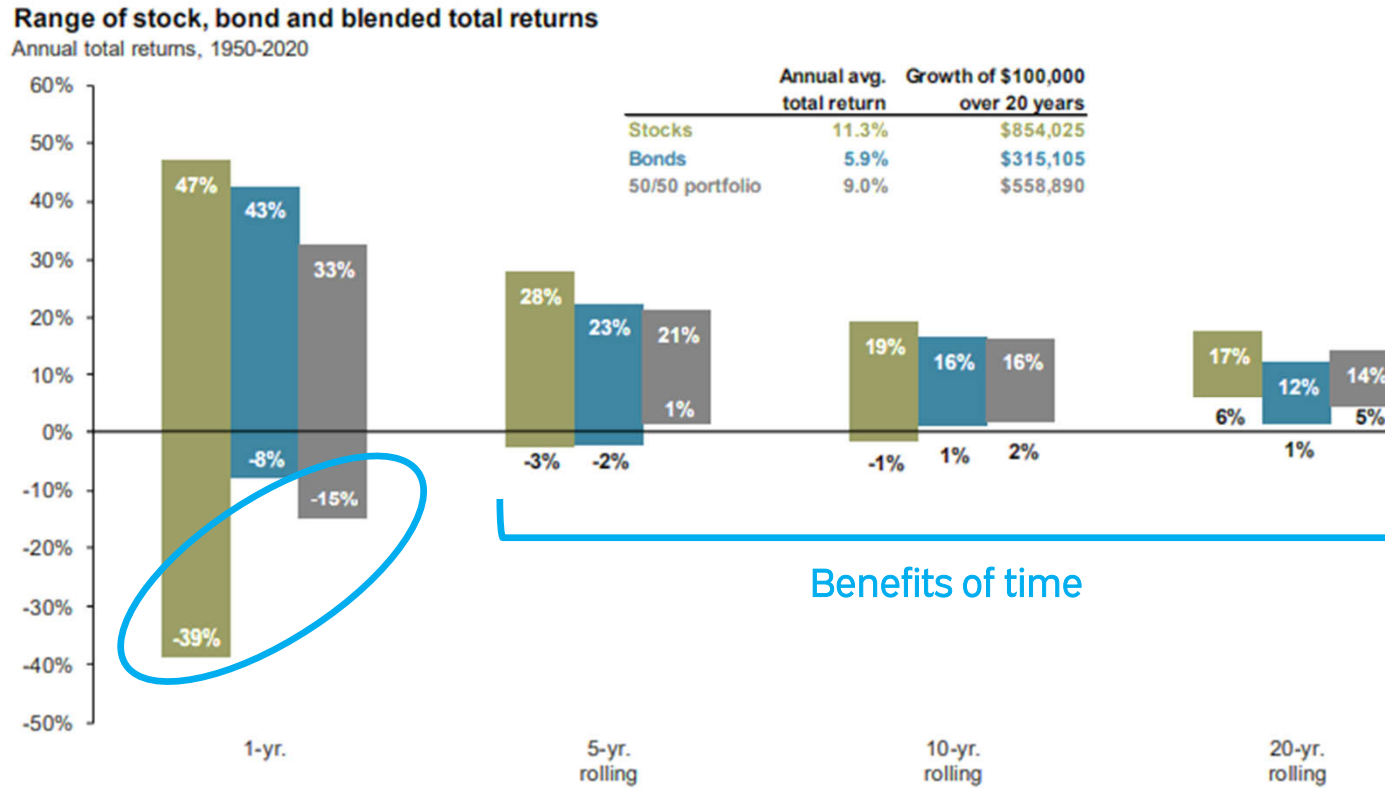


Source: Compustat, FactSet, Federal Reserve, Standard & Poor's, J.P. Morgan Asset Management.
 Dividend yield is calculated as consensus estimates of dividends for the next 12 months, divided by most recent price, as provided by Compustat. Forward price to earnings ratio is a bottom-up calculation based on the most recent S&P 500 Index price, divided by consensus estimates for earnings in the next 12 months (NTM), and is provided by FactSet Market Aggregates. Returns are cumulative and based on S&P 500 Index price movement only, and do not include the reinvestment of dividends. Past performance is not indicative of future returns.
 Guide to the Markets - U.S. Data are as of September 30, 2021.



Asset Allocation and Diversification

Over time, US equities produce the best returns but exhibit largest variation in returns



Source: Barclays, Bloomberg, FactSet, Federal Reserve, Robert Shiller, Strategas/Ibbotson, J.P. Morgan Asset Management. Returns shown are based on calendar year returns from 1950 to 2020. Stocks represent the S&P 500 Shiller Composite and Bonds represent Strategas/Ibbotson for periods from 1950 to 2010 and Bloomberg Barclays Aggregate thereafter. Growth of \$100,000 is based on annual average total returns from 1950 to 2020.
Guide to the Markets - U.S. Data are as of September 30, 2021.



Asset Allocation and Diversification

Diversification

- Combining risky assets (stocks) with relatively safe assets (bonds), the investor achieves diversification
- Diversification happens when assets don't move directly together
 - By holding assets that are not highly correlated, the overall portfolio exhibits less risk (volatility) than the individual risky assets
- Since diversification can reduce risk while not reducing expected return, diversification is often said to be **the only "free lunch" in investing**





Returns for Different Asset Classes

																2006 - 2020	
2006	2007	2008	2009	2010	2011	2012	2013	2014	2015	2016	2017	2018	2019	2020	YTD	Ann.	Vol.
REITs 35.1%	EM Equity 39.8%	Fixed Income 5.2%	EM Equity 79.0%	REITs 27.9%	REITs 8.3%	REITs 19.7%	Small Cap 38.8%	REITs 28.0%	REITs 2.8%	Small Cap 21.3%	EM Equity 37.8%	Cash 1.8%	Large Cap 31.5%	Small Cap 20.0%	Comdty. 29.1%	Large Cap 9.9%	EM Equity 23.3%
EM Equity 32.6%	Comdty. 16.2%	Cash 1.8%	High Yield 59.4%	Small Cap 26.9%	Fixed Income 7.8%	High Yield 19.6%	Large Cap 32.4%	Large Cap 13.7%	Large Cap 1.4%	High Yield 14.3%	DM Equity 25.6%	Fixed Income 0.0%	REITs 28.7%	EM Equity 18.7%	REITs 21.6%	Small Cap 8.9%	REITs 23.1%
DM Equity 26.9%	DM Equity 11.6%	Asset Alloc. -25.4%	DM Equity 32.5%	EM Equity 19.2%	High Yield 3.1%	EM Equity 18.6%	DM Equity 23.3%	Fixed Income 6.0%	Fixed Income 0.5%	Large Cap 12.0%	Large Cap 21.8%	REITs -4.0%	Small Cap 25.5%	Large Cap 18.4%	Large Cap 15.9%	High Yield 7.5%	Small Cap 22.6%
Small Cap 18.4%	Asset Alloc. 7.1%	High Yield -26.9%	REITs 28.0%	Comdty. 16.8%	Large Cap 2.1%	DM Equity 17.9%	Asset Alloc. 14.9%	Asset Alloc. 5.2%	Cash 0.0%	Comdty. 11.8%	Small Cap 14.6%	High Yield -4.1%	DM Equity 22.7%	Asset Alloc. 10.6%	Small Cap 12.4%	REITs 7.1%	DM Equity 19.1%
Large Cap 15.8%	Fixed Income 7.0%	Small Cap -33.8%	Small Cap 27.2%	Large Cap 15.1%	Cash 0.1%	Small Cap 16.3%	High Yield 7.3%	Small Cap 4.3%	DM Equity -0.4%	EM Equity 11.6%	Asset Alloc. 14.6%	Large Cap -4.4%	Asset Alloc. 19.5%	DM Equity 8.3%	DM Equity 8.8%	EM Equity 6.9%	Comdty. 18.8%
Asset Alloc. 15.3%	Large Cap 5.5%	Comdty. -35.6%	Large Cap 21.5%	High Yield 14.8%	Asset Alloc. -0.7%	Large Cap 16.0%	REITs 2.9%	Cash 0.0%	Asset Alloc. -2.0%	REITs 8.6%	High Yield 10.4%	Asset Alloc. -5.8%	EM Equity 18.9%	Fixed Income 7.5%	Asset Alloc. 8.7%	Asset Alloc. 6.7%	Large Cap 16.7%
High Yield 13.7%	Cash 4.8%	Large Cap -37.0%	Asset Alloc. 25.0%	Asset Alloc. 13.3%	Small Cap -4.2%	Asset Alloc. 12.2%	Cash 0.0%	High Yield 0.0%	High Yield -2.7%	Asset Alloc. 8.3%	REITs 8.7%	Small Cap -11.0%	High Yield 12.6%	High Yield 7.0%	High Yield 1.7%	DM Equity 5.0%	High Yield 12.2%
Cash 4.8%	High Yield 3.2%	REITs -37.7%	Comdty. 18.9%	DM Equity 8.2%	DM Equity -11.7%	Fixed Income 4.2%	Fixed Income -2.0%	EM Equity -1.8%	Small Cap -4.4%	Fixed Income 2.6%	Fixed Income 3.5%	Comdty. -11.2%	Fixed Income 8.7%	Cash 0.5%	Cash 0.0%	Fixed Income 4.5%	Asset Alloc. 11.8%
Fixed Income 4.3%	Small Cap -1.6%	DM Equity -43.1%	Fixed Income 5.9%	Fixed Income 6.5%	Comdty. -13.3%	Cash 0.1%	EM Equity -2.3%	DM Equity -4.5%	EM Equity -14.6%	DM Equity 1.5%	Comdty. 1.7%	DM Equity -13.4%	Comdty. 7.7%	Comdty. -3.1%	EM Equity -1.0%	Cash 1.2%	Fixed Income 3.2%
Comdty. 2.1%	REITs -15.7%	EM Equity -53.2%	Cash 0.1%	Cash 0.1%	EM Equity -18.2%	Comdty. -1.1%	Comdty. -9.5%	Comdty. -17.0%	Comdty. -24.7%	Cash 0.3%	Cash 0.8%	EM Equity -14.2%	Cash 2.2%	REITs -5.1%	Fixed Income -1.6%	Comdty. -4.0%	Cash 0.8%

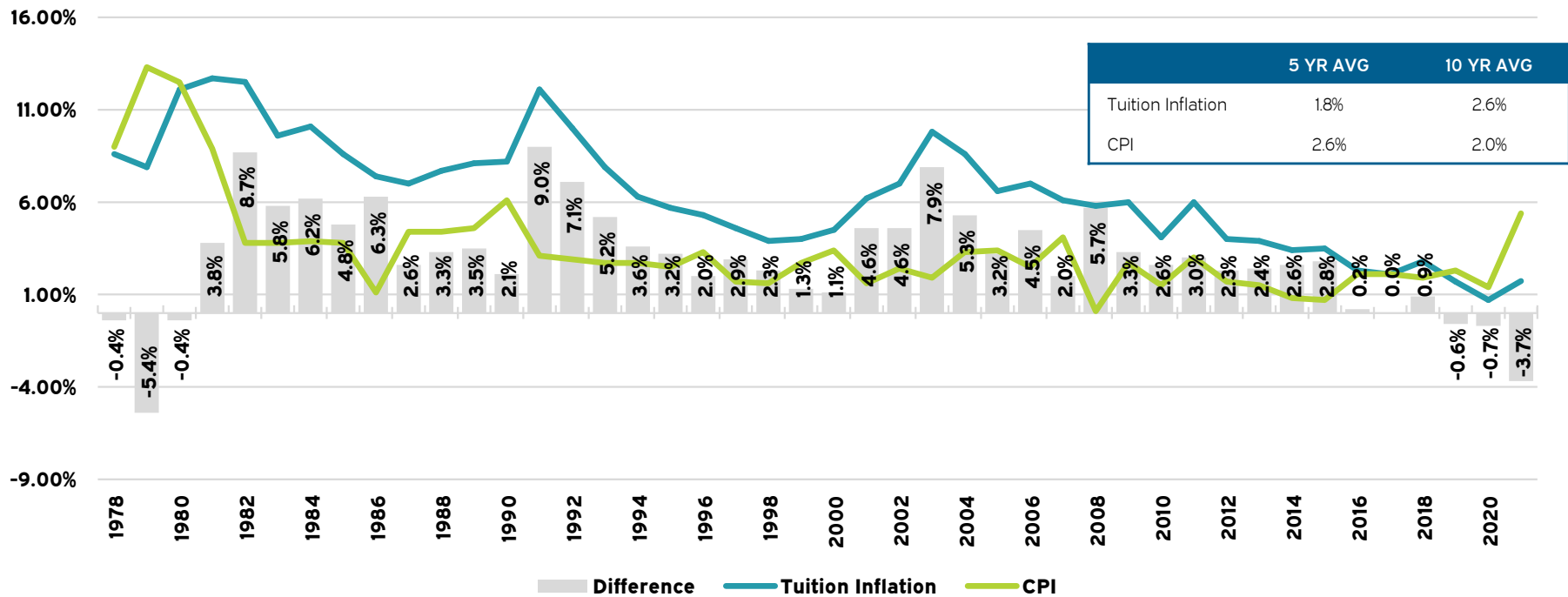
Source: Barclays, Bloomberg, FactSet, MSCI, NAREIT, Russell, Standard & Poor's, J.P. Morgan Asset Management.
 Large cap: S&P 500, Small cap: Russell 2000, EM Equity: MSCI EME, DM Equity: MSCI EAFE, Comdty: Bloomberg Commodity Index, High Yield: Bloomberg Barclays Global HY Index, Fixed Income: Bloomberg Barclays US Aggregate, REITs: NAREIT Equity REIT Index, Cash: Bloomberg Barclays 1-3m Treasury, The "Asset Allocation" portfolio assumes the following weights: 25% in the S&P 500, 10% in the Russell 2000, 15% in the MSCI EAFE, 5% in the MSCI EME, 25% in the Bloomberg Barclays US Aggregate, 5% in the Bloomberg Barclays 1-3m Treasury, 5% in the Bloomberg Barclays Global High Yield Index, 5% in the Bloomberg Commodity Index and 5% in the NAREIT Equity REIT Index. Balanced portfolio assumes annual rebalancing. Annualized (Ann.) return and volatility (Vol.) represents period from 12/31/2005 to 12/31/2020. Please see disclosure page at end for index definitions. All data represents total return for stated period. The "Asset Allocation" portfolio is for illustrative purposes only. Past performance is not indicative of future returns. Guide to the Markets - U.S. Data are as of September 30, 2021.



Building Portfolios Cost of College

- A 529 plan should at least keep up with tuition inflation

Year-Over-Year, 1977 – September 2021
Price Inflation for College Tuition and Fees
Consumer Price Index v. CPI, U.S. Bureau of Labor Statistics



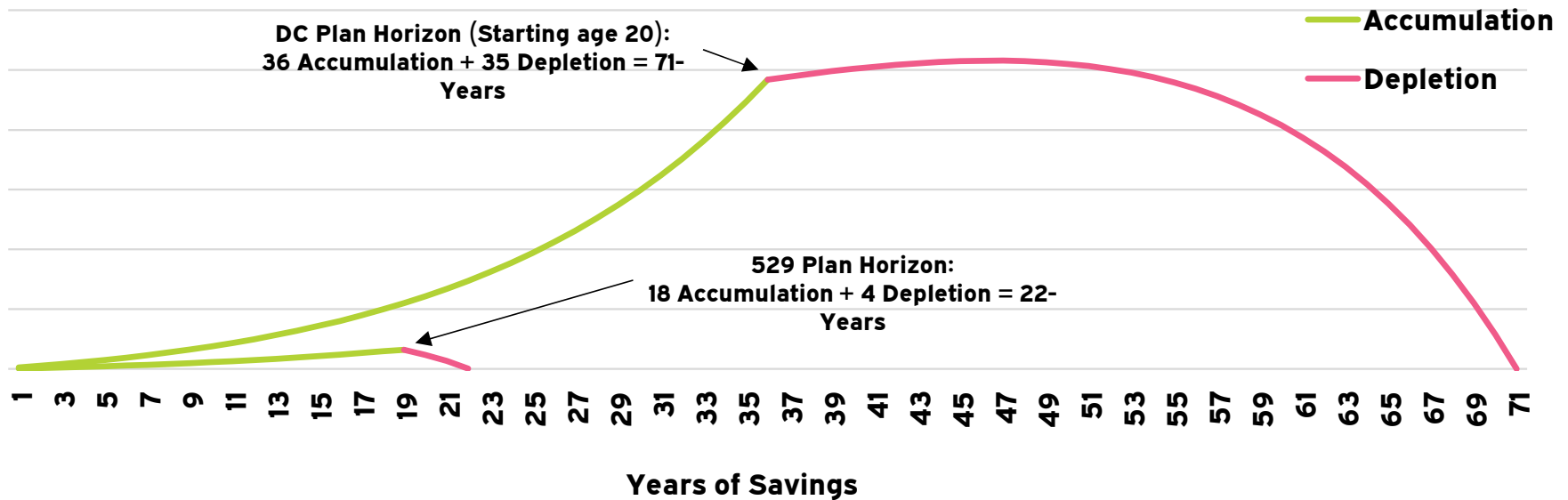


Building Portfolios

Biggest Constraint of All: Time

- Most plans use a condensed version of a defined contribution Glidepath
- The investment horizon of a 529 plan is < 1/3rd that of a defined contribution plan
- Shorter accumulation horizon = less time to recover from portfolio drawdowns

Comparing Investment Horizons



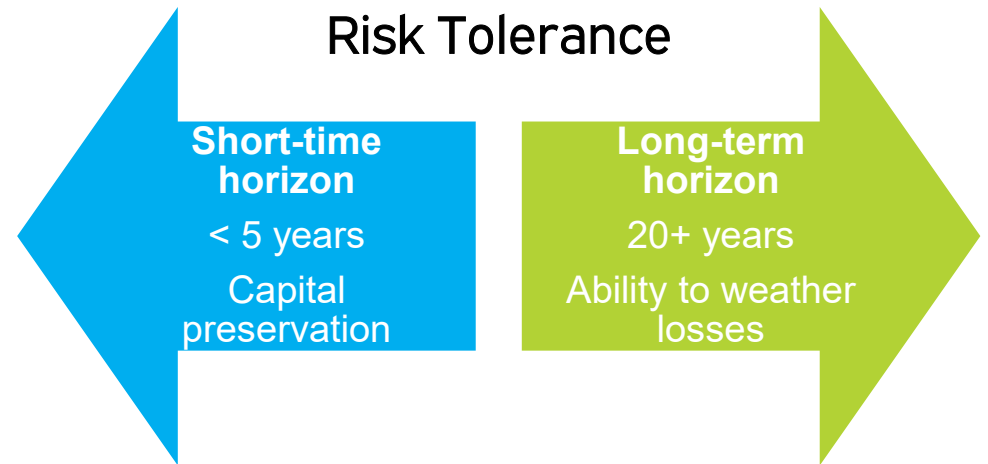


Building Portfolios

Glidepath

A Glidepath refers to a formula that defines the asset allocation mix of age- or enrollment-based funds

- From the inception to the end of the investment period
- Reflects risk tolerance changes over time
- All Glidepath gradually get more conservative over time

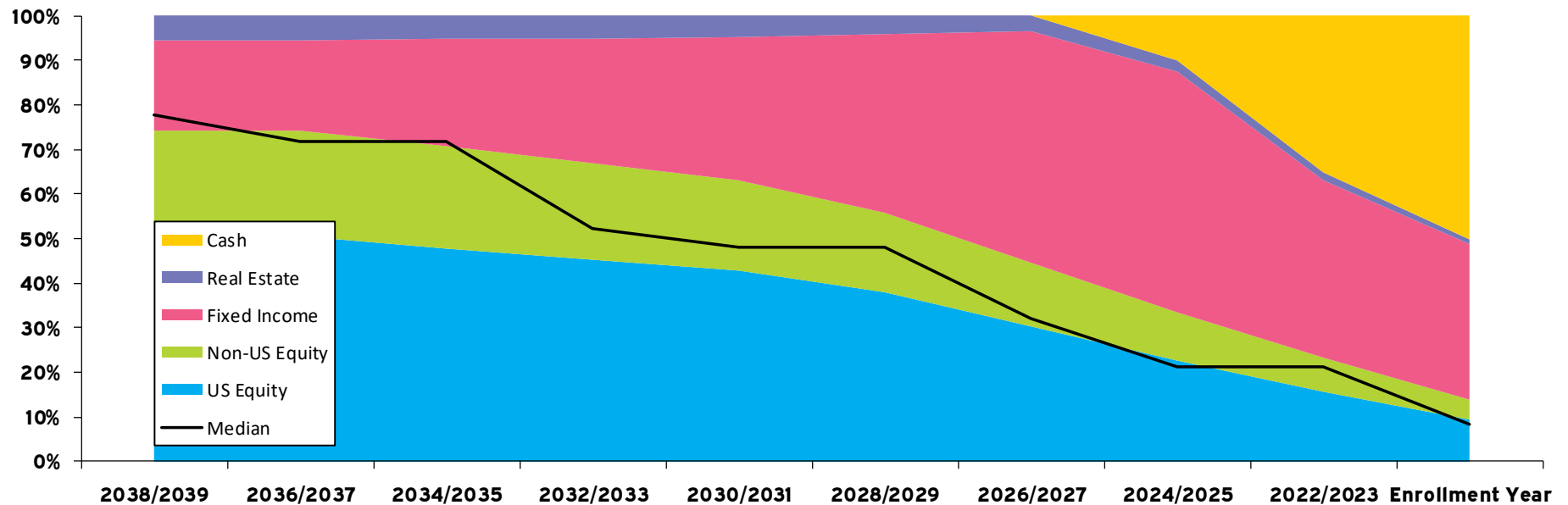




Building Portfolios

Sample Glidepath

- “One stop shop” for investors, the asset allocation automatically adjusts over time
 - Most providers follow similar broad asset class mixes over time (equity v. fixed)
 - At the sub-asset level, each can vary greatly and have materially different risk-return profiles

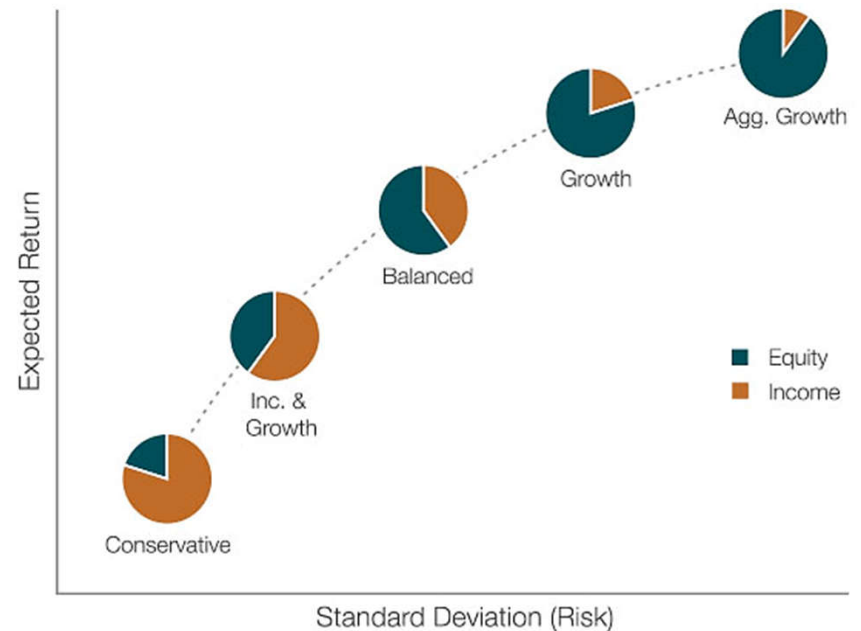




Building Portfolios

Static Portfolios

- Asset allocation remains unchanged over time
- Offered in index, active, or blended form
- Allows an investor to target a point along the efficient frontier that aligns with their risk tolerance



Questions?