MAY 16, 2022

AGENDA ITEM 2
ACTION ITEM

SCHOLARSHARE INVESTMENT BOARD

Resolution to Approve Investment Options for School-Age Beneficiaries for the California Kids Investment and Development Savings Program

Recommendation
ScholarShare Investment Board (SIB or Board) staff recommend the Board adopt Resolution No. 2022-10 approving the investment portfolio options for the School-Age Cohort Accounts for school-age beneficiaries in the California Kids Investment and Development Savings Program (CalKIDS or Program).

Background
CalKIDS, California's statewide children's savings account (CSA) program, was established in July 2019. In July 2021, CalKIDS was significantly expanded and requires the Board to open CalKIDS accounts for eligible first through 12th grade public school students, as identified by the Local Control Funding Formula (LCFF) in fiscal year 2021-2022, and eligible first grade public school students as identified by LCFF in fiscal year 2022-2023 and each subsequent year. CalKIDS is currently in development and preparing for launch.

Statute authorizes the Board to invest funds held in CalKIDS accounts within ScholarShare 529 (Plan) or other savings plan options as determined by the Board. In evaluating the Program's account structure and investment options for the School-Age Cohort Accounts for the school-age beneficiaries, Meketa, SIB's independent investment consultant, reviewed the investment portfolio options, along with the goals and objectives of the Program, and provided its analysis (Exhibit A) of investment options for these CalKIDS accounts. In consultation with Meketa and following a review of Meketa's analysis, SIB staff proposes the investment portfolio options as listed below:

- Funds in the School-Age Cohort Account for school-age beneficiaries in grades 1-5 be invested in the Plan in the corresponding Passive Enrollment Year Investment Portfolio.
- Funds in the School-Age Cohort Account for school age beneficiaries in grades 6-12 be invested in the funding agreement outside of the Plan and offered by TIAA-CREF Life Insurance Company (TCLIC).

Therefore, SIB staff recommends the Board adopt Resolution No. 2022-10, approving the investment portfolio options for the school-age beneficiaries in the Program.

Presenters
Julio Martinez, Executive Director, ScholarShare Investment Board
Noah Lightman, Manager, CSA Initiatives, ScholarShare Investment Board
Eric White, Principal, Meketa Investment Group, Inc.

RESOLUTION NO. 2022-10

RESOLUTION OF THE SCHOLARSHARE INVESTMENT BOARD RELATING TO THE APPROVAL OF THE INVESTMENT PORTFOLIO OPTIONS FOR SCHOOL-AGE BENEFICIARIES FOR THE CALIFORNIA KIDS INVESTMENT AND DEVELOPMENT SAVINGS PROGRAM

WHEREAS, the California Kids Investment and Development Savings Program ("CalKIDS" or the "Program") and CalKIDS fund are established pursuant to Education Code sections 69996.1 and 69996.9, respectively;

WHEREAS, the ScholarShare Investment Board (the "SIB" or "Board") was created under Education Code section 69980 et seq. (the "Golden State ScholarShare Trust Act" or "Act");

WHEREAS, Section 69996.4(c) of the Education Code provides that the Board shall have the powers and authority to cause moneys in the program fund to be held and invested and reinvested;

WHEREAS, Section 69996.3(f) of the Education Code provides that the Board shall establish one or more accounts (the "accounts") and shall make a separately accounted-for seed deposit from the CalKIDS fund into a KIDS Account established within a ScholarShare 529 (Plan) account or other child savings plan in an amount determined by the Board; and

WHEREAS, Section 69996.9 of the Education Code provides that the Board shall establish a KIDS Account, if not already established, for each eligible public school student and provide those students with one to three enhanced deposits of $500 each, as applicable; and

WHEREAS, in consultation with the Board's investment consultant (the "Consultant"), SIB staff reviewed the goals and objectives for the Program, the CalKIDS account structure, the Plan's investment portfolios and other investment portfolio options, and recommend the funds be invested in the investment portfolio options as follows:

- Funds held in the School-Age Cohort Accounts for school-age beneficiaries in grades 1-5 in CalKIDS be invested in the corresponding Passive Enrollment Year Investment Portfolio in the Plan.
- Funds held in the School-Age Cohort Account for school-age beneficiaries in grades 6-12 in CalKIDS be invested in the funding agreement outside of the Plan and offered by TIAA-CREF Life Insurance Company.

NOW, THEREFORE, BE IT RESOLVED, that the Board hereby approves the investment portfolio options for the School-Age Cohort Accounts for school-age beneficiaries in CalKIDS, as recommended by SIB staff, and as outlined in the Consultant's memo dated May 16, 2022.

BE IT FURTHER RESOLVED, that this Resolution becomes effective upon its adoption by the Board.

Attest: ___________________________________
Chairperson

Date of Adoption: __________________________

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MEMORANDUM

TO: ScholarShare Investment Board (SIB)
FROM: Meketa Investment Group ("Meketa")
DATE: May 16, 2022
RE: CalKIDS Expansion Recommendation

Recommendation

Meketa has reviewed the California Kids Investment and Development Savings Program's (CalKIDS or Program) investment structure as it relates to the July 2021 expansion to include eligible 1st through 12th grade public school students. It is our understanding that a portion of the funds for these participants will need to be held outside of ScholarShare 529 (Plan) in a non-529 account.

Following discussions with Staff, we jointly concluded the expansion results in two participant cohorts with distinct risk-return profiles. One cohort consisting of CalKIDS account(s) for eligible school-age beneficiaries (school-age cohort) composed of students in 1st through 5th grades and an additional non-529 cohort consisting of CalKIDS account(s) for eligible school-age beneficiaries closer to distribution age (distribution cohort) consisting of students in the 6th through 12th grades. We believe this structure matches the corresponding risk-return profiles of the individual components of the Program. This structure emphasizes capital preservation for those eligible beneficiaries near distribution while providing a low-cost dynamic investment for the eligible school-age beneficiary cohorts that self-adjusts to reduce risk as the cohort nears matriculation. In addition, this structure, which includes a larger age range for the distribution cohort than first envisioned, also accounts for a number of operational considerations which lead it to be optimal from a Program launch perspective.

Therefore, Meketa recommends the SIB approve Staff's recommendation to utilize the TIAA-CREF Life Funding Agreement outside of the Plan for the CalKIDS distribution cohort (school-age beneficiaries in grades 6-12) and the corresponding passive enrollment year portfolio within the Plan for the CalKIDS school-age cohort accounts (school-age beneficiaries in grades 1-5).

Background

In July 2021, CalKIDS was significantly expanded and requires the Board to open CalKIDS accounts for eligible 1st through 12th grade public school students. SIB Staff requested that Meketa review the Program's structure as it relates to how the assets from the expansion should be invested. Following discussions with Staff, it was determined that the school-age cohort, those school-age beneficiaries in the 1st through 5th grades, would be best served by being in an investment designed to generate principal growth in a manner consistent with their risk tolerance. For the school-age beneficiaries who are sufficiently close to distribution age, those in 6th through 12th grades, meaningful principal growth is not a realistic objective and instead principal preservation should be of primary concern.

CalKIDS Account	Grades	Primary Investment Objective	Recommended Investment
School-age Cohort(s)	1st through 5th	Principal growth consistent with risk tolerance	Passive enrollment year portfolios
Distribution Cohort	6th through 12th	Capital preservation	TIAA-CREF Life Funding Agreement (non-529)

Based on our analysis, we believe the primary objective for the distribution cohort (CalKIDS school-age beneficiaries in 6th through 12th grades) should be the preservation of capital as there is only a modest time until funds are distributed. We believe the TIAA-CREF Life Funding Agreement, outside of the Plan, meets this objective as the assets are not subject to NAV (principal) volatility as it maintains a stable NAV while offering a crediting rate (interest rate) at yields similar to high quality short-to-intermediate fixed income securities.

For the school-age cohort (CalKIDS school-age beneficiaries in 1st through 5th grades), we believe the primary objective should be to maintain tuition purchasing power over time. To maintain tuition purchasing power the corresponding investment option must have the ability to appreciate over time (principal growth). The investment should also take the beneficiary's risk tolerance into account which is largely driven by the time remaining until distribution. Accordingly, the investment should become more conservative over time as the time until distribution diminishes. We believe the enrollment year portfolios best meet this objective. The enrollment year portfolios invest in growth assets (stocks) when the beneficiary is young (and has a long-time horizon before distribution) and then shift to more conservative investments as the beneficiary nears distribution. We also believe the cost of the investment should be a secondary consideration and, therefore, believe the passive enrollment year portfolios within the Plan are the best investment options for the school-age cohort.

It could be argued that the distribution cohort covers an excessive age distribution leading to inefficient capital allocation for the younger segment of that cohort, those in the 6th through 8th grades. A number of considerations lead to the current recommendation relative to an arguable "more optimal" allocation wherein this segment would be allocated to the enrollment year portfolios:

1. The allocation to risk assets has already been materially reduced by that point in the glidepath limiting the exposure to growth assets. Combined with the modest sum of money invested the potential shortfall from the recommended structure versus a more optimal one is likely an immaterial difference in at-matriculation wealth.
2. The allocation to risk assets is eliminated shortly thereafter resulting in only a brief time exposed to growth assets which results in period-specific return pattern. Over simplistically, this essentially results in a couple year wager on the performance of the global equity markets.

3. Operational considerations make it significantly more advantageous to pursue the proposed structure relative to an arguably more optimal portfolio structure. This likely includes an earlier Program launch date.

Based on these factors, Meketa believes the operational considerations, including the potential launch date of the Program, trump the argument for pursuing optimal implementation structure. When accounting for the fact that the optimal implementation structure may, 1.) not prove to be "optimal" in the real-world experience, or 2.) that even if there is an advantage the actual difference in at-matriculation wealth will likely be immaterial, and 3.) the fact that all participants will benefit from the launch of the Program and any delay to launch in the pursuit of marginal structural improvements disadvantages (all participants including those that the delay would be designed to benefit) it is clear the proposed structure should be pursued.

Meketa, therefore, believes the TIAA-CREF Life Funding Agreement, outside of the Plan, is the optimal investment for the CalKIDS school-age beneficiaries in the 6th through 12th grades (the distribution cohort) and that the corresponding passive enrollment year portfolio within the Plan is optimal for the CalKIDS school-age beneficiaries in the 1st through 5th grades (the school-age cohort(s)).

EW/KC/IH/mp/ndb