



## Program Review

January 28, 2015

*Prepared for:*



## CollegeBoundfund 529 Program



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# Program Review Findings

Capital Cities has performed extensive due diligence on the CollegeBound*fund* Program since being retained as the investment consultant to the Program in October of 2014. Specifically, Capital Cities conducted interviews with Rhode Island personnel, performed an onsite visit at AllianceBernstein (Program Manager), participated in numerous conference calls with 529 professionals and investment managers at AllianceBernstein, completed a thorough review of the Program documents (Program Description, contracts, etc.), and evaluated 529 industry trends and peer group data. This due diligence, combined with our strong 529 experience, formed the foundation for this independent analysis. Outlined below is a summary of our Program Review findings.



**Investment Menus:** Overall, the investment menus are comprehensive, offering an investment solution for each type of investor with the Education Strategies Portfolios and Individual Funds. However, one gap exists within the International Equity space, as a Growth counterpart is not offered to the AllianceBernstein International Value Index Fund within the National Accounts' investment menu. Additionally, the Program offers a Small Cap Growth Fund as a “Specialty” option. This option is not required for participants to build a broadly, diversified portfolio.

➤ **Recommendations:**

- **National Accounts Menu:** Consideration should be given to the Value-bias within International Equity. Specifically, a Broad International Equity Fund should be considered in replacement of the International Value Index Fund or a complementary International Growth Equity Fund should be considered to be added to the line-up.
- **“Specialty” Individual Fund:** Consideration should be given to eliminating the AllianceBernstein Small Cap Growth Fund to simplify the line-up, given low participant utilization and investment overlap with the Discovery Growth Fund. Assets should be mapped to the Discovery Growth Fund.



**Education Strategies Portfolios & Construction:** The Education Strategies Portfolios offer Age-Based Portfolios and Fixed Allocation Portfolios. In total, 43 Education Strategies Portfolios are available to participants, which could lead to investment overlap and/or participant confusion. The Education Strategies Portfolios are broadly constructed with exposure to Equity, Alternatives and Fixed Income.

➤ **Recommendations:**

- **Active Age-Based Portfolios:** Further investigate the potential to diversify the equity and fixed income components. Closely monitor the effectiveness of the Volatility Management Strategy.
- **Age-Based CBf Morningstar Index Portfolios:** Closely monitor the performance and construction of the Portfolios relative to Morningstar's 529 College Savings Moderate Index.
- **Fixed Allocation Portfolios:** Consider the merits and consequences of offering the Fixed Allocation Portfolios.

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# Program Review Findings

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- **Manager Due Diligence/Monitoring:** All of the Education Strategies Portfolios require monitoring from both a qualitative and quantitative perspective. The majority of the Individual Funds rank well. Capital Cities will continue to monitor the qualitative and quantitative issues as part of our ongoing manager due diligence (see the Third Quarter Performance and Evaluation Report included as a separate attachment).
  
- **Fee Assessment:** While the CollegeBound*fund*'s bundled fee structure is not as transparent as some 529 Programs, the overall fees charged are competitive. Additionally, Capital Cities has uncovered ways to reduce investment management expenses for participants. Based on our due diligence, Capital Cities has received confirmation from AllianceBernstein that the CollegeBound*fund* is eligible for less expensive share classes for six Individual Funds. This savings represents ~\$270,000 annually for participants.
  - **Recommendations:**
    - Education Strategies Portfolios: Re-address stated Education Strategies Portfolios' fees with AllianceBernstein.
    - **Individual Funds: Move to less expensive share classes of the Individual Funds where appropriate.**
  
- **Investment Policy Statement:** Capital Cities has developed a Draft Investment Policy Statement for the CollegeBound*fund*.
  - **Recommendation:** Review and finalize the Investment Policy Statement prepared by Capital Cities (see separate attachment).

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# Investment Menus

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Education Strategies Portfolios		Individual Funds		
Age-Based	Age-Based Conservative Growth (8 Portfolios)	Value Equity	AllianceBernstein Growth and Income Fund	
	Age-Based Moderate Growth (12 Portfolios)		AllianceBernstein International Value Index Fund	
	Age-Based Aggressive Growth (12 Portfolios)		AllianceBernstein Discovery Value Fund	
	Age-Based CBf Morningstar Index (7 Portfolios)			
Fixed Alloc	Conservative		Growth Equity	AllianceBernstein Large Cap Growth Fund
	Balanced			AllianceBernstein Discovery Growth Fund
	Appreciation			AllianceBernstein Small Cap Growth Portfolio
			Fixed Income	AllianceBernstein Bond Inflation Strategy Fund
				AllianceBernstein Global Bond Portfolio
		AllianceBernstein Principal-Protection Income Portfolio		

- The investment menu for National Accounts is comprehensive, offering Education Strategies Portfolios (Age-Based and Fixed Allocation) and Individual Funds.
- **Age-Based Portfolios** offer participants pre-diversified portfolios that become more conservative over time as the beneficiary nears college entrance date. The Age-Based Portfolios are offered through a series of three active tracks based on risk tolerance and one passive track based on Morningstar's 529 College Savings Moderate Index.
- **Fixed Allocation Portfolios** offer participants three pre-diversified Portfolios based on risk tolerance. The strategic asset allocation of these Portfolios remain static over time.
- **Individual Funds** offer participants nine stand-alone Funds that are designed to provide the basic building blocks to create a diversified portfolio, along with exposure to some specialized asset classes for further diversification.
- The investment menu is solely comprised of proprietary AllianceBernstein Funds.
- **Overall, the Program offers an investment solution for each type of investor (“Do it For Me” vs. “Do it Myself”).**

# ➤ Examining the Individual Funds Offered to National Accounts

The investment menu for National Accounts offers exposure to each major asset class, which should allow investors to build broadly diversified portfolios from the Individual Fund line-up.

Basic Building Blocks	CollegeBoundfund (National Accounts)	Asset Class Coverage
Stable Value	AllBern Principal-Protection Income Portfolio	✓
Flexible Fixed Income	AllianceBernstein Global Bond Portfolio	✓
Large Cap Equity/S&P 500 Index	AllianceBernstein Growth and Income Fund	✓
	AllianceBernstein Large Cap Growth Fund	
Small/Mid Cap Equity	AllianceBernstein Discovery Value Fund	✓
	AllianceBernstein Discovery Growth Fund	
International Equity	AllBern International Value Index Fund	
	International Growth Fund (Missing)	
Specialty Styles:		
Small Cap Growth	AllianceBernstein Small Cap Growth Portfolio	Not Required
Real Return	AllianceBernstein Bond Inflation Strategy Fund	✓

- Each of the major asset classes is represented by one to two Individual Funds within the National Accounts' menu.
  - In the case where two Individual Funds represent a particular asset class (Large Cap Equity and Small/Mid Cap Equity), participants are able to reflect a style bias (Value or Growth) or can combine the Funds in order to gain style-neutral exposure.
  - On the other hand, offering two Individual Funds within the same asset class can lead to investment overlap and/or investor confusion.
- All of the Individual Fund offerings are actively managed, with the exception of the International Value Index Fund.
- One gap exists within the International Equity space, as a Growth counterpart is not offered to the AllianceBernstein International Value Index Fund.
  - **Recommendation:** Consideration should be given to the Value-bias within International Equity. Specifically, a Broad International Equity Fund should be considered in replacement of the International Value Index Fund or a complementary International Growth Equity Fund should be considered to be added to the line-up.

# Assessing the Investment Menu for RI Accounts

Education Strategies Portfolios		Individual Funds				
Age-Based	Age-Based Conservative Growth (8 Portfolios)	Value Eq	AllianceBernstein Growth and Income Fund	Passive Equity	Vanguard Total Stock Market Index Portfolio	
	Age-Based Moderate Growth (12 Portfolios)		AllianceBernstein Discovery Value Fund		Vanguard Total International Stock Index Fund	
	Age-Based Aggressive Growth (13 Portfolios)	Growth Equity	AllianceBernstein Large Cap Growth Fund		Passive Fixed Inc	Vanguard Total Bond Market Index Fund
	Age-Based CBf Morningstar Index (7 Portfolios)		AllianceBernstein Discovery Growth Fund			
	AllianceBernstein Small Cap Growth Portfolio					
Fixed Alloc	Conservative	Fixed Income	AllianceBernstein Bond Inflation Strategy Fund			
	Balanced		AllianceBernstein Global Bond Portfolio			
	Appreciation		AllBern Principal-Protection Income Portfolio			

- The investment menu for Rhode Island Accounts mostly mimics the line-up for National Accounts.
  - Three Vanguard options are offered as Individual Funds to Rhode Island participants.
  - The AllianceBernstein International Value Index Fund is not available to some participants given the Vanguard Total International Stock Index Fund is offered\*.
- The Vanguard Funds offer participants broad, passive exposure to domestic and foreign stocks, along with domestic bonds, at a low cost.
- **While there has been small participant adoption of the Vanguard options (\$23.4 million or 6.7% of Rhode Island Account assets), Capital Cities believes these passive options are prudent offerings in light of the fee sensitivity within the 529 space.**

# Examining the Individual Funds Offered to RI Accounts

Basic Building Blocks	CollegeBoundfund (Rhode Island Accounts)		Asset Class Coverage
	Active Management:	Passive Management:	
Stable Value	AllBern Principal-Protection Income Portfolio		✓
Flexible Fixed Income	AllianceBernstein Global Bond Portfolio	Vanguard Total Bond Market Index Fund	✓
Large Cap Equity/S&P 500 Index	AllianceBernstein Growth and Income Fund	Vanguard Total Stock Market Index Portfolio	✓
	AllianceBernstein Large Cap Growth Fund		✓
	AllianceBernstein Discovery Value Fund		✓
Small/Mid Cap Equity	AllianceBernstein Discovery Growth Fund		✓
International Equity		Vanguard Total International Stock Index Fund	✓
Specialty Styles: Small Cap Growth Real Return	AllianceBernstein Small Cap Growth Portfolio		Not Required
	AllianceBernstein Bond Inflation Strategy Fund		✓

- Each of the major asset classes is represented in the investment menu for Rhode Island Accounts.
- Participants have the option to utilize active and/or passive management in building a broadly diversified portfolio.
- No gaps in manager style coverage exist within the Rhode Island Accounts' line-up.



# ➤ Examining the “Specialty” Individual Funds Offered

The CollegeBoundfund Program (both National and RI Accounts) offers two “Specialty” options:

## AllianceBernstein Small Cap Growth Portfolio *Represents: \$19.6 mil (or 0.3% of Program Assets)*

Seeks long-term growth of capital by investing in a diversified portfolio of equity securities with relative smaller capitalizations as compared to the overall U.S. market. The Fund invests in well-known and established companies and in new and less-seasoned companies.

- ▲ The purpose of the Fund is to provide participants with dedicated exposure to Small Cap Growth stocks.
- ▲ The Fund allows participants to demonstrate a Growth bias within the Small Cap space if so desired.
- ▼ The Fund presents overlap with the AllianceBernstein Discovery Growth Fund (Small/Mid Cap Growth) which can lead to investment overlap and/or investor confusion.
- ▼ A Small Cap Value counterpart is not offered in the Program.

**Recommendation: Consideration should be given to eliminating the AllianceBernstein Small Cap Growth Fund to simplify the line-up, given low participant utilization and investment overlap with the Discovery Growth Fund. Assets should be mapped to the Discovery Growth Fund.**

## AllianceBernstein Bond Inflation Strategy Fund *Represents: \$470k (or 0.0% of Program Assets)*

Seeks to maximize real return by investing principally in Treasury Inflation-Protected Securities (“TIPS”), but has the flexibility to invest in other bond market segments.

- ▲ The purpose of the Fund is to provide a hedge against rising inflation and protect the purchasing power of a participant’s portfolio.
- ▲ Real Return/TIPS are commonly added Individual Fund options within the 529 space.
- ▲ The Fund provides diversification to the other Fixed Income options offered.
- ▼ TIPS performance can be potentially driven by non-inflationary factors such as market technicals.
- ▼ Diversified Real Return portfolios tend to provide the best protection against inflation, but can come at the cost of increased volatility.

Capital Cities will continue to assess the Real Return space and AllianceBernstein offerings in the future with consideration given to a more diversified exposure within Real Return.

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# Education Strategies Portfolios & Construction

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# Education Strategies Portfolios Overview

## Age-Based Portfolios

### Age-Based Conservative Growth

Before 1996  
1996-1998  
1999-2001  
2002-2004  
2005-2007  
2008-2010  
2011-2013  
2014-2016

### Age-Based Moderate Growth

Before 1984  
1984-1986  
1987-1989  
1990-1992  
1993-1995  
1996-1998  
1999-2001  
2002-2004  
2005-2007  
2008-2010  
2011-2013  
2014-2016

### Age-Based Aggressive Growth

Before 1984  
1984-1986  
Before 1987 (*RI Only*)  
1987-1989  
1990-1992  
1993-1995  
1996-1998  
1999-2001  
2002-2004  
2005-2007  
2008-2010  
2011-2013  
2014-2016

### Age-Based CBf Morningstar Index Portf

Age-Based CBf Morningstar Index Before 1999  
Age-Based CBf Morningstar Index 1999-2001  
Age-Based CBf Morningstar Index 2002-2004  
Age-Based CBf Morningstar Index 2005-2007  
Age-Based CBf Morningstar Index 2008-2010  
Age-Based CBf Morningstar Index 2011-2013  
Age-Based CBf Morningstar Index 2014-2016

## Fixed Allocation Portfolios

Conservative

Balanced

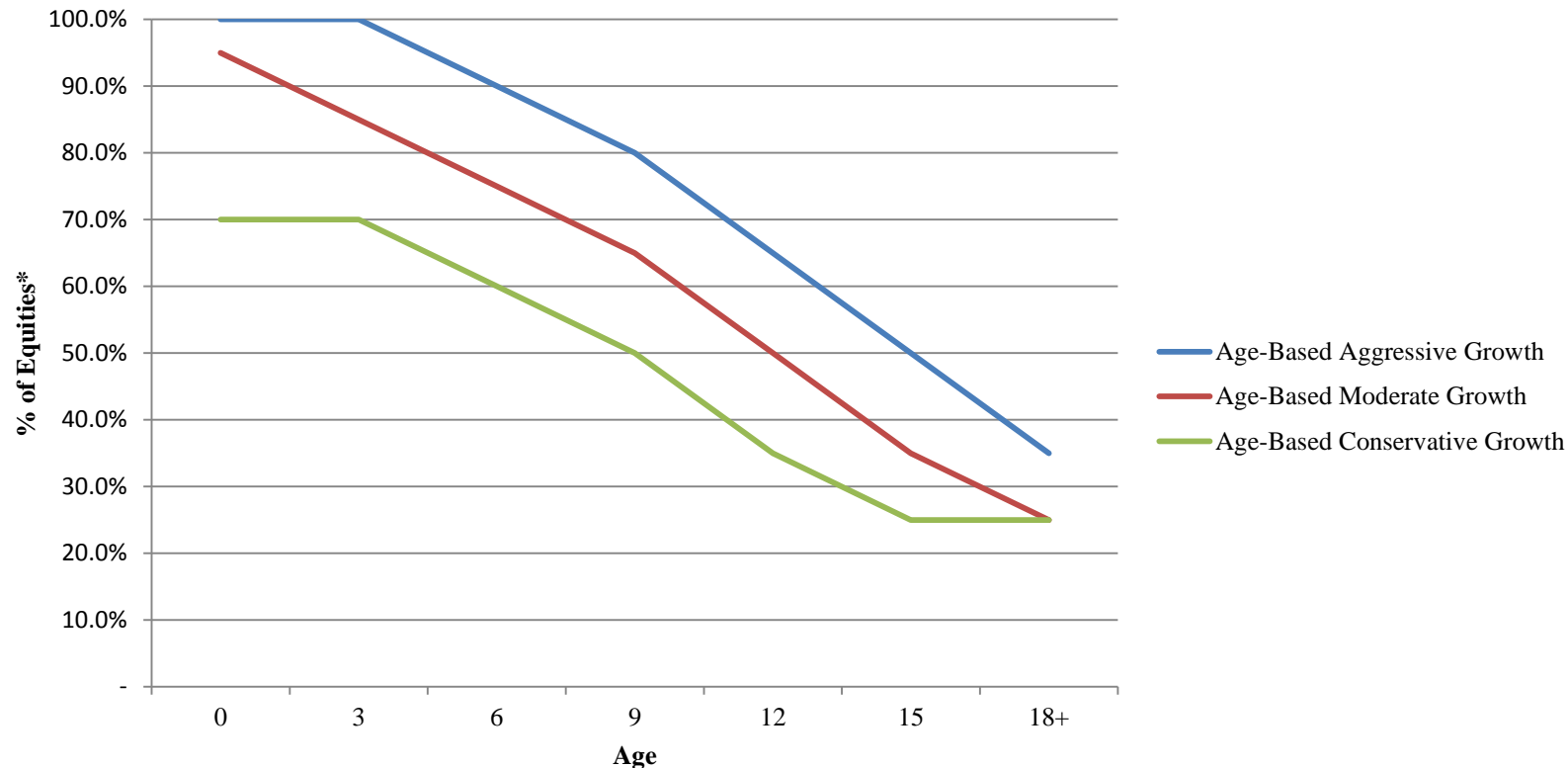
Appreciation

- The Education Strategies Portfolios offer Age-Based Portfolios and Fixed Allocation Portfolios.
  - **Age-Based Portfolios** offer participants pre-diversified portfolios that become more conservative over time as the beneficiary nears college entrance date. The Age-Based Portfolios are offered through a series of three active tracks based on risk tolerance and one passive track based on Morningstar's 529 College Savings Moderate Index.
  - **Fixed Allocation Portfolios** offer participants three pre-diversified Portfolios based on risk tolerance. The strategic asset allocation of these Portfolios remains static.
- **The CollegeBoundfund offers a total of 43 Education Strategies Portfolios, which could lead to investment overlap and/or participant confusion.**



# Active Age-Based Portfolios Overview

**The Active Age-Based Portfolios are appropriate offerings that provide participants pre-allocated solutions that factor both risk tolerance and time horizon.**

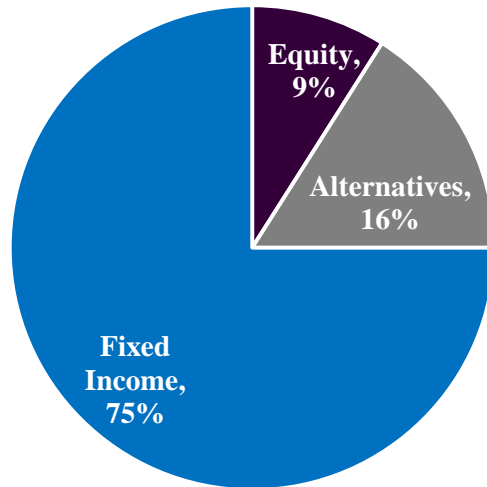


- The Active Age-Based Portfolios offer investors three distinct, pre-diversified Portfolio tracks based on a participant's risk tolerance and the beneficiary's birthdate.
- The Portfolios are broadly diversified with active exposure to equities, alternatives and fixed income.
- The Age-Based Portfolios' construction automatically becomes more conservative over time as the beneficiary nears his/her college entrance date (also known as the "glide path" of the Portfolios).
  - **The process in which the Portfolios become more conservative, along with rebalancing, occurs on a quarterly basis which is viewed quite favorably as this allows for a smooth transition to more conservative allocations.**

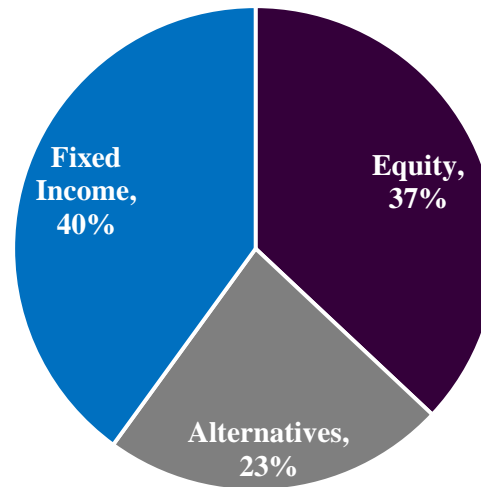


# Active Fixed Allocation Portfolios Overview

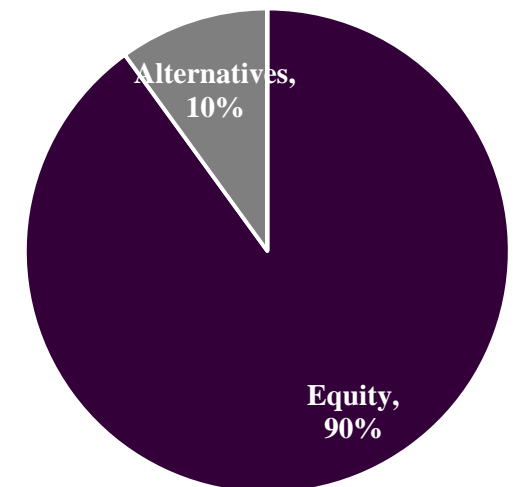
**Conservative**



**Balanced**



**Appreciation**



**Program Assets:** \$79.1 mil (1.1%)

\$435.1 mil (5.8%)

\$1.0 bil (13.8%)

- The Fixed Allocation Portfolios offer participants three distinct, pre-diversified Portfolios based on risk tolerance.
- The Portfolios are broadly diversified with active exposure to equities, alternatives and fixed income.
- Unlike the Age-Based Portfolios, the Fixed Allocation Portfolios maintain their strategic asset allocations over time and it is the participant's responsibility to shift from one Portfolio to another as his/her risk profile changes.
  - **The static allocation of the Fixed Allocation Portfolios requires active engagement by participants.**
- **The Fixed Allocation Portfolios present overlap with the Age-Based Portfolios (which already offer pre-diversified portfolios based on risk tolerance) which can lead to investment overlap and/or participant confusion.**
- The Fixed Allocation Portfolios are popular within the AllianceBernstein advisor community and represent a total of \$1.5 billion (or 20.7%) of Program assets.
- **Recommendation: Consider the merits and consequences of offering the Fixed Allocation Portfolios.**

# ▶ Active Education Strategies Portfolios Components

The Active Education Strategies Portfolios, including the Age-Based Portfolios and Fixed Allocation Portfolios, are broadly constructed with exposure to Equity, Alternatives and Fixed Income.

## Active Education Strategies Portfolios Components

Equity	Alternatives	Fixed Income
AllianceBernstein Growth & Income	AllianceBernstein Multi-Asset Real Return	AllianceBernstein High Yield
AllianceBernstein Small/Mid Cap Value	AllianceBernstein Volatility Management	AllianceBernstein Global Core Bond
AllianceBernstein Small/Mid Cap Growth		AllianceBernstein Bond Inflation Protection
AllianceBernstein International Factor		AllianceBernstein Short Duration Bond
		AllianceBernstein Exchange Reserves

The Equity component of the Portfolios provide exposure to Large Cap Value, Small/Mid Cap Value, Small/Mid Cap Growth, and International stocks.

- ▲ The Portfolios have exposure to both domestic and international stocks.
- ▲ The domestic/foreign allocation nearly reflects a neutral weighting at roughly 60%/40%.
- ▼ The Portfolios display a Value-bias within the Large Cap Equity space.
- ▼ The allocation to foreign stocks is more than peers and could present higher volatility.

### Recommendation:

Further investigate the potential to diversify the equity component.

The Alternatives component of the Portfolios provide exposure to Real Return and Volatility Management strategies.

- ▲ The Multi-Asset Real Return style provides an inflation-hedge component to the Portfolios and diversification to the traditional stock and bond exposure.
- ▲ The Volatility Management component is designed to smooth performance and volatility, particularly in extreme market environments.
- ▼ The tactical nature of the Volatility Management Strategy can materially alter the overall asset allocation of the Portfolios.

### Recommendation:

Closely monitor the effectiveness of the Volatility Management Strategy.

The Fixed Income component of the Portfolios provide exposure to High Yield, Global Core Bond, Bond Inflation Protection, Short Duration Bond and Cash.

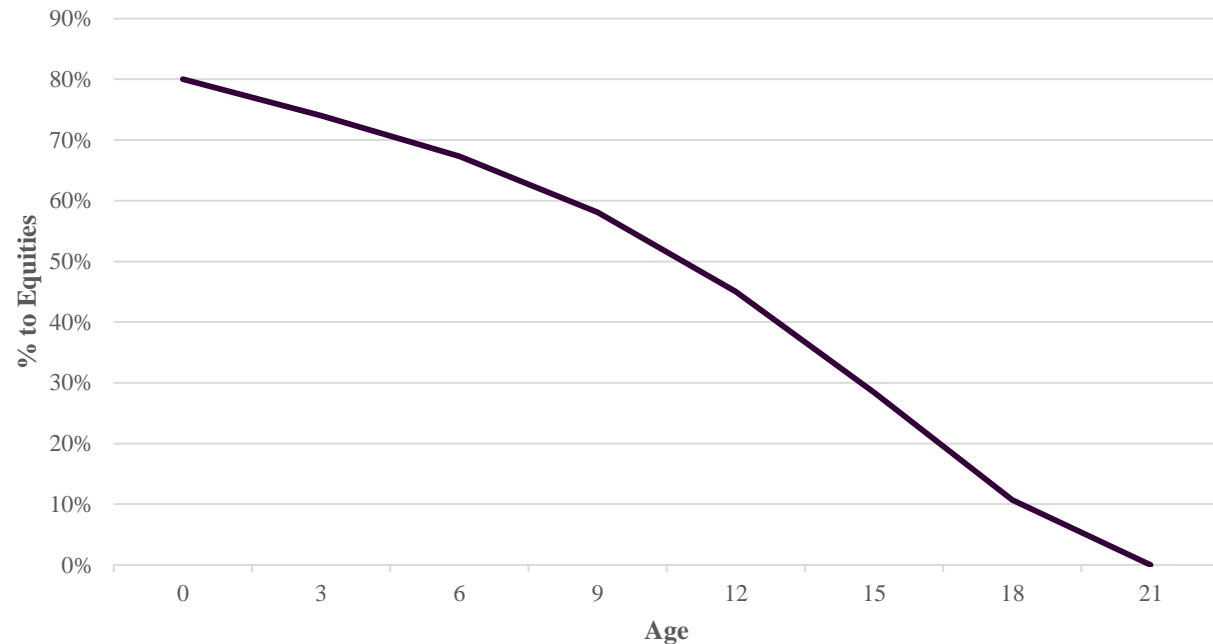
- ▲ The Portfolios have diversified exposure to the major bond segments.
- ▲ The Short Duration and Cash components should provide a ballast during times of market upheaval/flight to quality.
- ▲ The Bond Inflation Protection Strategy provides an inflation-hedge component to the Portfolios.
- ▲ The High Yield and Global Core Strategies can provide return potential.
- ▼ A multi-sector strategy might be more appropriate than dedicated High Yield.

### Recommendation:

Further investigate the potential to diversify and expand the fixed income allocations.

# ➔ Age-Based CBf Morningstar Index Portfolios Overview

**The Age-Based CBf Morningstar Index Portfolios are an attractive low-cost solution for investors seeking a “do it for me” investment option.**



- The Age-Based CBf Morningstar Index Portfolios are pre-diversified Portfolios that are based on the beneficiary’s birthdate.
  - The decision to select the Portfolios hinges on one variable—birthdate.
  - The Portfolios do not allow participants to factor in other variables, such as risk tolerance.
- The Portfolios are passively constructed and low cost.
- The construction of the Portfolios automatically becomes more conservative over time as the beneficiary nears his/her college entrance date.
- The glide path (the process in which the Portfolios become more conservative) is designed to mimic Morningstar's 529 College Savings Moderate Index.
  - The CollegeBoundfund is the first Program to leverage the asset allocation and index construction expertise of Morningstar.

# ➤ Age-Based CBf Morningstar Index Portfolios Components

Morningstar Moderate 529 College Savings Index	Age-Based CBf Morningstar Index Portfolios
US Large Value US Large Core US Large Growth US Mid Value US Mid Core US Mid Growth US Small Value US Small Core US Small Growth	AllianceBernstein US Equity Index Portfolio
NonUS Equity Emerging Markets	AllianceBernstein International Equity Index Portfolio
US REITs	AllianceBernstein REIT Index Portfolio
US Long Bond US Intermediate Bond US Short Bond	AllianceBernstein US Bond Index Portfolio
US TIPS	AllianceBernstein TIPS Index Portfolio
Non US Bond	AllianceBernstein International Government Bond Index Portfolio
Cash	AllianceBernstein Principal Protection Income Portfolio AllianceBernstein Exchange Reserves Portfolio

- The Age-Based CBf Morningstar Index Portfolios are broadly diversified with passive exposure to Equity, Alternatives and Fixed Income.
- The Age-Based CBf Morningstar Index Portfolios are constructed utilizing newly created AllianceBernstein collective funds.
  - **The relatively low asset levels within each of the underlying collective funds will likely result in tracking error relative to each fund's respective benchmark.**
- While the Morningstar's Moderate 529 College Savings Index is constructed utilizing 18 underlying manager styles, AllianceBernstein has simplified the construction to eight components mainly comprised of exchange-traded funds given the low asset levels. AllianceBernstein also utilizes its Stable Value Fund as a stabilizing component, which is not included within Morningstar's construction.
  - **The difference in underlying construction will likely cause tracking error relative to the Morningstar Index.**
  - As assets grow within the Portfolios, AllianceBernstein anticipates being able to match each Morningstar style and to construct the Portfolios utilizing a sampling and/or replication methodology.
- The deviation in performance of the CBf Morningstar Index Portfolios relative to the Morningstar benchmarks ranged from -4.05% to +0.85% for the since inception time period given cash flows, construction, etc.\*
- **Recommendation: Closely monitor the performance and construction of the Age-Based CBf Morningstar Index Portfolios relative to Morningstar's 529 College Savings Moderate Index.**



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# Manager Due Diligence/Monitoring

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# Evaluation Summary

## Education Strategies Portfolios:

Criteria	Aggressive Growth Age-Based Portfolios	Moderate Growth Age-Based Portfolios	Conservative Growth Age-Based Portfolios	Appreciation Portfolio	Balanced Portfolio	Conservative Portfolio	CBf Morningstar Index Age-Based Portfolios
Qualitative Review	●	●	●	●	●	●	●
Long Term Performance	●	●	●	●	●	●	--
Short Term Performance	●	●	●	●	●	●	●
Overall	●	●	●	●	●	●	●

Legend
● Everything is good to excellent in this area.
● Caution is warranted and further evaluation may be required.
● Action is required or is being taken.

## Education Strategies Portfolios Components:

Criteria	AB Growth & Income	AB Small/Mid Cap Value	AB Small/Mid Cap Growth	AB International Factor	AB Volatility Management	AB Bond Inflation Protection	AB Multi-Asset Real Return	AB Global Core Bond	AB High Yield	AB Short Duration Bond	AB Exchange Reserves	AB Passive Funds
Qualitative Review	●	●	●	●	●	●	●	●	●	●	●	●
Long Term Performance	●	●	●	--	--	●	●	●	●	●	●	--
Short Term Performance	●	●	●	●	●	●	●	●	●	●	●	●
Overall	●	●	●	●	●	●	●	●	●	●	●	●

## Individual Funds:

Criteria	AB Growth & Income	AB Large Cap Growth	AB Discovery Value	AB Discovery Growth	AB Small Cap Growth	AB International Value Index	AB Bond Inflation	AB Global Bond	AB Principal-Protection Income	Vanguard Total Stock Market Index	Vanguard Total Int'l Stock Index	Vanguard Total Bond Market Index
Qualitative Review	●	●	●	●	●	●	●	●	●	●	●	●
Long Term Performance	●	●	●	●	●	--	--	●	●	●	●	●
Short Term Performance	●	●	●	●	●	●	●	●	●	●	●	●
Overall	●	●	●	●	●	●	●	●	●	●	●	●

## Summary of Findings:

- All of the Education Strategies Portfolios require monitoring from both a qualitative and quantitative standpoint.
- The majority of the Individual Funds rank well.



# Qualitative Evaluation Notes

## Education Strategies Portfolios

**Age-Based Portfolios and Fixed Allocation Portfolios:** The tactical nature of the underlying Volatility Management Strategy can materially alter the overall asset allocation of the Portfolios which requires close monitoring of the Volatility Management Strategy's effectiveness.

**Age-Based CBf Morningstar Index Portfolios:** Tracking error is expected given the portfolio construction and low assets. While the Morningstar's Moderate 529 College Savings Index is constructed utilizing 18 underlying manager styles, AllianceBernstein has simplified the construction to eight components mainly comprised of exchange-traded funds given the low asset levels.

## Education Strategies Portfolios Components

**SMID Value:** Andrew Weiner, Director of Research for the Strategy since 2005, passed away in June of 2014. Shri Singhvi, an analyst on the team since 2008, assumed Mr. Weiner's position at that time. The Strategy continues to be lead by James MacGregor, Chief Investment Officer for the Fund, which mitigates concern.

**International Factor:** This Strategy's quantitative approach, along with the portfolio management team, is relatively new to AllianceBernstein (began in 2009 as a Long/Short mandate) and is not a core knitting of the firm. The International Factor Fund that is utilized within the Education Strategies Portfolios began in 2014. Additionally, the quantitative nature of the Fund requires close monitoring given its model-centric approach.

**Volatility Management:** The tactical nature of the Volatility Management Strategy requires close monitoring for effectiveness.

**Passive Funds:** The Program is utilizing newly created AB Passive Portfolios. The low asset levels within these Strategies will likely cause tracking error relative to each Portfolio's respective benchmark.

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# ➤ Qualitative Evaluation Notes *continued*

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## Individual Funds

**Discovery Value:** Andrew Weiner, Director of Research for the Strategy since 2005, passed away in June of 2014. Shri Singhvi, an analyst on the team since 2008, assumed Mr. Weiner's position at that time. The Strategy continues to be lead by James MacGregor, Chief Investment Officer for the Fund, which mitigates concern.

**Principal Protection:** The Principal Protection Fund is currently only wrapped by one firm, Voya, which raises concern regarding wrap diversification. AllianceBernstein's ability to gain additional wrap coverage should be closely monitored given the issues surrounding the stable value industry since 2008 (wrap providers exiting the business, increases in fees and investment constraints, etc.).



# Quantitative Evaluation Notes

## Short-Term Performance (three-year return for period ended 9/30/14):

**Age-Based Cbf Morningstar Index Portfolios and Underlying Passive Funds:** The deviation in performance of the Portfolios relative to the Morningstar benchmarks has been material given cash flows, construction, etc.

**AllianceBernstein Growth & Income:** The Fund's three-year return has fallen to the bottom half of peers given the significant underperformance displayed during the first half of 2014. The Portfolio's relative-value positioning, underweight to Utilities and REITs, and bias toward high-earnings-quality stocks detracted. This positioning is consistent with the Fund's philosophy/process.

**International Factor Fund:** The Fund has trailed its index in the short time it has been in the Program (March 2014). In particular, the Fund underperformed by 169 basis points during the second quarter. During this time period, a main contributor to underperformance was the Fund's exposure to companies with deep discounted valuation (most notably in Japan), as momentum stocks outperformed.

**Volatility Management:** The Strategy's three-year return has trailed its respective benchmark given underperformance displayed in calendar year 2012. During this time period, AllianceBernstein reduced equity and risk exposure given concerns regarding the market environment/fiscal cliff.

## Short and Long-Term Performance (three- and five-year returns for period ended 9/30/14):

**Age-Based Portfolios and Fixed Allocation Portfolios:** The Portfolios have materially trailed their respective benchmarks over the last three- and five-year time periods. The majority of the underperformance was a result of the Domestic and International Large Cap Equity Strategies (a total of four funds given respective Growth and Value exposure). These Strategies were removed from the Program in March of 2014 in lieu of AB Growth and Income and AB International Factor Strategies. Additionally, the relative underperformance of the Volatility Management Strategy was a detractor (as described above).

**Capital Cities will continue to monitor the qualitative and quantitative issues as part of our ongoing manager due diligence.**

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# Fee Assessment

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# 529 Fee Environment Overview

Program Manager

## Investment Management

The fees charged by investment managers for managing the investment options offered within the 529 Program. A portion of these fees can sometimes be rebated back to the Program to offset program management expenses (known as revenue-sharing).

## Program Management

The fee charged by the program manager to run the 529 Program, including recordkeeping, production of statements, etc.

## Enrollment

The fee charged by a program manager for a participant to enroll in the 529 Program.

## Account Maintenance

A fee charged by the program manager for the ongoing maintenance of a participant's 529 account.

## Service-Based/Other

Non-routine fees charged by the program manager to participants for returned checks, outgoing wires, etc.

## Distribution/ Servicing

A commission fee paid out of a participant's investment option(s) to his/her advisor.

## State Admin

A fee charged by the sponsoring state to cover 529 Program expenses, such as employee salaries, consultants, etc.

- There are a variety of fees that can be charged to participants within their 529 Program.
- **An apples-to-apples comparison of 529 Plans is difficult given that each state uniquely prices its Plan.**



# 529 Fee Structures

## “Unbundled”

Investment Management

Program Management

Enrollment/  
Account Maintenance/  
Other

Distribution/  
Servicing

State Admin

- 529 fees are impacted by:
  - Structure of the Program (Bundled vs. Unbundled)
  - Active (more expensive) vs. Passive (less expensive) Investment Management
  - Size of Program (larger leads to greater economies of scale)
- 529 fees have generally been trending down during recent years, but still tend to be higher than those experienced by consumers investing on their own given the costs of managing a 529 program.
- AllianceBernstein, the Program Manager, does not charge an explicit program management fee. A program management fee, however, is part of the total fee charged to both National and RI accounts in the Age-Based Portfolios.
  - 9.5 bps of Age-Based Portfolios’ investment management expense is rebated back to Rhode Island, representing an indirect “State Admin” fee.
- Additionally, AllianceBernstein, the sole investment management provider to the Program (with the exception of RI Vanguard Accounts), receives investment management fees.
- The CollegeBoundfund’s Enrollment/Account Maintenance/Other fees are in line with 529 peers.

## “Bundled” (CBf)

Investment Management/  
Program Management

Enrollment/  
Account Maintenance/  
Other

Distribution/  
Servicing

State Admin

**While the CollegeBoundfund’s bundled fee structure is not as transparent as some 529 Programs, the overall fees charged are competitive. Additionally, Capital Cities has uncovered ways to reduce investment management expenses for participants.**



# Investment Management Fees-Education Strategies

	Style	National Accounts	Median Peer Group Fee	RI Accounts	Median Peer Group Fee
<b>Age-Based Portfolios</b>					
Aggressive Growth	Age-Based	74-94 basis points	108 basis points	20 basis points	81 basis points
Moderate Growth	Age-Based	72-92 basis points	108 basis points	20 basis points	81 basis points
Conservative Growth	Age-Based	72-82 basis points	108 basis points	20 basis points	81 basis points
CBf Morningstar Index	Age-Based	45-56 basis points	75 basis points	16 basis points	37 basis points
<b>Fixed Allocation Portfolios</b>					
Appreciation	Fixed Allocation	94 basis points	108 basis points	94 basis points	81 basis points
Balanced	Fixed Allocation	80 basis points	108 basis points	80 basis points	81 basis points
Conservative	Fixed Allocation	72 basis points	108 basis points	72 basis points	81 basis points

- The Education Strategies Portfolios’ fees range from 45 to 94 basis points within the National Accounts’ investment menu and 16 to 94 basis points within the Rhode Island Accounts.
- All of the Education Strategies Portfolios have expense ratios below the median of their respective peers\*.
- Rhode Island Accounts receive an investment management fee discount relative to National Accounts with respect to the Age-Based Portfolios.
- The Education Strategies Portfolios have stated fees that are dictated by the contract with AllianceBernstein.
  - Fees were last negotiated in 2010.
  - The ability to reduce investment management expense within two of the underlying components of the Portfolios (AB Growth & Income and AB Exchange Reserves) further supports the need to address the Education Strategies Portfolios’ fees. See the following page for further detail.

**Recommendation: Re-address stated Education Strategies Portfolios’ fees with AllianceBernstein.**

\*Median Peer Group Fees are based on “Morningstar Names Best 529 College-Savings Plans for 2014” dated October 21, 2014.

# Investment Management Fees-Individual Funds

Manager	Style	Fee Schedule	Median Peer Group Fee
CBBYX AB Growth & Income	Large Value	65 basis points	90 basis points
APGYX AB Large Cap Growth	Large Growth	99 basis points	96 basis points
ABYSX AB Discovery Value	SMID Value	93 basis points	134 basis points
CHCYX AB Discovery Growth	SMID Growth	81 basis points	134 basis points
QUAIX AB Small Cap Growth	Small Growth	91 basis points	125 basis points
Alliance Bernstein International Value Index	International Value	55 basis points	119 basis points
ANBIX AB Bond Inflation Fund	TIPS	55 basis points	72 basis points
ANAIX AB Global Bond Fund	Global Fixed	59 basis points	90 basis points
Alliance Bernstein Principal-Protection Income	Stable Value	90 basis points	

Manager	Style	Fee Schedule	Median Peer Group Fee
<i>Rhode Island Accounts Only</i>			
VITSX Vanguard Total Stock Market	Passive Core Equity	4 basis points	46 basis points
VTIAX Vanguard Total Intl Stock Index	Passive International	14 basis points	99 basis points
VBTLX Vanguard Total Bond Index	Passive Fixed	8 basis points	53 basis points

**Legend:**

- Less expensive share class available
- Less expensive share class available & fee is higher than median of peers

- All of the active Individual Funds, with the exception of AB Large Cap Growth, have expense ratios below the median of their respective peers.
  - AB Large Cap Growth (99 bps) is slightly more expensive than the average Large Cap Growth Fund (96 bps).
- Many of the Individual Funds are not invested in the least expensive share class available at AllianceBernstein.
  - AB Growth & Income – 65 bps Adv share class > 63 bps Z share class
  - AB Large Cap Growth – 99 bps Adv share class > 90 bps Instl share class
  - AB Discovery Value – 93 bps Adv share class > 80 bps Z share class
  - AB Discovery Growth – 81 bps Adv share class > 67 bps Z share class
  - AB Bond Inflation Fund – 55 bps Instl share class > 52 bps Z share class
  - AB Global Bond Fund – 59 bps Instl share class > 54 bps Z share class
- The individual passive funds offered to Rhode Island residents in the *CollegeBoundfund* are competitively priced, as they are managed by Vanguard which is one of the lowest priced providers of passively managed funds within the retail space.

**Based on our due diligence, Capital Cities has received confirmation from AB that the CBf is eligible for the less expensive share classes detailed above. This savings represents ~\$270,000 annually for participants.**  
**Recommendation: Move to less expensive share classes of the Individual Funds where appropriate.**



\*Median Peer Group Fees are based on Callan Investments Mutual Fund Databases.

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# Investment Policy Statement

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# IPS Development of an Investment Policy Statement

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Fulfills the Most Important Function a Fiduciary Performs: To Set Investment Policy and Implementation Guidelines.

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Supports the “Paper Trail” and Provides the Best Defense in Litigation.

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Negates “Monday Morning Quarterbacking” and Provides Continuity During Board/Committee/Staff Turnover.

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Keeps Investment Process Intact During Periods of Market Upheaval.

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Reassures Account Owners and Beneficiaries of Investment Stewardship.

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- An IPS should give clear guidelines; create a reasonable process; provide a roadmap for making sound, long-term-oriented decisions; and, outline criteria to keep all fiduciaries on track.
- **Capital Cities has prepared a draft IPS for the Program (see attachment).**

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# Next Steps

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# Next Steps

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- Recommendations for Today:
  - Eliminate the AllianceBernstein Small Cap Growth Portfolio and map the assets to the AllianceBernstein Discovery Growth Fund (see page 8 for further details)
  - Move to less expensive share classes of the Individual Funds (share class Z or Institutional) as highlighted on page 25
- Review and formalize the Investment Policy Statement
- Further refine the Program Manager services and fees



# APPENDIX:

## CollegeBoundfund 529 Program

### Overview of Capital Cities

October 22, 2014

Joe Bill Wiley, Principal

Tiffany Spudich, Director, Client Relations





*Capital Cities' mission is to serve as your compass, resource and interpreter of all investment-related matters*

### Objective Partner

- Capital Cities' sole focus is to provide investment consulting services to tax-exempt institutions.
- Our interests are aligned with yours, as we are an **independent, employee-owned firm** with no affiliation with banks or investment managers—100% of our revenue is derived from providing investment consulting services.
- We utilize an *open-architecture* process in which the full universe of program managers and investment managers is at our disposal to evaluate and recommend to clients.

### Best Thinking, Custom Approach

- We believe each client's circumstance is unique and requires customized solutions—One size does not fit all.
- We always ask ourselves: *“What would we do if we were you?”*
- Our *seasoned team* members bring their unique set of talents and experiences to the table and weigh in on every material decision you face. Approximately two-thirds of the assets to which we consult are defined contribution and 529 plans.

### Differentiated Plan Construction & Efficient Monitoring

- We differentiate ourselves from others by our ability to incorporate an innovative thought process with forward-looking analysis.
- We believe decisions should be made only by considering the risk and return of the possibilities. ***Risk Measurement is not Risk Management.***
- Our efficient, productive approach to reporting focuses our clients' time and empowers them to make intelligent decisions.



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# Capital Cities, LLC

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## *Passionate People with Pure Intent*

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*Our commitment to providing the highest level of client service reflects the values ingrained in our seasoned professionals. We believe **honesty, integrity and respect** form the cornerstone for building trust.*



William Mauger  
*Principal,  
Managing Partner*



Joe Bill Wiley  
*Principal,  
Business Development*



Gene Krinn, CFA  
*Principal,  
Senior Advisor*



Amanda Black, MBA, CAIA  
*Director,  
Client Strategy*



Tiffany Spudich, MBA  
*Director,  
Client Relations*



Robert Pelkey  
*Director,  
Operations*



Tarek Zeni, MBA, CFA  
*Associate Consultant &  
Investment Analyst*



Corey Waddell  
*Associate Consultant  
& Investment Analyst*

*You will quickly  
learn to trust every  
member of our team  
to provide proactive  
and responsive  
service.*

*Prepared to be Your Partner*

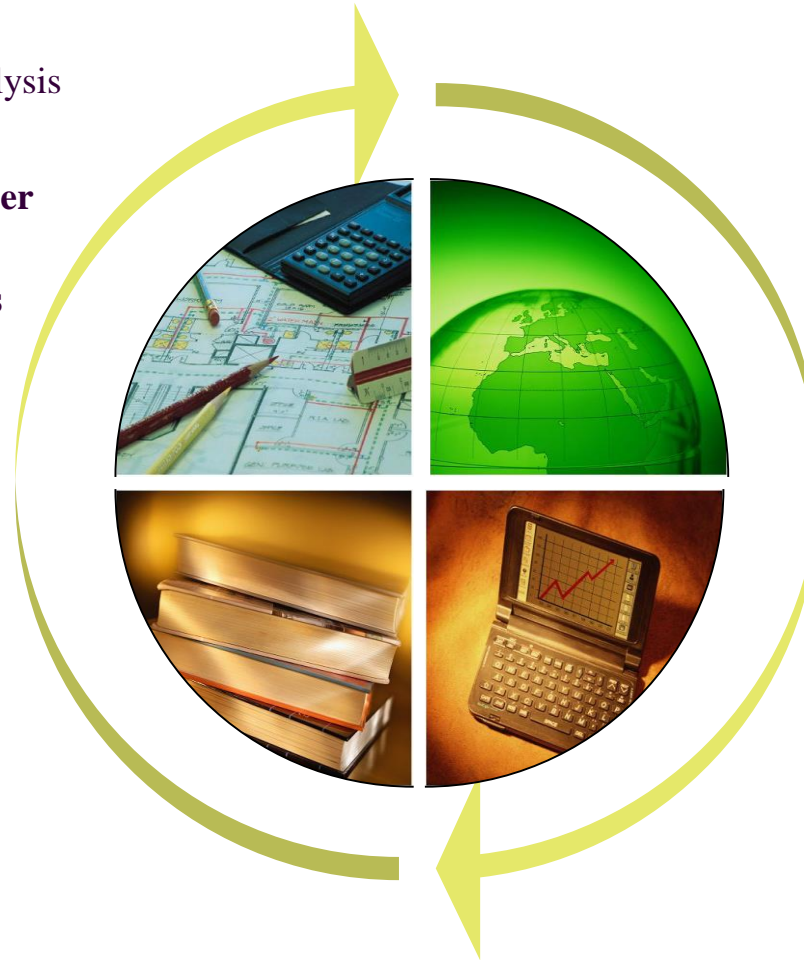
# Capital Cities' Services & Deliverables

## Strategic Planning

- Asset Allocation/Liability Analysis
- Cash Flow Analysis
- **Investment Structure/Manager Structure Evaluation**
- **Investment Policy/Guidelines**
- **Service Provider Evaluation**
- **Fiduciary Review**

## Education & Research

- Customized Client Workshops
- Callan Investments Institute
- Periodicals
- Research
- Surveys
- “Callan College”
- Weekly DC eNewsletter



## Plan Implementation

- **Manager/Fund Review and Search**
- **Custodian/Program Manager Review and Search**
- Transition Management
- Transaction Analysis
- **Fee/Cost Analysis**

## Measurement & Evaluation

- **Peer and Style Groups**
- **Risk Adjusted Returns**
- **Risk/Return Analysis**
- **Portfolio Characteristics**
- **Attribution Analysis**
- **Fund/Plan Competitiveness**

**We provide the full spectrum of consulting resources, but deliver them with the ‘high touch’ of a boutique firm. We pride ourselves on producing superior work, at a fair price.**

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# Exceeding Your Fiduciary Obligations

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*We pledge to provide our clients with the **leadership** and **stewardship** that will exceed their fiduciary requirements. Our service goes beyond simply providing quarterly performance measurement and evaluation reports. We deliver custom projects throughout the year that follow well-defined procedures and methods.*

## **Sample Annual Timeline**

### ➤ **February 2014 Meeting**

- Discuss the 529 Fee Landscape and Evaluate Plan Fees
- Discuss 2013 Year-End Performance and Outlook for 2014
- Fourth Quarter 2013 Performance & Evaluation Report

### ➤ **May 2014 Meeting**

- Discuss Trends within Portfolio Construction in the 529 Marketplace
- Review Investment Option Structure and Age-Based Glidepaths
- First Quarter 2014 Performance & Evaluation Report

### ➤ **August 2014 Meeting**

- Review and Amend Investment Policy Statement
- Second Quarter 2014 Performance & Evaluation Report

### ➤ **October 2014 Meetings**

- Conduct Due Diligence Meetings with Program Manager and Investment Managers

### ➤ **November 2014 Meeting**

- Discuss Relevant Topics (Education, Regulatory Updates, Peer Rankings, etc.)
- Third Quarter 2014 Performance & Evaluation Report

# Indiana CollegeChoice Program Manager Transition

*During 2007 and 2008, Capital Cities worked hand-in-hand with the Indiana Education Savings Authority (IESA) in conducting a program manager search, developing a new investment program, and transitioning the Plan to a new program manager based on IESA's unique objectives.*



*(Now known as Ascensus)*

**The J.P. Morgan platform was restrictive and did not reflect best practices:**

- Closed platform with little control over the investments
- Only four Age-Based options offered
- Expensive fees relative to other investment managers and 529 Plans
- Many investment options that exhibited qualitative and/or quantitative issues



**We successfully met all of the IESA's unique objectives during the transition:**

- ✓ Offer the best Plan possible to Hoosiers
- ✓ Retain open architecture platform structure
- ✓ Retain the Indiana Education Authority's control over the asset allocation of the underlying Age-Based options
- ✓ Simplify and reduce Plan fees to participants
- ✓ Improve upon performance of investment options

**Capital Cities is extremely proud of the success of the Indiana CollegeChoice Investment Program since the transition. Accounts have grown from 62,667 to 361,815, while assets have increased \$750 million to \$2.8 billion.**

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# DC College Savings Plan – Advocacy in a Bundled Structure

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*Capital Cities has had the pleasure to consult to the DC College Savings Plan (DC529) for more than five years. During this time, assets have grown from \$104 million to \$350 million.*



## Distinguishing Characteristics of DC529:

- Smaller-sized nature led to bundled structure
- Long-standing relationship with Calvert
- Preference for socially responsible investing



## CAPITAL CITIES

## Capital Cities serves as an independent advocate for DC529:

- ✓ Conducts extensive manager due diligence, lending objectivity to the process given Calvert's multiple roles
- ✓ Analyzes the proprietary Age-Based structures to ensure fiduciary duties are met
- ✓ Recently partnered with DC529 Legal Consultant to draft a Program Manager RFP

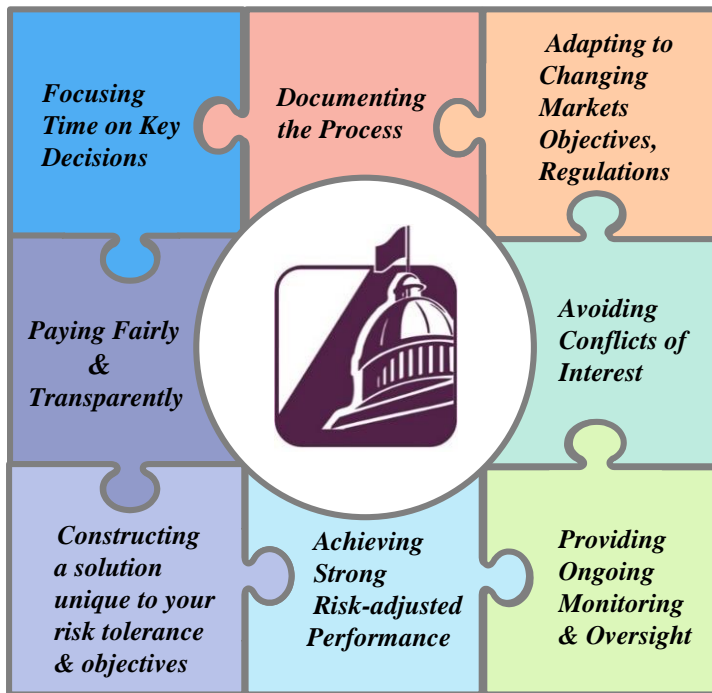
**Capital Cities' focus with DC529 is serving as an independent advocate to ensure fiduciary best practices are met, particularly given the bundled nature of the program.**

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# We Give You the Utmost Care and Attention

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*Our fee covers a comprehensive service model designed to assist you in meeting your goals*



**Our goal is to act solely in the interest of your Plan and its constituents.**

*Every decision related to your Plan starts with us asking “What would we do if we were you?”*

**We will protect you as a fiduciary, but we also strive to protect capital.**

*While most investment consultants are able to provide services to meet their clients’ fiduciary needs, we believe that there are very few who are truly providing this service from a risk management perspective.*

**Our clients are different from one another, with unique needs and risk tolerances.**

*We have experience working with all types of institutional clients and will draw on this to better serve you, but will approach your Plan with customized solutions.*

**An expected return is NOT an investment objective.**

*We ensure your investment programs meet the unique needs of your participants with regards to risk objectives and time horizon.*

**Your time is valuable.**

*We empower you to make key decisions and spend time where it is most impactful to the overall Plan. Think of us as an extension of your staff – we can handle time-consuming activities on your behalf, to your desired level of detail/participation.*

**It takes each piece of the puzzle to ensure that fiduciaries achieve their goals.**

*We serve as a trusted partner to our clients, ensuring that the assets they oversee are managed with the utmost care, in the context of an ever-changing investment environment.*

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# CollegeBoundfund 529 Program Scope of Work

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Capital Cities' fee for a full-retainer relationship with CollegeBoundfund is \$75,000. This fee covers the scope of work outlined below and detailed within your RFP. Capital Cities' fee also includes the attendance of two onsite meetings per year in which all travel expenses will be borne by Capital Cities.

- A. Serve as the State's expert on the national college savings landscape and offer recommendations regarding investment option(s) and underlying investments to position CollegeBoundfund as a "best in class" state-sponsored college savings program. Provide regular updates of economic, regulatory and market conditions that could impact 529 investments.
- B. Provide recommendations concerning long-term investment policy, objectives, statements, and strategy for the CollegeBoundfund.
- C. Provide suggestions as to the appropriate benchmarks for the various asset classes and an evaluation of the asset allocations for the plan's target-date glide paths.
- D. Monitor investment performance of CollegeBoundfund portfolios and the underlying funds. Provide a quarterly written evaluation of the performance of portfolios and underlying funds including attribution of such performance against benchmarks.
- E. Provide a relative strength and weakness analysis of CollegeBoundfund investment options against other 529 program investment options on at least a quarterly basis including investment and asset trends, underlying fees, and universe evaluations.
- F. Present findings and recommendations at SIC or RIHEAA meetings on a semiannual basis. Work with the staffs of the office of the State Treasurer and of RIHEAA as needed.
- G. Assist in drafting, issuing and evaluating RFPs for 529 Plan program and investment managers if requested.
- H. Assist the SIC and RIHEAA in monitoring and, when appropriate, offer recommendations for changes to CollegeBoundfund investments including investment philosophy and investment options including underlying funds, asset allocations and glide paths for target-date funds. Assess investment options and underlying fund recommendations made by the CollegeBoundfund Manager.

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# Biographies

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## ***Joe Bill Wiley, Principal – Business Development***

Mr. Wiley is a co-founding Principal of Capital Cities, L.L.C., of Indianapolis, Indiana. Before joining Capital Cities in 1991, Mr. Wiley spent eight years in and out of Washington, DC, working for several prominent members of the United States Senate. He maintains many of these relationships today. In 1996, he served as National Finance Director of the Richard G. Lugar for President Campaign. Additionally, Mr. Wiley is a founding member and past Chairman of the Board of the Indiana Chapter of ALS, Inc. (“Lou Gehrig’s Disease”). Mr. Wiley was appointed in 2012 by former Governor Mitch Daniels to serve as Commissioner to the White River State Park Commission. Mr. Wiley is responsible for marketing Capital Cities’ services and for coordinating the primary servicing and educational training to Capital Cities’ clients. He is a member of Capital Cities’ Investment Committee and of the Investment Management Consultants Association. B.A., Criminology, Indiana University. Mr. Wiley has been with Capital Cities, L.L.C. since the firm’s inception.

## ***Tiffany Spudich – Director, Client Relations***

Ms. Spudich is a Director at Capital Cities, L.L.C. of Indianapolis, Indiana. Her primary responsibilities involve overseeing and supporting the firm’s client relationships by providing proactive and responsive service. Ms. Spudich plans, develops and manages client projects by providing custom solutions for each client’s unique initiatives. While Ms. Spudich serves all of the firm’s clients, her expertise is in participant-directed plans including 529 and defined contribution plans. As a member of Capital Cities’ Investment Committee, she actively conducts investment manager research, along with ongoing due diligence of clients’ investment managers. Ms. Spudich authors insightful white papers for the firm’s clients and prospects. She also assists with the development and execution of Capital Cities’ marketing initiatives. Ms. Spudich is a twelve-year veteran of the firm. B.S., Business, Indiana University; M.B.A., University of Indianapolis.

## ***Amanda Black, CAIA – Director, Client Strategy***

Ms. Black is a Director at Capital Cities, L.L.C. of Indianapolis, Indiana. Her primary responsibility is to oversee the formulation of customized investments strategies for the firm’s clients, matching each client’s unique objectives with forward-looking portfolio construction. Ms. Black takes pride in the collaborative and educational aspects of the consulting role, always striving to help clients navigate the opportunities and risks they face in their fiduciary roles. As a member of Capital Cities’ Investment Committee, Ms. Black contributes to all areas of the Capital Cities’ client-centered experience, from strategic planning to investment manager due diligence to ongoing monitoring. Ms. Black’s investment career began at 40|86 Advisors, where she was a Senior Portfolio Analyst. Additionally, she honed her skills communicating the complexities of investing to a wide audience in her role as the Education and Marketing Communication Manager at the Indiana Public Retirement System (INPRS). Ms. Black serves as a gubernatorial appointee on the School Board for the Indiana School for the Blind and Visually Impaired. She holds the Chartered Alternative Investment Analyst (CAIA) designation and has completed Level I of the Chartered Financial Analyst (CFA) designation. B.A., Communication, Hanover College; M.B.A., Anderson University.