

DreamAhead College Investment Plan: Policy Goals, Objectives, and Performance Measures Update

Committee on Advanced Tuition Payment and College Savings
(WA529 Committee)

Report to the Legislature

December 2021

Executive Summary

The DreamAhead College Investment Plan is the state's 529 college investment plan opened in April 2018. When establishing DreamAhead, the Legislature established five policy goals for the program (RCW 28B.95.032(10)):

- (a) **Process:** To have an investment manager design a thoughtful, well-diversified glide path for age-based portfolios and offer a robust suite of investment options;
- (b) **People:** To have a well-resourced, talented, and long-tenured investment manager;
- (c) **Parent:** To demonstrate that the Committee is a good caretaker of college savers' capital and can manage the plan professionally;
- (d) **Performance:** To demonstrate that the program's options have earned their keep with solid risk-adjusted returns over relevant time periods; and
- (e) **Price:** To demonstrate that the investment options are a good value.

The Legislature directed the Committee on Advanced Tuition Payment and College Savings (WA529 Committee) to establish objectives and performance measures for these policy goals and provide updates to the Legislature before the start of Legislative Sessions occurring in even numbered years. The WA529 Committee has developed preliminary objectives and performance measures for each of the five policy goals and presents this update to the Legislature, as directed:

- DreamAhead launched in April 2018 with an innovative and diverse lineup of investment options, including year-of-enrollment portfolios with three different risk options, and seven static portfolios. The ten index mutual funds underlying the portfolios are from established and well-regarded fund managers.
- DreamAhead opened with nationally competitive fees, even with limited startup funding, and has already implemented multiple fee reductions for participants. The most recent fee reductions were the replacement of an underlying fund that saved customers up to seven basis points annually, depending on their selected investment portfolio(s) and a \$5 reduction to the annual account maintenance fee. The WA529 Committee remains committed to further reducing fees, including eliminating the plan's account maintenance fee as soon as possible.
- DreamAhead has been recognized by industry rating outlets such as savingforcollege.com and Morningstar. Since savingforcollege.com began evaluating DreamAhead in 2019, it has consistently assigned DreamAhead a "five-cap" rating for in-state residents (the highest available rating). Since 2020, Morningstar, Inc. has included DreamAhead in its 529 plan coverage. In October 2021, it recognized DreamAhead as one of the top 529 savings plans in the country and awarded the plan a bronze medal for the second year in a row.

- WA529 selected Sumday Administration, LLC as DreamAhead's program manager and Lockwood Advisors, Inc. as the program's investment manager. These firms are both companies of the Bank of New York Mellon, which has been in operation since 1784 and stewards \$2.3 trillion in public sector assets.
- The program management contract contains various service level agreements and deliverables that guide the Committee and WA529 staff in monitoring the performance of Sumday, Lockwood, and underlying fund managers. WA529 also engages the support of independent experts in managing the program, contract, and participant experience.
- To further evaluate how DreamAhead is helping families reach their savings goals, WA529 conducted formal customer surveys beginning in January 2021. Customer reviews regarding investment options, customer service and website experience were largely positive.

To provide additional transparency on DreamAhead's progress toward meeting the policy goals, WA529 created a performance dashboard, viewable to the Legislature, stakeholders, and the public. The WA529 Committee will provide a formal update to this report no later than before the start of the 2022 Legislative Session.

Table of Contents

- Introduction 5
- Key Developments: 2020 – 2021 6
- Objectives and Performance Measures 8
 - Process** 8
 - Objectives 8
 - Performance Measures 8
 - Progress Report..... 9
 - People** 12
 - Objectives 12
 - Performance Measures 12
 - Progress Report..... 13
 - Parent**..... 14
 - Objectives 14
 - Performance Measures 14
 - Progress Report..... 15
 - Performance** 17
 - Objectives 17
 - Performance Measures 17
 - Progress Report..... 17
 - Price** 20
 - Objectives 20
 - Performance Measures 20
 - Progress Report..... 21
- Contact Information 23

Introduction

The Washington College Savings Program, better known as the DreamAhead College Investment Plan or DreamAhead, is the state's 529 college investment plan opened in April 2018. Per the program's enabling statute, Chapter 28B.95 RCW, DreamAhead is intended to complement the Advanced College Tuition Payment (GET) program to help families save toward "the full cost of attending college" (RCW 28B.95.032(8)). DreamAhead is governed by the Committee on Advanced Tuition Payment and College Savings (WA529 Committee) and is supported by the Washington College Savings Plans (WA529) division within the Washington Student Achievement Council (WSAC).

Washington is one of 49 states, along with the District of Columbia, offering a direct-sold 529 college investment plan directly to the public without an intermediary such as an investment advisor or broker. Unlike 529 prepaid tuition plans such as GET, which generally permit only savers who reside within the plan's home state, college investment plans are typically available to savers nationwide. Accordingly, the Legislature adopted policy goals to ensure DreamAhead is competitive nationally. Specifically, RCW 28B.95.032(10), outlines the five following policy goals for DreamAhead.*

- (a) **Process:** To have an investment manager design a thoughtful, well-diversified glide path for age-based portfolios and offer a robust suite of investment options;
- (b) **People:** To have a well-resourced, talented, and long-tenured investment manager;
- (c) **Parent:** To demonstrate that the Committee is a good caretaker of college savers' capital and can manage the plan professionally;
- (d) **Performance:** To demonstrate that the program's options have earned their keep with solid risk-adjusted returns over relevant time periods; and
- (e) **Price:** To demonstrate that the investment options are a good value.

The Legislature has directed the WA529 Committee to establish objectives and performance measures for these policy goals and to provide updates to the Legislature before the start of every Legislative Session occurring in even numbered years. The Committee submitted its first formal report to the Legislature on this topic in January 2020. The report, entitled ['DreamAhead College Investment Plan: Policy Goals, Objectives, and Performance Measures Update,'](#) laid out preliminary objectives and initial associated performance measures.

During 2020 and 2021, the Committee worked to refine these objectives and performance measures and is incorporating them into a performance dashboard accessible to the Legislature, other stakeholders, and the public. When complete, this dashboard will provide more regular, real-time-updates on the current status of the plan relative to the five policy goals. The Committee is also including GET program data in the build out of this dashboard for added transparency and to better understand the two plans' collective impact and future opportunities. A phase one implementation of this dashboard is currently live at wsac.wa.gov/college-savings-dashboard. The Committee will add more data points to the dashboard in future phases and will continue providing the Legislature with a formal report on a biennial basis. The Committee will provide the next formal update before the start of the 2024 Legislative session.

* These policy goals are directly aligned with what used to be known as the "Five Pillars" criteria that the investment research firm, Morningstar, used to evaluate and rank 529 plans through 2019. Beginning in 2020, Morningstar updated the format of their analysis and as part of that update, Performance is no longer its own separate pillar.

Key Developments: 2020 – 2021

Fee Reductions

Each year since DreamAhead opened, the WA529 Committee, WSAC, and DreamAhead's program manager and investment advisor have worked together to lower fees for account owners. Two recent notable fee reductions included the lowering of asset-based fees due to an underlying fund replacement and a negotiated \$5 reduction to the annual account maintenance fee. The asset based fee reduction took effect on December 1, 2020 and was made possible by replacing an underlying money market fund. This change reduced the expense ratios of each DreamAhead investment portfolio, with the largest decrease being a seven basis point reduction to cost of the Cash Preservation Portfolio. The account maintenance fee reduction took effect on July 1, 2021 and lowered the annual cost to account owners from \$35 to \$30.

Customer Feedback

The WA529 team conducted customer surveys in 2021 to assess DreamAhead customer perceptions of the overall quality of the program, customer service, and the current investment lineup, as well as to identify opportunities for new investment offerings. Customer reviews regarding investment options, customer service, and website experience are largely positive. Though the survey findings cannot be generalized among all DreamAhead account owners due to the small completion rate, they show that over three quarters of account owner respondents (77%) are satisfied overall and are likely to recommend DreamAhead to others (78% of respondents). The findings also show that 62% of respondents are satisfied or very satisfied with the variety of investment options currently available through DreamAhead.

Data Dashboard

In 2020, WA529 began developing an online performance dashboard for the benefit of the WA529 Committee, the Legislature, other stakeholders, and the public. This dashboard will provide more regular, real-time-updates on the current status of both GET and DreamAhead, including DreamAhead's progress on the five policy goals. WA529 recently completed the first phase of this project, which provides various indicators and trend data for the GET program. Detailed DreamAhead data is currently being added to the dashboard and will be available by early in calendar year 2022. The Committee will continue providing the Legislature with a formal report biennially.

National Recognition

DreamAhead has been evaluated by two different independent providers of 529 information, reviews, and plan ratings.

- DreamAhead received a 5-cap rating from savingforcollege.com (their highest possible plan rating) for in-state residents in three consecutive analyses. These positive ratings indicate that DreamAhead's investment offerings are considered reliable and that its costs are competitive.

- Morningstar, Inc. first included DreamAhead in its 529 Analyst Ratings in October 2020, where it recognized DreamAhead as one of the top 529 savings plans in the nation by awarding the plan a bronze medal. In 2021, Morningstar again recognized DreamAhead as a bronze medalist and stated: “With its attractive fees and flexible menu design, Washington residents have a compelling option worth considering.”

Investment Portfolio Refinements

Effective December 1, 2020, the Committee voted to replace the JPMorgan U.S. Government Money Market underlying fund with the lower cost Vanguard Federal Money Market Fund. The Vanguard Federal Money Market Fund is the sole underlying fund of the Cash Preservation Portfolio and is a component in each of the Static and Year of Enrollment Portfolios. This change resulted in significant fee reductions for account owners, including a seven basis point (7 bps) reduction to the cost of the Cash Preservation Portfolio.

The most recent area of investment portfolio research and development for DreamAhead was focused on providing terminal portfolios for each Year of Enrollment glide path. Terminal ‘College Enrolled’ portfolios were introduced on July 1, 2020 and all 2018 and 2020 portfolios were rolled into their respective terminal portfolios. On July 1 of each even numbered year, that year’s portfolios will roll into the terminal portfolio. This enhancement ensures continuity and clarity for account owners whose students have reached their college years and are using benefits.

Objectives and Performance Measures

Process

Objectives

Objective 1: Offer a customizable but user-friendly set of investment portfolios

DreamAhead should offer a set of investment options that balance variety and customizability with low fees and ease of use. It is important that DreamAhead offer year-of-enrollment portfolios constructed, based on the latest industry research, to maximize participant returns while adequately protecting against relative risk. The static portfolios should allow savers to customize their investment mix base on their investment goals and risk tolerance. Thus, it is important to offer a wide range of strategies from cash preservation to aggressive growth.

Objective 2: Ensure investment portfolios are continually monitored and adjusted as needed

Once the investment portfolios are established, they should be continually monitored to ensure they are meeting the stated investment goals and objectives and are performing as expected. If any of the portfolios are not meeting expectations, adjustments should be made to the allocations and/or to the underlying funds.

Objective 3: Continue offering new investment options that are of interest to savers

DreamAhead should offer best in class investment options that appeal to savers not only in Washington, but across the U.S. Once a strong initial menu of options is set for the program, WA529 staff, the program manager, investment manager, and WA529 Committee should work together to continue assessing market trends and customer demands. This research will inform the Committee if any new offerings (e.g. Environmental, Social and Governance (ESG) portfolios) should be added to the lineup.

Performance Measures

Measure 1: Monitor key indicators for investment portfolios

The investment manager should continually monitor DreamAhead's portfolios using both quantitative and qualitative evaluation metrics and report back to the Committee at least quarterly. This ongoing monitoring and evaluation should identify any issues that need remediation, up to and including removal of a fund and/or restructuring of the DreamAhead portfolios.

Measure 2: Monitor market trends, best practices, and innovations

The WA529 team and the contracted program and investment managers should remain current on the latest industry developments and regularly report back to the Committee to assess DreamAhead's competitive position in the market. At a minimum, team members who are involved in the College Savings Plans Network (the 529 industry trade group) and are subscribed to business intelligence services should leverage these relationships and resources to monitor industry trends. Whenever a new trend or best

practice is identified, such as a continued movement towards smoother glide paths for year of enrollment portfolios, the team should evaluate DreamAhead's current position and necessary response. At the quarterly WA529 Committee meetings, it is critical for the investment manager to always be at the table to provide detailed updates on DreamAhead's investment portfolio performance, as well as broad market trends and indicators that may affect current or future investment offerings.

Measure 3: Assess demand for new investment offerings

The WA529 team and DreamAhead program and investment managers should continually monitor participation across the various investment portfolios to assess how well the current offerings are satisfying customer demands. Additionally, the team should conduct market research and customer surveys to identify new investment options (e.g. ESG portfolios) that may be of interest to savers. The WA529 team and contractors should share findings with the Committee at quarterly meetings to determine if any new products should be added to the investment lineup.

Progress Report

Lockwood Advisors, Inc. (Lockwood) continues to serve as the DreamAhead investment manager/advisor (read more about Lockwood in the "People" section below). In order to keep costs reasonably low to customers, Lockwood constructed the DreamAhead investment portfolios using passively managed index mutual funds. In selecting the funds to underly the portfolios, Lockwood took an 'agnostic' approach by sourcing funds from multiple managers based on quantitative and qualitative analyses. Through this process, Lockwood selected 10 underlying funds from which to build an innovative and diverse set of investment options. Initially, the underlying funds included four Fidelity funds, three Vanguard funds, two Schwab funds, and one JP Morgan fund. Effective December 1, 2020, the Committee voted to replace the JP Morgan money market fund with a lower cost Vanguard money market fund (see the "Price" section below).

DreamAhead currently offers two types of investment options to DreamAhead participants:

Year of Enrollment Option (3 options). This option offers portfolios designed for different anticipated college enrollment years in two-year increments. In addition, the year of enrollment investment option has three risk tolerances (Conservative, Moderate or Growth) to choose from. In each portfolio, the participant's money is moved automatically to progressively more conservative investments as the student approaches the targeted year of enrollment.

Static Investment Option (7 total portfolios). Investment allocations within the static portfolios remain fixed over time, subject to periodic re-balancing back to the portfolio guidelines and any changes in investment policy made by the Committee. If a participant invests in a static portfolio, assets will not shift to more conservative investments over time unless the participant specifically directs us to move the assets to another portfolio.

Charts 1-4 on the following pages provide a summary of the current asset allocations for each investment portfolio as of July 1, 2021.

Chart 1: Conservative Year of Enrollment Portfolio Asset Allocations

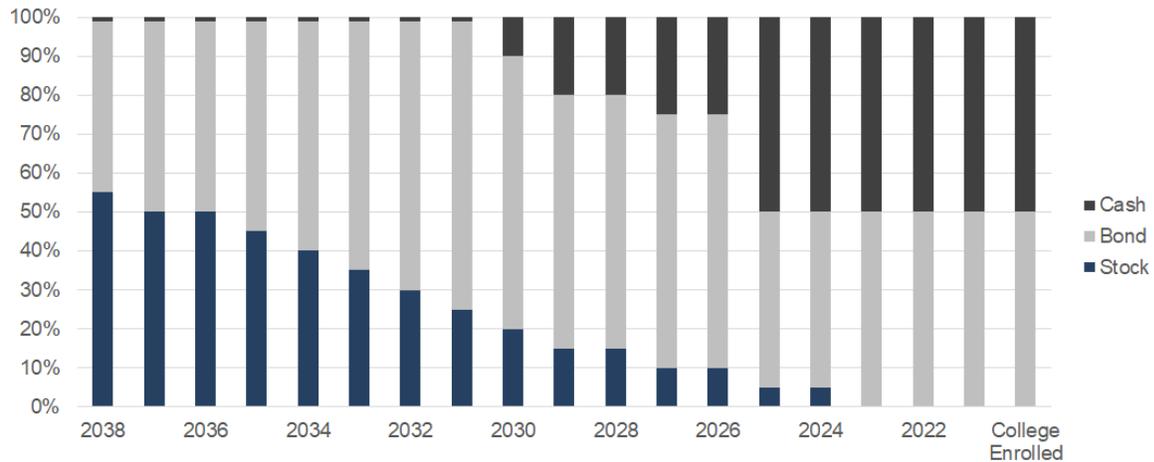


Chart 2: Moderate Year of Enrollment Portfolio Asset Allocations

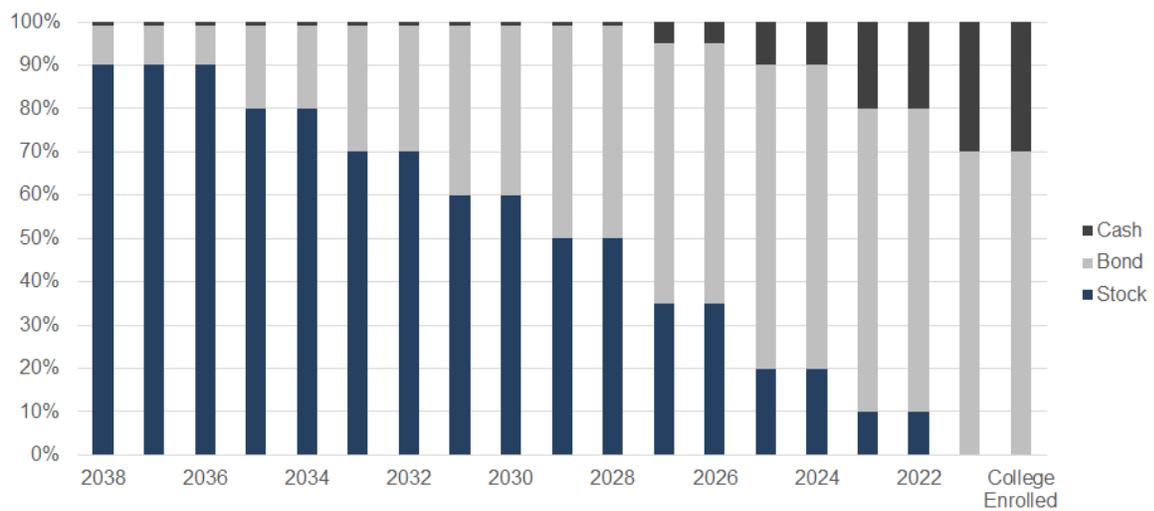


Chart 3: Growth Year of Enrollment Portfolio Asset Allocations

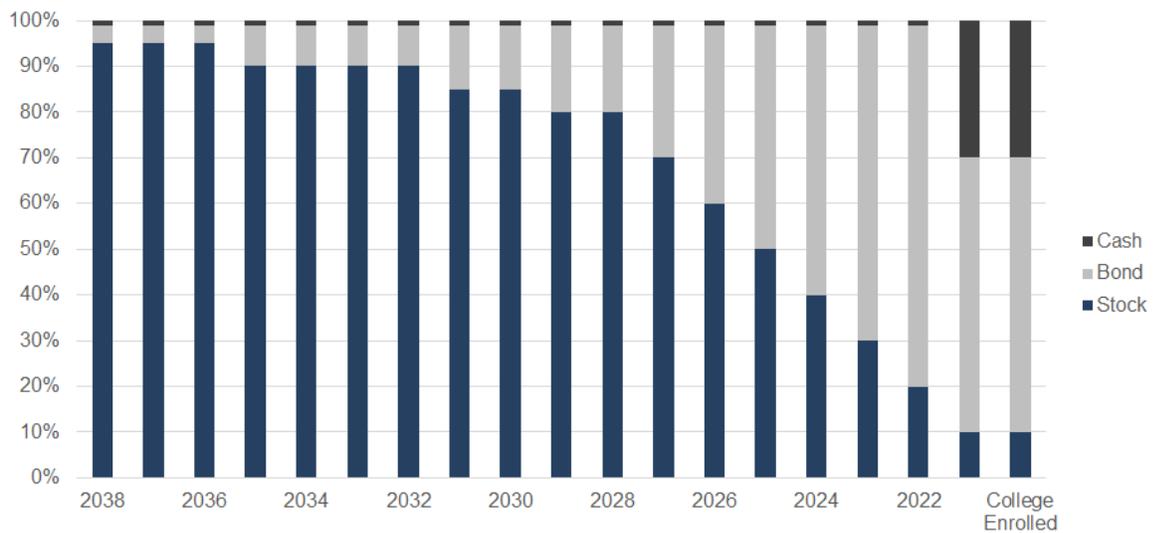


Chart 4: Static Portfolio Asset Allocations

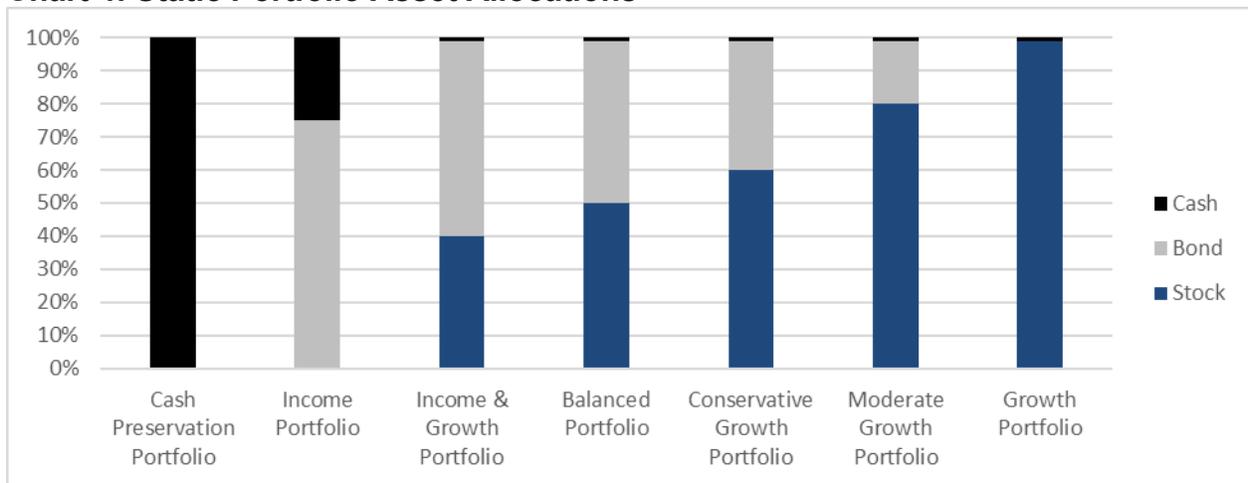


Table 1 below lists the ten mutual funds that underly all the DreamAhead portfolios.

Table 1: DreamAhead Underlying Mutual Funds

Fund	Ticker
Fidelity® Total Market Index Fund	FSKAX
Fidelity® International Index Fund	FSPSX
Fidelity® Emerging Markets Index Fund	FPADX
Fidelity® U.S. Bond Index Fund	FXNAX
Schwab Total Stock Market Index Fund®	SWTSX
Schwab® Treasury Inflation Protected Securities Index Fund	SWRSX
Vanguard Emerging Markets Government Bond Index Fund – Institutional Shares	VGIVX
Vanguard Total Bond Market Index Fund – Institutional Plus Shares	VBMPX
Vanguard Long-Term Treasury Index Fund – Institutional Shares	VLGIX
Vanguard Federal Money Market Fund	VMFXX

Lockwood regularly monitors and reports at least quarterly to the WA529 Committee on portfolio performance compared to custom benchmarks, broad industry and market trends, and the status of underlying funds and managers. Lockwood also works with DreamAhead’s program manager, Sunday Administration (Sunday), and the WA529 team to assess customer participation in and movement in and out of the various investment portfolios.

The WA529 team conducted customer surveys in 2021 to assess customer perceptions of the current investment lineup and identify opportunities for new investment offerings. Customer reviews regarding investment options, customer service and website experience were largely positive. Though these survey findings cannot be generalized to all DreamAhead account owners due to the small completion rate, they show that over three quarters (77%) of account owner respondents are satisfied overall, while 78% of respondents are likely to recommend DreamAhead to others. The findings also show that 62% of respondents are satisfied with the variety of investment options currently available through DreamAhead.

People

Objectives

Objective 1: Secure experienced and capable program and investment managers

It is vital that DreamAhead's program manager and the investment manager are both experienced, competent, ethical, and customer-focused. DreamAhead's investment manager should have a good track record and significant experience with the types of mutual funds that typically underly 529 plan investment portfolios. Additionally, the WA529 Committee should be confident that the program manager always puts customers first in its operations, platform development, and business decisions.

Objective 2: Ensure underlying funds are sourced from reputable fund managers

An investment portfolio is only as good as the underlying funds that compose the portfolio. Therefore, it is vitally important that the funds selected for DreamAhead are from well-regarded fund companies with strong track records and sound processes. The Committee will look to the DreamAhead investment manager's expertise in sourcing firms that are a good fit for the program.

Objective 3: Ensure consistent and continued performance from program, investment, and underlying fund managers

Securing experienced and capable program and investment managers is only the first step in ensuring the right people are in place to support the program. The WA529 team should continually monitor performance of the contracted DreamAhead program and investment managers and notify the Committee of significant compliance issues to ensure these contractors are held accountable to the program, State, and the public.

Performance Measures

Measure 1: Monitor the practices and philosophies of underlying fund managers

As described in the "Process" section above, the Committee looks to the investment advisor to continually monitor DreamAhead's portfolios using a number of quantitative and qualitative evaluation metrics. As part of this regular review, the investment advisor should take particular care in evaluating the managers of the underlying funds. If DreamAhead's investment advisor identifies concerns about a fund manager's practices or SEC filings, it should immediately alert WA529 staff and the Committee to discuss next steps.

Measure 2: Monitor the program and investment managers' processes and practices

The DreamAhead program management contract contains service level agreements and deliverables, which the program manager and investment advisor should consistently deliver on. The WA529 team should use this contract as a guide and assess contractor performance against expectations and requirements. As needed, the WA529 team should engage the services of outside experts to provide third-party review. Outside expertise may include special assistant attorneys general with specific 529 plan industry knowledge, independent investment advisory consultants, and audit firms.

Progress Report

Sunday Administration, LLC and Lockwood Advisors, Inc. provide program and investment management services to DreamAhead. Both firms are wholly-owned subsidiaries of The Bank of New York Mellon Corporation (BNY Mellon), which was founded in 1784. The bank has Assets under custody and/or administration of \$45.0 trillion as of June 30, 2021, has industry leading credit ratings, and is designated as a Global Systemically Important Bank (G-SIB) meaning it is subject to intense scrutiny and regulatory oversight. BNY Mellon delivers investment management and investment services for institutions, corporations, and individual investors in 30 countries and more than 100 markets. Importantly, BNY Mellon has significant experience supporting public sector funds, including other state-sponsored 529 and ABLE savings plans, with \$2.3 trillion in public sector assets under custody and administration.

Lockwood was founded in 1996 and is an investment adviser registered in the U.S. under the Investment Advisers Act of 1940. It is an affiliate of Pershing LLC, which is a wholly-owned subsidiary of BNY Mellon. Lockwood applies a team-based comprehensive, long-term approach to portfolio construction, with an emphasis on downside risk management.

Lockwood receives manager research and vehicle selection information from the BNY Mellon Manager Research Group, with the core focus on investment manager research and oversight. The team uses quantitative and qualitative analyses throughout the manager evaluation and selection process. The manager screening process begins with evaluating risk and return data from multiple databases and ranking prospective sub-managers. For candidates that pass this initial quantitative screening, Lockwood reviews qualitative factors of the investment managers, including the tenure and the depth of key investment professionals, investment philosophy and process, sources and methods of investment research, implementation of the investment process, portfolio turnover, and ownership/business structure. Lockwood then performs an additional layer of analysis to assess the viability of the investment firm, including a review of the manager's regulatory filings.

As referenced in the preceding "Process" section, in building the DreamAhead portfolios, Lockwood selected underlying funds from four established and well-regarded fund managers. They continually monitor the underlying funds and managers and report to the Committee quarterly. Lockwood has established a "watchlist" procedure to identify any funds or managers that present risk to the program and participants.

Additionally, the WA529 team monitors both Sunday's and Lockwood's compliance with the program management contract and reports to the WA529 Committee when issues are identified. The "Parent" section below provides more detail on these processes.

The WA529 team also intends to contract with an independent investment advisory consulting firm every two to three years to review the current DreamAhead investment offerings, underlying funds, and selection process to ensure the investment manager and underlying fund managers are meeting performance expectations.

Parent

Objectives

Objective 1: Ensure strong state administrative management, including effective contract oversight

The Committee expects DreamAhead to be administered professionally and to the high standards consistent with the administration of the state's GET program. This includes ensuring that program and investment management contractors are consistently meeting service level agreements and other contract requirements and deliverables. WA529 staff should manage the day-to-day interactions with the program and investment managers' staff to ensure both entities are meeting service level agreements and providing periodic contract deliverables on schedule. Whenever WA529 identifies significant issues, staff should document the deficiencies and remediation plans, and brief Committee members.

Objective 2: Ensure program participants are satisfied with DreamAhead and their interests are protected

The Committee must be confident that existing, new, and prospective participants have good perceptions of the program. This is especially important, as they will act as conduits to future customers. The Committee's two decades of experience with overseeing the GET program indicates that the most common way in which people hear about and decide to enroll in the program is from information shared by trusted friends, family members, and colleagues. Therefore, it is vitally important that DreamAhead participants feel that the program is adding value to their savings efforts, that they have good options to choose from, and that they can rely on program staff to assist them in managing their accounts.

Performance Measures

Measure 1: Track internal WA529 staff processes and performance

Holding the program accountable to participants starts with effective internal administration of WA529 processes and staffing. The WA529 team should engage in various activities and feedback loops that assess team performance. Efforts should include developing strategic growth plans, holding regular cross-functional meetings, engaging with and seeking feedback from stakeholders, and ensuring every staff member's performance is formally evaluated at least annually.

Measure 2: Track contract performance via contract management tools, meetings, due diligence visits, and performance reviews

WA529 should also have several processes in place to ensure the program and investment managers are held accountable to contract requirements and customer service standards. The program management agreement for DreamAhead contains service level agreements on which the program manager is expected to report to the Committee on a quarterly basis. As stated in the "People" section above, WA529 staff should regularly monitor performance under the contract and alert the Committee of significant issues.

Measure 3: Regularly review customer service interactions, end user experience, and solicit participant feedback

WA529 staff should regularly measure the customer experience by monitoring day-to-day customer interactions, web metrics, and enrollment and portfolio selection trends. The team should also employ customer surveys and feedback forms to garner feedback on various program features and functionalities, as well as ideas for future enhancements.

Progress Report

The WA529 team has effectively administered the GET program for over 20 years, with a focus on customer service, operational excellence, and continuous improvement. The WA529 Committee provides oversight, benefitting from the expertise of Committee members including the State Treasurer, the director of the Office of Financial Management, the director of WSAC, and two citizen members with extensive business, marketing, and/or investment sector experience. Since the previous update in 2020 there are three new Committee members: two new citizen members with substantial investment and business development experience and the new State Treasurer. Each new member has brought valuable skillsets and perspectives to the oversight of DreamAhead.

The WA529 Committee meets quarterly to discuss policy matters related to GET and DreamAhead. In these meetings, WA529 staff, Sumday, and Lockwood provide detailed program updates. Sumday reviews various program aspects including enrollment and distribution trends, data on service level agreements, and ideas for enhancing the customer experience. Lockwood presents a comprehensive quarterly investment report that recaps relevant U.S. and global market trends, the performance of the underlying mutual funds, and the performance of each investment portfolio against custom blended benchmarks. Lockwood also prepares an annual review that identifies key market indicators and trends, as well as ideas for future investment lineup enhancements.

Beginning in late 2020, the WA529 Committee has engaged in strategic planning discussions on how to increase the impact of and access to both GET and DreamAhead. This work is continuing into 2022, with the goal of ensuring both plans are meeting Washingtonians' needs, are competitive with other 529 options, and are accessible to people of all backgrounds and income levels.

To ensure effective day-to-day administration of DreamAhead, WA529 staff employ various strategic planning initiatives, lean process improvement practices, and weekly cross-functional team meetings. WA529 staff also regularly collaborates with key WSAC and external stakeholders and conducts individualized annual performance reviews for each WA529 staff member. Importantly, WA529 staff is also tasked with ensuring that DreamAhead's contractors are meeting performance expectations and service level agreements under the program management contract. WA529 staff is in regular, daily correspondence with the program and investment managers, including a formal, comprehensive bi-weekly status call. Monthly, WA529 staff conduct spot audits of

customer interactions with the program manager's staff. At least annually, WA529 staff conduct due diligence visits to meet with the program and investment managers on-site. Note that in-person visits to BNY Mellon's headquarters and operations center have been temporarily suspended due to the impact of COVID-19.

To aid this contract management, WA529 staff regularly consults with WSAC's assigned assistant attorney general and special assistant attorneys general with 529 expertise. If concerns or issues are identified, WA529 staff alert the Committee and discuss remediation steps. At the end of each calendar year, WA529 staff conduct a performance review of the program and investment managers to memorialize what went well during the year, what issues were identified, any expected remedies and action plans, and ideas for future enhancements.

Performance

Objectives

Objective 1: Ensure each investment portfolio meets performance expectations

Each DreamAhead investment option should (at least) remain within the acceptable tracking error relative to its custom benchmark. Any adverse deviations should be immediately researched and addressed to bring performance in line with expectations.

Objective 2: Receive positive reviews from ratings firms based on performance

Program staff and the investment manager should pay close attention to investment performance of the DreamAhead portfolios relative to offerings from other 529 plans. DreamAhead can garner a certain level of interest and participation simply by being a program offered by the State of Washington. That alone, however, is not sufficient to help the program meet growth objectives and ensure the WA529 Committee is fully exercising its fiduciary obligations to participants. It is important that the program's performance is assessed and holds up against its competitors in the direct-sold 529 plan space.

Performance Measures

Measure 1: Measure investment portfolio performance relative to its benchmark

DreamAhead's performance should be assessed first by tracking investment portfolio performance against custom benchmarks developed by the investment manager. WA529 staff and DreamAhead's contracted program and investment managers should continually monitor portfolio performance and provide detailed reports to the WA529 Committee at least quarterly. The investment manager should establish a process to identify portfolios that are not meeting performance expectations and/or if risks are materializing that may impact future performance expectations. The investment manager should immediately alert the Committee of any such issues so problematic funds can be addressed.

Measure 2: Review quarterly and annual 529 plan rankings

Currently, the most tangible means of comparing 529 plans is through rating outlets. Two firms that assess 529 plan performance are Morningstar and savingforcollege.com. The savingforcollege.com group produces reports quarterly, whereas Morningstar reviews plans annually. WA529 should closely track these industry reports to determine how DreamAhead holds up nationally.

Progress Report

As described in the "Process" section, each DreamAhead portfolio invests in one or more underlying funds and has varying objectives and strategies. For example, the Static Growth Portfolio is designed for investors with a very high tolerance for short-term equity market fluctuations who expect maximum capital appreciation and have no desire for income. The Static Income Portfolio, alternatively, is designed for investors with a very low tolerance for short-term market fluctuations who want low risk to principal and have a high desire for current income with limited capital appreciation.

With such varied objectives and strategies for each portfolio, performance expectations differ. To ensure portfolios are meeting expectations based on the stated objectives and strategies, Lockwood developed custom blended benchmarks for each portfolio. First, Lockwood selected asset class benchmarks for each underlying fund based on best fit criteria. Since all of the mutual funds in the portfolios are passively-managed index funds, performance of each fund is measured against the respective benchmark index identified in Table 2 below.

Lockwood then constructed final portfolio benchmarks by assigning a weighting for the benchmark index identified for each asset class in the portfolio based upon that asset class allocation percentage. As benchmarks are not investable directly, portfolio benchmarks are not used to evaluate direct performance; rather they are used to monitor tracking error for the overall portfolio. Lockwood expects the portfolio net performance to experience deviations from the index performance due to representative index sampling, trading costs, participant fees, or other trading frictions.

Table 2: Asset Class Benchmarks

Asset Class	Fund	Ticker	Benchmark
U.S. Large Cap Blend	Fidelity® Total Market Index Fund	FSKAX	Dow Jones US Total Stock Market TR USD
U.S. Large Cap Blend	Schwab Total Stock Market Index Fund®	SWTSX	Dow Jones US Total Stock Market TR USD
Foreign Large Blend	Fidelity® International Index Fund	FSPSX	MSCI EAFE NR USD
Diversified Emerging Mkts	Fidelity® Emerging Markets Index Fund	FPADX	MSCI EM NR USD
Intermediate-Term Bond	Fidelity® U.S. Bond Index Fund	FXNAX	Bloomberg US Aggregate Bond TR USD
Intermediate-Term Bond	Vanguard Total Bond Market Index Fund – Institutional Plus Shares	VBMPX	Bloomberg US Aggregate Bond TR USD
Long Government	Vanguard Long-Term Treasury Index Fund – Institutional Shares	VLGIX	Bloomberg Long Term US Treasury TR USD
Inflation-Protected Bond	Schwab® Treasury Inflation Protected Securities Index Fund	SWRSX	Bloomberg US Treasury US TIPS TR USD
Emerging Markets Bond	Vanguard Emerging Markets Government Bond Index Fund – Institutional Shares	VGIVX	Bloomberg USD Emerging Markets Government RIC Capped TR USD
Cash	Vanguard Federal Money Market Fund	VMFXX	Bloomberg US Treasury Bill 1-3 Mon TR USD

As discussed in the “Parent” section above, the WA529 Committee meets quarterly. In those meetings, the Committee reviews portfolio performance against the custom benchmarks and Lockwood advises if there are any performance concerns. Lockwood has established a process to address portfolios that are not meeting performance expectations and/or if risks are materializing that may impact future performance expectations. Lockwood will notify the Committee of any problematic funds and place them on a watchlist that will receive increased scrutiny and monitoring.

Through the third quarter of 2021, the DreamAhead investment portfolios and the underlying funds have consistently met performance expectations. Lockwood has not yet identified any funds at risk of not achieving their expected returns. Lockwood will continue monitoring performance to ensure returns remain within the expected tracking error for the benchmarks. If performance of any portfolio begins lagging behind its benchmark, Lockwood and the Committee will work to make the necessary adjustments to the investment mix, up to and including, changing out any problematic underlying funds. To date, the only portfolio changes implemented have been to take advantage of lower underlying fund fees. No portfolio changes have been made due to performance concerns.

The independent 529 plan information clearinghouse [savingforcollege.com](https://www.savingforcollege.com) reviews 529 plans on a quarterly basis. The firm analyzed DreamAhead most recently as of May 26, 2021. As a whole, the plan received a 5-cap rating ([savingforcollege.com](https://www.savingforcollege.com)'s highest possible plan rating) for in-state residents in three consecutive analyses. These positive ratings indicate that DreamAhead's investment offerings are considered reliable and its costs are competitive.

Morningstar, Inc. first included DreamAhead in its 529 Analyst Ratings in October 2020, where it recognized DreamAhead as one of the top 529 savings plans in the nation by awarding the plan a bronze medal. In 2021, Morningstar again recognized DreamAhead as a bronze medalist and stated: "With its attractive fees and flexible menu design, Washington residents have a compelling option worth considering." In its ratings, Morningstar highlighted DreamAhead's Year of Enrollment portfolios as a bright spot in the plans offering.

Price

Objectives

Objective 1: Achieve positive plan rankings from 529 plan rating outlets

Most direct-sold 529 plans rely heavily on passively-managed index mutual funds. Fund managers such as Fidelity and Vanguard continue to compete to drive down fees on their mutual fund offerings, creating a low-price environment. Accordingly, rating outlets such as Morningstar weigh plan fees relatively heavily in their plan rankings. Therefore, it is vital that DreamAhead offers low cost options relative to other direct-sold 529 plans.

Objective 2: Reduce and eventually eliminate the account maintenance fee

Many 529 plans have imposed flat fees such as enrollment fees or account maintenance fees in the past, especially upon startup. The challenge for DreamAhead is that it is a new plan entering a maturing industry. The majority of investment-based 529 plans have been in operation for over a decade and have been able to reduce or eliminate such flat fees over time. Therefore, it is the Committee's intent to reduce and eventually eliminate the account maintenance fee for all DreamAhead account holder types as soon as possible.

Objective 3: Continue growing program participation to drive down asset-based fees

In order for DreamAhead to continue reducing asset-based fees and establish the program as a low-price leader in the industry, it is important to grow the asset base. Since price is regarded so favorably by 529 plan rating outlets, this process becomes cyclical – that is, in general, the more a plan grows and reduces fees the more positively it is rated and accordingly, the more interest and participation it garners.

Performance Measures

Measure 1: Review quarterly and annual 529 plan rankings

As with plan performance, the most tangible means of comparing 529 plans side-by-side on price is through rating outlets. Both Morningstar and savingforcollege.com include price as substantial factor in their ratings. The savingforcollege.com group produces reports on a quarterly basis, whereas Morningstar reviews plans annually. The program should closely track these industry reports to determine how DreamAhead holds up nationally.

Measure 2: Monitor program enrollments, cash flows, and asset growth

It is vital to closely track program enrollment, contribution, and distribution activities as well as program expenditures to identify opportunities to lower fees. Each time the program hits significant growth milestones such as \$1 billion, \$1.5 billion, or \$2 billion in assets, there may be opportunities to negotiate fees down for the benefit of customers.

Progress Report

DreamAhead was developed and launched with zero plan assets and with limited state appropriations to defray administrative costs (\$25,000 was appropriated during the 2016 Legislative Session). DreamAhead is authorized to maintain a temporary cash deficit that must be repaid with the goal of the plan being self-sustaining. Accordingly, WA529 lacked the resources or leverage to negotiate the lowest fees in the nation at start up.

Despite this challenge, WA529 was able to negotiate a program management agreement that resulted in a competitive asset-based fee structure. On opening, DreamAhead was able to offer low cost investment options ranging from 28 to 40 basis points. This fee structure put DreamAhead immediately in a competitive position on asset-based fees, ranking in the top half of plans nationwide. Since program inception, DreamAhead has been able to continually lower asset-based fees, which now range from 25.4 to 33 basis points, due to increasing assets under management and underlying fund changes. The plan charges a flat annual account maintenance fee, which is becoming less common among 529 plans. Reducing and eliminating this fee has been a primary target for the Committee as assets grow. As a first step toward this goal, the Committee voted to reduce the account maintenance fee from \$35 to \$30 as of July 1, 2021. The Committee remains focused on continuing to reduce fees and will keep the Legislature updated on its progress.

Table 3 on the following page provides the current asset-based fees for each investment offering.

As of the most recent analysis available on industrywide 529 plan fees, conducted by Strategic Insight in April 2020, the direct-sold 529 plan average for asset-based fees is 40 basis points. The asset-based fees for each of DreamAhead's investment portfolios, ranging from 25.4 to 33 basis points, are significantly below this industry average. As mentioned in the performance section above, as of May 26, 2021, DreamAhead has maintained its five out of five "cap" rating from savingforcollege.com. In the most recent analysis, DreamAhead received 4.5 out of five caps on "Fee Score." This metric considers all asset-based fees, as well as other fees such as enrollment and/or annual account maintenance fees. In Morningstar's 2020 and 2021 analyses, it awarded DreamAhead a bronze rating, recognizing the plan with a "Positive" score on Price.

The Committee is encouraged by these positive plan ratings and is committed to continue reducing fees whenever possible. The Committee anticipates being able to continue fee reduction negotiations once DreamAhead plan assets reach \$1 billion. It is important to note that while Senate Bill 6087 helped grow plan assets quickly to over \$800 million, DreamAhead has already distributed over \$325 million to plan participants, as many accounts that rolled over from GET were for mature beneficiaries. This highlights the importance of securing a positive reputation for the program through sound program management and attractive investment offerings, while continuing marketing efforts to stimulate account openings and contributions.

TABLE 3: ANNUAL ASSET-BASED FEES AS OF JULY 1, 2021

Portfolio	Underlying Fund Fee	Service Fee	State Admin Fee	Total Asset-Based Fee	Change since inception (in basis points)
YEAR OF ENROLLMENT – CONSERVATIVE PORTFOLIOS					
2038	0.052%	0.12%	0.10%	0.272%	-2.2 bps
2036	0.052%	0.12%	0.10%	0.272%	-2.2 bps
2034	0.052%	0.12%	0.10%	0.272%	-2.1 bps
2032	0.052%	0.12%	0.10%	0.272%	-1.9 bps
2030	0.059%	0.12%	0.10%	0.279%	-2.5 bps
2028	0.066%	0.12%	0.10%	0.286%	-3 bps
2026	0.070%	0.12%	0.10%	0.290%	-3.3 bps
2024	0.089%	0.12%	0.10%	0.309%	-4.6 bps
2022	0.089%	0.12%	0.10%	0.309%	-4.6 bps
College Enrolled	0.089%	0.12%	0.10%	0.309%	-4.6 bps
YEAR OF ENROLLMENT – MODERATE PORTFOLIOS					
2038	0.043%	0.12%	0.10%	0.263%	-2.1 bps
2036	0.043%	0.12%	0.10%	0.263%	-2.1 bps
2034	0.053%	0.12%	0.10%	0.273%	-2.2 bps
2032	0.053%	0.12%	0.10%	0.273%	-2.2 bps
2030	0.052%	0.12%	0.10%	0.272%	-2.1 bps
2028	0.052%	0.12%	0.10%	0.272%	-2.2 bps
2026	0.055%	0.12%	0.10%	0.275%	-2.3 bps
2024	0.059%	0.12%	0.10%	0.279%	-2.5 bps
2022	0.066%	0.12%	0.10%	0.286%	-3 bps
College Enrolled	0.074%	0.12%	0.10%	0.294%	-3.5 bps
YEAR OF ENROLLMENT – GROWTH PORTFOLIOS					
2038	0.043%	0.12%	0.10%	0.263%	-2.2 bps
2036	0.043%	0.12%	0.10%	0.263%	-2.2 bps
2034	0.043%	0.12%	0.10%	0.263%	-2.1 bps
2032	0.043%	0.12%	0.10%	0.263%	-2.1 bps
2030	0.053%	0.12%	0.10%	0.273%	-2.2 bps
2028	0.053%	0.12%	0.10%	0.273%	-2.2 bps
2026	0.052%	0.12%	0.10%	0.272%	-2.2 bps
2024	0.052%	0.12%	0.10%	0.272%	-2.1 bps
2022	0.051%	0.12%	0.10%	0.271%	-2.1 bps
College Enrolled	0.074%	0.12%	0.10%	0.294%	-3.5 bps
STATIC PORTFOLIOS					
Growth	0.034%	0.12%	0.10%	0.254%	-2.2 bps
Moderate Growth	0.053%	0.12%	0.10%	0.273%	-2.2 bps
Conservative Growth	0.052%	0.12%	0.10%	0.272%	-2.1 bps
Balanced	0.052%	0.12%	0.10%	0.272%	-2.2 bps
Income & Growth	0.052%	0.12%	0.10%	0.272%	-2.1 bps
Income	0.070%	0.12%	0.10%	0.290%	-3.2 bps
Cash Preservation	0.110%	0.12%	0.10%	0.330%	-7 bps

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