

White Paper:

Savingforcollege.com's 529 Performance Ranking Methodology

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The methodology employed by Savingforcollege.com ("SFC") to compare and rank the performance of 529 plans is described below.

Background

Each 529 savings plan offers a menu of investment options to its participants. In most 529 plans, an option represents a "portfolio" of one or more underlying mutual funds. In some 529 plans, however, an option represents the 529 share class of a mutual fund registered with the SEC. Investment options may also be categorized as "static" or "dynamic." A static option is one that maintains a specific targeted asset allocation over time. A dynamic option, usually labeled as the age-based option or the enrollment-based option, is one in which the targeted asset allocation becomes more conservative over time as the account beneficiary approaches college age. In some 529 plans, the dynamic option represents a set of "target-year portfolios," where each such portfolio evolves to a more conservative asset allocation over time. In other 529 plans, the dynamic option involves a transfer of the participant's invested balance from one static portfolio to another static portfolio at specific points in time tied to the age of the beneficiary.

Among all 529 plans, there exists a significant variation in the number of options and the portfolio construction. For example, a portfolio may consist of a single underlying mutual fund, or it may consist of multiple underlying mutual funds.

This variation poses special challenges when attempting to compare the investment performance between 529 plans. SFC has developed a methodology for ranking investment performance on an "apples to apples" basis by comparing and ranking the performance of selected portfolios. The "asset-allocation category rankings" compare the historical performance of all 529 portfolios selected by SFC within a particular asset-allocation category, such as 100% equity. The "composite 529 performance rankings" represent an overall, or composite, ranking for each 529 plan based on a comparative analysis of the asset-allocation category rankings across all categories. These two sets of rankings are produced each quarter and made available to subscribers on the Savingforcollege.com web site.

Asset-Allocation Category Rankings

First, portfolios from all direct-sold and advisor-sold 529 plans are assigned to a specific asset-allocation category. SFC utilizes the following seven (7) asset-allocation categories in the rankings:

- 100% Equity
- 80% Equity
- 60% Equity
- 40% Equity
- 20% Equity
- 100% Fixed Income
- 100% Short-term

Then, within each category, portfolios are compared and ranked based on published investment returns. Separate rankings are produced for different performance periods (i.e. one year, three years, five years, and ten years). In addition, two versions of rankings for each performance period are produced, one based on performance without sales charges, and the other based on performance with maximum sales charges. SFC has established the following “rules” in selecting portfolios and producing the asset-allocation category rankings:

1) A portfolio will usually be included only if its targeted allocation of equity, fixed income, and short-term income investments, as reported in the plans’ disclosure materials, is within a range of +/- 6 percentage points from the category’s target asset allocation. For example, a portfolio invested 85% in equity mutual funds will be considered for inclusion in the 80% asset allocation category but a portfolio invested 88% in equity mutual funds will not. Exceptions to this rule may occur in plans where there are an insufficient number of options that meet this guideline but where two options can be “averaged” for a specific asset-allocation category.

2) SFC will generally select only one portfolio in each 529 plan for any particular asset-allocation category. The portfolio selected is the portfolio that most closely resembles the composition of the asset-allocation category. Exceptions are made where a 529 plan offers multiple investment tracks and each track contains a portfolio that conforms to the asset allocation target. For example, some 529 plans now offer one set of options using index funds and another set of options using actively-managed funds. In those cases, SFC will include more than one portfolio from the 529 plan in each asset allocation category. Another exception occurs where a plan offers investment options from multiple fund managers and each manager provides a portfolio or multiple portfolios that meet the criteria for inclusion.

3) If the 529 plan offers both an individual-fund portfolio and a multi-fund portfolio within the same asset allocation category, SFC will have a selection bias towards the multi-fund portfolio. If an appropriate multi-fund portfolio does not exist, but more than one individual-fund portfolio satisfies the asset allocation target, SFC will select the portfolio with an underlying fund that is used in any of the plan’s multi-fund options. If no such portfolio exists, then SFC will select the individual-fund portfolio that most closely resembles the benchmark portfolio for that asset category. The equity benchmark is the Russell 1000 Index, the fixed-income benchmark is the Lehman Aggregate Bond Index, and the short-term benchmark is the 3-month Treasury Bill.

4) If a selected portfolio is offered in multiple pricing classes (e.g. A, B, and C), each class is included in the asset allocation-category rankings as a separate portfolio. However, only the “A” class are used for the composite rankings of advisor-sold 529 plans (see below).

Composite 529 Plan Performance Rankings

An overall (or “composite”) performance score is calculated for each 529 plan for a given performance period based on the plan’s performance rankings for each asset-allocation category as described above. To calculate the composite ranking for the plans, SFC recomputes the asset-allocation category rankings based on a standard normal distribution of the returns included within each category. Unlike calculating an average ranking based on the plan’s nominal ranking in each asset allocation category, this approach

takes into account the varying standard deviation of returns among the different asset-allocation categories. To produce the composite ranking for a plan, the plan's composite performance score is compared to the composite performance scores of all other 529 plans. Separate composite rankings are published for advisor-sold 529 plans, direct-sold 529 plans, and plan classes distributed through fee-based planners (RIA channel). For advisor-sold 529 plans, only the A-class units are used for purposes of the composite rankings. If the 529 plan has 7 portfolios in the asset allocation rankings, one for each asset allocation category, its composite score will be the sum of its asset allocation rankings divided by 7. When multiple portfolios are included in an asset allocation category, the plan's ranking in that asset-allocation category is calculated by first averaging the separate rankings of the portfolios included in the category. In order to receive a composite score and be included in the composite rankings, a 529 plan must have portfolios in a minimum of four asset allocation categories.
