2006 Annual Review of MOST

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June 2007

Overview

Section 166.450, RSMo requires an annual review of the Missouri Higher Education Savings Program (or “MOST”) by the director of investments of the state treasurer's office and the reporting of findings to the MOST Board. The statute requires a review of five areas:

- Board administration
- Financial status
- Investment policy
- Participation rate
- Continued viability

This last year was a year of transition for the MOST plan, as the program went through the conversion process to a new program manager, Upromise, for the first time in its history. My report for the 2006 calendar year thus differs from previous years’ reports for two primary reasons. First, the year’s activity reflects the performance of the previous program manager, TIAA-CREF, through June 2, 2006 and then Upromise for the remainder of the year.

The shorter period for each program manager makes it difficult to fairly evaluate their performance; moreover, a detailed review of some of the features of the old MOST plan is now largely irrelevant. Conversely, to make concrete judgments about Upromise’s performance for a 7-month period also is problematic.

Secondly, I have tried to use more graphs than in previous reports as a way for you and other readers of this report to more quickly and easily grasp trends for the MOST plan. Due to the split year between program managers, I have also tried to concentrate more on providing a general overview of the MOST plan and its position relative to the 529 industry. Thus, I am hopeful that this more graphical report succeeds in giving you an assessment of the overall plan including both weaknesses and strengths of the plan.

Board Administration

In December 2005, the MOST Board selected Upromise Investments, Inc., as the new program manager for MOST upon the expiration of TIAA-CREF's contract. Due to the need to negotiate certain contractual issues related to the Guaranteed Option, TIAA-CREF's term was extended from May 9 to June 2, 2006. Upromise Investments Inc., a division of Upromise, took over as program manager on June 3, 2006.   MOST account owners who were invested in the TIAA-CREF Guaranteed Option were allowed to remain in that option, but it is closed to new investors.

The MOST program was successfully converted from TIAA-CREF to Upromise over the weekend of June 3-4, 2006. Shortly after the conversion, it was announced that SLM Corporation, the largest provider of student loans in the nation, was acquiring Upromise, which to that point was privately held. There were no disruptions to service or Upromise's performance as a result of this acquisition.

The Board and the State Treasurer's Office worked closely with both program managers and monitored their management of the program. The Board met quarterly during 2006, as required by law.

Financial Status

The MOST plan's partners remain strong entities with significant financial resources and steady financial growth. TIAA-CREF's financial strength continued to be rated AAA by all three major rating agencies as well as A.M. Best (see right). This is important because the funding agreement for the Guaranteed Option is provided by TIAA-CREF.

SLM Corporation, which acquired Upromise, maintained a single-A senior unsecured debt rating in 2006 from Moody's, Standard & Poor's and Fitch. SLM's credit rating is less of an issue for the new plan, however, because none of the investments of the new MOST plan are secured by SLM. The Vanguard Interest Accumulation Fund invests in non-collateralized guaranteed investment contracts (GIC's) with insurance companies and banks but Vanguard requires a "AA" rating for such entities.

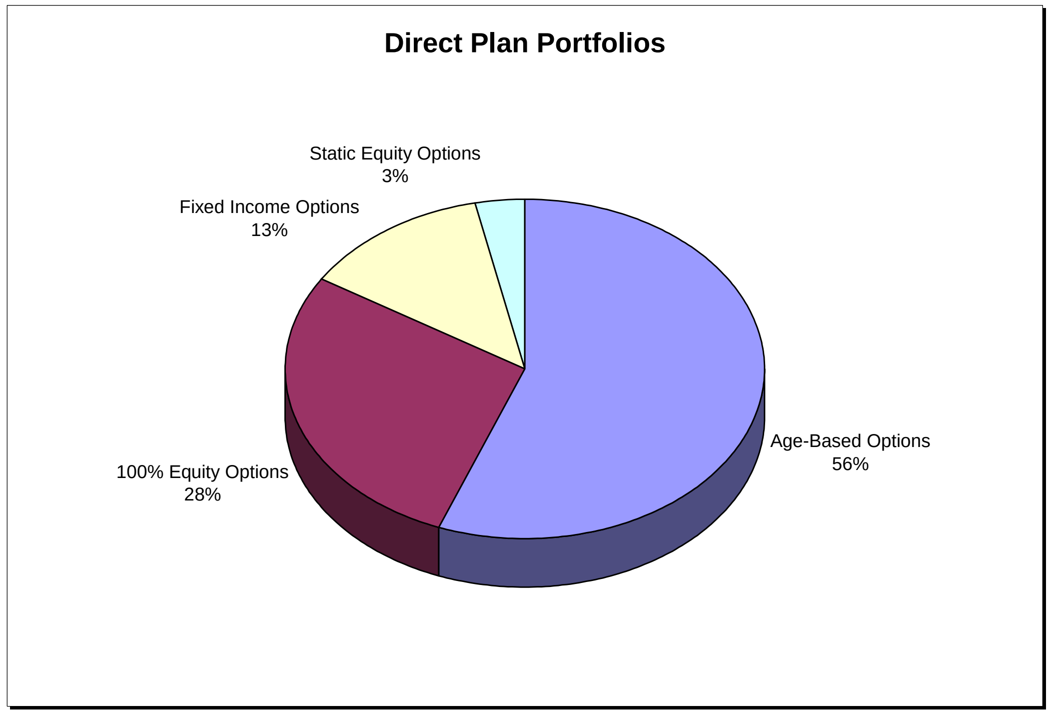
MOODY'S	
1) Outlook	STABLE
2) Insurance Finl Strength	Aaa
STANDARD & POOR'S	
3) Outlook	STABLE
4) LT Local Issuer Credit	AAA
5) Financial Strength	AAA
FITCH	
6) Outlook	STABLE
7) Financial Strength	AAA
A.M. Best	
8) LT Credit Outlook	STABLE
9) Finl Strength Outlook	STABLE
10) Long Term Issuer Credit	aaa
11) Financial Strength	A++

Investment Policy

The Missouri Higher Education Savings Program did not retain a separate investment policy governing MOST investments in 2006. The establishment of investment options and asset allocation changes are set by the Board based on recommendations of the program manager. The asset allocations approved by the Board thus served as the de facto investment policy for the program. Therefore, I have included my review of the MOST program's asset allocation under this section.

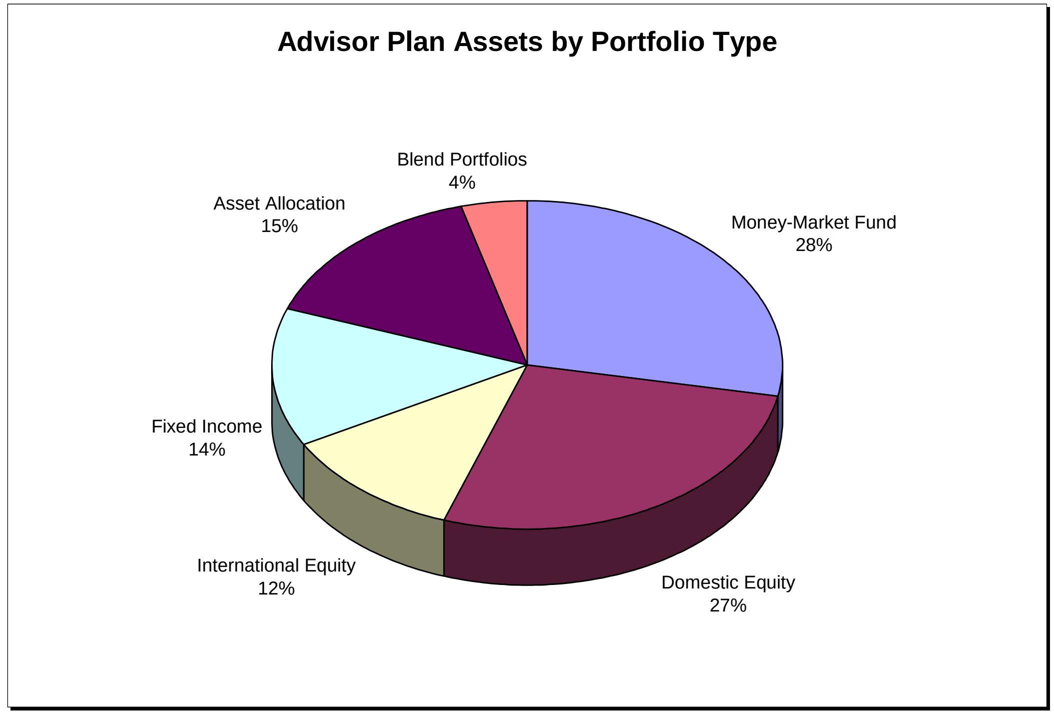
Under TIAA-CREF, the Direct Plan continued to offer three investment options to participants: an age-based managed allocation, a 100% equity option and a guaranteed option.

The new MOST plan launched on June 5 greatly expanded the Direct Plan lineup to include three age-based options (Aggressive, Moderate and Conservative), three 100% equity options, various fixed income options and for the first time, five unique static or stand-alone funds which allowed MOST account owners to customize investments. The chart, right, shows total assets by portfolio type as of December 31, 2006.



Investment Policy

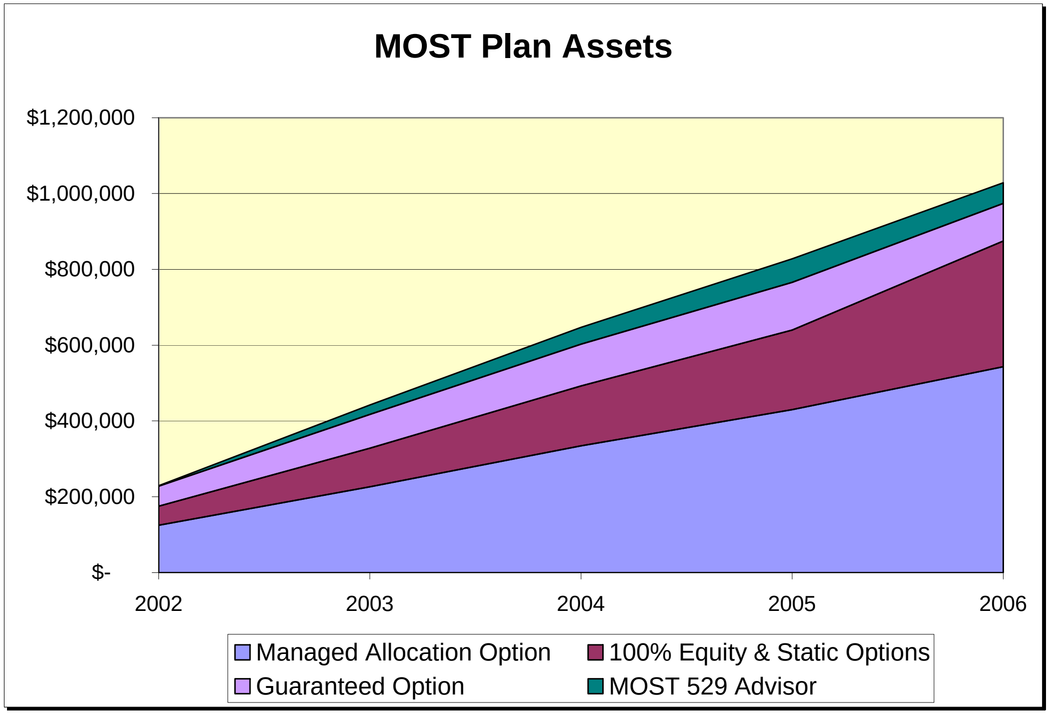
The MOST Advisor Plan was expanded from a lineup of eight TIAA-CREF funds to a new lineup of 24 funds comprised of 10 fund families. The chart, right, shows total assets by portfolio type as of December 31, 2006. Clients in the Advisor Plan were first mapped to the money-market fund upon conversion of the plan. Clients then could re-allocate holdings to the new portfolios offered. As of December 31st, 28 percent of account owners remained in the money-market fund. Upromise and the State Treasurer's Office continue to strategize about ways to encourage movement out of this fund.



Participation Rate

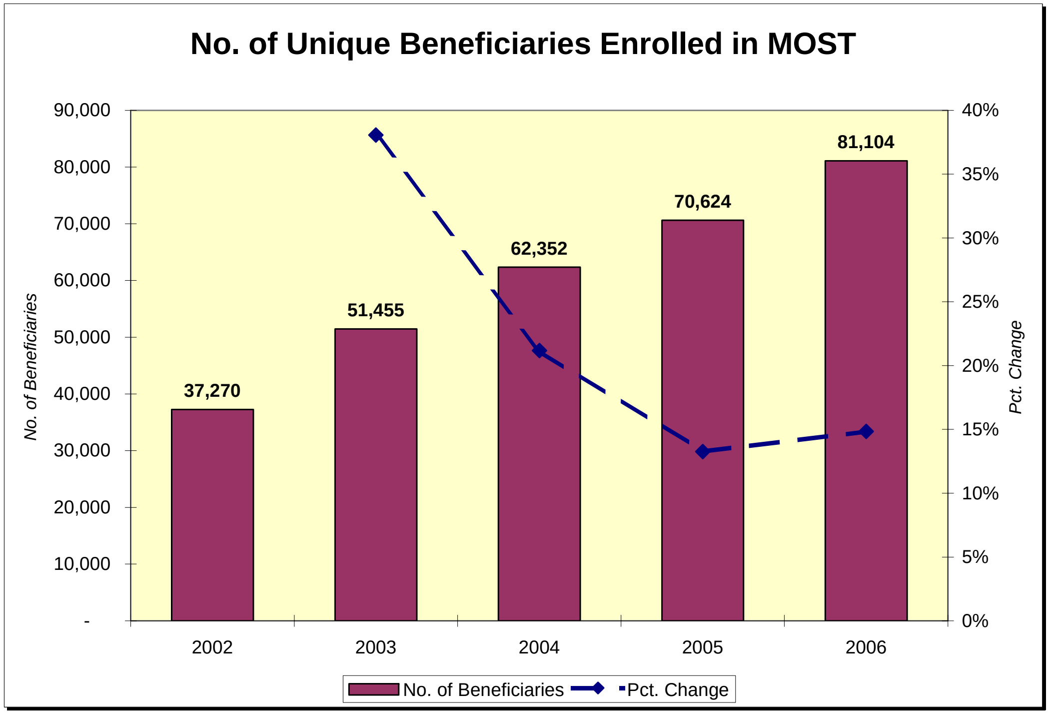
Overall, the MOST plan has shown steady growth since its launch in late 1999. This growth is attributable to both the appreciation of assets in the plan and the contributions of new and existing account owners. With the bull market in the broad stock market that we have experienced since early 2003, asset appreciation is a significant factor in this growth. MOST plan assets crossed the $1 billion threshold at the end of 2006.

From 2002-2006, assets in the age-based options have consistently ranged near 55% of total Direct Plan assets. Assets in the 100% equity and static options increased from 22% of Direct Plan assets in 2002 to 34% in 2006, as interest in the TIAA-CREF Guaranteed Option dropped.



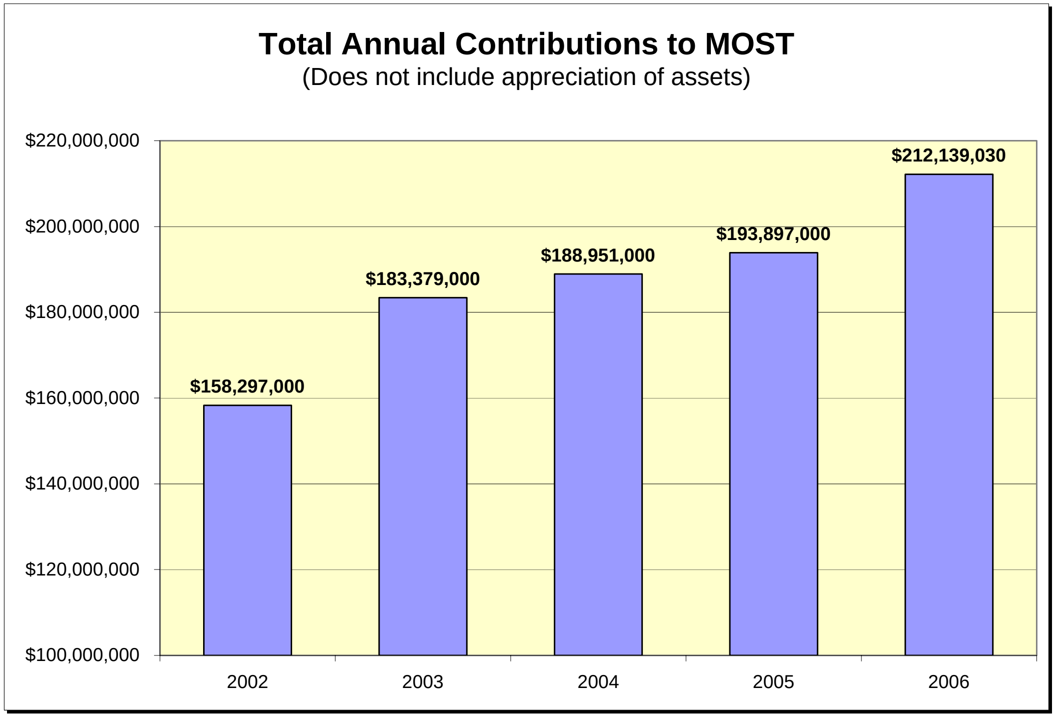
Participation Rate

While a review of the assets in the MOST plan is informative, it is difficult to separate the effect of the capital appreciation of assets versus the actual growth of participants. A useful measure of participation in a plan is the number of beneficiaries enrolled in the plan. Since 2003, we have seen steady growth of 8,000 to 12,000 new beneficiaries per year. However, in terms of percentage growth of new accounts, there had been a decline in the growth rate of accounts until 2006 (see dashed line). The increase of beneficiaries in 2006 is primarily attributable to the second half of the year after Upromise assumed the program.



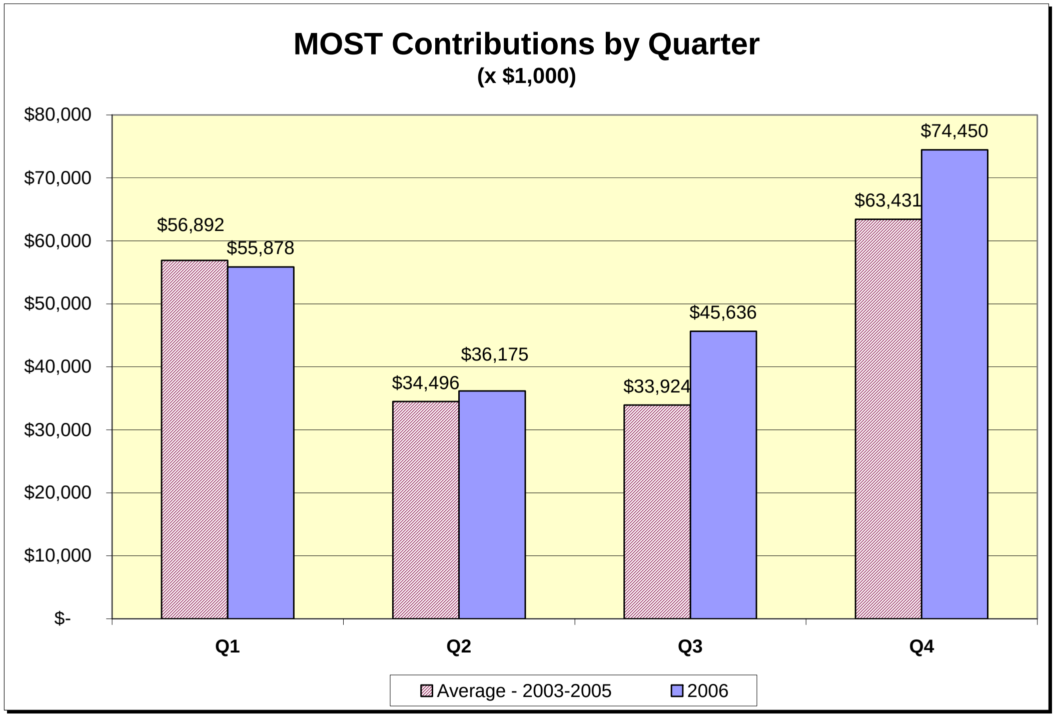
Participation Rate

A second measure of the participation levels in MOST is to review total annual contributions to the plan. The level of contributions takes into account both the number of participants in the plan and the amount they are contributing. Again, contributions were steady from 2003 through 2005, but with 8,000 to 12,000 new account owners added each year, we would expect to see a better growth rate. We finally saw this in 2006 as annual contributions topped $200 million for the first time.



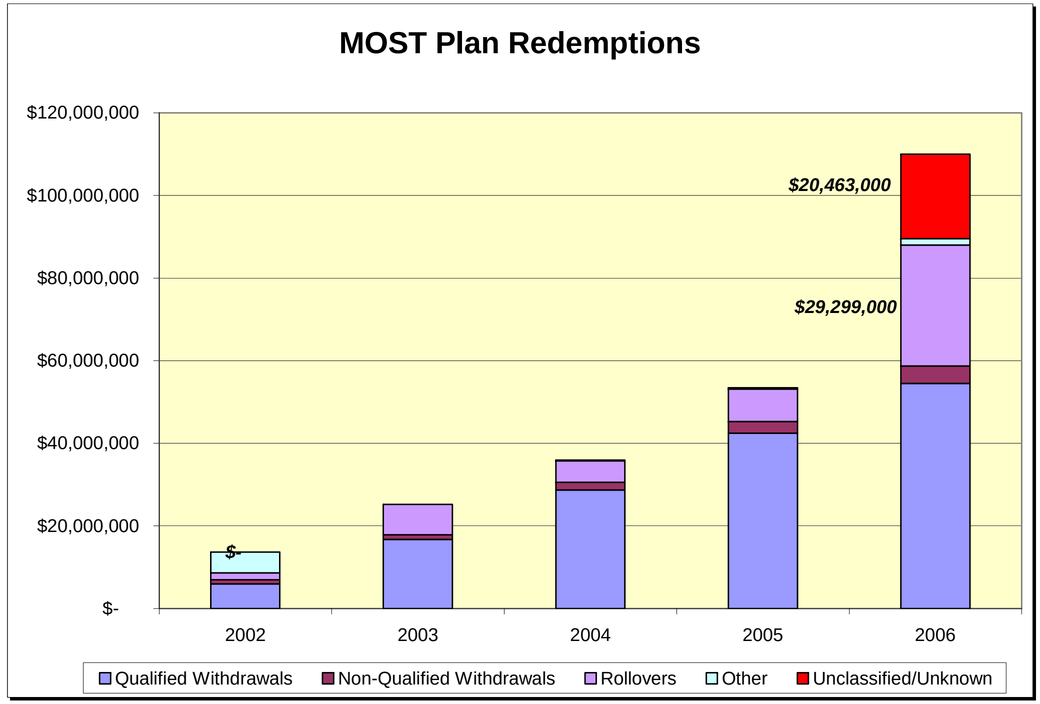
Participation Rate

When we compare contributions on a quarterly basis in 2006 to average contribution levels from 2003-2005, we can see a distinct pattern. Contributions under TIAA-CREF in Q1 actually declined from the 2003-05 average and were flat in Q2. In the third and fourth quarter under Upromise, however, contributions ramped up and increased 35% and 17% respectively from the average levels in 2003-05. Contributions were more than $11 million higher than the 2003-05 average in each of those two quarters.



Participation Rate

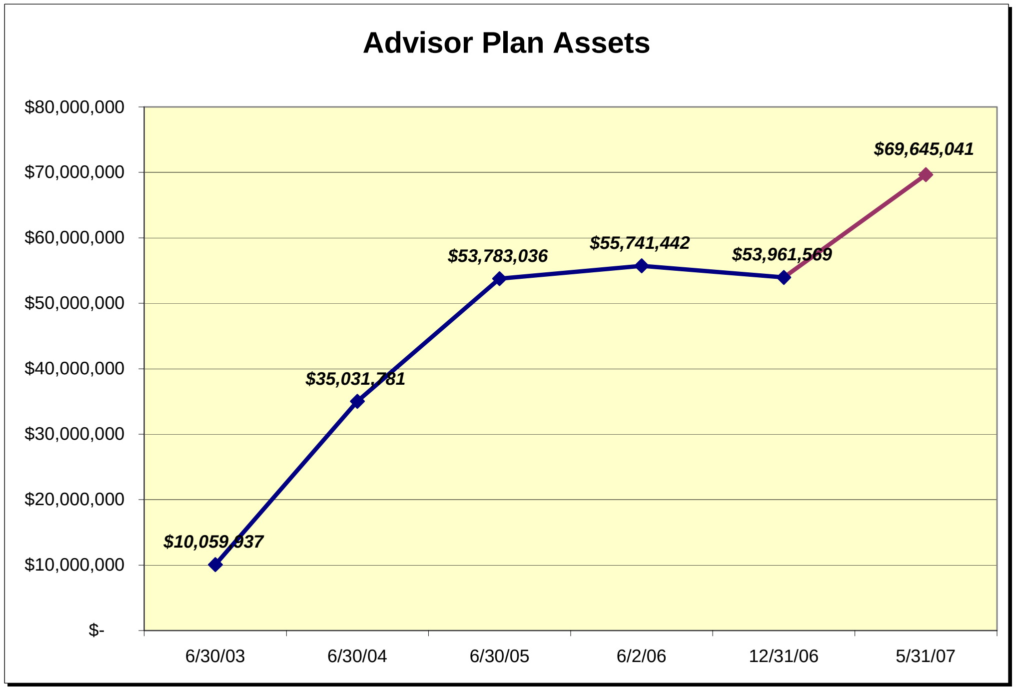
While contributions were up for 2006, we also saw a significant increase in redemptions, or withdrawals, out of MOST this year. These redemptions included a mix of qualified withdrawals for college expenses, transfers from the Advisor Plan to the Direct Plan, and rollovers out of the MOST plan. With any change in program manager, we would expect to see some "defections" of account owners who prefer the old program manager. In 2006, we saw rollovers increase from $7.8 million the prior year to at least $29.3 million, however. An additional $20.5 million is unclassified and may also consist primarily of rollovers out of the plan or other withdrawals not associated with the payment of college expenses .



Advisor Plan

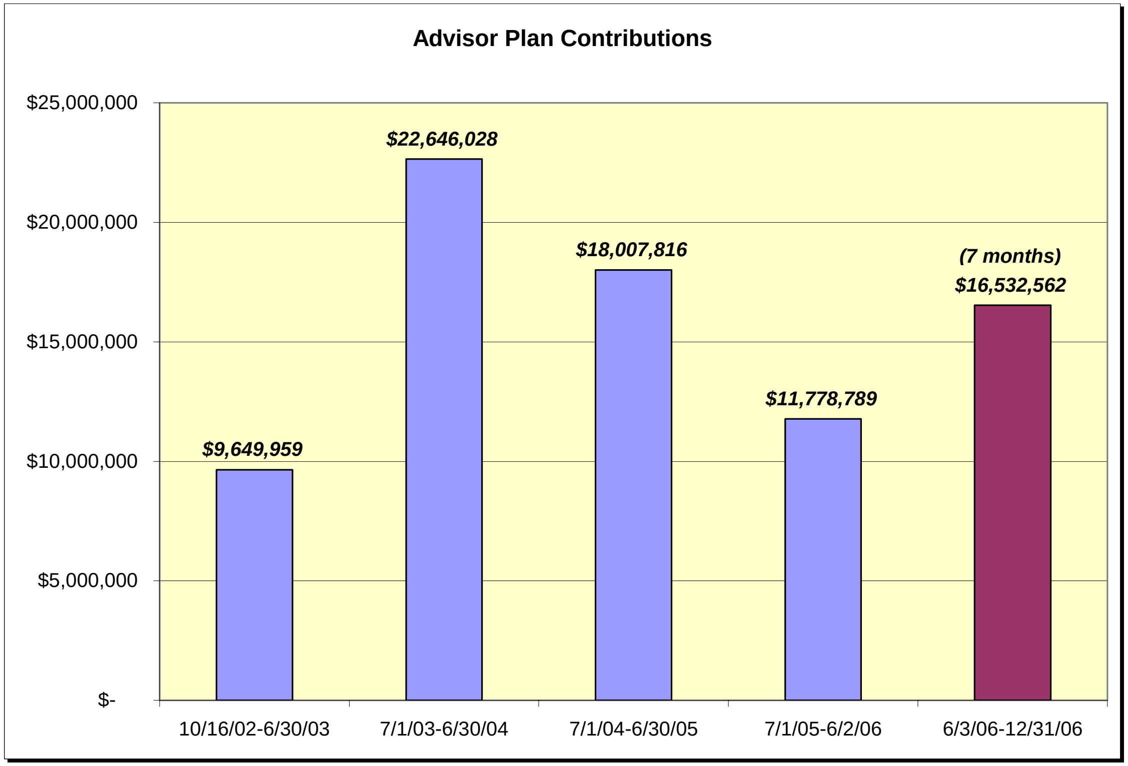
With the overhaul of the Advisor Plan in June 2006, we also provide a review of participation in this plan.

We had seen respectable growth in the assets in the Advisor Plan until early 2006, when we saw a number of redemptions out of the plan prior to conversion. Additionally, there were a number of clients represented by registered investment advisors rather than broker-dealers who transferred from the Advisor Plan to the Direct Plan this year. As a result, growth was flat through the end of 2006. However, growth in assets has been very strong through the first five months of 2007 under Upromise's management.



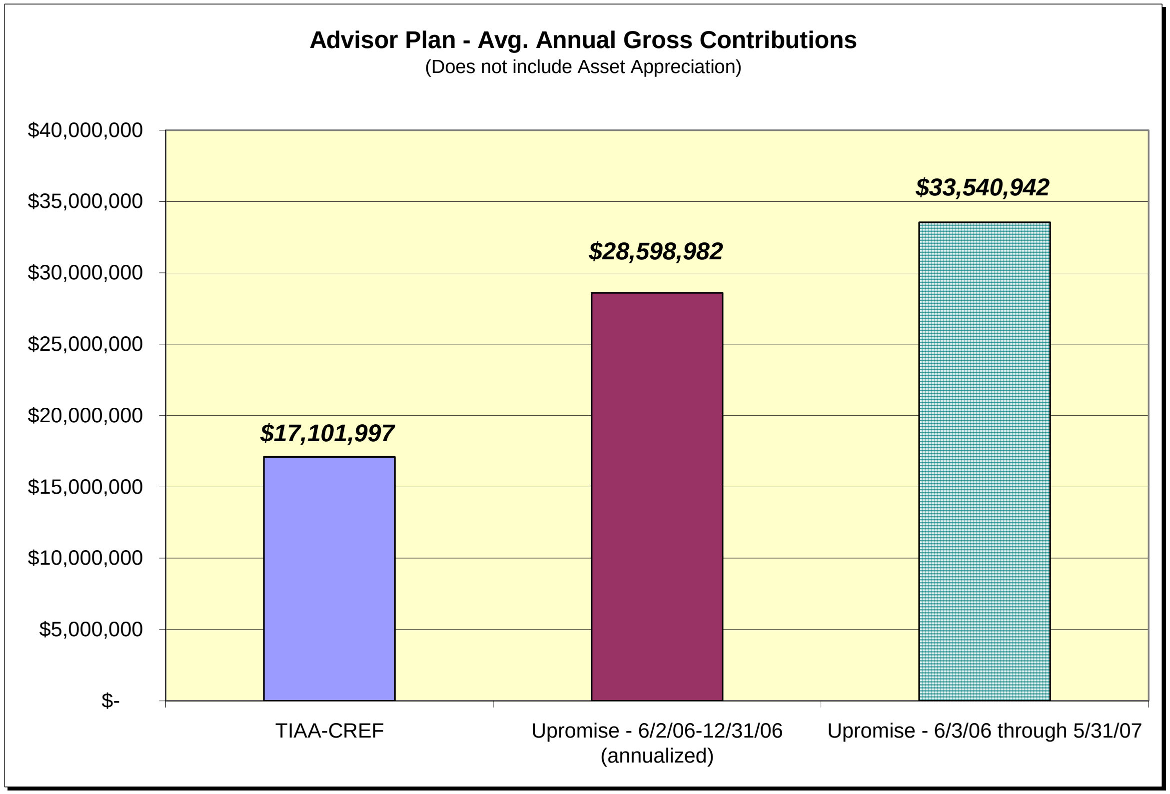
Advisor Plan

The chart on the right compares annual contributions by fiscal year (the year ending June 30th) since the launch of the Advisor Plan in October 2002. In the first seven months of the new Advisor Plan's existence (June 5 – December 31, 2006), contributions were very strong and totaled $16.5 million.



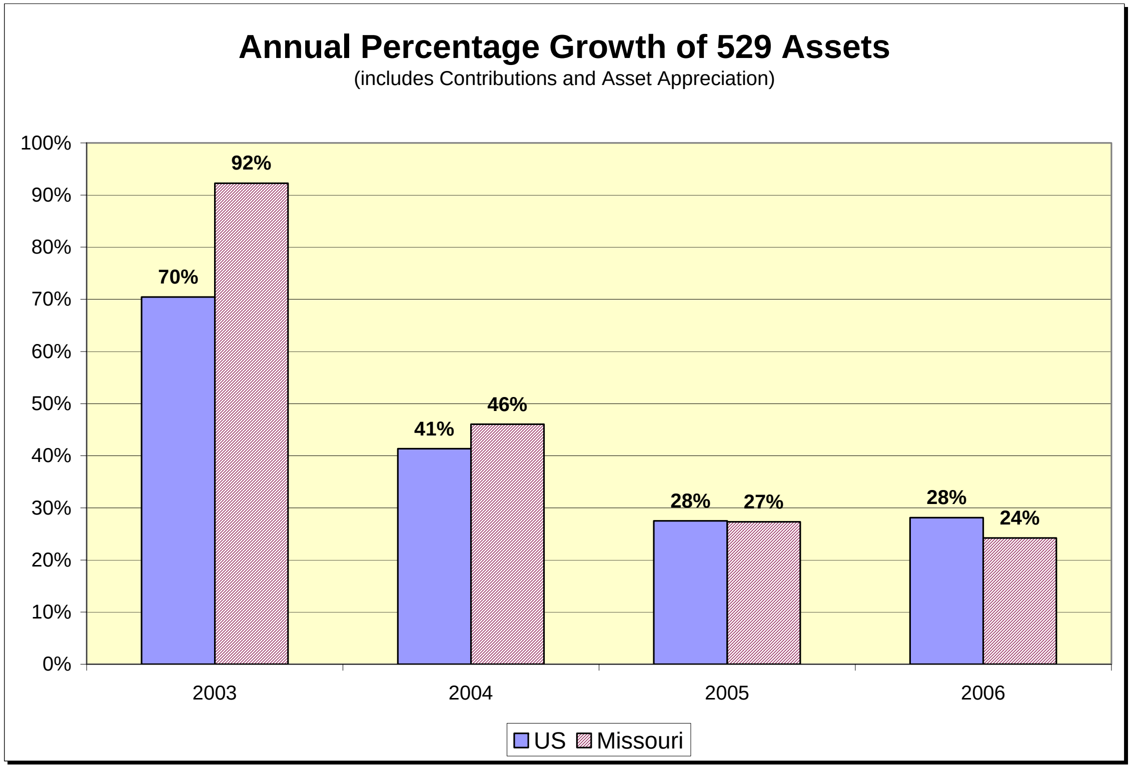
Advisor Plan

The chart on the right further compares average annual contributions in the old TIAA-CREF Advisor Plan to annualized figures for the new Advisor Plan managed by Upromise. Additionally, the bar on the far right provides actual contributions for the first year of the new plan (June 2, 2006 through May 31, 2007). Contributions to the new plan for this period were nearly double the average rate under TIAA-CREF.



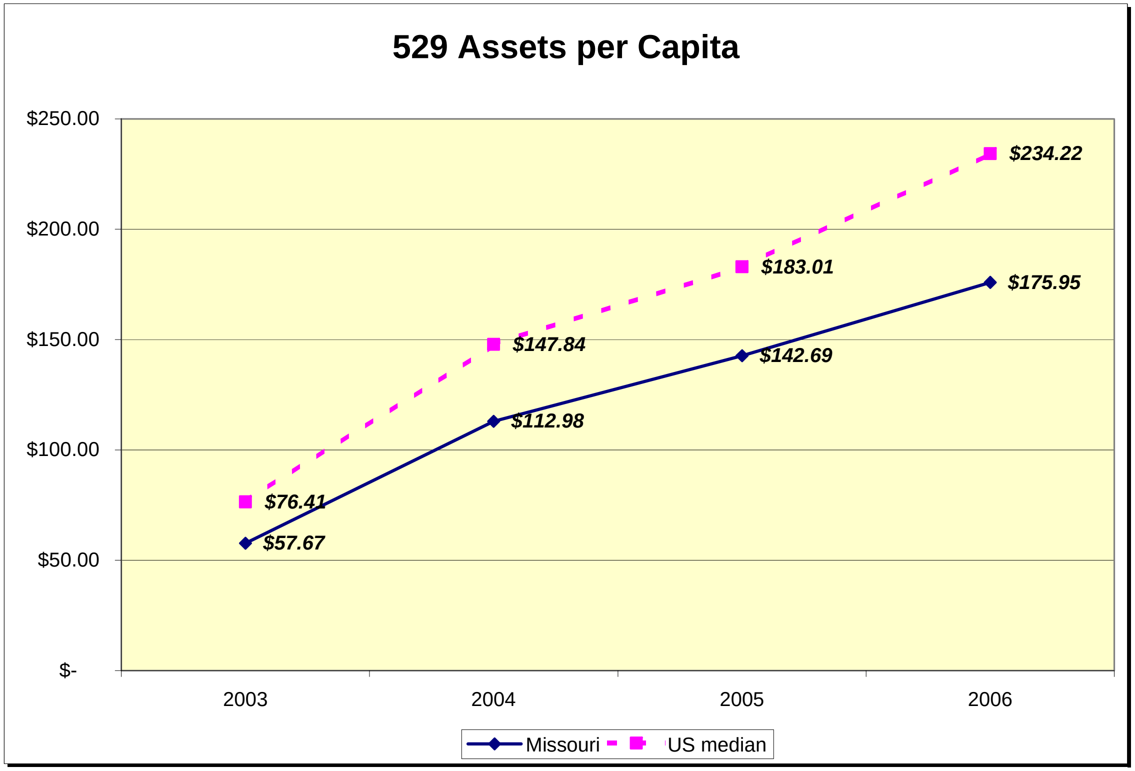
Comparison of MOST Participation to National Trends

In addition to a longitudinal approach, another way to evaluate the growth of the MOST plan is to compare the growth in assets in our plan to total 529 assets nationwide. By that measure, MOST had for the most part kept pace with national trends until 2006. The primary reason for the lower growth rate this year was the second quarter when MOST assets were basically flat due to the number of redemptions out of the plan versus growth in 529 assets of 4% nationally.



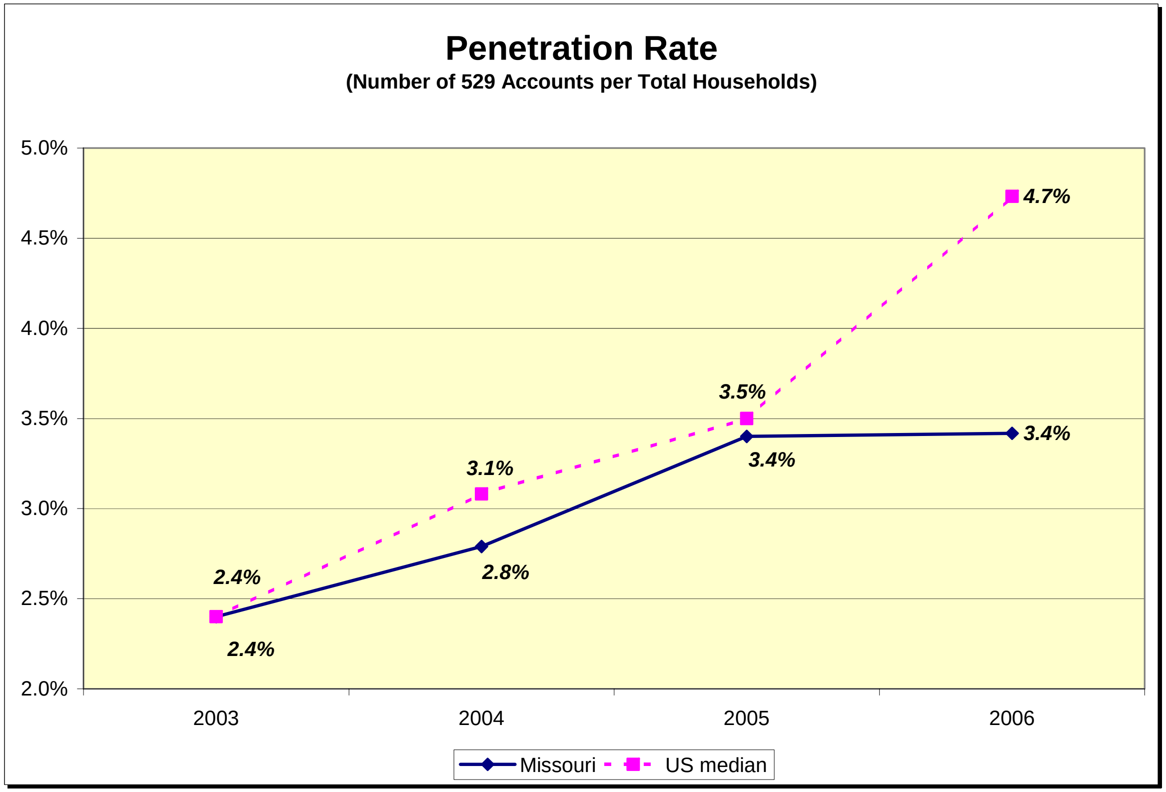
Comparison of MOST Participation to National Trends

The chart on the right provides another measure against national statistics, this time comparing MOST assets on a per-capita basis (MOST assets divided by Missouri's population) to total 529 assets per capita. We have seen the gulf in this measure widen over time. This is due to a slower growth rate for the MOST plan than the national rate (see above) as well as greater penetration among households by other state plans (see next slide).



Comparison of MOST Participation to National Trends

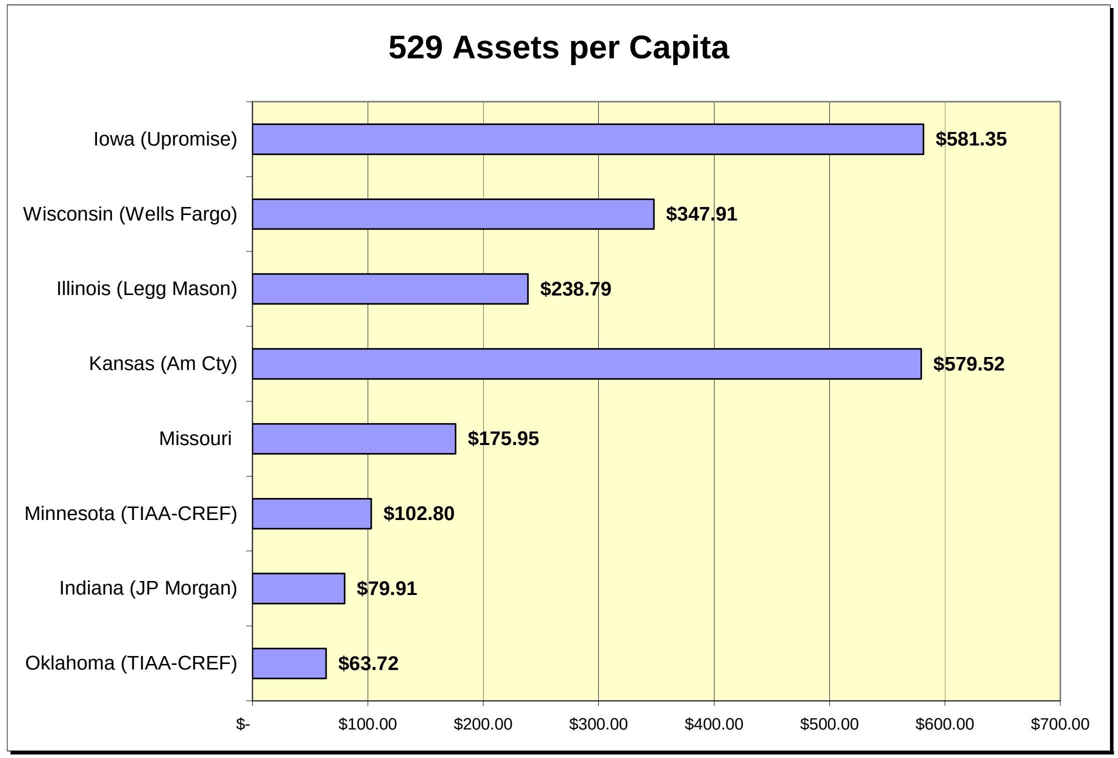
Rather than comparing asset growth, a second basic way to compare our plan to other states is to examine the number of account owners to the number of households in the state. In 2005, 3.4% of households had a MOST account. This compared favorably to the median of states. However, in 2006, based on the number of redemptions out of the program, MOST's penetration rate held flat while the median increased to 4.7%. Missouri's ranking for the penetration rate has declined from 26th among states in 2003 to 30th in 2006.



Comparison of MOST to Peer Group

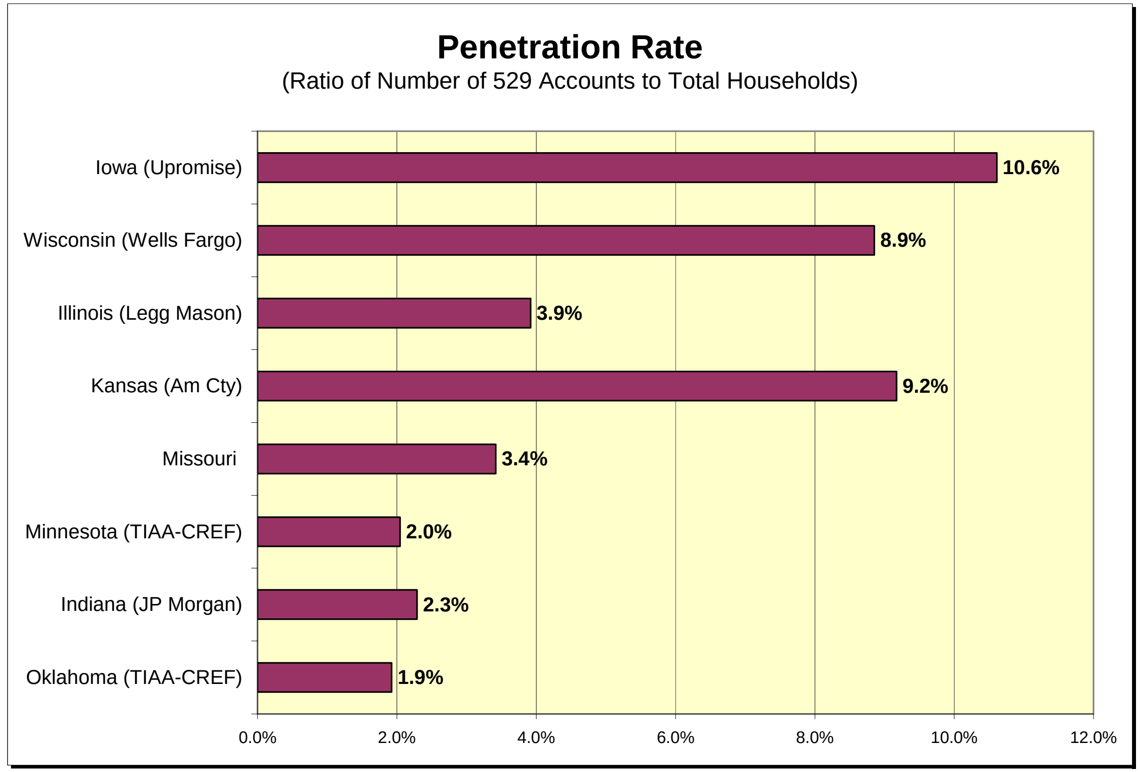
For several years, the annual report on MOST has compared the MOST program to a peer group of other Midwestern states. This year's report updates these statistics.

The chart on the right once again compares 529 assets per capita. Missouri ranks near the middle of this peer group. The average per-capita 529 assets of this peer group is $236 per person. As further explanation, we understand that roughly 60% of Kansas' 529 plan consists of out-of-state account owners, so without these out-of-state holders, their per-capita 529 assets would be $232 per capita. We also believe a large portion of Wisconsin's assets consist of out-of-state account owners.



Comparison of MOST to Peer Group

In terms of its penetration rate, Missouri ranks near the middle of this peer group although once again well below Iowa, Kansas and Wisconsin. The average penetration rate for this peer group is 4.7%, compared to Missouri's rate of 3.4%. Kansas' estimated penetration rate after discounting 60% of accounts as out-of-state is 3.7%.



Participation

Conclusion

Participation in the MOST program has gradually fallen compared to national trends and Missouri now ranks 30th among states in terms of both assets per capita and the penetration rate to households. Among Midwestern states, Missouri's penetration rate and assets per capita also continue to lag that of Iowa, Kansas and Wisconsin although these states also attract a far greater number of out-of-state customers.

Part of the reason why we lag these three states is their longer affiliation with their asset managers. Additionally, in contrast to the MOST plan, in both Wisconsin and Kansas their asset managers -- Wells Fargo and American Century respectively – do not sell any other direct plans. As a result, undoubtedly these two plans have attracted a sizeable number of out-of-state clients. The same dynamic holds true for Kansas' relationship with Schwab, which manages the Schwab 529 College Savings Plan.

At the same time, there is evidence that since Upromise assumed management of the program in June 2006, the number of new accounts and asset growth in the overall plan and in the Advisor Plan have increased considerably. This is partly due to efforts to link existing Upromise and Vanguard account owners with the MOST plan, as well as the increased attention that the new enhanced MOST plan has received. Still, there will there need to be a sustained effort to bring MOST participation in line with national averages.

Continued Viability

In last year's report, we commented on a number of factors facing the MOST program including increased competition for 529 assets among states and their asset managers, a reduction in program expenses among state programs and the introduction of state tax deduction parity in three states. The competitive pressures facing MOST seem certain to continue for the foreseeable future.

Fortunately, we see signs that the selection of Upromise as the new program administrator and the restructuring of the MOST program to include greater investment options and lower costs in June 2006 has generated positive results. Specifically, we have seen increased participation in the MOST plan, especially the Advisor Plan, after several years of flatter growth. In order to continue to favorably position the MOST plan, we believe there are several critical items that will help attract assets to MOST. These include:

1. Greater awareness and penetration of the MOST and Upromise brands in the St. Louis metropolitan area, especially in the grocery sector.
2. Launch of the MOST CD program
3. Focused marketing to elementary, secondary and higher education facilities about MOST.
4. Marketing of the newly revised MOST Advisor Plan lineup approved by the Board in June 2007.

Efforts in each of the four areas are underway but as we indicated in last year's report, the success of these initiatives will depend greatly on the skills and expertise of MOST's new corporate partners during the next several years.

Continued Viability

Looking forward, the Board and State Treasurer staff should be open to look at new opportunities in order to continue to enhance the program. The open architecture of the investment program, which is provided for in the contract with Upromise, certainly allows for this with regard to available investment options. In the future, the Board may also wish to set certain benchmarks or goals for participation, asset growth and other areas to gauge the relative success of the program. In conclusion, for states that wish to continue to offer a competitive product In this industry, it is probably no longer possible to operate on “auto pilot” for the term of the current program manager’s contract.