The Education Trust Board of New Mexico

THE HONORABLE SUSANA MARTINEZ
GOVERNOR OF NEW MEXICO

DR. BARBARA DAMRON, CABINET SECRETARY
NEW MEXICO HIGHER EDUCATION DEPARTMENT

BOARD MEMBERS
DR. BARBARA DAMRON, CHAIR
ROBERT J. DESIDERIO, VICE-CHAIR
DR. JOSE Z. GARCIA
DAVID JANSEN
MARK JARMIE
EXECUTIVE DIRECTOR
THEODORE MILLER

Meeting Minutes of April 27, 2017
Gravitate, 1121 4th Street NW
Albuquerque, NM 87102

APPROVED
Vera Lyons
Board Secretary
8/30/2017

Board Members in Attendance
Dr. Barbara Damron – Chair
Robert Desiderio – Vice Chair
Dr. Jose Garcia -- Member
David Jansen -- Member
Mark Jarmie -- Member

Other Individuals in Attendance
Theodore Miller -- Executive Director ETB
Vera Lyons – Board Secretary ETB
Javier Pachuca – REDW
Janet Pacheco-Morton – Morton Accounting Services
Helen Atkeson -- Hogan Lovells US LLP
Brian Parrish – Sommer Udall
Del Esparza – Esparza Advertising
Emily Howard -- Esparza Advertising
Mikaela Roos – Esparza Advertising
Eric White -- Pension Consulting Alliance
Chris Werner – OppenheimerFunds
Heather Holliday – OppenheimerFunds
Leslie Ann Bednar – OppenheimerFunds
Michele Nelson -- Court Reporter

1) CALL TO ORDER

Dr. Damron, the Chair, called the meeting to order at 9:01 AM. The roll was called and all Board Members were present.

2) PUBLIC COMMENT

The Chair called for public comment. There being none, the Chair moved on to the next agenda item.

3) APPROVAL OF AGENDA

Dr. Damron noted the agenda as presented to the Board and asked if there was any comment on the agenda. There being none, she called for a motion to approve the agenda as presented. Dr. Garcia so moved, and Mr. Jansen seconded the motion. The motion passed unanimously.

4) APPROVAL OF MINUTES

Dr. Damron referenced the minutes of the January 26th meeting of the Board. Mr. Jansen moved that the minutes be approved. Mr. Jarmie seconded the motion. The vote to approve the minutes of the meeting of January 26, 2017 was unanimous.

5) EXECUTIVE DIRECTOR'S REPORT

Mr. Miller then gave the Executive Director's report.

He reviewed the National Junior Honor Society Outstanding Achievement Award Ceremony and the National Honor Society State Summit held at UNM on April 25. The event was at capacity with 300 attendees. There were 7 award winners from New Mexico. Senator Bill Soules gave out the awards and also gave the keynote speech for the State Summit. The State Summit that followed featured three New Mexico presenters speaking on the topics of Global Citizenship, Educational Innovation and Stress Management.

NASSP has indicated that it intends to continue the Awards Ceremony in New Mexico. There are many states in the country competing for state summits. New Mexico will be communicating with NASSP to continue the annual state summit here as well.

Mr. Miller then reported on the Administrative Fund. The balance in the Fund at the beginning of April was $7.7 million. He noted that the current wording of the ETB statute limits the uses to which the Fund can be put. This was the reason for a request to the Attorney General's Office for an opinion of the ability of ETB to create a grant program.

He then proceeded to a one-year extensioOn of the Hogan Lovells legal services contract. Responding to a question from Mr. Jarmie, Mr. Miller confirmed that the contract extension was on the same terms and with the same personnel as the prior year. Mr. Jarmie moved to approve the contract extension. Vice Chair Desiderio seconded the motion. The vote to approve the contract extension was unanimous.

Mr. Miller then advised the Board that a review of potential cash management options was made in the hopes of finding a more technologically advanced system with web access to information. Unfortunately the technology was available, but the returns being offered on the invested cash could not compete with the Local Government Investment Pool operated by the state treasurer's office. Mr. Miller states that he would continue to research the matter in the future.

He then turned to the issuance of a small contract for community outreach for the 529 program in New Mexico. He noted that work being done by Mikaela Roos in this regard as the director of outreach. He recommended that the board approve a small contract for a presenter to supplement the activities of the director.

He also requested authority from the Board to enter into a small contract for investment services with Pension Consulting Alliance. This would be for a completely different service than that undertaken by PCA under the investment consulting contract with the board. Mr. Miller explained that the investment consulting contract is limited to advising the board with regard to the investment activities and recommendations of the program manager. The proposed contract would involve the potential restructuring of the asset allocation portfolios in the 529 program. The first phase of the project would involve examining the investment objectives for the portfolios, and adopting a strategic asset allocation approach.

Dr. Damron asked whether this activity would be allowed under the Procurement Code, given that PCA already performs services for the board. Mr. Miller stated that this was a contract for a different type of service not contemplated under the original contract. Mr. Parrish stated that he did not think there would be a Procurement Code problem. Dr. Damron stated that counsel to the board should research the matter, and that she would take it to a vote conditioned on counsel's favorable review.

Vice Chair Desiderio so moved. Mr. Jarmie asked for the amount of the small contract. Mr. Miller responded that it was $50,000 plus gross receipts tax. He also asked if there was budget for this contract. Mr. Miller stated that there was.

At this point Dr. Garcia asked for a review of what was being proposed. Mr. Miller responded that he would be working with PCA to investigate a potential new design for the asset allocation portfolios. Dr. Garcia asked why this went above and beyond the current contract with PCA. Mr. Miller responded that the current contract was limited to reviewing and advising the board as to the investment recommendations of the program manager.

Dr. Garcia stated that he did not understand why this was not already part of the existing contract. He started that if the matter was to be voted on he would vote 'no'.

Dr. Damron called for a vote on the motion. Mr. Jansen, Mr. Jarmie, Vice Chair Desiderio and Dr. Damron voted in favor. Dr. Garcia voted against.

Dr. Garcia then raised the matter of a board retreat. He stated that he had recommended a board retreat for the last few months and that he had not heard anything about it.

Dr. Damron noted that Mr. Miller set a date for such a retreat. Mr. Miller noted that the date was communicated to the board several weeks ago. A meeting was scheduled for May 26. He stated that counsel had advised that the retreat had to be in the form of a special board meeting. The board could not schedule an informal meeting. Matters relating to the Oppenheimer relationship can be discussed in a closed session, but other matters could be dealt with in open session.

Mr. Miller then turned to the budget for FY2018. He noted that the budget projected a small decrease in revenue, but an increase in expenses, primarily for contractual services.

Mr. Jansen asked a question as to the $200,000 allocation to a Native American grant program. Mr. Miller responded that the amount is carried from last year to the new year, pending the Attorney General's opinion as to the ability of the board to distribute funds for a grant program.

Mr. Jarmie asked for an explanation of the spending of the $650,000 made available annually to the board by Oppenheimer under the contract for marketing. Mr. Miller noted that the Esparza firm already had been engaged by Oppenheimer for doing program marketing. It made no sense to have the board do an RFP for marketing services under that circumstance. Oppenheimer had agreed to add the $650,000 to the statement of work under the contract they already have with the marketing firm. Oppenheimer spends the money that would have otherwise been distributed to the board for marketing on projects of importance to the board.

Vice Chair Desiderio asked for a clarification of the request to the board regarding the vote on the FY2018 budget. Ms. Pacheco-Morton stated that the request was for approval of the FY2018 budget request which includes an estimate of $2.9 million in revenue and expenditures of $2.4 million.

Mr. Jarmie so moved. Mr. Jansen seconded the motion. The vote to approve the FY2018 budget request was unanimous.

6) LEGAL MATTERS

Ms. Atkeson then updated the board on the "rate of return" issue discussed at the January meeting. She noted that a new format had been developed and was nearing implementation. The website information and the information on paper statements will be the same in this regard. It will show the beginning balance, contributions that were made during the period, withdrawals from the account and the effect of market changes on the account. The ending balance for the period will then be displayed. This removes any ambiguity as to the nature of the disclosure.

Ms. Atkeson then addressed the creation of Spanish language program materials. She noted that if materials were produced by the Board at its expense, as opposed to being produced by a heavily regulated entity like Oppenheimer, the standard would be that the materials would have to be accurate and not misleading. The goal was to produce some marketing material that might be useful to those that speak Spanish as a primary language. If they have any questions they can then call the phone center where Spanish speaking representatives are available. Ms. Holliday confirmed that the call center had such representatives.

Dr. Damron noted the complications and delays that can arise from creating such materials. Ms. Bednar also observed the same thing from the standpoint of the program manager. She also observed that the plan demographics did not appear to support a significant.

Mr. Miller agreed, and noted that the effort would involve a one page brochure that could be handed out by the outreach staff. The front would be in English and the back would be in Spanish, with a reference to the call center number. Dr. Damron and Ms. Bednar thought that this approach appeared sensible.

Dr. Garcia thought that there may be a more significant opportunity in the state, but he agreed that a major effort to translate the marketing materials and the website was not appropriate at this time.

Ms. Atkeson then turned to the matter of the maximum contribution amount for 529 plans. She observed that the current maximum in New Mexico was $400,000, and that Mr. Miller was proposing that the amount be raised to $450,000. Mr. Miller noted that a number of states had raised the maximum contribution amount above $400,000, including the state with the largest 529 program, Virginia. The state had a $500,000 limit. He supported this proposal by mentioning that the Chronicle of Higher Education showed that a number of schools had annual costs in excess of $60,000. The highest in the survey was Harvey Mudd at $69,717 per year. Ms. Atkeson had already pointed out that the IRS proposed regulations on 529 plans contemplated 5 ears of costs. Mr. Miller noted that the states had also calculated a percentage increase in costs based on college cost inflation from the time an account is established for a newborn.

Mr. Jarmie asked why the limit could not be raised to $500,000. Mr. Werner observed that one of the differentiators for 529 plans among financial advisors was the maximum contribution amount. Mr. Jansen stated that he would support a move to $500,000. Mr. Desiderio asked what the downside of raising the limit. Ms. Atkeson noted that the costs had to be in line with schools that were available for attendance under the program. The amount could not be inflated solely for tax advantages. Mr. Miller observed that New Mexico did not impose any limits on the schools that could be attended – including Harvey Mudd.

Mr. Miller stated that he would be comfortable with the suggestion to move the maximum contribution limit to $500,000. He also agreed to draft a file memo outlining the justification for the move.

Mr. Jarmie made a motion to raise the maximum contribution limit for the program to $500,000. Mr. Jansen seconded the motion. The vote to raise the limit was unanimous.

Mr. Parrish of the Sommer Udall firm then updated the board on the status of the Attorney General's opinion request regarding the proposed grant program. He noted that the AG's Office was working on the request, but would give no timetable for its release.

Dr. Damron observed that this was an example of the limitations under the current form of the ETB statute.

7) INDEPENDENT AUDITOR'S REPORT FOR FY 2016

Dr. Damron then asked Mr. Machuca of the REDW firm to review the FY2016 independent financial audit of ETB. He noted that this was the sixth and final year that REDW was performing the ETB audit. He commented favorably on the Board's retention of Ms. Pacheco-Morton as an accounting consultant, as well as the cooperation received from Oppenheimer and ETB staff. He noted that ETB received an unmodified opinion.

There was one finding, a significant deficiency, regarding a cash overdraft that occurred at year end. There was a system put in place to catch such items, but by human error the overdraft was not caught when the report was reviewed. This could have been corrected easily at any time other than year end. Mr. Miller and Ms. Pacheco then outlined the additional controls that had been put in place, including maintaining a larger cash balance in the short-term investment poll, and more frequent cash projections and review of reports by Ms. Pacheco-Morton in addition to ETB staff.

Mr. Machuca noted that two findings, including a material deficiency, from the last audit had been corrected, including one that had been open since 2012.

Mr. Machuca thanked the Board for the opportunity, and several board members and Mr. Miller thanked Mr. Machuca and REDW for their service over the previous six years.

Dr. Damron called for a motion to accept the independent auditor's report for FY 2016. Mr. Jarmie so moved. Vice-Chair Desiderio seconded the motion. The vote to accept the report was unanimous.

8) RFP FOR AUDIT SERVICES

Mr. Miller than addressed the recommendation for a new independent audit firm for ETB to succeed REDW. He reviewed the process for creating the audit RFP. Ms. Lyons served as the procurement manager for the RFP and had a major part in drafting it. The evaluation committee for the selection process consisted of Mr. Miller, Ms. Pacheco-Morton and Ms. Atkeson.

Five firms submitted RFPs. Two firms were disqualified for failure to supply mandatory information as part of their proposals. The three remaining firms were evaluated by the evaluation committee. All three firms qualified as New Mexico Resident firms. The highest score went to the Clifton Larson Allen firm. This firm had the greatest expertise in the audit of investment trusts. The firm was the only firm with 529 audit experience. The firm has a dedicated investment trust practice that operates out of its Baltimore office. It also has a partner experienced in investment trusts in its Denver office. This facilitates communication with the Denver-based operations of Oppenheimer and Brown Brothers Harriman -- the accounting agent for Oppenheimer. The firm has also done a significant amount of audit work for the state of New Mexico, including the State Treasurer's Office, the CAFR audit, and PERA. The firm also received a recommendation from the Educational Retirement Board as part of the RFP process.

Dr. Garcia asked what the broad category of "capability of the firm" encompassed. Mr. Miller noted that this category encompassed a number of particular requirements outlined in more detail in the RFP.

Dr. Garcia moved that the Board accept the recommendation of the evaluation committee. Vice-Chair Desiderio seconded the recommendation.

Mr. Jarmie stated that he would abstain from voting since one of the other finalist firms was also his accountant. He stated that if he had voted he would have voted "No" since he did not consider Clifton Larsen Allen to be a New Mexico based firm compared to the others on the list.

The motion to accept the recommendation was passed with four "ayes" and one abstention.

9) INVESTMENT CONSULTANT QUARTERLY REVIEW AND WATCH LIST RECOMMENDATION

Due to a technical error the physical copies of the Executive Summary from Oppenheimer were not available in the Board books. While the electronic version of the Executive Summary was being put on a projector, the Board moved to item 10 on the agenda. Mr. White of PCA addressed the Board.

He first noted that the appropriate revisions to the Monitoring Procedures and Criteria had been made to accommodate the recent revisions to the fund line up. This was a ministerial change that did not affect the substance of the document. It was an information item for the Board.

Mr. White then summarized a series of meeting that had been held with the managers of the Oppenheimer Value Fund. The fund managers had mentioned that they were evaluating the methodology due to recent underperformance, and this had caused PCA to more closely investigate the situation. A major concern with regard to any manager is a change to the investment philosophy and process. The result of these meetings had been that the changes were more evolutionary than radical. They involved the use of multiple quantitative models in order to get a more robust factor analysis. It is mainly an enhancement of the input into the process rather than a major change to the process.

Mr. White then turned to fund performance. He noted that it had generally been a good quarter for the underlying funds in the program. This is because there was a lessening of the influence of macro factors, such as Fed policy, that were causing securities to move in a similar fashion.

Mr. White did not believe that the trend toward passive management would not go away. He also thought that there are too many active managers. The market is oversupplied with them. That being said, in TEP 53% of the funds were in positive territory and another 20% were at the acceptable level. In ScholarsEdge 33% were in the positive category and 38% were acceptable. Having funds at 70% or more in these two categories is what PCA likes to see.

He then turned to the risk-reward pages for the age-based portfolios in the program. These pages are of particular significance because they represent both the contribution of asset allocation and manager stock selection to return. There is also a separate set of charts showing where the plans fall compared to the Morningstar medal-rated programs. In general the majority of the age-based portfolios fall above the median risk/return line.

Mr. Miller returned to the idea of asset allocation and stock selection. He noted that the returns in the program can be attributed to asset allocation, but not to stock selection. Mr. White noted that over the long term stock selection has detracted from the performance of the plans. Mr. White attributed the asset allocation contribution to performance as being due to the relatively high percentage of equities in the portfolios. Asset allocation is the key to success in the long term.

Mr. Miller noted that this is one of the reasons he recommended retaining PCA under a separate contract to investigate asset allocation based on ETB staff ideas, and not simply as a reaction to Oppenheimer's recommendations. The current PCA contract is directed toward an evaluation of recommendations made by the Program Manager, and not as direct advice to the Board with regard to investments. In order to secure that kind of advice a separate contract is required.

Dr. Damron and Dr. Garcia opined that such a contract would be appropriate.

The discussion turned to what value active managers can provide to a portfolio. Mr. Miller observed that asset allocation is itself an active management decision. How to combine various passive funds is an active decision. Also active managers may be able to provide some downside risk protection in volatile market environments. Mr. White agreed.

Mr. White then turned to the Watch List recommendations. He recommended that three funds be removed from watch status- the Oppenheimer Value Fund, the Monetta Young Investor Fund and the Oppenheimer Global Fund. He recommended that the Oppenheimer Global Value Fund remain on watch status, and he recommended adding the Dreyfus Research Growth Fund to the watch list. The Dreyfus fund has significantly underperformed due to bad stock selection in the technology sector.

Mr. White also noted that PCA is concerned about the underperformance in the Oppenheimer International Growth Fund and the Capital Income Fund. He noted that they had not yet satisfied the criteria for being placed on watch.

Dr. Garcia asked why the Value Fund was recommended for removal. Mr. White replied that PCA's analysis indicated a positive trend in the fund's performance over the medium term. Mr. Jarmie opined that the Value Fund has been on and off watch status several times since he joined the board. He questioned the remove from watch status. Mr. White noted that PCA did not object to leaving the fund on watch status for another quarter. This would help confirm whether or not a trend was in place.

Mr. Jarmie made a motion that the Monetta Young Investor Fund and the Oppenheimer Global Fund be removed from watch status, while the Oppenheimer Value Fund remain on watch status, and that the Global Value Fund and the Dreyfus Research Fund be added to watch status. Mr. Jansen seconded the motion. The vote to approve the motion was unanimous.

10) PROGRAM MANAGER'S QUARTERLY REPORT

After a short break for lunch the board reconvened to hear the Program Manager's Quarterly Report. Dr. Damron asked Mr. Werner to give the report. He referred the Board to the Executive Summary. He began with a brief review of the quarter and the year-to-date in terms of the economy and markets.

For The Education Plan Mr. Werner noted that the funds in the index portfolios were across the board performing as expected. Moving to the blended portfolios, he noted that the portfolios had outperformed relative to their benchmarks and net of fees.

With regard to underlying funds the Oppenheimer Global Fund outperformed its benchmark by three and one half percent. The Value Fund also outperformed for the quarter. The Senior Floating Rate Fund slightly outperformed. The Main Street Fund underperformed mainly due to its investment in energy related stocks. The Main Street Small Cap Fund outperformed. The International Growth Fund slightly underperformed.

Mr. Werner mentioned the upcoming due diligence meeting in New York. He noted that the asset allocation team was scheduled to present.

Page 144

11) QUARTERLY MARKETING REPORT AND FY2018 MARKETING PLAN

Ms. Bednar then began the marketing and sales update. She referred to the 8 key performance indicators in the marketing report. She noted that the number of "impressions" was above 13 million and the number of website visits and website users were at all-time highs.

Mr. Jarmie then noted that the total of new accounts were up somewhat, but the sales sales dollars for the quarter were down when comparing Q1 to prior year Q1. Dr. Damron expressed concern about this trend. Ms. Bednar observed that new account contributions were smaller despite the increase in new accounts. In a sense this was good because it could indicate that account owners with more moderate incomes were contributing to the program.

Mr. Werner went over the sales figures for the program. Foe new accounts there was growth in both plans in Q1 versus Q1 of the prior year. After three quarters of the fiscal year the contributions were at 63% of goal. Dr. Damron again expressed concern about the pace of new asset growth.

Ms. Howard then began the review of the marketing plan for the coming fiscal year. She described the cycle from awareness to interest to conversion and then encouraging more contributions. In the last couple of years the focus was on awareness. Going forward the focus would be on interest and conversion. There will be a heavy focus on digital marketing – it is more affordable, trackable and more easily changed than other forms of marketing.

There will also be more of a focus in Scholar'sEdge on developing content that is useful to brokers. They will be working closely with the sales team on this.

There will be a focus on building relationships with employers in New Mexico and building awareness and converting accounts in tax parity and no income tax states.

She noted that for The Education Plan there would be three major targets for marketing efforts – middle income and up individuals in New Mexico and tax friendly states, large employers in New Mexico, and low-to-moderate income people in New Mexico.

Dr. Garcia asked how much of the effort was devoted to the last group. Mr. Miller noted that it would depend on a favorable outcome from the opinion request to the Attorney General. He said that the idea was to partner with programs that had state-wide coverage but a local presence – such as the National Honor Society and Junior Achievement.

Dr. Garcia stated that New Mexico needed even C-minus students to go to college. As a policy matter, New Mexico needs more college graduates. Ms. Howard noted that the research showed that accounts owners that invested through employer payroll deduction tended to have lower incomes than those that invested on their own. That is one reason why the employers are being targeted.

Ms. Roos noted the efforts that were now being made both in the public education system as well as the counties to promote the program.

Ms. Howard noted the efforts being made to redesign the website for The Education Plan to appeal to different investor types, including unsophisticated investors. Mr. Miller noted the intention of ETB to take control of the marketing "front end" of the website while leaving the Oppenheimer transactional portion of the site with the program manager. This would allow more ready tracking of site visitor activity, better lead generation and easier navigation.

Ms. Howard referred again to digital marketing as being a major effort. The plan was also to continue with outdoor advertising. There will be no radio or tv advertising, although some of that content will be repurposed for the internet. She also mentioned the use of social media like Facebook. Dr. Damron also asked for content for Twitter. Ms. Howard also mentioned the use of paid search to increase exposure when people search for information on the internet. Ms. Howard then gave an overview of the marketing calendar for The Education Plan.

Community outreach will be increased. Ms. Roos mentioned Kid Fest as an example.

Ms. Bednar then went through the marketing plan with regard to Scholar'sEdge. She noted that the principal audience was financial advisors. She mentioned the creation of tools to make the advisor's job easier with regard to explaining 529 plans—similar to the "chart books" used for retirement plans. The marketing plan also envisions digital ads and search engine marketing. Ms. Bednar then gave an overview of the marketing calendar for Scholar'sEdge.

The last part of the presentation was the marketing budget for FY2018.

Dr. Damron asked for a motion to approve the marketing plan as presented to the board. Mr. Jansen so moved. Vice-chair Desiderio seconded the motion. The vote to approve the marketing plan was unanimous.

12) ADJOURNMENT

Dr. Damron asked if there was any other business to come before the Board. There being none, the meeting adjourned at 1:20PM.