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

Meeting Minutes of August 8, 2017
1516 Paseo de Peralta, Santa Fe, New Mexico 87501

APPROVED
Vera Lyons
Board Secretary

Board Members in Attendance (by telephone)
Dr. Barbara Damron – Chair
Robert Desiderio -- Vice Chair
Dr. Jose Garcia – Member
David Jansen – Member
Mark Jarmie – Member
Board Staff in Attendance
Theodore Miller -- Executive Director ETB
Vera Lyons – Board Secretary
Other Individuals in Attendance (by telephone)
Chris Werner – OppenheimerFunds
Heather Holliday – OppenheimerFunds
Raquel Granahan -- OppenheimerFunds
Helen Atkeson -- Partner, Hogan Lovells US LLP
Kurt Sommer -- Sommer Udall
Kay Ceserani, Pension Consulting Alliance, LLC
Andrea Feirstein – AKF Consulting
Michelle Nelson -- Court Reporter

1) CALL TO ORDER

Dr. Damron called the meeting to order at 4:00 PM. All board members were in attendance with the exception of Dr. Garcia and Mr. Desiderio. A quorum of three members were present.

2) PUBLIC COMMENT

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

3) APPROVAL OF AGENDA

Dr. Damron noted the agenda as presented to the Board. She noted that she had discussed Item 4 of the agenda with Mr. Desiderio and they had agreed that this item should be removed from the agenda. She asked if there a motion to approve the agenda with the removal of Item 4. Mr. Jansen so moved and was seconded by Mr. Jarmie. The vote to remove Item 4 was unanimous. (At this point Dr. Garcia joined the meeting.)

5) REVIEW OF OPPENHEIMER FEE AND INVESTMENT PROPOSAL

Dr. Damron asked Mr. Miller to address Item 5 on the agenda. (At this point Vice-Chair Desiderio joined the meeting. All board members were now present.)

Mr. Miller referred the Board to the PowerPoint presentation. He began by noting the high level facts. There has been a rapid adoption of index funds by the direct-sold 529 plans, with a resulting decline in fees. Fees in blended direct-sold products have also declined. The advisor-sold channel is affected by the switch to direct-sold plans, as well as the challenges arising from potential fiduciary regulation and lower cost forms of investing – including automated platforms.

He noted that at this time the Education Plan is stagnant in terms of growth and Scholar'sEdge is losing accounts. Asset growth in each plan is primarily through market growth and not account growth.

In an attempt to reinvigorate the direct-sold plan ETB wanted to significantly reduce fees so as to become competitive with the top-quartile plans. This involved replacing existing index product with lower cost Vanguard funds, as well as eliminating "wrap fees", and addressing the issue of small account fees.

With regard to investment design in both plans the goals were to better align the investment structures of the two plans, to create more diversity in our investment portfolios as well as address the Morningstar criticism of an equity step down between age-based portfolio steps of more than 10%.

He then turned to the summary of changes in the proposal. First he noted the goal of diversifying the underlying investments in the portfolios as well as more closely aligning the investment design of the plans in the program. There are significant differences between the Scholar'sEdge and The Education Plan portfolios. The goal was to make them more consistent. This could improve the chance that Morningstar could rate the direct-sold program.

Another goal was to reduce fees in several ways. First, Vanguard index funds replace Dreyfus and TIAA index funds. This also eliminated wrap fees placed around the former index funds. The program manager fees on The Education Plan were lowered from 10 bps to 5 bps. The state administrative fee on the Blended option was lowered to 5 bps to match the fee on the Index option. In addition the $25 annual fee was dropped for the direct-sold program.

With regard to Scholar'sEdge the state administrative fee was dropped from 10 bps to 8 bps. The program manager fee was increased from 10 bps to 12 bps.

Finally the age-based risk tracks in The Education Plan were reduced from three to two. This change was made in recognition of the fact that the growth and balanced tracks were not attracting much money. A new balanced track that starts at 70% equities was created to accommodate both the default investment option available under the direct-sold plan and to provide a track for more conservative investors.

In Scholar'sEdge the three risk-based tracks were reduced to one – the current aggressive track. Nearly all the money in the age-based risk tracks is in the aggressive track. In addition the reduction to one track will facilitate the omnibus account effort with larger brokerage firms.

Finally, Mr. Miller noted that in order to accommodate the significant fee reduction in the program, the proposal included a recommendation that the New Mexico fee rebate program be discontinued.

Dr. Garcia asked about the principal purpose of the proposal. Mr. Miller answered that the proposal was designed to make the direct-sold much more competitive with regard to its fees, both for New Mexico residents and nationally.
Mr. Miller then turned to Ms. Ceserani and Mr. Werner to go through the proposal in detail. They noted the reductions in fees in the direct-sold program, as well as the swapping out of Dreyfus and TIAA index funds for Vanguard index

Mr. Miller then turned to Ms. Ceserani and Mr. Werner to go through the proposal in detail. They noted the reductions in fees in the direct-sold program, as well as the swapping out of Dreyfus and TIAA index funds for Vanguard index funds, the increase in the number of age-based portfolios to reduce the equity drop down between portfolios to 10%, the correction of some percentage anomalies in the fixed income portfolios, and the increase in portfolios diversity particularly with regard to emerging markets and alternative investments.

Mr. Jansen noted the decreased fees from the swap out of funds, and asked about the performance of the replacement funds and other new funds. Mr. Miller asked Mr. Jansen to hold his question until PCA gave its analysis of the program changes. Mr. Jansen agreed.

Mr. Miller then turned to Scholar's Edge and described the increase in the number of portfolios to address the equity stepdown issue. Ms. Ceserani then noted the addition of six new funds to the advisor-sold plan, both to replace some existing offerings and to improve the diversity of the investments.

Mr. Miller noted that there was no significant change in the overall fees for the advisor-sold program. The administration fees remained at 20 bps, with the split being adjusted to 12 bps for OppenheimerFunds and 8 bps for the state.

Ms. Ceserani then reviewed the PCA memo for the board. She reminded the board of the May 26 meeting at which the original OppenheimerFunds proposal was reviewed. She noted the three main purposes of the proposal – to address the equity stepdown issues for the age-based glidepaths, to address fees and to address underlying investments. The initial proposal addressed the first two of these items but did not address the third.

ETB, with PCA's assistance, responded to the OppenheimerFunds proposal. The five major points that ETB wanted addressed were further diversification of the underlying funds, better alignment of the portfolios between the two plans, a review of Scholar'sEdge standalone options, a further reduction in costs and a further review of all the underlying funds in the program.

Ms. Ceserani noted that nine new funds had been added to the program and four existing funds were repurposed by including them in the glidepaths. All of the funds are rated three stars or better by Morningstar. Six of the funds are medal rated as well. She then analyzed the funds from the watch list perspective, and concluded that any funds on watch or that might qualify for watch currently did not do so for any meaningful reasons.

Mr. Miller asked Mc. Ceserani to comment on the alignment of the portfolios better returns with less risk. On the balanced tracks they have higher returns with more risk. The added risk is from more exposure to equities, particularly international equities. In her view the revised funds made more sense than the previous ones.

She then went through the asset allocations for the various classes of investments. She noted the better alignment among the plans with regard to alternative investments like REITS, as well as equities – particularly international equities. With regard to fixed income she noted the improved alignment of The Education with Scholar'sEdge.

Dr. Garcia asked Mr. Werner of his opinion of the counterproposal. Mr. Werner stated that Oppenheimer thought that all the suggestions put forward by ETB and PCA were reasonable. He thought the comments by ETB and PCA on the counterproposal were accurate. He thought the program was a solid program for the cost. Dr. Garcia observed that it was like moving up to the latest model of a car as opposed to an older model. Mr. Werner noted that the industry was changing so rapidly that even the program launched just two years ago was outdated.

Mr. Miller observed that the program was now current with others in the marketplace, but would need to change in the future in order to stay current.

Dr. Damron asked if there were any other comments from Mr. Miller. He replied that he wanted to go over the financial impact to ETB from the proposed program.

Mr. Miller noted that the state administrative fee reductions in the TEP Blended option and in SE would result in an estimated $200,000 annual reduction in the fee revenue. He was of the opinion that the revenue reduction was in the best interests of the program.

He observed, however, that in order to accommodate the fee reduction, the board should consider enduing the rebate of the state administrative fee to New Mexico residents account owners. He noted that the current fee rebate was running at about $375,000 annually. After the reduction in fees the rebate would run at about $252,000 annually. The combination of the fee reduction and the fee rebate would reduce state fee revenue too much in his view. He pointed out that the fee reductions in the proposal would benefit account owners in TEP by over $500,000 a year. SE owners would not experience a reduction in fees, but they will benefit from a more diverse and competitive investment program.

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He then went on to talk about the timing of the proposed changes. He noted that the most difficult part of the change would be the addition of the extra portfolios to the program. The swapping out of underlying and the repricing of the portfolios were simpler in that regard.

Ms. Holliday estimated that the entire project would take about 1500 hours, and that a realistic time frame for completion would be in the January-February timeframe. Ms. Holiday also noted that OppenheimerFunds does not undertake any systems development work for the entire month of December in order to focus on year-end processing.

Dr. Damron asked the board if there were any further questions, and if someone would make a motion. Dr. Garcia moved that the proposal as presented by approved. Mr. Jansen seconded the motion.

Mr. Jarmie asked if Ms. Ceserani and Ms. Feirstein to give their perspectives on the proposal. Ms. Ceserani stated that from an investment perspective it was a move in the right direction. The added investment portfolios were needed, the underlying investments needed to be more diversified and the product made more competitive. Importantly, the changes needed to be adopted now by the board if they are going to be considered by Morningstar in the upcoming 529 industry review.

Ms. Feirstein agreed with Ms. Ceserani's comments. She questioned the amount of time the OppenheimerFunds needed to make the changes. She asked if it were not possible to make some of the changes before the December blackout. She noted that it was imperative that the program be made more competitive as soon as possible. She asked if OppenheimerFunds intended to charge the program for the development cost. Mr. Werner said that that was not the case. It was an internal cost, although the marketing efforts would be paid for from the marketing budget.

Mr. Jansen asked to clarify that the vote would also be to rescind the current fee rebate program. Dr. Garcia and Mr. Jarmie agreed. Dr. Damron called for each member to state his vote. Dr. Garcia voted yes. Mr. Jansen voted yes. Mr. Jarmie voted yes. Vice-Chair Desiderio voted yes. Dr. Damron also voted yes.

OppenheimerFunds to the due diligence questions that had not been answered by the firm in the New York due diligence visit in June. Rocky Granahan spoke for OppenheimerFunds on the matter.

Mr. Jarmie opened the discussion by expressing his disappointment that the questions presented to OppenheimerFunds had not been answered prior to the New York meeting. He thought the meeting would have been more substantive, especially with regard to OppenheimerFunds' business plans for the 529 business.

Dr, Damron then noted that she took issue with some of the comments in the letter from Kathleen addressed to the board. The concerns of the board were not "newly introduced". They had been expressed repeatedly in the past. Next she observed that the board was not seeking "to initiate a new arrangement" with another vendor. She thought that both of these statements were inaccurate.

Dr. Damron thought that the letter did not address the board's concerns, and that it had been phrased in such a way as to change the intent and the facts.

Ms. Granahan asserted that there were new points raised by the board at the New York meeting that Ms. Beichert was trying to address in her letter. Dr. Damron rejected this assertion with regard to the three points she had noted in the letter.

Ms. Granahan then stated that OppenheimerFunds is 100% focused on the New Mexico plan. She stated that the firm had not reduced any headcount with regard to the advisor-sold plan. She stated that OppenheimerFunds supported the changes to the plan necessary to make it more attractive to advisors. She thought the changes were a net-positive contribution to the plan.

Mr. Jarmie stated that her comments told him nothing. What specifically was OppenheimerFunds going to do other than to say that the changes were a good idea?

Mr. Werner said that the specific goal was a 5% increase in new assets with a 10% stretch goal for the advisor-sold plan. He thought that it would take a year to see the effects of the changes to the plan. He also made reference to the marketing plans being created by Esparza including the digital marketing plan for advisors.

Mr. Jarmie asked Mr. Werner if the 5% growth target was only on assets or also on accounts. Mr. Werner said it was on both. Mr. Jarmie also asked about the

Mr. Jarmie asked Mr. Werner if the 5% growth target was only on assets or also on accounts. Mr. Werner said it was on both. Mr. Jarmie also asked about the direct-sold plan. Were his comments directed to that plan as well? Mr. Werner said that they were not.

Dr. Damron agreed with Mr. Jarmie that Ms. Granahan had not provided any tangible detail about OppenheimerFunds' future plans for the 529 program.

Mr. Jansen referred to Ms. Beichert's letter again, and noted that the board had just approved moving forward with the fee and investment proposal. As to the other two points in the letter regarding web enhancements and Spanish-language materials, he wanted to be sure that OppenheimerFunds understood that the board did not want any delays on implementation in the redesign of the program or the other projects.

Dr. Damron stated that she thought that web enhancements were already in progress and should continue, but that was no request that a new start be made. Dr. Garcia and Mr. Jansen agreed. In New York ETB was expressing its frustration with the poor quality of the website and the time it was taking to make improvements.

Dr. Damron also countered the implication in Ms. Beichert's letter that the board was demanding a Spanish-language website and materials. Dr. Garcia agreed. He noted that in New York he made the point, in response to John McDonough's comment about OppenheimerFunds' interest in pursuing the Hispanic community, that the New Mexico program would be a good place to acquire some knowledge as to how to approach that community. Dr. Damron agreed with Dr. Garcia's comments.

Dr. Damron stated that she still did not see evidence of OppenheimerFunds' commitment to the 529 program. She also thought that the responses in Ms. Beichert's letter were a misinterpretation of the conversation that occurred in New York.

7) ADJOURNMENT

Dr. Damron called for a motion to adjourn. Dr. Garcia so moved. Mr. Jansen seconded the motion. The vote to adjourn was unanimous. The meeting adjourned at 5:35 PM.