The Education Trust Board of New Mexico

THE HONORABLE MICHELLE LUJAN GRISHAM
GOVERNOR OF NEW MEXICO

STEPHANIE RODRIGUEZ, CABINET SECRETARY
NEW MEXICO HIGHER EDUCATION DEPARTMENT

Approved
Vera Lyons
Board Secretary
8/5/2021

Meeting Minutes of
April 30, 2021
1516 Paseo de Peralta
Santa Fe, New Mexico 87501

Board Members (all remote)
Sandra Liggett, Chair
Robert Desiderio, Vice-Chair
Dr. Jose Garcia, Member
Lawton Davis, Member
Mont Green, Member

ETB Staff (all remote)
Ted Miller, Executive Director
Carolyn Fittipaldi, Director of Marketing
Vera Lyons, Board Secretary

Meketa Investment Group (all remote)
Kay Ceserani, Managing Principal
Eric White, Principal

HoganLovells (remote)
Helen Atkeson, Partner

SommerUdall (remote)
Kurt Sommer, Partner

Morton Accounting Services (remote)
Janet Pacheco-Morton, CPA

Ascensus (all remote)
Tom Hewitt, VP Relationship Management
Tom Lowe, VP Investment Management

Principal (all remote)
Paul Schieber, Managing Director, 529 Distribution
Randy Welch, Managing Director, Portfolio Manager
James Fennessey, Portfolio Manager, Director of Research
Tracy Bollin, Managing Director – Fund Operations
Jori Horn, 529 Marketing Director

Sunny 505 (remote)
Jerry Matthews, Senior Account Manager

1) **CALL TO ORDER**
The meeting was called to order at 8:30 AM. There was a quorum and all board members were present.

2) **APPROVAL OF AGENDA**
Ms. Liggett called for a motion to approve the agenda. Dr. Garcia so moved. Mr. Davis seconded. The vote to approve the motion was unanimous.

3) **APPROVAL OF MINUTES**
Ms. Liggett called for a motion to approve the minutes of February 5, 2020 board meeting. Dr. Garcia so moved. Mr. Davis seconded the motion. The vote to approve the minutes was unanimous.

4) **PUBLIC COMMENT**
The Chair then called for any public comment. There being none, she moved to the nextitem.

5) **EXECUTIVE DIRECTOR'S REPORT**

a) **FY21 Q3 Financial Report**

Ms. Liggett asked Ms. Pacheco-Morton to give the quarterly financial report. She first reviewed the Board's program administrative fund and the budget. She noted that administrative fee revenue was slightly ahead of budget, interest earnings were below budget, but that it was expected that the program revenue target probably would be met for the year.

Expenses were in line with budget for the quarter. The change in net position for the quarter was positive by $394,000. The net position of the administrative fund at the end of the quarter was $11.2 million. She noted that spending was in line with or under budget for all major categories in the budget.

Ms. Pacheco-Morton then reviewed the fiduciary funds. She noted that the net fiduciary position had increased from $2.2 billion to $2.6 billion year over year at the quarter. This was primarily due to favorable market conditions and a decrease in redemptions.

Ms. Liggett called for a motion to accept the financial report. Mr. Desiderio so moved. Dr. Garcia seconded the motion. The vote to approve the motion was unanimous.

b) **FY22 Budget Approval**

Ms. Pacheco-Morton then presented the FY22 budget proposal to the board. She noted that the budget proposal was for $3.1 million for FY22. Revenue is budgeted conservatively at $2.8 million based upon no increase in assets under management and continued low interest on administrative fund balances along with a slight increase in marketing money from Ascensus. About $300,000 will be drawn from existing reserves to complete the funding.

She noted that marketing expenses will increase by about $150,000. She reviewed other contractual expanses as well. Dr. Garcia asked why legal expenses were budgeted at about $230,000 when project FY21 legal expenses are projected to come in much lower. Mr. Miller noted that the board has always budgeted legal expenses aggressively in the event that significant unexpected legal issues are encountered during the year. A recent example was the sharp increase in legal expenses associated with the acquisition of Oppenheimer by Invesco and the new contract with Ascensus in FY20.

Ms. Pacheco-Morton then compared the budget request for FY22 to the actual budget for FY20 as well as the projected budget for FY21.

Mr. Green asked how the administrative fund was invested. Mr. Miller responded that the state has strict rules on the investment of cash reserves. If they are invested with a third party they must be fully collateralized. This significantly reduces available return from a third party. In today's low interest environment, the best return, although meager, is received by investing the funds in the Local Government Investment Poll run by the state.

At this point the Chair called for a motion to approve the FY22 budget proposal as presented to the board. Dr. Garcia so moved. Mr. Desiderio seconded the motion. The vote to approve the motion was unanimous.

c) Small Contract Update and Contract Approvals

Mr. Miller then reviewed the small contracts that he would be signing on behalf of the board for FY22. He noted that the board had delegated this authority to him in 2018, with the proviso that he informs the board as to the contracts signed.

He then turned to contracts requiring the board's approval. He asked that the board approve a one-year extension of the CLA contract for independent audit services. Dr. Garcia so moved. Mr. Desiderio seconded the motion. The vote to approve the motion was unanimous.

Mr. Miller then asked for a one-year extension of the HoganLovells contract for legal services. Dr. Garcia so moved. Mr. Desiderio seconded the motion. The vote to approve the motion was unanimous.

He then asked for approval of a one-year extension of the website hosting contract with SilverTech. Dr. Garcia asked if Mr. Miller was satisfied with the performance of SilverTech. Mr. Miller stated that he was very satisfied with the services of SilverTech. Dr. Garcia moved to extend the contract for one year. Mr. Desiderio seconded the motion. The vote to approve the motion was unanimous.

Mr. Miller then asked for approval of a one-year amendment of the Esparza contract for digital marketing at $900,000 plus gross receipts tax. Mr. Davis asked how Mr. Miller measured the effectiveness of the spending on marketing. Mr. Miller stated that he measured it in terms of the ability to add new accounts – both to offset the loss of old accounts as beneficiaries took withdrawal and left the plan, as well as the growth of new accounts in excess of that number. He noted that, so far, the plan had succeeded on both counts. Mr. Davis observed that the marketing effort based on that definition was succeeding very well. Mr. Miller agreed.

The Chair called for a motion to approve the Esparza contract for FY22. Dr. Garcia so moved. Mr. Davis seconded the motion. The vote to approve the motion was unanimous.

He then turned to the contract with Sunny505. He noted that the contract amendment would extend it for one year at $575,000 plus gross receipts tax. Dr. Garcia asked how Mr. Miller was evaluating Sunny505's performance. Mr. Miller noted the data that showed that the plan had accounts in more than 167 cities and towns in New Mexico. Many of those places were reached primarily by traditional advertising. He also noted the extensive national exposure of the program through many news outlets both online and in print. Sunny505 has been very successful through its traditional medias and PR campaigns in driving people to the website. Many of those people have opened accounts.

Ms. Liggett called for a motion to approve the Sunny505 contract amendment for one year. Mr. Davis so moved. Vice Chair Desiderio seconded the motion. The vote to approve the motion was unanimous.

d) Escheatment Policy

Mr. Miller then raised the matter of updating the board's policies and procedures with regard to unclaimed property. He asked Mr. Hewitt to briefly explain the work done by Ascensus in the unclaimed property area.

Mr. Hewitt observed that over time contact can be lost with account owners. As a result, both account assets and uncashed checks can present unclaimed property issues. Working with a third-party vendor, Ascensus tries to re-establish contact with the account owners. In the event that communication cannot be established after three years, Ascensus informs its 529 clients of any such unclaimed accounts and uncashed checks, and asks for instructions as to how to proceed.

Mr. Miller then asked Ms. Atkeson to explain the proposed updated escheatment policies and procedures to the board. She noted that the states treat unclaimed property of their residents in different ways. Assets held in trust may be subject to escheatment, for example, if the passage of time would result in some sort of federal tax penalty, such as failure to take a required 401(k) distribution. Some states have adopted a version of a uniform act that could result in the escheatment of such assets if 30 years have passed without any contact with the account owner.

The updated policies and procedures attempt to provide the board with guidelines for dealing with these matters so as to fulfill its fiduciary responsibility to account owners as well as to act responsibly with regard to state unclaimed property laws.

Mr. Miller noted that from the perspective of assets held in a fiduciary capacity in trust, the board will review the law of each state in which such account owners last resided, and escheat or not escheat based on applicable state law. In the case of uncashed checks, the issue is treated differently. Assets backing uncashed checks are no longer held in the trust, but in a disbursement account. As a result, these amounts will be dealt with in a manner consistent with ordinary property under the applicable state's law.

Mr. Sommer agreed with the description of the two situations and the policy responses to both.

Mr. Desiderio asked if it was known how many accounts are affected and the amounts involved. Mr. Hewitt confirmed that it was the case. Mr. Desiderio then stated that he assumed the reports would be presented to counsel to the board for advice as to escheatment. Ms. Atkeson said that this would be the case.

Mr. Miller stated that counsel would review any reports prepared by Ascensus and its third-party provider, and would advise the staff.

The Chair called for a motion to adopt the policies and procedures n escheatment as presented to the board. Mr. Desiderio so moved. Dr. Garcia seconded the motion. The vote to approve the motion was unanimous.

6) PROGRAM MANAGER'S QUARTERLY OPERATIONS AND INVESTMENT REPORTS

Mr. Miller noted that Ascensus had prepared a letter for board signature consenting to the acquisition of a majority interest in the firm by Stone Point Capital. Mr. Miller asked Mr. Hewitt to explain the request to the board. Mr. Hewitt noted that Ascensus was already owned by private investment firms, and that the ownership had changed in the past. Stone Point Capital has proposed to acquire a majority interest in Ascensus. The transaction is expected to close in the third quarter of 2021. Stone Point is an investment firm focused on financial services. It has roughly 425 billion in private investments across eight different funds. The investors who currently own Ascensus will remain as minority investors. He stated that it was expected that Ascensus would retain its operational autonomy as a business and that key management would remain in place.

Mr. Miller noted that the board has a contract with Ascensus Government Savings that requires the consent of the board to the change in control of Ascensus. He asked Ms. Atkeson to comment as the counsel that helped the board negotiate the provision. Ms. Atkeson noted that the provision was designed to give the board some leverage in the event that a change in control might threaten the ability of the board to receive the appropriate services for the 529 program from Ascensus. She noted that the board's consent cannot be unreasonably withheld. In the event that the board did reasonably refuse its consent, the result would be termination of the contract with Ascensus and a rebid for program management services

Mr. Green asked what sorts of events could trigger the right of refusal. Mr. Miller noted such matters as material changes in service levels or operations, substantial changes to key personnel without replacement by equally qualified people. Ms. Atkeson conformed that matters such as these were covered by the provision in the contract with Ascensus. Mr. Sommer agreed.

Ms. Liggett asked about the timing of the matter. Mr. Miller said that he thought it would be somewhere in late second quarter. Ms. Atkeson noted that Ascensus would be pushing for signature sooner rather than later. Mr. Sommer agreed, and said that it would be needed relatively soon for transactional due diligence purposes.

Mr. Hewitt then reviewed the account and asset figures for the plans for the quarter. He noted that for TEP assets increased during the quarter and that net cash flow was positive. TEP new account activity was also positive for the quarter and has increased over last year.

He also noted that SE assets were up for the quarter due to market gains. SE continued to lose accounts during the quarter, but average new account sales for the quarter were up compared to the same quarter last year.

He also noted that the new mobile app for TEP had been well received by account owners.

Mr. Hewitt then asked Mr. Lowe to give the TEP investment report. He noted that it was generally a good quarter for the markets. In contrast to the recent history value stocks outperformed. Financial stocks, energy and industrial stocks led the way. In contrast technology stocks lagged. Bonds were negatively affected by increasing interest rates.

The Year of Enrollment Portfolios, all passive funds, had performed as expected. They were in the 37th percentile for performance, which is quite good for passive portfolios. He then moved on to the static asset allocation portfolios. The passive asset allocation portfolios all performed as expected. He nor=ted that the active asset allocation portfolios performed quite well, in part due to the outperformance of the value oriented funds like the DFA funds. The more conservative portfolios were affected by the bond components due to the increase in interest rates. This was particularly true of the PGIM fund.

At this point Mr. Bollin of Principal reviewed the proposal to reduce the C share distribution cost of the Capital Preservation Portfolio to 50 basis points. This reduction will prevent the fund from having a reduction in net asset value in this low interest rate environment. Prior to this, Principal had voluntarily waived this distribution cost in order to prevent a reduction in the Portfolio's net asset value.

Ms. Liggett called for a motion to approve the reduction in the distribution cost of the Capital Preservation in SE to 50 basis points. Vice-Chair Desiderio so moved. Dr. Garcia seconded the motion. The vote to approve the motion was unanimous.

Mr. Welch then reviewed the SE portfolios. He noted that value stocks had outperformed, but also noted that lower quality and cyclical stocks had outperformed.

For the quarter the Year of Enrollment Portfolios (Today Portfolio through 2022-2023) slightly underperformed the benchmarks net of fees. Peer performance for these Portfolios was in the 90th percentile. The rest of the Portfolios underperformed their benchmarks net of fees. Peer performance, however, improved as the Portfolios increased in equity exposure.

As for individual funds, the Intermediate Fixed Income and Core Fixed Income Fund underperformed. The US Blue Chip Fund outperformed its benchmark. The Equity Income Fund underperformed despite its value orientation. This Fund concentrates more on high quality companies, companies generating free cash flows. These factors were not in favor in the quarter. There was also significant underperformance from the JP Morgan Emerging Markets Fund. This was due primarily to the emphasis on growth and larger cap in this fund. Despite that the fund has performed extremely well over the past year.

Mr. Fennessey then reviewed the Principal propriety ratings of the funds in the program. He noted that most were well-rated as represented by green highlighting. The small company fund was yellow rated.

Mr. Desiderio returned to the performance of the underlying funds, and asked why the longer-term performance of the funds was largely in the green while, as the shorter-term performance was often in the red or yellow. Mr. Welch replied that good long-term performance was the goal for the funds. Shorter term performance was affected by a number of factors he had mentioned earlier such as the outperformance of value stocks, lower quality stocks and cyclical stocks.

7) INVESTMENT CONSULTANT'S QUARTERLY REPORT AND WATCH LIST RECOMMENDATIONS

Ms. Liggett then asked Ms. Ceserani and Mr. White to begin the Investment Consultant's Quarterly Report.

a) Economic and Market Update

Mr. White gave the quarterly Economic and Market Update. He covered a number of topics, including a COVID Update, Market Returns. S&P Equity Valuations, Sector Returns, Growth versus Value Returns for the past year and year-to-date, Volatility, Key Elements of the Federal Fiscal Stimulus Package, Key Elements of the Proposed Federal Stimulus Package, Value of the Dollar Against Other Currencies, Oil Prices, the Steepening US Yield Curve, the Prospects for Interest Rate Increases, Inflation Breakeven Rates, Credit Spreads, GDP Projections for the US and Europe, Global PMIs, US Unemployment and Jobless Claims, Savings, Wages and Spending, Sentiment Indicators, and Retail Sales.

b) Quarterly Investment Report and Watch List Recommendations

Ms. Ceserani then turned to the quarterly investment report. She reviewed both TEP and SE Year of Enrollment Portfolios against the corresponding Morningstar data for the types of portfolios.

Moving to the funds in the plans. She noted that most of the funds in the plans have a Morningstar medal rating. In ranking 529 plans Morningstar tends to ignore funds which it has noted rated. In addition, Morningstar looks at the asset weightings in each fund. She noted that the report contains the percentages in each fund. 67% of the assets are in medal-rated funds. Morningstar does not rate insurance contracts such as those in the Capital Preservation Portfolios.

With regard to Morningstar star ratings, Ms. Ceserani noted that 91% of the funds in the plans have a rating of 3 stars or better.

She also reviewed the funds in each program that outperformed our underperformed by more than 1% for the quarter.

Ms. Ceserani then reviewed the plans' performance for the board. Her analysis was similar to that provided by the investment managers. She noted that the two DFA funds in TEP no longer qualified for Watch status. Based on Meketa's proprietary rating system 80% of TEP funds rate Positive or Acceptable. 81% of the SE funds were positive or acceptable. She also noted the Principal Blue Chip fund qualified for "Caution" status.

She then turned to the Watch List Memorandum. She recommended that the DFA International Core Equity fund and the DFA Emerging Markets be removed from Watch status. She also recommended that the American Funds Fundamental Investors Fund remain on Watch status. Finally, she recommended that the Principal International Small Company Fund remain on Watch status.
The Chair called for a motion to accept the Investment Consultant's recommendations. Mr. Desiderio so moved. Dr. Garcia seconded the motion. The vote to approve the motion was unanimous.

c) Quarterly Underlying Funds Credit Quality Report

She then turned to the credit quality report for the quarter. She noted that the holdings of most funds with significant credit exposure had shifted slightly higher in credit quality.

Ms. Ceserani then turned to the chart representing the percentage of below investment grade securities held by these funds. More or less exposure was represented by shaded grades of red. These funds were all allowed to have BBB exposure as part of their mandates, and used it to enhance returns over their benchmarks. The allocations appeared reasonable, and Meketa recommended no board actions need be taken based upon the review.

d) Quarterly Report on GIA Carriers – New York Life and Principal Life

Ms. Ceserani began with the review of the insurance companies that issued the contracts backing the Capital Preservation Portfolios in each plan. Each company responds to an RFI from the board also prepares its own presentation materials. She noted that both firms remain stable from a personnel standpoint as well as being financially strong. The portfolios for each firm remain defensively positioned with no material changes to their structures. Meketa advised the board that no actions were being recommended at this time with regard to either firm.

8) ADJOURNMENT

Ms. Liggett asked if there were any other questions. Ms. Liggett called for a motion to adjourn. Dr. Garcia so moved. Mr. Desiderio seconded the motion. Vote to approve the motion was unanimous. Meeting adjourned at 11.26 am.