

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 August 19, 2016

New Mexico Higher Education Department, 5201 Eagle Rock Rd. Suite 1A Albuquerque, NM

Board Members in Attendance

Dr. Barbara Damron -- Chair
Dr. Jose Garcia -- Member
David Jansen -- Member
Mark Jarmie -- Member

Other Individuals in Attendance

Theodore Miller -- Executive Director ETB
David Mathews -- HED/ETB Attorney
Vera Lyons -- Board Secretary
Helen Atkeson -- Partner, Hogan Lovells US LLP
Del Esparza -- Esparza Advertising
Adam Greenhood -- Esparza Advertising
Emily Howard -- Esparza Advertising
Hannah Hand -- Esparza Advertising
Kay Ceserani -- Pension Consulting Alliance
Raquel Granahan -- OppenheimerFunds
Bill Raynor -- OppenheimerFunds
Chris Werner -- OppenheimerFunds
Keith Hylind -- OppenheimerFunds
Andrea Feirstein -- AKF Consulting
Michele Nelson -- Court Reporter

APPROVED
Vera Lyons
Board Secretary
11/21/16

1) CALL TO ORDER

Dr. Damron, the Chair, called the meeting to order at 9:00 AM. The roll was called and all Board Members were present with the exception of Vice Chair Desiderio

2) PUBLIC COMMENT

The Chair called for public comment. There being none, Dr. Damron 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 then turned to the minutes of the board meetings of March 18 and April 27. There being no comments or questions regarding these minutes they were put to separate votes. Dr. Garcia moved to approve the minutes of March 18. Mr. Jansen seconded the motion. The vote to approve the minutes was unanimous. Mr. Jansen moved to approve the minutes of the meeting of April 27. Dr. Garcia seconded the motion. The vote to approve the minutes was unanimous.

5) INTRODUCTION ON NEW OPPENHEIMER 529 TEAM

Dr. Damron then asked Raquel Granahan of OppenheimerFunds to introduce the new management team and discuss the structural changes to the management of the 529 business at OppenheimerFunds.

Ms. Granahan reminded the Board that she was a project manager at OppenheimerFunds in the late 1990s, and first met Mr. Miller when he was a State Street Bank. State Street was the first program manager for New Mexico, and OppenheimerFunds was an investment manager in the program.

She then gave the Board an overview of the new 529 management structure at OppenheimerFunds. She noted that in the past the 529 business was in its own "silo" separate in many ways from regular sales and distribution. The firm had reorganized the 529 business and placed it in the distribution group headed by John McDonough. Distribution is responsible for sales and marketing for the firm.

She acknowledged the poor performance of recent years, and reaffirmed OppenheimerFund's commitment to the New Mexico 529 program. This commitment had been acknowledged at the highest management levels of the firm, including in a meeting with the CEO and his direct reports.

Ms. Granahan then referenced the organization chart again, and noted that 529 marketing was now overseen by Keith Hylind. Mr. Hylind is part of the marketing group for the firm.

She observed that Chris Werner now reported to Kathleen Beichert – the head of third party relationships that involve both asset management and distribution.

Mr. Raynor then spoke. He is changing roles at OppenheimerFunds to become an institutional sales representative for the West Coast. He also acknowledged the continued poor performance in adding accounts to the program. He also observed that the new organization was designed to bring the best personnel at the firm into the 529 business, such as Mr. Hylind.

He thanked the Board for the opportunity to work on the 529 program.

Mr. Hylind then addressed the Board. He noted that he had 35 years in the financial services business, largely focused on retirement marketing and product work. He observed that a lot of what is done in the retirement business, especially the defined contribution business is translatable to 529. He pointed out that he has access to the full resources of the marketing group including web development and creative resources.

Mr. Jarmie then spoke with regard to the service of Mr. Raynor. He asked the Chair if it would be appropriate to commend Mr. Raynor for his service to the New Mexico 529 program. Dr. Damron agreed, and treating Mr. Jarmie's inquiry as a motion, asked for a second. Dr. Garcia seconded the motion. The motion was unanimously approved.

6) EXECUTIVE DIRECTOR'S REPORT

Mr. Miller then gave the Executive Director's report. He thanked Mr. Raynor for his service to the program. He noted that Mr. Raynor not only listened to the concerns of the Board and staff, he took those concerns back to his firm at the highest levels. He wished Mr. Raynor well in his new role.

Mr. Miller then reported on the program administration fund. He noted that the fund had a balance of about \$7.2 million at the end of July.

He observed that these funds would be critical going forward to the success of a grant program. He noted that at the last Board meeting concerns were raised about the appropriate way to carry out such a program – particularly by Vice Chair Desiderio. He noted that in the interim both he and Mr. Sommer had spoken with Vice Chair Desiderio. Mr. Desiderio told him that he is in favor of moving forward with the legal analysis for this program. Dr. Damron noted that she is in contact with the Governor's Office on the matter as well. Mr. Miller stated that he would update the Board at the November meeting.

Mr. Miller then turned to the ongoing investment and fee restructuring project with OppenheimerFunds. He noted that it took a couple of months for the parties to agree

on the revenue streams available to the firm in the program, and how to account for them. The goal of the project is to create a very competitive investment product offering and a low a low cost index product for The Education Plan while preserving the firm's overall revenue. Another goal is to have full transparency in fees so that investors know exactly what they are paying. He noted that the asset allocation team at OppenheimerFunds is working on the investment structures. Mr. Miller expected to come back to the Board with a proposal for its approval before the end of 2016.

7) UPDATE ON EXECUTIVE DIRECTOR POSITION

Dr. Damron then gave the Board an update on the executive director compensation matter. She noted that it is important that the Board desires to have an executive director with the appropriate background and experience to carry the program forward in the future. This is the reason for seeking the proper compensation level for the position.

Under current State Personnel rules the Executive Director position is a classified position with a limited pay band. The Board has discussed the possibility of making the position as governor exempt position, but this has the potential to make the position subject to the changing political landscape as new administrations come into power. At the same time it does provide for state benefits. She also noted that the position could be structured as a contract position. This could mean that the contracted person might have no benefits as provided to state employees.

Dr. Garcia spoke of the uncertainty associated with an exempt position. Mr. Jansen then noted that the current classified position doesn't really have the salary structure necessary to attract highly qualified candidates. Dr. Garcia noted the slow and arduous process of putting a new position with an appropriate salary structure through the State Personnel Office. Dr. Damron agreed with the comments of both Dr. Garcia and Mr. Jansen.

Dr. Damron then summarized the three options under discussion. Both Mr. Jarmie and Mr. Jansen were of the opinion that either an exempt or a contract position should be pursued.

As a person with long experience in private business Mr. Miller opined that a contract position seemed the best option. A contract could be structured to attract a person with the appropriate background into the agency.

Dr. Damron noted that any such contract would be subject to the Procurement Code. Mr. Mathews observed that under the present statute an RFP would probably be necessary. He noted the benefits of a contract arrangement in terms of flexibility, but he also noted the difficulty of negotiating through the RFP process.

Dr. Damron stated that a revision to the Procurement Code was under review that might make the process a matter of Board discretion, but that any changes to a statute carried the risk of unintended consequences.

8) PROGRAM MANAGER'S QUARTERLY INVESTMENT REPORT

Dr. Damron then asked Mr. Henry to begin the quarterly investment review. He remarked on the desire of the Board and staff to see a form of a supplemental investment summary of important investment matters precede the detailed material in the traditional investment report. Mr. Henry then addressed the material in that new summary.

He led off with a discussion of general market performance for the quarter, year-to-date and one year using typical market benchmarks for different asset classes. He also noted the effects of the Brexit vote in the UK, the prospects for a Federal rate hike, a move from growth to value, the recovery of the oil price and the search for yield.

He then discussed The Education Plan Age-Based Portfolios. He noted the negative effects on the quarterly performance relative to benchmarks of the Value Fund (-272 bps), the International Growth Fund (-280 bps) and the Global Fund (-264 bps). Portfolio performance was aided by the performance relative to benchmarks of the Main Street Fund (+118 bps), Senior Floating Bank Loan Fund (+133), the Limited Term Bond Fund (+56bps) and the Limited Term Government Bond Fund (+.09). He also provided commentary on the reason for the over- and under-performance of each fund. The Age-Based Index Portfolios provided benchmark returns before fees as expected.

He then turned to Scholar'sEdge performance. The previous discussion of funds in The Education Plan Age-Based Portfolios was reiterated for the advisor-sold plan, since both plans contain these funds in the Age-Based Portfolios. He also noted that the Global Value Fund (- 3.78 bps) negatively impacted Age-Based performance, as did the High Yield Fund (-.23 bps) and the International Bond Fund (-.84). The Dreyfus Research Growth Fund (+111 bps) had a positive effect on performance.

Individual Portfolios with positive performance included The Discovery Fund (+366 bps) the Global Opportunities Fund (+303 bps), and the International Small-Mid Cap Fund (+182). The Monetta Young Investors Fund (-130 bps) and the Equity Income fund (-348 bps) were noted under-performers.

Mr. Jarmie thanked Mr. Henry and Mr. Werner for their efforts to prepare the Supplemental Report. Dr. Damron agreed, but added that it was incumbent on all Board members to continue to improve their investment knowledge. The program manager and the investment consultant can prepare reports and make recommendations to the Board, but it is the fiduciary responsibility of the Board to make investment decisions concerning which funds to keep in or remove from the program.

9) INVESTMENT CONSULTANT QUARTERLY REVIEW AND WATCH LIST RECOMMENDATION

Ms. Ceserani then gave the investment Consultant's Report and Watch List Recommendations. She noted that PCA was reformulating its reports to reflect some the changes that are being made to the program manager's report. She reviewed the

Summary of Performance Status. She reminded the Board that the monitoring of funds has a longer time horizon than the quarterly data provided by the program manager. PCA's analysis looks at rolling One- and three- year periods.

She noted that the TEP portfolios 80% of the funds were rated as positive or acceptable, and in Scholar'sEdge 70% were so rated. She observed that in the typical 529 program 2/3 of the funds are so rated. Thus TEP is performing somewhat better than other plans and Scholar'sEdge is performing in line with other plans by these measures.

Ms. Ceserani noted that within the 529 industry there was a noticeable downward bias in fund performance during the quarter. The difficult times continue for active management.

Mr. Jarmie noted that the report showed no new funds qualifying for watch status. He asked just how a fund gets on watch. Ms. Ceserani stated that a fund can go on watch for two principal reasons – underperformance or some organizational issue like a recent management change. She noted that as to performance rolling one- and three- year periods are important. Underperformance thresholds are set for each fund. To get on watch a fund must underperform the threshold for six consecutive months on either the short term or the long term time frame. The funds currently on watch have been on watch for varying lengths of time.

The Rising Dividends Funds has been on watch status for 36 months, but compared to its peers it was matching industry performance. Dividend strategies have simply been out of favor for a long while. The last two quarter, however, the fund began to underperform its peers. PCA asked Oppenheimer if the fund should be removed from the program, and Oppenheimer agreed.

Mr. Jarmie then brought up the Value Fund and expressed concern as to its underperformance. Ms. Ceserani noted that the fund has been in the Caution Zone and that continued underperformance will probably put it on the watch list next quarter.

She then referenced the Capital Income Fund, an individual fund option in Scholar'sEdge with only \$200,000 in it. It has been on watch for 9 months. PCA recommends no change in status at this time. The Senior Floating Rate Fund has been on watch for 8 months due to a management change. Given its long term under-performance she recommended leaving it on watch to see if performance improves.

She noted that the recommendation is to remove the Rising Dividends Fund and to map the assets to the Main Street Fund. PCA agrees with this recommendation. The Main Street Fund represents the same segment of the market, has better performance on a risk-adjusted basis and the fee is slightly lower.

The Equity Income Fund has dramatically under-performed for the last two quarters. It has about \$3,000,000 in it. The recommended replacement was the Value Fund, but that fund has in turn under-performed and may be placed on watch next quarter. Given that the Value Fund has about 8% of the assets in the program, this recommendation

should be put on hold until Mr. Spahr can come before the Board and explain the fund's performance to the Board and what he intends to do about it.

Ms. Ceserani then reviewed the risk v. return charts for the aggressive age-based portfolios. She noted the PCA uses the Morningstar age bands, which are not exactly those of the New Mexico 529 program. In addition the earlier age bands used by Morningstar have a smaller equity weighting than the New Mexico age bands. Thus in the early years there is some slight under-performance to the median plan in the Morningstar universe. In the later years there tends to be out-performance.

The Board then took action on the watch list recommendations and the fund removal and mapping for the Rising Dividends Fund.

Mr. Jarmie made a motion to remove the Rising Dividends Fund from the Scholar'sEdge plan and map the funds to the Main Street Fund. Mr. Jansen seconded the motion. The motion passed unanimously.

After questioning by Dr. Damron and Ms. Atkeson, Ms. Ceserani stated that the removal of the Equity Income Fund from the Scholar'sEdge plan could be delayed until the next meeting in order to give the Board the opportunity to hear from Mr. Spahr regarding the Value Fund.

Upon questioning from Dr. Damron, Ms. Ceserani said that the recommendation of PCA is to leave the Oppenheimer Senior Floating Rate Fund, the Oppenheimer Capital Income Fund and the Oppenheimer Equity Income Fund on the watch list, and to review the Equity Income Fund's status at the next Board meeting.

Dr. Garcia so moved. Mr. Jansen seconded the motion. The motion was passed unanimously.

10) LEGAL MATTERS

Dr. Damron then asked Ms. Atkeson to review legal matters. Ms. Atkeson began with a review of the Contingent Deferred Sales Charge issue. She noted that due to incorrect programming of the recordkeeping system there had been an incorrect contingent deferred sales charge applied to certain accounts in Scholar'sEdge. The number of affected accounts and the dollar amounts involved were small.

Upon receiving this information ETB staff requested a written memo from OppenheimerFunds describing the matter in detail. The Board book contains the memo. Mr. Miller sent an email to the Board during the quarter summarizing the memo as well as the memo itself.

The concern for the Board and ETB staff was that the problem resulted from a systemic error that was programmed into the system and not detected for 5 years. In addition the error was not reported to ETB staff until four months after its discovery by OppenheimerFunds.

Affected account owners and their financial advisors were notified and these account owners were made whole for any overcharges.

OppenheimerFunds committed to reviewing all of the programmed settings in its recordkeeping system for correctness by the end of the third quarter of this year. They also agreed to implement review procedures to prevent similar errors in the future.

Ms. Atkeson then asked OppenheimerFunds representatives at the meeting if they had anything else to report on comment on regarding this matter.

Mr. Raynor addressed the Board and apologized for the error and for not reporting the matter to ETB staff more quickly. He had wanted to understand the scope of the problem and have a plan in place to correct the error. In the future OppenheimerFunds would bring such matters to ETB staff's attention in a timelier manner.

Dr. Damron expressed her deep concern that the matter has not been discovered for five years. She noted that OppenheimerFunds and the Board had "escaped a bullet" and that controls should be in place that accord with the best practices in the industry. General statements about future controls sounded lame to her.

Dr. Garcia asked for an explanation of the error from OppenheimerFunds. Mr. Raynor responded that the error occurred in the programming of the recordkeeping system that is used to account for 529 plans. There was not a system in place to catch errors on a regular basis, such as annually. This is why the error went undiscovered for so long.

Dr. Damron noted that there could well have been other such errors that have not been discovered.

Ms. Atkeson agreed with the comment, and stated that to her understanding there are numerous such boxes to be checked for different functions in connection with the different portfolios and accounts. She asked Mr. Raynor if all such settings were under review. Mr. Raynor confirmed that they were.

Mr. Raynor then pointed out that OppenheimerFunds had been program manager since 2005, and this was the first such error that has occurred. Dr. Damron acknowledged that this was a fair point. She asked how the error was found. Mr. Raynor said that it had been found by an employee during an internal review.

Ms. Granahan stated that OppenheimerFunds had appointed a new head of operations. There is a project plan in place to automate more functions to reduce the possibility of manual error. She stated that the firm takes the matter seriously.

Ms. Atkeson then address the issue of custody of the cash and portfolios in the New Mexico 529 program. She noted that the new program manager agreement effective July 1, 2015 provided required a custodian bank to hold all of the assets of the 529 program. It had been the understanding of ETB and its counsel that Citibank was the custodian bank for this purpose.

Citibank contacted OppenheimerFunds early in 2016 as the result of an audit, and stated that they considered themselves to be custodian of only the cash assets held in the 529 program. They were not custodian for the investment portfolios.

ETB staff and counsel learned of this state of affairs from OppenheimerFunds. The firm took the position that the 529 program assets were still under custody, but with the transfer agents of the mutual funds in which the program invests. ETB staff and counsel have had numerous conversations with OppenheimerFunds and their internal counsel to try to work through this explanation and to try to understand it.

If Oppenheimer's version of a custody arrangement is accepted, then the Program management agreement needs to be amended to reflect this. The counsel for OppenheimerFunds has been asked to provide draft language to this effect.

Mr. Miller noted, that with the exception of the New York Life funding agreement, the assets of the 529 program were invested in mutual funds. Each mutual fund is required by the SEC to have a custodian bank hold the assets of the fund.

He explained that the 529 program creates portfolios that are legally municipal securities. These municipal securities hold cash as well as interests in underlying funds. They also accrue expenses. These portfolios have to be valued daily. According to counsel for OppenheimerFunds that work is being performed by BBH as the "accounting agent" for OppenheimerFunds. Mr. Raynor agreed.

Mr. Miller asked Ms. Atkeson if there was any securities law requirement that municipal securities be held by a custodian bank. She stated that there was not such a requirement.

Mr. Miller noted that the underlying mutual funds in the 529 program have bank custodians, the cash in the program is custodied by Citibank and that BBH is the "accounting agent" that prepares the unit values for the portfolios.

The portfolios are pretty abstract entities in that they hold only interests in mutual funds and cash. But the fact is that they are not held by a custodian bank.

Dr. Damron asked what other 529 plans around the country did for custody. Ms. Feirstein noted that her firm usually sees a single custodian for these plans, as opposed to the more complicated structure used by OppenheimerFunds. Ms. Atkeson noted that other 529 plans she works for have a single custodian.

Ms. Granahan stated that the current arrangement at OppenheimerFunds was just the way OppenheimerFunds had chosen to do custody. Dr. Damron said she was not concerned with how OppenheimerFunds did it, but with what was the best practice for 529 plans generally.

Ms. Atkeson noted that she was aware of other custodian banks that would serve as custodian for all the assets. She also reminded the Board that prior to the new contract OppenheimerFunds was responsible for paying the custodian. Under the new contract custody costs are paid as an expense of the Trust. She noted that at that time

OppenheimerFunds represented that Citibank was the full custodian and that the cost was approximately \$25,000.

Mr. Miller stated that he became concerned the previous summer at a Board meeting discussing the custody contract with OppenheimerFunds. The custody fee appeared to be very low – less than \$25,000. At the fall operations due diligence in Denver it began to appear that Citibank was only dealing with the cash.

Later that year counsel to OppenheimerFunds inserted new language in the plan disclosure documents changing the description of custody. That's what triggered Mr. Miller and Ms. Atkeson to understand that Citibank was truly not the custodian for all the assets. That led to the discussion as to whether or not municipal securities should be held by a custodian bank.

Ms. Granahan stated that she would get up to speed on the matter and report back to the Board. Dr. Damron told Ms. Granahan that the Board expected to have an explanation of why the current custodial arrangement was put in place why is Citibank the custodian for the cash only and what is the process going forward. The Board and its staff should not have to discover these things after the fact.

Mr. Jarmie stated that he would like to know about costs. Mr. Miller noted that full custody would be a higher cost.

Dr. Damron noted that OppenheimerFunds used to pay for custody under the old contract. She asked if Board members still on the Board from that time remembered why the switch occurred. What do other plans do with regard to custody fees? Does the program manager pay them or not?

Mr. Jansen asked if OppenheimerFunds should be asked to switch to a full custodian.

Dr. Damron stated that she was willing to let OppenheimerFunds come back to the Boards with a recommendation. If OppenheimerFunds recommends keeping the current arrangement the Board needs really clear reasons why this is the case.

Mr. Miller noted that there was a custodian for the 529 program's cash, and that the underlying mutual funds all had custodians, but that the issue is the custody of the municipal securities that form the investment portfolios. Ms. Atkeson noted that the mutual fund custodians do not have a direct contractual relationship with the 529 program. Mr. Miller agreed.

Ms. Ceserani noted that a number of defined benefit pension plans of which she was aware were receiving fixed fee bids for custody services.

Ms. Atkeson then turned to a third legal issue, which she characterized as the sales remediation issue. The new contract provides annual targets for both new accounts and new assets. The contract language provides that, if OppenheimerFunds does not meet the targets by the end of the fiscal year, a remediation plan must be created and approved by the Board in August of the new fiscal year. OppenheimerFunds must report to the Board in January of the following year as to whether or not the remediation

targets have been met. If the targets have not been met, then OppenheimerFunds must contribute an additional \$200,000 toward marketing efforts.

Dr. Damron noted that the goals had not been met, which was a source of concern to the Board.

In addition the remediation plan in her view was ill-conceived. It was cumbersome and took everyone's eyes off the goal of selling the program. Also she regarded the \$200,000 as inadequate and a good deal for OppenheimerFunds.

Mr. Miller noted that OppenheimerFunds had come close to the targets, but had not met them for FY2016. He then observed that the remediation plan process is very time consuming and protracted. The result is that if targets under the plan are not met, the prime selling season for 529 plans is missed before the extra \$200,000 is spent.

In discussion with OppenheimerFunds he suggested that the contract provision be waived, at least for FY2016, and the \$200,000 be immediately made available for marketing. Mr. Raynor noted that OppenheimerFunds agreed with this proposal.

Mr. Jarmie expressed his disappointment at missing the targets. He was also of the view that the \$200,000 was not adequate.

Dr. Garcia asked Mr. Raynor if during contract negotiations OppenheimerFunds said that the first year goal would be difficult to meet. Mr. Raynor said it was a true statement. Dr. Garcia asked if the relatively small failure to meet the targets was within the caveat given during contract negotiations. Mr. Raynor agreed that it was.

Mr. Raynor noted that Mr. Jarmie had asked in the past as to how soon the program would turn the corner as to sales. He remembered that he answered in the August/September timeframe.

Mr. Raynor stated that business as usual was not working to grow the program and that changes were necessary. The marketplace has changed, and the program had to adapt to meet the changes and the competition. The program required a nationwide approach in order to be successful. Dr. Damron agreed. Mr. Raynor also noted that changes needed to be made to the advisor-sold program in order to differentiate the program from other advisor-sold plans. He noted that the management changes at OppenheimerFunds 529 team had caused the changes to slip so that the peak of the sales cycle would be missed this year. He hoped that the changes to come would improve the sales in the program.

Dr. Damron noted that neither she nor Mr. Jansen nor Mr. Miller were with ETB when the contract was negotiated. She expressed surprise that the change in the advisor market was not foreseen. She expects more proactive support from OppenheimerFunds.

Dr. Damron suggested that the motion be made for FY2016 to waive the requirement of a remediation plan and to have OppenheimerFunds contribute an additional \$200,000 toward marketing the 529 program.

Mr. Jansen made the motion. Mr. Jarmie seconded the motion.

Dr. Garcia asked to make a few comments before the vote was taken. He noted that at the time of contracting he thought the process was robust, careful, clear, and a thorough discussion of the milestones and where the program was headed. He did not think that it was primarily a fault of the contract or of oversight. He heard Mr. Raynor say that the climate has changed since the contract was negotiated. We need to work through the changes to go in the direction that the program needs.

Mr. Raynor noted that the market changed more dramatically and more quickly than anybody thought it would. OppenheimerFunds and the Board need to make changes to the program to be successful. The firm has agreed to open up the contract for discussion.

Dr. Garcia stated that the \$200,000 contract issue was a small issue given the more important changes that may be need in the program. Is the Board confident that it is on the same page with OppenheimerFunds?

Mr. Raynor noted that OppenheimerFunds had spent several days in the state to specifically talk with the Executive Director on the specifics of moving forward both for a more competitive index product in The Education Plan and to revive the sales in Scholar'sEdge. It is Scholar'sEdge that drives the financial success of the program.

Dr. Garcia said that he would like to have some clarity and transparency about what program changes could be made. He also thought that the Board needed to have more discussion about the changes taking place in the market.

Dr. Damron agreed. She noted that Ms. Feirstein would be giving the Board a presentation about what the future will look like. She also agreed that the Board needed to keep informed on what was happening and what questions to ask. Dr. Garcia said that he thought the Board needed more information than it had now.

Dr. Damron agreed, and urged the Board members to ask for information both from the staff and from OppenheimerFunds. She asked Dr. Garcia what sort of information he would like to have. He stated that he would like to know more about what is happening at the national level, and some detailed information about what OppenheimerFunds proposes to do to overcome those headwinds.

Dr. Damron agreed, and stated that she wanted to hear more from OppenheimerFunds on these topics. At the same time the motion on the floor needed to be addressed.

The vote to accept the motion was unanimous.

Dr., Damron asked OppenheimerFunds for comment. Mr. Raynor said they have had very open and honest conversations with the Executive Director. He asked the Board if it wished to suit in on those conversations. Dr. Garcia said that he would. Dr. Damron agreed, but she noted that the presence of a number of Board members could come in conflict with the open meetings law. Mr. Jarmie suggested that a workshop of some kind could be helpful. Perhaps both OppenheimerFunds and Ms. Feirstein could attend.

Dr. Garcia suggested that certain Board members might focus on specific topics such as investments, legal, etc. Then the Board could meet to hear from these members on the specific topics.

Dr. Damron thanked DR. Garcia for his thoughts, and agreed with them. She noted that the Board was an all-volunteer group with other responsibilities. She hoped that despite this, Board members would be willing to take on this task.

At this point the Board took a short break from 11:44 to 11:55 AM.

Upon returning from the break, Ms. Atkeson concluded her remarks by referencing the new marketing phrase "When they're 5 to 9, it time for a 529." She noted that under the program management agreement, the Board owns items of this type developed and used in connection with the plans.

Her firm was asked by ETB staff to commission a search to determine if anyone else has the rights to the phrase and to register this phrase as a protected mark of the plans. Based upon the firm's research it appears that the phrase is not being used by others and the plans are going to start using it. As soon as it is used an application will be filed with the US patent and Trademark Office to obtain a trademark for the Board.

Mr. Esparza noted that the phrase is now in use and the application can be filed.

11) INDUSTRY UPDATE AND RATING AGENCY OVERVIEW

Dr. Damron then asked Ms. Feirstein to begin her presentation. She first highlighted some key points with regard to the 529 market.

There is a continuing shift in the marketplace in favor of direct-sold plans as opposed to advisor-sold plans. The growth of The Education Plan is positive, but below the national average for direct-sold plans.

The advisor-sold market is consolidating. Missouri closed its advisor-sold plan in 2015.

There is a continued downward pressure on fees.

There are two major sources of 529 plan ratings – Morningstar and Saving for College.com. Morningstar has begun its ratings review for this year, and will be issuing a report in October. Six months later they issue a detailed industry survey. Her firm visits with Morningstar both before and after the issuance of its reports for the year.

Ms. Feirstein then began her general review. She noted that the 529 industry had about \$241 billion in savings plan assets. Direct-sold plans have \$133 billion of that and advisor-sold plans have the remainder. This is a large shift from the past. In the beginning of the 529 industry the division of assets was 90% for advisors and 10% for direct-sold plans.

The average account size in the industry is about \$21,000 for direct-sold plans. The Education Plan is above the average at about \$23,000. On the other hand the average account size for advisor-sold plans is around \$20,000. Scholar'sEdge is below that

average at about 15,000. Combined the average account size for the New Mexico plans is about \$17,000.

She noted that the national market continues to shift in favor of direct-sold plans. Over the last 18 months there has been a 2% increase in the national direct-sold market share. In New Mexico there is a 1% shift.

Ms. Feirstein attribute the shift to direct-sold plans to more awareness on the part of the public, direct-sold plans being less costly and registered investment advisors (as opposed to commission-based brokers) being more of a factor in the market for financial planning.

She then turned to the charts related to national 529 asset and account growth compared to New Mexico 529 asset and account growth. The national charts show both assets and accounts increasing. The New Mexico charts show choppiness in asset growth, as well as a flattening of growth in recent years. Of more concern is the continued downward slope to the numbers of accounts. The Education Plan shows steadiness in accounts and some asset growth. Scholar'sEdge shows as flattening of asset growth and a steady decrease in accounts.

From 2010 through 2nd Quarter 2016, New Mexico overall plan asset growth was less than half the national rate (4.5% v. 10.8%). During the same period, overall account growth was negative while national account growth was positive (. -2.5% v. 3.6%). The under-performance was largely driven by Scholar'sEdge.

Ms. Feirstein then reviewed the New Mexico plans by assets and accounts relative to the national rankings for all plans. Compared to other direct-sold plans The Education Plan is a very small plan (#32 in assets and #39 in accounts). Compared to other advisor-sold plans Scholar'sEdge is #11 in assets and #13 in accounts. The difference between #10 and #11 is very large (\$3.2 billion v. 1.8 billion).

Mr. Werner asked if the move to omnibus accounting with broker-dealer firms was important for the 529 business. Ms. Feirstein explained to the Board that omnibus accounting allowed brokers to open accounts and maintain account detail on the broker-dealer's own internal system. She thought that it was important to go to an omnibus relationship. Omnibus accounting is a driver of asset and account growth.

She also noted that the broker-dealers were concerned with the relationship between the plan and the program manager. If a contract was coming to bid in a year or two, some broker-dealers were not willing to go to an omnibus relationship until the contract was awarded. She noted that OppenheimerFunds was still not in omnibus relationships for its 529 business.

Ms. Feirstein observed that the number of investment options in 529 plans appears to be stabilizing or even decreasing slightly. There is still room for greater diversification in the form of alternative investments and specialized asset classes.

The first 529 plan to involve a robo-advisor was announced recently. It remains to be seen if this development grows into anything.

The general message on fees is that they are coming down. In part this has to do with the introduction of index products in direct-sold plans. Active managers and states with actively managed plans aren't reducing their fees so much as states are adding index investments. In the index products the fee competition appears to be a race to the bottom. There will be a bottom limit put in, probably in the 10 to 12 basis point range. She noted that at 16 basis points the New York plan with \$17 billion in assets is overpriced in her view. Much depends on plan size.

She was of the opinion that The Education Plan is still reasonably well-positioned in terms of fees. On the advisor-sold side the fees tend to be much higher and more clustered toward the high end. This is due to the fact that such plans utilize active management and not index funds.

Ms. Feirstein then went on to discuss the two principal ratings firms for 529 plans – Morningstar and Saving for College.com. Morningstar is a long-standing rater of mutual funds generally. The investment industry and the financial press tend to use Morningstar as a guide when discussing investments, including 529 plans. Saving for College.com is a more retail-oriented site limited to education savings and used more by retail investors.

The 529 ratings systems are different for the two organizations. Morningstar has a medal rating system that focuses on the future, and gives the firm's view how plans might perform going forward. Saving for College.com uses a graduation cap rating system (0-5 caps) that indicates whether or not the firm thinks the plan is a good plan. She personally disregards Saving for College.com and concentrates on Morningstar. Neither firm is fully transparent on how they come up with their ratings.

She then discussed the Morningstar ratings in more detail. The Education Plan has never been rated by Morningstar. Probably the small size of the plan is the cause of this although there are several smaller state plans. Scholar'sEdge is neutral rated. There is no change since last year in the ratings.

Mr. Jarmie asked how New Mexico could improve its ratings with Morningstar. Ms. Feirstein noted that for the first time Morningstar has indicated that one of its five "pillars" for rating plans, the "process" pillar includes a review of the glide path construction and equity step-downs in age-based funds.

Ms. Granahan noted that OppenheimerFunds would go to Chicago to meet with Morningstar, and would introduce the firm to its global asset allocation team. This team will address the glide path issue. OppenheimerFunds will review with ETB staff and PCA the presentation it will give to Morningstar.

Ms. Feirstein then outlined the five "pillars" that make up the Morningstar ratings – parent, people, process, price and performance. She noted that Morningstar is aware that New Mexico has taken strides in the last year or two to exercise more oversight over the 529 program. This is a component of the parent pillar.

She also mentioned that when Mr. Miller meets with Morningstar he can stress this added oversight. He can also point out the efforts being made with OppenheimerFunds to improve pricing.

She pointed out that these are seeds to be planted for the future. Morningstar will not make a rating change without at least Board approval of action already in place.

Mr. Miller noted that last year was the first time that both OppenheimerFunds and ETB staff had visited Morningstar in the same year. He noted that Morningstar had asked for a telephone conference call this year, but that he would be pushing for a personal visit to Chicago. He noted that the management changes at OppenheimerFunds in the last nine months had slowed the progress on plan redesign. He was frustrated by presenting the "fixing to get ready" story to Morningstar.

Dr. Damron then asked the Board if, in the interest of a full discussion of the issues, it would be willing to extend the meeting past its usual adjournment time. The Board was in agreement and Ms. Feirstein continued.

She noted that even if Board approval of changes occurs after the October reporting period Morningstar will consider them. It is always useful to keep the firm informed.

Mr. Raynor observed that in the past the Morningstar relationship had been discounted under the previous 529 management at OppenheimerFunds. He acknowledged the importance of having a relationship with the firm going forward, and to make sure that the firm was physically visited.

Mr. Jarmie asked if it would be helpful to have Esparza visit Morningstar. Ms. Feirstein thought that Morningstar was an investment shop, and would not be interested in such a visit. She did, however, think that state initiatives such as the foundation formed for the purpose of promoting low and moderate income participation in college savings is of interest to Morningstar.

Mr. Miller thanked Ms. Feirstein for her report and recommended it for close reading to the Board.

12) MARKETING AND SALES UPDATE

Dr. Damron then asked Esparza and OppenheimerFunds to present the marketing and sales update. Ms. Howard reviewed the marketing efforts for the last quarter. There were 1952 new accounts with 720 of them in The Education Plan and the rest in Scholar'sEdge. There were \$4.7 million new sales dollars, with 85% of that in Scholar'sEdge.

She noted that this quarter is typically a very light quarter for marketing efforts in 529 plans. With regard to The Education Plan, she noted that website traffic goes up and

down with advertising efforts. Online search was pretty light in the quarter. On the Scholar'sEdge side website traffic was relatively steady and online search impression, fairly low in April, ramped up in May and June.

Mr. Werner then presented the sales results for the fiscal year. He noted that Mr. Miller had asked him to do this since the contract sales requirements were on a fiscal year basis. For the fiscal year OppenheimerFunds was at 94% of goal on new accounts and at 86% on new assets.

Ms. Howard then continued with a review of marketing efforts for The Education Plan. She noted new television and radio ads had been produced. New online banner ads were created. In addition a new relationship was established with the school photographer to many public schools to place 529 marketing on the frame that surrounds the photo as well as an insert in the package when the student takes it home.

She noted that the advertising done this year focuses more on creating a sense of urgency to enroll now in a 529 plan.

Mr. Greenhood reviewed the research done for the new campaign. He focused on retirement saving and how it is pretty clear why one needed to save for retirement, how much needed to be saved and when one should start saving. These things are not so clear with college savings.

The research showed two key pieces of information. The first is that saving \$500 or less made a child several times more likely to attend college, and once there, several times more likely to graduate. The other piece of information is that most parents do not begin to think of saving for college until their child is 5 years old. Parents get serious about college savings between the ages of 5 to 9.

The advertising tries to integrate these two key elements. In particular the phrase "5 to 9" makes the idea of a 529 account more real and less abstract.

Some advertising will run not only in New Mexico but in other states such as Texas, Florida, New Jersey through digital media. Mr. Greenhood then played some of the ads for the Board.

Dr. Garcia noted that Native Americans and Hispanics make up over 50% of the population of New Mexico. He thought that these groups should be specifically targeted. He would prefer to see account numbers go up in New Mexico even if assets don't grow as much. He said that New Mexico has a very low percentage of college graduates in its population, and that rate of increase is slower than in other states.

Ms. Howard responded that the pilot grant program will speak to that audience. Dr. Garcia replied that the ads don't mention that. Dr. Damron mentioned that ETB was in discussions with IAD and others about Native American initiatives. Dr. Garcia responded that radio in particular could hit these targets.

Mr. Greenhood said that the new ads would focus on the fact the \$500 or less would be a great help toward future college attendance and graduation. Dr. Garcia commented that people should be reminded that they could start with \$25 as a contribution. In his opinion this would reach the demographic better. Mr. Greenhood noted that the radio ads make reference to the fact that it only takes \$25 to open an account. Ms. Howard noted that the website features that statement. Dr. Garcia stated that not everyone gets on the web.

Mr. Greenhood then reviewed the school photo campaign directed at the parents of elementary school children.

Mr. Hyland addressed changes to The Education Plan website. It will be redesigned to convey investment information in basic terms and to be more user friendly for naïve investors.

Ms. Howard then briefed the Board on the employer outreach efforts. She mentioned that good progress was being made getting a meeting with Los Alamos National Labs. Approaches will be made to ETB's top five targets – UNM, UNM Hospital, Presbyterian, City of Albuquerque and Albuquerque Public Schools.

Efforts are underway to craft materials for and give presentations to HR managers, CPAs, estate planners and other professional groups.

Dr. Damron noted that she visits higher education institution regularly, and that she should have a presentation packet to leave with them.

Ms. Howard also mentioned that ETB would have a stronger public relations effort this year. An editorial calendar had been created with a goal of getting out stories monthly, as well as blog posts and a quarterly message to account owners from the Executive Director.

Ms. Howard then reviewed the next quarter's media calendar.

Mr. Werner went over sales for the preceding fiscal year. He noted that the trend in new accounts sales had been relatively constant for the last several years, but that a drop had occurred in the 4th quarter of calendar 2015 and the first quarter of calendar 2016 – these are typically the strongest quarters for 529 sales. This is one of the reasons that goals weren't met for FY2016. He noted that one positive data point was that account growth was higher in 3rd quarter 2016 than in 3rd quarter 2015.

Dr. Garcia asked if Spanish surnames could be sorted out in The Education Plan. He noted that the New Mexico population was 45% Hispanic. Mr. Werner stated that data could be produced.

Mr. Werner noted that year-to-date sales are about 6% behind plan. Since typically 20%-30% of sales occur in the 4th quarter, he thought that goals could be met.

At 1:20PM Dr. Damron left the meeting.

Mr. Werner then reviewed the top distribution channels for Scholar'sEdge with the Board. He noted that his goal was to engage the 100 people on the phones and the 100 in the field that deal with the broker-dealer community. He has also trained the 6 product specialists in New York and the 6 in Denver on 529. In the past these specialists had handed off 529 calls to others.

He told the Board that due to the change in management at Oppenheimer the compensation plan that he had mentioned to the Board in the last meeting had not been put in place. The plan has now been approved by new management. It will affect what he referred to as "Division 800" as well as the 12 product specialists. This is a total of 112 people.

He also noted the creation of new sales materials that can be used to train in-house personnel as well as be sent to financial advisors. He also noted that a 529 product specialist from his team is now on the weekly calls for Division 800.

Ms. Howard then reviewed the marketing plan for Scholar'sEdge.

13) ADJOURNMENT

In Dr. Damron's absence Mr. Jarmie chaired the remainder of the meeting. He thanked attendees for their participation in the meeting.
The meeting adjourned at 1:30 PM.