The Education Trust Board of New Mexico

Meeting Minutes of March 18, 2016

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

APPROVED
Vera Lyons
Board Secretary
8/23/16

Board Members in Attendance

Robert Desiderio - Vice Chair
Dr. Jose Z. Garcia - Member
David Jansen - Member
Mark Jarmie - Member

Other Individuals in Attendance

Theodore Miller - Executive Director ETB
David Mathews - HED/ETB Attorney
Helen Atkeson - Partner, Hogan Lovells US LLP
Del Esparza - Esparza Advertising
Emily Howard - Esparza Advertising
Kay Ceserani - Pension Consulting Alliance
Teresa Ward - OppenheimerFunds
Bill Raynor - OppenheimerFunds
Ken Henry - OppenheimerFunds
Chris Werner – OppenheimerFunds
Matt McGee – OppenheimerFunds
Javier Machuca -- REDW
Michele Nelson - Court Reporter

1) CALL TO ORDER

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

2) PUBLIC COMMENT

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

3) APPROVAL OF AGENDA

Mr. Desiderio noted the agenda as presented to the Board and asked if there was any comment on the agenda. There being none, he 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

The Vice-Chair turned to the minutes of the meeting of December 2, 2015. He asked if there was any comment or discussion as to those minutes. There being none, he asked for a motion to approve the minutes of the meeting. Dr. Garcia so moved, and Mr. Jansen seconded the motion. The motion passed unanimously.

5) OPEN MEETING RESOLUTION

Mr. Desiderio called on Mr. Mathews, Board counsel, to explain the purpose of the resolution. Mr. Mathews noted that at the first Board meeting of each year, the resolution must be adopted. He observed that the resolution was in substantially the form presented to the Board in prior years, and provided not only for physical meetings but also for telephone meetings.

The Vice-Chair asked for a motion to approve the resolution. Mr. Garcia so moved, and Mr. Jansen seconded the motion. The motion passed unanimously.

6) EXECUTIVE DIRECTOR'S REPORT

Mr. Miller reported that the program administration fund balance at the end of December was about $6.7 million. He also reported that the fund has been entered in the state's SHARE accounting system as a restricted fund.

Mr. Miller then briefly outlined the agenda for the day. He noted that there were a number of marketing initiatives underway, as well as work being done on enhancements to the investments in the program. At this meeting the Board would be asked to approve the creation of a default investment option for The Education Plan.

The Board would also be asked to extend the Hogan Lovells contract for an additional year, as well as approve a "small" contract for marketing services to allow for the creation of radio ads for The Education Plan that are not burdened by the lengthy legal disclaimers required of broker-dealer ads.

He also noted that Mr. Werner from OppenheimerFunds would outline his sales plan for the coming year.

Also the independent audit firm, REDW, would report on its audit of the program for the last fiscal year. Mr. Jansen asked if would be necessary to vote to accept the audit report. Mr. Mathews stated that it would not be necessary.

7) AMENDED CONTRACT FOR LEGAL SERVICES

Mr. Miller was asked by Mr. Desiderio to address the amended contract for legal services. He noted that counsel for DFA had stated that the current legal contract with Hogan Lovells could be amended to extend its term. He proposed that the term be extended by one year, to the end of FY2017. He also proposed that the contract contain a schedule of fees for various categories of legal professionals, and that the senior counsel's hourly rate be raised from $525 to $575, in line with the standard hourly billing rate for counsel of this level at the firm.

Mr. Jarmie noted that he was willing to accept the hourly rate for Ms. Atkeson's service as well as the hourly rate for other senior counsel and senior and mid-level associates, but that he thought the rates for junior associates and paralegals were too high. Ms. Atkeson stated that junior associates and paralegals did not work on the account, and she would be happy to delete them from the contract. Mr. Jarmie asked if the rates to be paid under the amendment were the usual and customary rates charged by the firm. Ms. Atkeson confirmed that they were.

Mr. Desiderio asked if the value of the amended contract for the coming year was the same numbers as in the original contract. Mr. Miller stated that the number was the same on an annual basis, and that it was a ceiling on the contract, not a floor. In fact prior spending for Hogan Lovells' services had not reached this ceiling in prior years.

Mr. Jarmie that the amended contract be approved. Mr. Jansen seconded the motion. The motion to approve the amended contract was unanimous.

8) PROGRAM MANAGER'S QUARTERLY REPORT

Mr. Raynor then began the Program Manager's quarterly report by noting the organizational changes that occurred in the first quarter of 2016. In particular the dissolution of the Marketing group that reported directly to the CEO and the movement of the 529 business, formerly in that group, to the Investment group. Christina Nasta remains the head of the 529 business. Two executives who headed the Marketing group, Marty Willis and Julie Libby, left the company. Marketing under Stephen Tisdalle now reports to the head of Distribution for the firm.

He also noted that Oppenheimer was working with ETB staff to improve the quarterly reporting to the Board – particularly with regard to investments.

He also mentioned that Oppenheimer and ETB staff were working on some investment changes, particularly with regard to TEP, in an effort to lower fees and make the plan more competitive. In addition it is hoped the changes will attract the attention of Morningstar, and get that firm to rate TEP. Oppenheimer also has its Asset Allocation group working on recommendations for improving the multi-asset Investment Portfolios for Scholar's Edge and TEP.

Mr. Raynor noted that TEP assets and accounts were growing, although quite slowly. He noted the need to make the plan more competitive nationally.

Ms. Ceserani asked if there had been any significant flows into the new Growth and Balanced Age-Based tracks. Mr. Henry noted that very few existing account owners had transferred to the new tracks. Mr. Raynor said that he would get back to Ms. Ceserani on the flows into the new tracks.

Mr. Werner then addressed the sales plan for Scholar's Edge. He noted that 529 industry sales were up 6%, but that almost all of the growth was in direct-sold plans (up over 10%), while advisor-sold plans only grew about ½%. The long-standing trend of slowing advisor sales and growing direct sales continued for the last year.

He noted that in the 4th quarter, usually a strong quarter for sales, advisor sales were down 4.3% while direct-sold sales were up 4%.

He noted that industry advisor sales growth was down about 16% for 2015. Scholar's Edge sales growth was down about the same. Industry asset growth was down about 4.3% but Scholar's Edge assets growth was down 12%.

He then turned to a review of where national sales occur for Scholar's Edge. He noted that 90% of the sales occur outside New Mexico. California and the Southwest make up the bulk of these sales. Additional significant sales occur in the Northeast and in Minnesota. He noted that each part of the country has both field reps and telephone reps. There is also a group of telephone reps that cover smaller broker-dealers. This group is responsible for some 40% of new sales for 529.

Mr. Raynor and Mr. Werner both noted that some states have closed advisor plans, such as Missouri and Texas, and that advisors in those states were a good ground for sales efforts.

Mr. Werner noted that a few large broker-dealers have the bulk of the assets in Scholar's Edge. New York Life is the leading source with 30%-50% in any given month. The top 20 brokers are responsible for 50% of sales. Nonetheless, growth in advisor sales are down generally, including 529.

Mr. Werner wants to increase assets sales by 10% over 2015 numbers -- $139 million as compared to $129 million. Mr. Jarmie asked about incentives for the sales force. Mr. Werner noted that the 529 field reps are receive salary, commission and, if goals are met, quarterly bonuses. He is seeking approval for an incentive structure for 529 involving the small broker telephone reps that involves rewards for new account growth.

He then described in more detail the sales territories for his three 529 field reps.

He noted the pressures on the advisor-sold market from the direct-sold plans. Some advisors are now pushing their clients to the direct-sold 529 plans. Many direct plans have low cost index product that appeals to investors.

Also many of the larger advisor-sold plans, like the Virginia plan under American Funds, have gone to an "omnibus" relationship with the large brokerage firms. This makes it much easier for the advisor to sign up a 529 client. He noted that only three advisor-sold plans had significant growth – Virginia, New York and Illinois. New York and Illinois both cut fees in their programs.

Mr. Werner noted that Oppenheimer is working on how to go omnibus with the larger firms, like Ameriprise.

Mr. Werner then turned to Mr. McGee. He noted that he is in the field, but also spends time training other Oppenheimer personnel on 529. He noted that he works in states that either don't have an income tax. Like Washington and Texas, or that have no income tax deduction for 529 contributions, like California. He also explained how he tries to compete against the Virginia plan. He also described a recent visit to New Mexico where he addressed a group of financial planners, as well as Edward Jones brokers. He also targets Prudential and UBS because they do not have omnibus relationships.

Mr. Henry then addressed the performance of the plans for the 4th quarter. He noted that the conversion of the Institutional Money Market Fund into a Government Money Market Fund was on track for the end of September. Only government money market funds will be able to maintain a constant $1.00 per unit value and avoid potential withdrawal restrictions in the future. Regular money market funds will have a floating unit value and may be subject to liquidity restrictions in the event of a financial crisis.

Mr. Henry noted that the format of the Board report was starting to change in an attempt to summarize information for the Board in a more useful fashion. One such change is to highlight funds that outperform or underperform by more than 100 basis points compared to their benchmarks.

He observed that the funds generally outperformed for the entire calendar year, but that generally there was moderate underperformance for the fourth quarter. He noted some significant out performance in several of the international funds.

He referred to industry rankings of performance by Morningstar and SavingforCollege.com. He noted that in the SavingforCollege.com rankings for one-, three- and five-year performance the New Mexico funds were in the top third or top quarter in terms of performance. In the Morningstar system the risk return profiles of the New Mexico funds were positive for the three year period.

9) ESTABLISHMENT OF DEFAULT INVESTMENT OPTION FOR THE EDUCATION PLAN

At this point Mr. Desiderio advised the Board that it needed to consider Item 12 on the agenda in order to ensure a quorum if a vote on the Item was taken. Mr. Kurt Sommer of the law firm of Sommer Udall joined the meeting by telephone.

Mr. Miller noted that a legal review under New Mexico fiduciary law was conducted by Mr. Summer, and that his firm had issued an opinion with regard to the adoption of a default investment option for The Education Plan. This type of option is in use in many retirement plans as well as several college savings plans. It is designed to provide an investment option for investors who want to save money for college in the plan, but who do not wish to make an investment decision as to wish investments to use.

The proposal before the Board would place any money received from these investors into the Age-Based Balanced Index option. A balanced option is a common choice for such options in retirement plans and in college savings plans. It allow for a conservative exposure to equities, which is reduced over time.

Mr. Desiderio, an experienced fiduciary lawyer as well, noted that he had reviewed Mr. Sommer's opinion, and that he would have come to the same conclusion as Sommer Udall.

Mr. Sommer then described the substance of his opinion. He noted that New Mexico law places an obligation on the Board to promulgate regulations and guidelines and to otherwise administer the college savings program in compliance with the Uniform Prudent Investor Act. He observed that if the Board acted as a prudent man would do in investing the money, in this case into an age-based balanced portfolio, this would be permissible under the UPIA.

Mr. Jansen asked if the Board had received Mr. Sommer's written opinion on the matter. Mr. Miller said that the opinion had been received. Since it is privileged and confidential legal advice, it is not part of the public record of the meeting. It is available to all Board members upon request.

Dr. Garcia asked what an investor would be told if he was considering such an investment. Mr. Sommer noted that the investor would be informed that if no investment selection was chosen, the money would be put into the default investment option.

Mr. Esparza noted that language would be developed that would explain the nature of the investment to the investor in plain language.

Ms. Howard noted that the explanation could be in the form of a window that opens to give an explanation of what the default investment option is.

Mr. Desiderio called for a motion to adopt the default investment option for The Education Plan in the form presented to the meeting. Mr. Jansen so moved. Mr. Jarmie seconded the motion. The motion was approved unanimously.

10) INVESTMENT CONSULTANT QUARTERLY REVIEW AND WATCH LIST RECOMMENDATION

Ms. Ceserani gave the Investment Consultant's quarterly update. She noted that the markets had rebounded over the 4th quarter. Large cap stocks outperformed small caps and growth outperformed value. In the first quarter of 2017 the markets became quite volatile, but were nearly unchanged for the year by the beginning of March.

She addressed the report on the 35 underlying funds in the program. Mr. Miller asked her to explain the different Morningstar ratings in stars and in medals. She relied that the star system is backward-looking and related to performance. The medal system is forward-looking and related to the five Morningstar pillars – People, Process, Parent, Performance, and Price. She noted that the watch list prepared by PCA is also backward looking. It is performance driven.

Ms. Ceserani also reviewed the plans in terms of Morningstar ratings. The Education Plan has 15 funds with a Morningstar average star rating of 3.8. Scholar's Edge has 27 funds with an average Morningstar star rating of 3.6 stars.

Mr. Jarmie sought further clarification on why a fund might not have both types of rating. Ms. Ceserani noted that star ratings require the funds to have a significant performance history. The medal ratings are more subjective. Morningstar rates the funds that it chooses to rate.

She then turned to the PCA ratings for the funds. For TEP, 93% of the funds are either positive or acceptable. This is quite good. Typically one third of funds would be on caution or watch status for 529 plans. Scholar's Edge also rated well. 81% were positive or acceptable.

She also reviewed the funds in each plan that had either moved up or down in status for the quarter.

Ms. Ceserani called out the Rising Dividends Fund for particular notice. It has been on watch status for several years. The benchmark underperformance in the past has been due largely to this style of investing being out of favor. The fund performed largely in line with its peers.

She also noted that the fund is in a lineup of individual fund options available in Scholar's Edge only. The account owners has access to advisors who recommend placement in these individual funds in order to get exposure to certain asset classes. Also the amount of assets in the fund is a very small percentage of plan assets.

She then moved on to a risk reward analysis. She observed that the funds in each plan compare well with the Morningstar 3-year medians. The plans have done well compared to the median plan.

Mr. Jarmie moved to maintain the current funds on the watch list as recommended by PCA. Mr. Jansen seconded the motion. The motion passed unanimously.

11) PROPOSED CONTRACT FOR MARKETING SERVICES

In order to ensure a quorum for voting purposes the Board brought forward item 12 on the agenda, the proposed contract for marketing services between the Board and Esparza Advertising.

Mr. Miller reminded the Board of the long list of legal disclosures at the end of the radio ads for The Education Plan. A 30 second ad contains an added 30 seconds of legal disclosure. According to Hogan Lovells as well as inside counsel for OppenheimerFunds these disclosures are required because the sponsorship of the ads is through OppenheimerFunds.

The Board has received privileged and confidential legal analysis from Hogan Lovells that concludes that the state, while required to make statements that are accurate and not misleading, is not bound by the extensive regulatory requirements applicable to OppenheimerFunds for advertising disclosure.

Ms. Atkeson noted that, if the ads are prepared and paid for exclusively for the state, the extensive disclosures mandated for OppenheimerFunds can be dropped from the ads. The ads themselves must be general in character and make reference to where the public can go for more information. Proposed ads will be subject to legal review by counsel to the Board.

Vice Chair Desiderio asked for a motion to approve a contract not to exceed $60,000 plus gross receipts taxes in the standard form professional services contract directly between the Board and Esparza Advertising for the purpose of preparing and placing the radio ads. Dr. Garcia so moved. Mr. Jarmie seconded the motion. The vote to approve was unanimous.

12) ETB MARKETING INITIATIVES UPDATE FOR FY 2016

The Board then turned to a marketing initiatives update from OppenheimerFunds and Esparza Advertising. Teresa Ward of OppenheimerFunds described the internal efforts at Oppenheimer to improve the visibility of Scholar's Edge and 529 among distribution partners. Ms. Ward and Mr. Werner conducted training for the firm's strategic accounts team. This team interfaces with key broker dealers.

Mr. Werner's sales team has conducted in-person training with the internal regional advisor consultants and the product specialists to keep them informed about 529.

Ms. Ward's team is creating online learning for the firm's sales teams. This will be available internally at the firm's learning centers. Work is being done to update the firm's continuing education materials and consumer seminar materials.

Work is also being done to target the states of Washington and Missouri, where recent in-state changes in 529 have led to opportunities to sell Scholar's Edge.

Ms. Howard of Esparza then continued. She pointed out that during the 4th quarter of 2015, 215 of the 337 new Education Plan accounts could be credited directly to recent marketing efforts. She observed that 85% of new enrollments for The Education Plan were online. Online marketing efforts will continue and be expanded in New Mexico and in states where there are significant numbers of current New Mexico plan accounts.

She reviewed the new account and new asset metrics for the 4th quarter of 2015. She noted that as advertising "impressions" increase so does web traffic to the New Mexico plans' sites. Banner ads are a good way of generating these impressions. Many of these ads are tied to the themes found in the TV and radio advertising for the plans. She noted that one of the TV ads for The Education Plan won a New Mexico ADDY award. She noted that Esparza picked up 22 of these ADDY awards.

Responding to a question from Mr. Miller, she disclosed that Mr. Esparza had received an award, called the Silver Medal Award, from his peers in the advertising industry in New Mexico.

Ms. Howard then addressed the website traffic for both The Education Plan and Scholar's Edge. She noted that more people are accessing the sites through phones and tablets. Each website has been adapted to work properly on those devices. She noted that several states were being targeted for web advertising due to the account activity already present in those states for the New Mexico 529 program – California, Texas, Florida, New Jersey and Massachusetts.

She noted the increased efforts on social media such as Facebook. Social media can be used as a tool for reinforcing the recognition of the New Mexico plans. Posts don't need to be specific to the plans. A post about daylight savings time change was widely read.

An email campaign called InMail has been developed for Scholar's Edge. Of 65,000 sent, nearly 50% were opened. Emails are also sent to TEP account owners and prospects. Account owners opened the emails at nearly a 50% rate.

She also discussed changes being made to the websites. Changes are being made to the TEP website to make enrollment more streamlined. Work is being done on a "microsite" to inform naïve investors about 529 and basic investment knowledge. Also the TEP website will allow those trying to enroll to save their work and return later to complete the application.

Ms. Howard mentioned the strategic relationship with the National Association of Secondary School Principals. This association sponsors the National Honor Society. The first annual National Junior Honor Society scholarship awards will made this year, with 500 awards of $500 each into accounts in TEP. The awards will be announced at a ceremony at UNM in Albuquerque. This will be followed by the first annual state summit for the National Honor Society. Nearly 300 students and advisors will attend the event. Speakers included Dr. Damron (who will the keynote address), Hanna Skandera, Secretary of Public Education (who will present 529 scholarship awards to New Mexico winners) and President Bob Frank of UNM.

Another education effort will be the placement of TEP advertising on 10,000 school folders in elementary schools in the Los Alamos, Santa Fe and Albuquerque areas. This program, if successful, will be expanded to other parts of the state. In addition TEP bookmarks are being placed in nearly 80 libraries across the state.

PR efforts are being developed in-state. Dr. Damron and Mr. Miller spoke to Cumulus Radio for 30 minutes. This program was distributed to the seven Cumulus stations in New Mexico. Articles and advertising are being created for insertion into publications of wide circulation in New Mexico such as Round the Roundhouse Tumbleweeds and People of God.

After completion of the CEPRS study last winter, work began on a community outreach pilot program aimed at increasing participation in the 529 program, particularly among low and moderate income families. The program will feature matching grants to encourage formation and contribution to 529 accounts.

A consulting firm has been retained to create an employer outreach strategy for payroll deduction with large New Mexico employers.

In total there are 25 projects aimed at increasing participation in New Mexico's 529 program.

13) INDEPENDENT AUDITOR'S REPORT

Vice Chair Desiderio asked Mr. Machuca of REDW to give the independent auditor's annual report for FY 2015. He noted that the audit was completed and submitted on time. He noted that cooperation from management of ETB was excellent.

He then discussed adjustments made during the course of the audit. He also noted that for the first time the program administration fund is denoted as a restricted fund on the state accounting system. By statute this fund is dedicated to operating the 529 program and should not be classifies as generally available state funds.

He observed that the audit would not be "qualified" as it had been in prior years due to the state's inability to confirm the accuracy of amounts invested in the general investment pool. The source of the Board's funds is external to the state and the volumes are very low. It was possible to confirm that the Board's balance was accurate.

He noted a material weakness due to an old audit finding from 2012 that had not been cured. Cash balances should always be reconciled between SHARE and the local government investment pool.

There is also a new significant deficiency that a reconcilement was not done between SHARE and the general fund investment pool. This reconciliation is done BY DFA, but DFA also insists that the state agencies do their own reconciliation. There was no imbalance, but the agency reconciliation was not done.

He also noted a deficiency in that records could not be found that indicated that RFPs for several old procurement were properly communicated by public notice in newspapers of general circulation. Some notices were found, but not all of them.

Mr. Miller attributed these deficiencies to a lack of manpower at ETB. ETB has hired a full time financial coordinator and is going to recommend to the Board that a CPA firm with state accounting experience be retained on a "small" professional services contract to assist the staff and the Board of accounting and financial matters.

14) ADJOURNMENT

There being no further questions, Dr. Garcia made a motion to adjourn. This was seconded by Mr. Jansen. The vote to adjourn was unanimous. The meeting concluded at 1:30 PM.