# 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 May 20, 2016**

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

APPROVED
Vera Lyons
Board Secretary
11/21/16

**Board Members in Attendance**

Dr. Barbara Damron -- Chair
Robert Desiderio -- Vice Chair
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
Adam Greenhood -- Esparza Advertising
Emily Howard -- Esparza Advertising
Kay Ceserani -- Pension Consulting Alliance
Sean Copus -- Pension Consulting Alliance
Teresa Ward -- OppenheimerFunds
Bill Raynor -- OppenheimerFunds
Chris Werner – OppenheimerFunds
Kurt Sommer -- Sommer Udall (by telephone)
Michele Nelson -- Court Reporter

1) **CALL TO ORDER**

Dr. Damron, the Chair, called the meeting to order at 9:02 AM. The roll was called and all Board Members were present with the exception of Dr. Garcia

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. Mr. Jarmie so moved, and Mr. Desiderio seconded the motion. The motion passed unanimously.

4) **CLOSED SESSION**

The Board went into Executive Session at 9:03 AM to discuss personnel matters. At 9:30 AM the Chair asked for a motion to return to open session. Mr. Jansen so moved. Vice-Chair Desiderio seconded the motion. The vote was unanimous to return to open session. Mr. Mathews stated that the closed session was limited to a discussion of personnel matters. No other matters were discussed and no action was taken.

5) **EXECUTIVE DIRECTOR'S REPORT**

Mr. Miller then gave the Executive Director's report. He reported on his presentation to the Investments and Pensions Oversight Committee of the state legislature. He stated that the presentation appeared to be well-received.

He also mentioned the success of the National Junior Honor Society Award ceremony and the First Annual National Honor Society State Summit at UNM in Albuquerque. The National Association of Secondary School Principals, which sponsors the National Honor Society, chose The Education Plan (TEP) to hold awards of $500 each granted to 500 students nationwide. There were 7 New Mexico award winners. Nearly 300 attended the event and it was reported in New Mexico media. The contributions of Dr. Damron and Secretary Skandera in speaking to the students at the event in a heartfelt and direct way were also noted.

Mr. Miller then presented a Statement of Mission, Vision and Goals to the Board. He noted that during the annual budget process, each agency is asked for its mission, vision and goals. In the past, ETB had simply stated that its mission was to administer the 529 program for the state. No vision or goals were stated. He noted that most enterprises have such a statement.

Mr. Jarmie asked if Oppenheimer and Esparza had reviewed the statement. Mr. Raynor stated that Oppenheimer had reviewed and commented on the statement, and that it was supported by the firm as presented to the Board. Ms. Howard of Esparza noted that Esparza had been heavily involved in the drafting of the statement, and also stood behind it. Dr. Damron asked for a motion to approve the statement as presented to the Board. Mr. Jansen so moved. Mr. Jarmie seconded the motion. The vote to approve the statement was unanimous.

Mr. Miller then asked for Board approval to approve a small contract for IT services for FY2017 in the amount of $50,000 plus gross receipts tax. He noted that the approval of such a contract would give ETB control of its IT services, and remove the final area of reliance by ETB on HED administrative support. Dr. Damron stated that the IT group at HED was short-staffed, and that she supported the idea of a contract that could ensure consistent, professional and timely IT support for ETB.

In addition Mr. Miller asked for Board approval for small contracts for New Mexico legal counsel, accounting support and marketing support for FY2017. All contracts would be based upon standard state forms for professional services.

The Chair asked for a motion to approve the four contracts. Mr. Jarmie made a motion to give the Executive Director the authority to enter into small contracts for marketing services, accounting services, IT services and legal services for FY2017 at his discretion. Mr. Jansen seconded the motion. The motion passed unanimously.

**6) INVESTMENT POLICY STATEMENT AND MONITORING GUIDELINES**

Mr. Miller led off the discussion by presenting the written recommendation of Pension Consulting Alliance with regard to the selection of the Balanced Age-Based Index Track as the default investment option for TEP.

Then Mr. Miller turned to the proposed drafts of the Investment Policy Statement and the Monitoring Procedures and Criteria. He noted that both documents had been revised to incorporate the advice of counsel with regard to the inclusion of a default investment option in the Education Plan, as well as language changes designed to more closely track the Uniform Prudent Investor Act.

Dr. Damron asked if both New Mexico counsel and 529 counsel had reviewed the documents. Ms. Atkeson, 529 counsel, confirmed that she had reviewed them and Mr. Miller confirmed the Mr. Sommer, New Mexico counsel, had reviewed them as well.

Dr. Damron called for a motion to approve the two documents in the form presented to the Board. Vice-Chair Desiderio so moved. Mr. Jansen seconded the motion. The vote to approve the documents was unanimous.

**7) MARKETING PLAN FOR FY2017**

Dr. Damron then asked Ms. Howard to present the Marketing Plan for FY2017. Ms. Howard introduced Adam Greenhood, the creative director at Esparza. She also introduced Ms. Ward of Oppenheimer. Ms. Ward praised the work done on the marketing plan, and the close cooperation with Esparza and the ETB staff. She also praised the work done by Esparza and ETB staff on the Honor Society events.

Mr. Raynor then noted that Oppenheimer understood that the primary concern of the Board was to grow accounts in the 529 Program. He observed that the new marketing plan was taking creative approaches that he had not seen elsewhere in the 529 industry.

Dr. Damron thanked Mr. Raynor for confirming that Oppenheimer understood the Board's priority in growing new accounts.

Ms. Howard then reviewed the first quarter of calendar 2016 results. She noted the creation of 246 new TEP accounts, with 213 or 87% opened online. She also highlighted the national reach of the marketing efforts through the internet, and noted that the addition of more marketing money under the new contract would allow for year-round marketing efforts. She noted the increase in new site visits to TEP, and the increased frequency of TV and radio ads.

She noted how activity tailed off at the end of the first calendar quarter. Mr. Raynor noted that the 529 business is highly cyclical with the first and fourth quarters of the calendar year being the most active. Ms. Howard then reviewed the same information for Scholar's Edge.

She noted that there are new tracking tools on the internet that can target the users that engage in certain word searches, and can track users that sign up for a 529 plan. The conversion rates for some search terms are quite high.

She then reviewed the marketing budget for FY2017. She noted that almost half of the budget was going to media. She also observed that 12% of the budget is going to website development.

Elementary schools hand out folders at the beginning of the year that are used to communicate back and forth with families about the students. There is competition among businesses to advertise on these folders. ETB is going to be an advertising presence on these folders in some New Mexico schools.

Ms. Howard noted that the advertising for the new fiscal year would attempt to create more of a sense of urgency about the need to create a 529 account and start saving for education.

She introduced Mr. Greenhood. He explained how research generates ideas for marketing. He noted that most people understand why they need a retirement plan. The need is clear and the goal specific. The same is not the case for college saving. There is not a good sense of when to start and how much to save.

A surprising fact in the research was that if even small amounts were saved for college, $500 or less, the child was several times more likely to attend college and several times more likely to graduate. This fact can give hope and direction to a parent trying to save for higher education.

A second key fact from the research is that most parents don't start saving for higher education until the child is 5 or six years old.

This led to a discussion about how ineffective the industry response has been to encouraging college saving. The industry has created 529 day, May 29, and focuses events like scholarship awards and contests around it.

Esparza came up with the slogan "If your child is 5 to 9, it's time for a 529."

The combination of the two facts, even $500 makes a difference and most people think of saving for college when a child is about age 5, created a framework for making the goal and the start time concrete.

He then reviewed the advertising ideas related to these themes for TV, radio and the internet.

Mr. Greenhood also outlined a creative idea to partner with a photography firm that produces a large number of the school photographs in elementary and middle schools. It is possible to place creative advertising on the picture frame that comes with the photographs.

Ms. Howard then reviewed the marketing calendar for the board.

Then Mr. Werner gave his sales report. He noted that for the first quarter they were at 23% of goal for gross sales. He noted that the industry was down for the first quarter both in direct sold and advisor sold plans. The industry as a whole was down around 8%, but the New Mexico plans were down a combined 7.5% -- slightly better than the industry.

He then described the sales goals for his 3 sales people, and how those goals have now been tied more closely to incentive compensation. An incentive plan has also been put in place for the internal telephone sales reps. Finally smaller payouts are available to product reps who take calls from financial advisors. The plan affects 3 sales people, 20 internal sales reps and 10 product specialists.

A discussion ensued about the broad industry trend of slowing growth in the advisor sold business compared to the direct sold business. Mr. Raynor noted the importance of making TEP a more national plan. This will require changes to TEP to make it more competitive nationally.

Mr. Jansen raised a concern about the 23% of goal first quarter. He noted that if the first quarter is one of the strong quarters, what would happen in the second and third quarters? Will the goal be met?

Mr. Werner said that while he was not at 25%, he was close. He noted that the fourth quarter is usually the strongest quarter. It can make or break a year for sales.

He then turned briefly to the creation of new accounts. He noted that year over year the first quarter new account growth in Scholar's Edge was down 20%. This is significant. He also noted that the advisor sold new accounts were down industry-wide by 15%. Mr. Werner then noted that the numbers for March and April were up in new accounts year over year. These are some of the first positive numbers seen in a long while.

**8) EMPLOYER OUTREACH AND PILOT GRANT PROGRAM**

For this agenda item, Mr. Miller and Ms. Howard were joined by Kurt Sommer of the Sommer Udall law firm. Mr. Sommer joined the meeting by telephone.

Ms. Howard led off with a discussion of the employer outreach initiative. She noted that LEH Consulting, was retained to assist the Board in developing a strategy for the large employer market in New Mexico. LEH focused on the largest 25 employers in New Mexico, and tried to determine each employer's current involvement with the New Mexico 529 program, if any, as well as how the 529 program might be brought to the attention of decision makers at those employers.

A scoring system was developed and each employer was ranked. It was discovered in the course of this research that several large New Mexico employers have listed TEP as an employee benefit, and link to the TEP website. Unfortunately, these relationships have not received attention from, ETB staff for quite some time. Thus the participation levels are low, and no assistance is offered to these employers when benefits enrollment occurs.

Dr. Damron noted that several of these employers were of importance to the Higher Education Department and involved in initiatives important to the state. She and other Board members had good relations with senior management of those employers. She advised that the Board Chair be consulted prior to direct contact with senior management at those employers.

Mr. Miller note that the FY2017 budget had allocated funds to staff an outreach director and several presenters. These would be brought onboard only as the need arose.

Mr. Miller then addressed the pilot grant program. He reminded the Board of the research project that had been done on grant programs by CEPRS at UNM. Dr. Damron noted that a grant program is not the same as awarding college scholarships. A grant program would focus on growing the number of 529 accounts in TEP.

Mr. Miller concurred. He then gave a general overview of the operation of a grant program, with particular emphasis on the controls necessary to keep the program financially sound. Grant moneys would remain under the control of the entity operating the program, and any distributions would be restricted to paying for qualified education expenses.

Ms. Atkeson observed that this type of structure is permitted under the IRS section 529 rules. Under those rules such grants do not constitute taxable income to account owners or beneficiaries.

Mr. Miller observed that the program would begin as a small pilot program, and that ETB would seek to partner with education-related organizations that have a state-wide reach but a local presence. The initial program would have a life of 3 to 5 years. At that point the Board could evaluate the results and elect to continue, modify or end the program.

Mr. Miller then turned to the legal issues surrounding such a program. He had consulted Sommer Udall with regard to these issues. At this point Mr. Sommer was asked to address these issues.

Mr. Sommer stated that the first issue is whether or not the Board had the statutory authority to grant scholarships or others forms of grants to individuals. The second issue is the limit imposed on payments to individuals by the anti-donation clause of the state constitution.

With regard to the first issue, legislation could be introduced to revise the statute. The legislative process can be fraught with difficulties. With regard to the second issue, the legislative process cannot affect the limits imposed by the state constitution.

Faced with these difficulties, Mr. Sommer looked for another solution. He noted that the statute expressly permits the Board to expend administrative funds to market the 529 program and to promote the creation of 529 accounts. So he proposed the creation of a non-profit corporation that would contract with the Board for the purpose of promoting the growth of the 529 program. He recommended the idea of approaching the Attorney General's Office to obtain an opinion that the issuance of grants by such an entity would not violate the anti-donation clause. He noted that there were two Attorney General's opinions that support this line of reasoning.

Dr. Damron again reinforced the notion that the purpose of the grant program is to promote the growth of 529 college savings accounts. The grants may be regarded as scholarships for income tax purposes, but that is all.

She also noted that the presentation at this meeting was for informational and discussion purposes only.

Vice Chair Desiderio asked Mr. Sommer how the money would get to the non-profit entity. Mr. Sommer replied that the money would come from the program administration fund as part of the marketing and promotion activities for the 529 program. There would be a contract with the non-profit entity for marketing and promotion activities. This structure may be the way to avoid a potential violation of the anti-donation clause.

Vice Chair Desiderio then turned to the non-profit entity. He asked Mr. Sommer who would control the board of the entity. Mr. Sommer stated that it would be controlled by the Board. Vice Chair Desiderio then noted that the entity, if it were classified as a private foundation as opposed to a public charity, would have to be administered separately from the Board and comply with strict IRS rules. Mr. Sommer agreed.

Mr. Jansen noted that he had experience with the complexity of running a private foundation, and that the administrative burdens were significant.

Mr. Jarmie asked if Oppenheimer could make the contributions to the entity. Mr. Raynor advised that, based on previous experience, the regulators overseeing

Oppenheimer might not approve of that activity. Mr. Sommer stated that he would like to see the money come directly from the Board as part of its marketing and promotional activities.

Dr. Damron noted in closing that there were a number of issues that need further clarification before any action would be taken by the Board.

**9) PROGRAM MANAGER'S QUARTERLY INVESTMENT REPORT**

Mr. Raynor led off the Program Manager's Investment Report by noting that the Commodity Strategy Total Return Fund was closed to new investors on April 29, 2016, and would be officially closing On July 15, 2016. This fund is in a separate portfolio in Scholar's Edge with approximately $165,000 invested in the portfolio for 117 accounts.

Mr. Raynor noted that the fund would no longer be available as an investment option in a portfolio of the 529 program. Thus the Board must act to remove the Portfolio from the plan. This means that something would have to be done with the money already in the fund and any new money that comes in before the fund is closed. If the decision is left to account owners, then it would use up one of their two available investment changes for the year. If the Board made the decision on behalf of the 529 program, then the direction would not count against this twice annual limit.

He recommended that, given the lack of a similar portfolio option in Scholar's Edge, the Board authorize the movement of funds into the Institutional Money Market Portfolio. From there, account owners and their financial advisors can decide where to put the funds.

Mr. Jansen than asked Mr. Raynor if the Board was simply deciding the mechanics of what to do with the moneys in a closed portfolio. Mr. Raynor said that this course of action would not count against the twice annual investment change limit for account owners. Mr. Jansen then observed that he did not think that a commodity strategy was appropriate for a plan focused on education saving. Ms. Atkeson noted that the portfolio was only in Scholar's Edge as an individual investment option, and that the account owners are advised by their financial advisors. She also observed that a Board decision to move the money into a conservative option like the Institutional Money Market Portfolio, in the absence of another similar fund in the plan, would not put the account owners' funds at risk.

Mr. Jansen moved that the Commodity Strategy Total Return Portfolio be removed from the plan, and that any existing and new dollars in that portfolio be moved to the Institutional Money Market Portfolio.

Mr. Jarmie seconded the motion. The vote to approve the motion was unanimous.

Mr. Werner then addressed the Board as to quarterly performance. He noted that the report would now contain an executive summary, so that the Board would have the most critical information before it in summary form. He noted that the report would continue to carry all the detailed information provided in the past as well.

He observed that the first quarter 0of 2016 was a very volatile quarter. This affected the performance of the actively managed funds in the program in a generally negative way. The first six weeks of the year were marked by a market sell off. In particular the banks sold off.

In the second six weeks of the quarter market sentiment improved. The US was growing, albeit slowly, the price of oil rallied and unemployment ticked down.

Overall for the quarter financials were down, health care was down and energy, telecom, utilizes and materials did reasonably well. The broad market as measured by the S&P 500 was up 1.35%. Value stocks outperformed growth, and large and mid-cap stocks out-performed small cap stocks.

For TEP the index funds performed as expected. The blended portfolios all underperformed their benchmarks by 19 to 82 basis points. He noted that the Value Fund and the Global Fund underperformed their benchmarks by more than 100 basis points.

The Main Street Small Cap fund outperformed by underweighting health care and financials. He International Growth Fund was also up because it was underweight financials. The Value Fund underperformed in part because of exposure to financials. Similarly the Global Fund underperformed due to financial exposure as well as because of exposure to SunEdison – a company that went into bankruptcy. In the past the Global Fund had been a strong performer.

Mr. Werner then turned to Scholar's Edge. He noted the underperformance of the age-based portfolios due to the general underperformance of actively managed funds. Only the Main Street Small Cap Fund and the International Growth Fund outperformed.

Answering a question from Mr. Jarmie, Mr. Werner noted that performance with regard to the age-based portfolios is measured against customer benchmarks for each portfolio based on the individual benchmarks for the funds that constitute that portfolio.

Mr. Jarmie also noted the underperformance against its benchmark of the Gold and Special Minerals Portfolio. Mr. Werner answered that the underlying fund for that portfolio invested in the larger cap and higher quality names in the industry and that the smaller cap and lower quality names had significantly outperformed for the quarter. This resulted in the fund being up 36% for the quarter against a 53% rise for the benchmark. Ms. Ceserani also noted that over the longer term one year period the fund outperformed the benchmark.

Mr. Werner then discussed a number of the funds in the individual portfolios and in the age-based portfolios in Scholar's Edge.

At this point Dr. Damron noted that the discussion was becoming hard to follow because of the number of funds and benchmarks and performance numbers discussed in a short period of time. She expressed the concern that as fiduciaries the Board members need to have a clearer understanding of the performance of the funds, and in particular the trends for the funds. She expressed a desire for a more concise grouping of funds by type of investment –equities, bonds, etc.

Ms. Ceserani observed that ETB staff, PCA and Oppenheimer recognize the difficulty and are trying to come up with a better reporting solution. Mr. Miller stated that a more graphic approach would be helpful, as would breaking the investments up into broad classes such a domestic equity, international equity, domestic bonds, international bonds, etc. He compared the current format to trying to read an accountant's spreadsheets.

Dr. Damron stated that she thought the Board needed to see a more concise format for the investment information in order to exercise its fiduciary responsibility.

After this discussion Mr. Werner addressed the Monetta Young Investors Portfolio. The underlying Fund was placed in Scholar's Edge because of the Fund's emphasis on financial literacy for children. The fund is invested about 50% in the S&P 500 and 50% in large cap companies familiar to children – such as MacDonald's, Coca Cola and Disney.

The portfolio containing this fund has not grown as expected, and Oppenheimer will place more marketing efforts towards creating interest in the Portfolio.

Mr. Miller noted that neither the Monetta Young Investors Portfolio nor the PACE initiative had performed up to expectations, and that it was due to a lack of execution. Mr. Miller also pointed out an apparent typographical error in the investment report for the Monetta Portfolio that appeared to show much higher performance than the actual performance. Mr. Werner acknowledged the error.

**10) INVESTMENT CONSULTANT'S QUARTERLY INVESTMENT REPORT AND WATCH LIST RECOMMENDATIONS**

Ms. Ceserani first presented some summary information about the underlying funds in the plans and their Morningstar ratings. She noted that 82% of the underlying funds in the program have three or more stars, and about a third of the funds are medal-rated. She observed that the star rating is backward looking based on investment performance and the medal rating is forward looking based on 5 factors that Morningstar considers important as a gauge of potential future performance. She noted that Morningstar only gives ratings to funds that it chooses to cover, and that the mutual fund companies have no control over this process.

She then turned to a summary page that gave an overview of how the various funds in the program have moved up or down among the watch list categories. These rankings are based on rolling one-year, three-year and five-year performance.

For TEP 11 funds are positive and 3 are acceptable. So 93% of the funds in TEP are meeting or beating the thresholds set for them. For Scholar's Edge 80% of the funds are either positive or acceptable in the ratings. She noted that there were more Scholar's Edge funds that were downgraded (6 funds) in ratings then were upgraded. This is in line with Mr. Werner's comments about the underperformance of funds during the quarter.

Dr. Damron asked how this compared with other states' programs. Ms. Ceserani stated that usually about 66% of funds have positive or acceptable ratings. So overall the New Mexico program was doing well.

Ms. Ceserani then turned to the watch list memo. Four funds are on the watch list. Three are on the list for performance reasons and the fourth is due to a manager change (Senior Floating Rate Fund). All of the funds are in Scholar's Edge and only one of them in in TEP (Senior Floating Rate Fund). The Equity Income Fund is a new addition to the watch list.

She noted that the Rising Dividends Fund had been on watch for a long time. As discussed previously, dividend funds have been out of favor for a long period of time, and the fund had at least performed in line with its peers.

Ms. Ceserani introduced her colleague, Mr. Copus, to provide more detail on this fund. Mr. Copus noted that the funds had not only continued to underperform its benchmark, but was now underperforming a group of peer funds as well. In this market environment a dividend fund should be performing better than the Rising Dividends Fund is performing.

An extended discussion then took place of the effect of removing the fund from the program. What were the reasons that the fund was placed in Scholar's Edge? Was there a suitable Oppenheimer replacement? Should an outside fund be used?

The decision was made to accept PCA's recommendations with regard to the Rising Dividends Fund and the other funds on the watch list.

Mr. Jarmie made a motion to keep the Rising Dividends Fund, the Commodity Strategy Fund, the Senior Floating Rate Fund and the Capital Income Fund on the watch list and to add the Equity Income Fund to the watch list. Vice Chair Desiderio seconded the motion. The motion was passed unanimously.

**11) ADJOURNMENT**

Dr. Damron called for a motion to adjourn. Vice Chair Desiderio so moved. Mr. Jarmie seconded the motion. The vote to adjourn was unanimous. The meeting adjourned at 1:07 PM.