The Education Trust Board of New Mexico

THE HONORABLE MICHELLE LUJAN GRISHAM
GOVERNOR OF NEW MEXICO

DR. KATE O'NEILL, CABINET SECRETARY
NEW MEXICO HIGHER EDUCATION DEPARTMENT

BOARD MEMBERS
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EXECUTIVE DIRECTOR
THEODORE MILLER

APPROVED
Vera Lyons
Board Secretary
6/4/2020

Meeting Minutes of April 3, 2020 10:00a.m.

Special Telephone Meeting

Board Members in Attendance
Sandra Liggett, Chair
Dr. Jose Garcia – Member
Mont Green – Member

Board Staff
Theodore Miller -- Executive Director ETB
Vera Lyons – Secretary
Carolyn Fittipaldi -- Marketing Director

Board Counsel

Helen Atkeson – Hogan Lovells
Kurt Sommer – SommerUdall

Meketa Investment Group
Kay Ceserani
Eric White

Ascensus
Tom Hewitt

Michelle Nelson -- Court Reporter

1) CALL TO ORDER

The Chair called the meeting to order at 10:00 AM. The role was called and three Board members were present – Ms. Liggett, Dr. Garcia and Mr. Green. A quorum existed.

2) APPROVAL OF AGENDA

Ms. Liggett turned to the agenda and asked if there was any discussion. There being no discussion he called for a motion to approve the agenda. Dr. Garcia so moved. Mr. Green seconded the motion. All present voted to approve the agenda as presented to the meeting.

3) PUBLIC COMMENT

The Vice-Chair asked if there were any public comments. There were no public comments.

4) UPDATES

Ms. Liggett asked the executive director to present updates to the board.

Mr. Miller introduced Ms. Fittipaldi to the board as the new Marketing Director replacing Jocelyn Hodes.

Mr. Miller reminded the board of the importance of the upcoming meeting of April 30th. At this meeting the FY2021 budget would be approved. In addition the FY2021 marketing plans for both The Education Plan and Scholar'sEdge would be approved.

Mr. Miller informed the board that the recent developments with the COVID virus and the economic lockdown had caused the staff to reduce the fee revenue projection from its normal range of $1.75 to $1.8 million down to $1.65 million. Despite the reduced fee revenue Mr. Miller stated that staff was of the opinion that a strong marketing effort was still required for the new budget year. For the first time since he became executive director it would be necessary to dip into the program administration fund for about $500,000 to provide funding for the coming year.

Dr. Garcia raised a question as to whether or not the state could reach the board's program administration fund to use for other state purposes. Ms. Liggett asked New Mexico counsel for his views. Mr. Sommer was of the view that such a move would require legislative action to change the enabling statute for the board.

Dr. Garcia asked if there might be a way to discuss this matter with legislative leaders in advance of a potential June special session. Mr. Sommer stated that he was aware of a conversation with members of the Governor's staff earlier in the fiscal year on this topic.

Ms. Liggett noted that the board's annual presentation to LFC raised some concern due to the nature of some of the questions put to herself and Mr. Miller. Afterwards a meeting was held with Mr. Bingaman of the Governor's Office and Ms. Padilla-Jackson of DFA to make the senior executive staff aware of the importance of the program administration fund in the proper operation of the state's 529 program. She thought that a meeting prior to any special session might make sense. She suggested that the board, counsel and staff might meet to discuss the matter further. Mr. Sommer advised that any discussion should not involve more than two members of the board due to the strict open meeting rules.

Mr. Miller then asked Ms. Ceserani and Mr. White of Meketa to give the market updates.

5) MARKET UPDATES

a) Market Overview

Mr. White went through the market update. He reviewed the COVID data, and made a number of observation. In effect Meketa thought that death rates were understated in most countries, infection rates were higher than being reported, medical equipment and human resources were being severely strained. In effect the COVID situation was the most extreme health situation in modern times.

The response of many governments has been to lockdown national and local economies. This is expected to lead to the most severe and rapid contraction of GDP. US GDP could shrink by 15%-30% in the second quarter.

He then went through the economic data in his presentation. US initial jobless have spiked faster and higher than even the great recession of 2008-2009. Some countries, especially in Asia, are trying to restart their economies, and this raises the danger of a spike in new infections which could further delay normal economic activity.

The stock markets has reacted accordingly with a drop of around 25%. Market recovery will depend on the effectiveness of containment efforts and the absence of long delays in reopening economies. The US government has responded with a $2 trillion relief program. This is twice the size of the 2008-2009 relief effort. The Federal Reserve has established a number of programs to provide liquidity to markets. Thus some of the strain on the cash and fixed income markets has been relieved for now. In Meketa's view, the stock markets will respond based on the perceived length of the economic shutdown and the containment of the virus.

Dr. Garcia asked about the relationship between the mortality rate and economic recovery. Mr. White noted that a reduction in the mortality rate would be perceived by the markets as indicating a greater chance of the economy opening up again. Dr. Garcia said that it appeared to be a decrease in the rate that was most important. Mr. White agreed.

Dr. Garcia asked what would be the market impact if the economy started to open up in the next few months, and his generated a surge in infections and further mortality. Mr. White said that this was the great fear. That a recovery would be reversed and markets would seriously decline again. The fall and winter are already times for heightened illness.

Dr. Garcia observed that the interests of public health and the economy seemed to be at odds. Mr. White agreed that there were definitely competing demands.

At this point, there being no further question for Mr. White, Ms. Liggett asked for the Flash Performance Report.

b) Plan Performance Flash Report

Ms. Ceserani noted that while plan data was available this early in the month, some benchmark data was still not available. She noted that program funds with significant equity components were down by double digits. The document presented to the board would be fleshed out as data came in.

c) New York Life and Principal Life Funding Agreements

Ms. Ceserani then turned to the due diligence recently performed with New York Life and Principal Life as providers of the underlying investment options in the Capital Preservation Portfolios for the program. She noted that telephone calls were held with the general account portfolio managers for each company. These Capital Preservation options in the program are backed by contracts with the insurance companies. The general account assets of the insurance companies governs their ability to payout under these contracts.

She noted that as of the end of December there was $81.5 million or about 14% of assets in TEP invested with New York Life. For Scholar'sEdge the plan held $285 million or about $15.2% of assets with Principal Life.

Calls were held with Principal Life and New York Life on March 20th and 27th respectively. The general accounts of both companies hold BBB securities. Since this is the lowest rating for investment grade securities, some of these could be downgraded to junk status – with a corresponding drop in value and a possible increase in illiquidity.

She noted, however, that both companies appeared defensively positioned going into the crisis. In addition there were net inflows into both company's general accounts from investors seeking a stable value product. Finally, neither company has experienced a credit downgrade. She stated that Meketa would continue to evaluate the companies on a quarterly basis.

She then noted that the New York Life product has a six month reset period for the rate that will be paid. The next reset will be in July. The current payout is 2.5% after fees. Principal sets the rate quarterly. The original rate was 1.85% and was reset to 1% in April. ETB negotiated a floor interest rate of 1% with each company. If interest rates stay low the floor rate will be paid in the future.

Mr. Green asked if the portfolios were structured to allow for negative interest rates, and if the liquidity issues experienced by bond ETFs were of concern for the companies.

Mr. White said that the companies both noted the forced selling of securities by large funds, although not by their own funds, and that the Fed's actions, including buying ETFs had stabilized the market.

As to negative interest rates, Mr. White observed that both 529 plans had negotiated a 1% floor on the payouts. Of course if the companies are forced to invest in negative interest investments there could be stress on them over time. He noted that both companies invested in corporate debt and mortgage securities – these tended to have positive interest rates - as opposed to some government debt.

Ms. Liggett asked if there were further questions. There being none she moved on the next item.

6) PROGRAM MANAGEMENT UPDATE

a) Accounts and Assets as of March 31, 2020

Mr. Hewitt observed that quarter over quarter both plans assets had declined by about 11%. Most of the drop occurred in March.

He noted that TEP accounts had increased slightly for the quarter – about 300 net new accounts. The plan was in net liquidation of assets, in part due to outflows for college payments.

Scholar'sEdge accounts had continued to drop quarter over quarter by about 1300 accounts.

He also noted that the relatively high average beneficiary ages for TEP and Scholar'sEdge had preserved value to some extent since the assets were largely invested in fixed income and capital preservation investments.

Ms. Liggett asked why contributions were up year over year for TEP but down for Scholar'sEdge. Mr. Hewitt noted that both plans were still in net distribution. He did note that there had been problems with getting the Scholar'sEdge distribution efforts off to a good start.

Dr. Garcia asked what the effect of the current health crisis was on the plans. Mr. Hewitt agreed the decline in the value of program assets was driven by the crisis. However, he had not yet seen a decline in contributions from existing accounts. That could happen in the future. Also it was possible that fewer new accounts would be open as the crisis continues.

Dr. Garcia asked Ms. Ceserani if there was anything about the two New Mexico plans that might make them different than other plans in the country. She noted that the problems encountered by Principal in staffing the distribution effort could have an adverse effect on the plan compared to others. For TEP she noted that the relatively small and poor population in New Mexico could be a negative over time compared to other states. Mr. White observed that other states with a narrow economic base like New Mexico would also be expected to suffer. Ms. Ceserani noted that Nevada is heavily dependent on tourism and gambling, and could suffer relatively more as a result.

b) Operational Update

Mr. Hewitt then gave a brief operational update on Ascensus. He told the board that Ascensus had been successful in moving all of its work streams and personnel to at home locations. The only exception being the mailroom activities. These require a physical presence. The physical presence is maintained in Newton and Kansas City. The Kansas City location experienced a cutback in available staff, and a process was put in place to overnight physical mail to Newton, increase the Newton staff and operate without detriment to clients. The Ascensus staff are operating with the same equipment that was used in the workplace. As far a client projects, the work flow is on target, and there have been no delays. He also noted that mail volumes have been down about 30%

Mr. Miller asked about the security of client data if people are working from home. Mr. Hewitt noted that the only equipment being used at home is the same equipment used in the work place. No one at home has the ability to use their personal equipment, to download files from the office equipment or to print any documents. In addition use of the internet by the at home workers is secured through Ascensus secure VPN connections.

He also noted that all call center operations are remote and working normally, and that call center volumes have not spiked. In fact it is down about 10%. He said a spike could occur after monthly statements go out, but that is being anticipated.

He noted that there has been an increase in plan transactions online in TEP. People are exchanging into more conservative funds. Scholar'sEdge activity has not been affected in the same way. This is probably the result of financial advisors being involved. There has been a slight increase in "panic" calls to the call center, but it is quite small compared to overall call volume. If daily call volume is about 3,000 calls, panic calls are about 30 to 40.

He noted that service targets are still being met despite the remote servicing.

He noted that BNY/Mellon is performing all custody functions remotely, and that operations are normal.

The extreme market volatility in March did mean that on two trading days a few of the underlying mutual funds could not deliver prices by the deadline for nightly processing. This triggered the use of "benchmark pricing" for nightly processing on certain Portfolios where the Portfolio value changed by more than 1 cent. If an account owner transacted on one of these days there could be a financial effect on the transaction.

Once the correct prices are available, a determination is made as to the effect on the 529 account transactions. Using a standard industry practice for mutual funds, accepted by the SEC, if the effect is less than $25 positive or negative, then no adjustment is made to the account. If the adjustment is greater than positive $25 dollars the account owner keeps the difference. If the adjustment is greater than negative $25 the account owner is made whole. Ascensus funds these adjustments at its expense. He noted that about 167 transactions were done which required account adjustments over $25.

c) Proposed Merger of SystematEX Fund into Principal Diversified International Fund

Mr. Hewitt then addressed a proposal by Principal that would merge the SystematEX Fund into the Principal Diversified International Fund. He noted that this would trigger the process used by the board to replace an underlying fund in the affected Portfolios. He stated that Principal had been working on a recommendation for a replacement fund, and that Meketa had been in contact with Principal about the matter. The goal was to come to the board at the next meeting on April 30 with a replacement fund recommendation. Meketa would have reviewed the recommendation, and also provided its own written report to the board as to whether not to accept the Principal recommendation.

Mr. Miller noted that the board had been provided a document by Meketa that outlined the process. Ms. Ceserani noted that Meketa would be involved with Principal in discussions around the selection of several suitable funds as a sort list for the replacement – not just the Principal Diversified International Fund. He also noted that the board was under no obligation to wait until the proposed merger to make a decision to replace the current fund. Ms. Ceserani agreed.

Ms. Atkeson observed that the account owners and new investors would need to be made aware of the proposed change in advance. Mr. Miller said that the discussion was underway with Ascensus and Principal on the topic.

c) Scholar'sEdge Staffing and Distribution

Mr. Hewitt then addressed the staffing and distribution issues with Principal and Scholar'sEdge. He reminded the board that Principal had planned to hire as the 529 director a person formally in that role with the previous provider. It turned out that that person was not able to take the job. He noted that Principal did not have a backup plan. There was no one in place with 529 expertise to get distribution up and running, or to move the plan forward with relationships or to do the necessary hiring of 529 personnel.

He admitted that the plan had gotten off to a very slow start as a result. He noted that the plan to hire a senior and a junior 529 sales specialist did not happen, and that the pace of hiring had been too slow. He stated that there was no excuse for the kind of speed at which Ascensus and Principal had been moving so far.

He noted that the two staff had finally been hired subject to background checks. They are scheduled to start on April 13th.

He stated that Principal had made a change in the oversight of the 529 program, and moved a more senior person - a managing director – into the role. His name is Paul Schieber, and Mr. Hewitt had been working with him since the transition. Mr. Hewitt thought that there was more rapid progress under this new person.

Ms. Liggett thanked Mr. Hewitt for his part in moving this forward. Mr. Hewitt noted that as program manager Principal was a subcontractor, and "ultimately it's on us".

Mr. Hewitt noted that an agreement had finally been reached between Principal and Ameriprise so that the plan could continue to be sold nationwide by this large distributor.

d) SEC Reg BI Update

Mr. Hewitt then turned to a discussion of the new Reg BI issued by the SEC and to take effect on June 30. This new regulation will change the current standard of "suitability" for recommendations of an investment to financial advisor clients to one of "best interest". This new standard for making investment recommendations to clients is a higher standard and applies to all recommendations to clients – not just 529 recommendations.

With regard to the 529 business Ascensus has seen one firm, UBS, propose to restrict 529 sales to programs that contain a "clean share" that does not charge a commission. Fortunately Scholar'sEdge has such a clean share. In addition the broker in question is insisting that trading in 529 shares be facilitated through the electronic network used by the brokerage firm, and that application forms created by the brokerage firm be used. As a fiduciary and business matter this requires operational adjustments by 529 plan providers as well as review of the broker's documents to make sure that the disclosures and protections necessary for investors and the plan and its providers are in those documents. Any such documents will be presented to board staff and counsel for prior review and approval.

Another firm, Merrill Lynch, is requiring all 529 plans sold by it to be on a common commission schedule, and the only 529 plans that will be sold nationally by the firm must be on the firm's omnibus platform. Scholar'sEdge is not on the platform. He noted that 75% of the Scholar'sEdge plans sold by this firm are to New Mexico residents. It may not be practical to make the plan available nationally through this firm even though it is a significant source of business for then plan. Principal is exploring whether or not it thinks the firm's overall relationship with Merrill Lynch may still make it worth it to establish the omnibus relationship.

7) CLOSED SESSION PURSUANT TO NMSA 10-15-1(H)(6)

At this point the Chair called for a motion to go into closed session to discuss contract matters as provided by NMSA 10-15-1(H)(6). Dr. Garcia so moved, and Mr. Green seconded the motion. Each board member present was individually polled. Each responded by supporting the motion.

The Chair called for a motion to move on of closed session into open session. She noted that the only matters discussed were those permitted by the statute, and that no action had been taken. Dr. Garcia so moved. Mr. Green seconded the motion. The board members present were individually polled. Each responded by supporting the motion. The board moved back into open session

8) ADJOURNMENT

MS. Liggett asked for a motion to adjourn the meeting. Dr. Garcia so moved. Mr. Green seconded the motion. The vote to adjourn was unanimous.

The meeting adjourned at 12:30 PM