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
SANDRA LIGGETT, CHAIR
ROBERT J. DESIDERIO, VICE-CHAIR
DR. JOSE Z. GARCIA
LAWTON DAVIS
MONT GREEN

THEODORE MILLER
EXECUTIVE DIRECTOR

APPROVED
Vera Lyons
Board Secretary
6/4/2020

Meeting Minutes of April 30, 2020 9 a.m.

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

ETB Staff
Ted Miller, Executive Director
Carolyn Fittipaldi, Marketing Director
Vera Lyons, Board Secretary

Meketa Investment Group
Kay Ceserani, Managing Director
David Hetzer, Principal, Research
Orray Taft, VP, Fiduciary Management

HoganLovells
Helen Atkeson, Partner

SommerUdall
Kurt Sommer, Partner

Morton Accounting Services
Janet Pacheco-Morton, CPA

Ascensus
Tom Hewitt, VP Relationship Management
Jay Candelmo, SVP Head of Relationship Management
Tom Lowe, VP Investment Management

Principal
Paul Schieber, Managing Director, 529 Distribution
Kamil Bhatia, President & CEO, Principal Funds
Michael Scholten, CFO, Principal Funds
Randy Welch, Managing Director, Portfolio Manager
James Fennessey, Portfolio Manager, Director of Research
Jori Horn, 529 Marketing Director
Kris Goeden, Director National Accounts
Tracy Bollin, Managing Director, Principal Funds Operations

1) **CALL TO ORDER**

The meeting was called to order at 9:15. There was a quorum and all five board members were present.

2) **APPROVAL OF AGENDA**

Ms. Liggett called for a motion to review the agenda. Mr. Green so moved. Mr. Davis seconded the motion. The vote to approve the motion was unanimous.

3) PUBLIC COMMENT

Ms. Liggett next asked if there was any public comment. There being none, she moved to the next agenda item.

4) INVESTMENT CONSULTANT'S REPORT

a) Market Update

Ms. Ceserani introduced Orray Taft from Meketa's Fiduciary Management Group. Mr. Taft noted that he was also a member of the Global Macroeconomic Working Group that is responsible for producing the economic and market update that was being presented to the board.

Mr. Taft described a significant number of economic statistics including market returns around the world for both stack and fixed income securities, year-to-date sector returns, the plunge in oil prices and volatility. He also compared the policy response to the current crisis with the policy response in the 2007-2009 financial crisis. He noted that the current crisis developed more rapidly as did the policy responses.

He also discussed inflation expectations, credit spreads on both investment grade and high yield securities, jobs data, small business confidence and the manufacturing data for the US, Eurozone and China. He then discussed the policy responses to the crisis in detail as well as the federal re-opening recommendations.

Mr. Taft noted several aspects of the economic impact of the crisis including supply chain disruption, labor force impacts, decline in business and consumer sentiment, the deterioration in markets and the wealth effect among consumers.

Looking forward he said that Meketa expected significant economic impact and a global recession. The length and the depth of the recession would be governed by the course of the disease and the effectiveness of various countries' responses to it, the amount of central bank and government support and heightened volatility.

He then reviewed this crisis in comparison with past crises, noting the degree of the decline in stock markets and the timeframe for each past recovery.

Mr. Davis expressed the view that the economic crisis would be deep and without a V-shaped recovery. Mt. Taft said he agreed that a V-shaped recovery was unlikely. Dr. Garcia asked as to the effect on the 529 program. Mr. Hewitt noted that the 529 program along with other 529 programs serviced by Ascensus had not yet seen significant withdrawals or reductions in contributions. He said the board would be kept informed as to changes in account owner behavior as well as any reduction in account openings.

b) BBB Securities Discussion

Ms. Ceserani then presented Meketa's BBB securities report. She noted that Meketa and Board staff had presented a report at the last board meeting on April 3rd about the general account securities holdings of both New York Life and Principal Life since these general accounts backed the guaranteed investment contracts that form the underlying funds for the Capital Preservation Portfolios in both The Education Plan and Scholar'sEdge respectively.

Ms. Ceserani began by reviewing the size of the BBB securities market in the US. She noted that there were over $3 trillion worth of BBB securities on the market. These securities are considered the lowest-rated investment grade securities. The issue for investors is the extent to which BBB securities will suffer credit downgrades to non-investment grade or "junk" status. Such securities are called "fallen angels".

She observed that fallen angels will suffer a reduction in market value, and there may be liquidity concerns when trying to sell them. In addition fallen angel securities would have to be sold by any fund that can invest only in investment grade securities. Many large bond index funds have this limitation.

At the request of board staff Meketa had reviewed the credit quality of all the 15 fixed income funds in the 529 program. Ms. Ceserani noted that the program has 7 funds with meaningful overweight to BBB securities. She observed that two funds have benchmarks that are consistent with the overweight – the Vanguard Ultra Short Term fund and the Vanguard Total International Bond fund. Two other funds are below investment grade focused – the Vanguard High Yield Corporate Bond fund and the MainStay Mackay High yield Corporate Bond fund.

The remaining 3 funds have varying degrees of overweight to BBB securities. The PGIM fund has only a 3% overweight, which she did not think would overly impact the performance of the fund relative to its benchmark. The TIAA-CREF Core Plus Bond fund has a 22.0% weighting to BBB securities, and the Principal Core Fixed Income fund has a 30.5% weighting to BBB securities. She noted that both funds are actively managed and employ teams of security analysts to review fund holdings. Due to this overweight Ms. Ceserani stated that Meketa would continue to monitor the BB securities markets for potential impact on the funds.

Mr. Miller asked Mr. Welch of Principal if he had any comments on the Core Bond fund. Mr. Welch stated that BBB securities were commonly used to add investment return to the portfolios, especially in a low interest rate environment. He then observed that the average credit quality of the fund was rated as A+.

Mr. Miller then told the board that this review completed the initial review of the credit quality of funds in the program, and that Meketa would continue to monitor the situation and report as appropriate to the board and staff.

c) Watch List Recommendations

Ms. Ceserani then provided the board with Meketa's watch list review and recommendations. She noted that the Vanguard Developed Markets fund qualified for "Monitor" status. This was due to short-term underperformance issues that she identified as being caused by the "Fair Value" pricing procedure employed by the fund. This procedure takes account of changes in the market value of securities between the time that foreign markets close and the US markets close. In some cases the effect is positive and in other cases negative for valuation of the fund's units. She stated that Meketa would continue to monitor the fund and update the board to ensure that the current underperformance is temporary.

She then turned to the Principal SystematEX fund. She noted that the fund was currently on watch, and recommended that it be maintained on watch status for both qualitative issues of underperformance as well as for the qualitative issue that the fund may be merged with the Principal Diversified International fund in the near future.

Mr. Welch noted that the fund had been on watch within Principal itself, it had been closed to new shareholders, and there was a recommendation to merge the fund as Ms. Ceserani mentioned.

Ms. Liggett called for a motion to retain the Principal SystematEX fund on watch status. Mr. Green made the motion. Mr. Davis seconded the motion. The vote to approve the motion was unanimous. She then called for a motion not to place the Vanguard Developed Markets fund on watch status but to continue to monitor it. Mr. Green made the motion. Mr. Davis seconded the motion. The vote to approve the motion was unanimous.

5) RECOMMENDATION FOR REPLACEMENT OF PRINCIPAL SYSTEMATEX FUND

Ms. Liggett then asked Mr. Welch to address Principal's recommendation for a replacement fund for the SystematEX fund. Mr. Welch noted that the SystematEX fund had been under review at Principal due to recent performance issues. It was placed on the quantitative watch list for underperformance, and then placed on qualitative watch when the portfolio manager was removed from the fund.

Principal started screening for funds in the Morningstar Foreign Large Blend category, with assets over $1 billion, Morningstar rating of 4 to 5 stars, holding between 70-200 securities and an expense ratio of 80 basis points or lower.

Principal also worked with Meketa to identify additional funds, and to narrow the list of finalist funds. He stated that based on the analysis of the finalist funds, Principal is recommending that the Principal Diversified International R6 fund replace the SystematEX fund.

He also noted that the recommended fund is slightly more expensive than the SystematEX fund, and that the current fee structure could be retained by reducing the split between active and passive US large cap funds in the affected portfolios from 60-40 to 50-50.

He then turned to Mr. Fennessey to review the finalist funds, and to explain the basis for the recommendation.

Mr. Fennessey noted that the four finalist funds were:

Principal Diversified International Fund;

Causeway International Value Fund;

Hartford International Opportunity Fund; and

T. Rowe Price Overseas Stock Fund.

Each of these funds was reviewed for strategy, characteristics and performance over recent quarter, 1, 3 5, and 10 years.

In addition each fund was reviewed for MPT statistics over 3, 5 and 10 year periods.

Morningstar star and medal ratings were also considered.

Finally a proprietary quantitative due diligence score was given to each fund which considered 1,3 and 5 year peer group rank, 3 and 5 year information ratio, and 3 and 5 year capture ratio.

The Diversified International Fund had the highest due diligence score.

Mr. Fennessey also noted that the proposal to alter the active versus passive ration of US large cap equity for the Year of Enrollment Portfolios and the Asset Allocation Portfolios would result either in no fee change to the Portfolios or a slight reduction in fee in some cases. The standalone Non-US Equity Portfolio would increase from 0.92 % to 1.01%.

Ms. Ceserani then introduced David Hetzer of Meketa's Research Group. She and Mr. Hetzer then presented the Meketa review of the Principal report and recommendation for fund replacement.

They noted that Principal had worked with Meketa to identify a short list of funds. Meketa then considered five factors and scoring weightings in reviewing the funds:

Organization (16.6%);

Investment Team (16.6 %);

Investment Philosophy (16.6%);

Investment Process & Risk Management (25.0%); and

Performance & Fees (25.0%).

Other considerations included maintaining fee neutrality for multi-fund Portfolios as well as Morningstar star and analyst (medal) ratings.

Based on these criteria the Principal Diversified International was ranked first among the four finalist funds. Meketa observed that the Principal fund was not the lowest priced fund in the group, but was in the lower range of pricing. They noted that Principal had proposed adjusting the ratio of US large cap equity funds from 60% active – 40% passive to a mix of 50% active -- 40% passive. This caused the multi-fund Portfolios to either maintain current pricing levels or have a slight reduction in overall fees.

Meketa supported the Principal recommendation that the board approve the Principal recommendation of a replacement fund.

Ms. Liggett called for a motion to approve the replacement of the Principal SytematEX fund with the Principal Diversified International R6 fund as recommended by Principal and supported by Meketa. The

Vice-Chair, Mr. Desiderio so moved. Mr. Green seconded the motion. The vote to approve the replacement was unanimous.

The Chair then called for a motion to adjust the US large cap equity ratio in the multi-fund Portfolios from 60% active-40% passive to 50% active 50% passive as recommended by Principle and supported by Meketa. The Vice-Chair made the motion. Mr. Green seconded it. The vote to approve the motion was 4 ayes and 1 nay. Mr. Davis voted against the motion.

At this point Mr. Hewitt from Ascensus and Mr. Bolin from Principal stated that although the plan was to replace the fund in Scholar'sEdge by June 5th, the fund's board of directors was being asked later in the day to approve a merger of the SystematEX fund into the Diversified International fund set for later in June. They noted that the fund's shareholders as of May 1 would be mailed proxy voting materials. This list would include the board. They requested that the board also approve the merger of the SystematEX fund into the Diversified International fund. Counsel was consulted at the meeting, and she concluded that there did not seem to be any reason not to approve the merger given the facts of the matter.

Ms. Liggett called for a motion to approve the merger of the SystematEX fund into the Diversified International fund. Dr. Garcia made the motion. Mr. Green seconded the motion. The vote to approve the motion was unanimous.

6) PRINCIPAL AND ASCENSUS BUSINESS UPDATES

Mr. Schieber of Principal then introduced Kamal Bhatia, President & CEO, and Michael Scholten, CFO, of Principal Funds. Mr. Bhatia gave an over view of the most recent quarter for Principal Financial Group. He noted that the first two months of the quarter had been very good for the company. Pre-tax operating earnings were $386 million and net income was $1.04 per share. These were down from the same quarter in the previous year, but still positive. The common stock dividend was increased by 4% to $.56 per share. All major business segments had positive earnings except for its corporate segment. He also noted the strong credit rating of the company, and the availability of $3 billion of company cash and liquid assets and $800 million of revolving credit facilities.

He noted that there was a high degree of uncertainty about the effects of the COVID crisis and the economic lockdown on the next several quarters.

Mr. Scholten the Principal Funds business. He noted that first quarter mutual fund sales were a record $7.9 billion. In response to a question from Ms. Ceserani he stated that margins in the investment management business, Principal Global Investors, were at 32.6%, and within the normal range for the business. He observed that the Retirement and Income Solution business was still integrating the Wells Fargo retirement business acquisition. There was a 14% increase in recurring deposits from the previous year. He noted that 64% of Principal Investment options were above median on a one year basis, 77% on a three year basis And 80% on a five year basis. 73% of fund level assets under management had a 4- or 5-star rating.

Mr. Hewitt then introduced Jay Candelmo, SVP Relationship Management at Ascensus. Mr. Candelmo noted that Ascensus had a mix of recordkeeping and administrative businesses with a mix of both asset based fees and hard dollar fees. The largest of the business is the retirement business where hard dollar fees predominate. The firm had not yet seen a significant decrease in these fees.

He expected that over the next several quarters it could develop that 529 investors and retirement plan participants could decrease contributions or take withdrawal from the plans for other purposes. In addition companies could reduce or eliminate company matches to the retirement plans. He noted that there were early indications that 529 investors were reducing recurring contributions.

Mr. Hewitt told the board that as of yet the New Mexico 539 plans were holding stable, but that he would continue to update the board and its staff on developments.

7) PROPOSED BUDGET FOR FY 2021

Mr. Miller then introduced Ms. Pacheco-Morton and asked her to present the proposed budget for FY 2021. She began by noting that projected revenue for the year was $2.642 million, and that projected expenses were proposed at $3.325 million. This meant that the reserve in the program administration fund would be used to cover the projected deficit of $683.000. She stated that revenue had been projected conservatively with a reduction in both fee revenue and investment income. She also noted that, compared to the marketing revenue for FY 2021, FY2020 marketing revenue had been dramatically increased due to final payout of marketing dollars negotiated with Invesco as well as the commitment of marketing dollars under the new contract with Ascensus. She observed that board management had determined that the spending on marketing should be increased to slightly above the level of FY2020, due to the need to continue the momentum for growth in accounts in The Education Plan.

Mr. Davis questioned the proposal for increased marketing dollars given the economic environment. Mr. Miller stated that the proposal was designed to keep the 529 program in the public eye despite the economy, and that the program had for a number of years not spent the money required to raise awareness of the program with the public in New Mexico or, in the case of digital advertising, nationally. He reminded the board that the New Mexico program was one of the lowest cost in the country – competitive with states like California and New York. Gaining both in-state and out-of-state accounts was crucial to keeping the costs down for New Mexico families that save for college.

Mr. Miller also noted that the proposed spending was entirely discretionary with the board and its staff. The major marketing vendors all had contracts that provided for a maximum amount of spending, but did not guaranty them that amount. It was within the discretion of the board to reduce the spending at any time.

Ms. Pacheco-Morton then continued on with the presentation. She reviewed expenditures in more detail, including contractual services, travel, rent, utilities, dues and subscriptions and others. She also reviewed comparisons for the proposed budget and the previous two years for both revenue and expenses and the change in the program administration fund balance. She noted the variances in each category.

With regard to the program administrative fund balance, Mr. Miller noted that he had advised the board on a number of occasions that three years' of operating reserves should be held in the fund to provide for market downturns that affect revenue as well as unforeseen expenses such as the cost of litigation. He noted that FY2021 could well be such a time.

Ms. Liggett called for a motion to approve the proposed FY2021 as presented to the board. Mr. Davis so moved. Vice-Chair Desiderio seconded the motion. The vote to approve the motion was unanimous.

8) EXECUTIVE DIRECTOR'S REPORT – Ted Miller, Executive Director

a) FY2020 Q2 Financial Report -- Janet Pacheco-Morton, Morton Accounting Services -- discussion and possible action

Mr. Miller asked Ms. Pacheco-Morton to review the quarterly financials for both the trust funds and the program administration fund.

Ms. Pacheco-Morton began with the thrust funds. She noted the decrease in the trust assets since the last quarterly report. She noted that this was a combination of the decrease in market value of assets due to the recent adverse markets as well as continued redemptions in excess of subscriptions.

Overall the fiduciary net positions had decreased for the quarter to $1,686,098,519 for Scholar'sEdge and to $527,956,072 for The Education Plan.

She then reviewed the program administration fund. The total net position of the non-reverting fund had increased by $1,276,005 since the beginning of the year to $11,405,112. She observed that this increase was due to additional negotiated payments received from OppenheimerFunds/Invesco for the fiscal year as the outgoing program manager as well as negotiated payment of current year marketing moneys from Ascensus to the board as the incoming program manager. She noted that this double payment was a one-time matter and that in future fiscal years Ascensus would provide marketing money at the beginning of each fiscal year for the board's use pursuant to its contract.

Ms. Pacheco also noted that fee revenue and interest income were roughly in line with budget with three months remaining in the fiscal year, but that a decrease in interest income and fee revenue were a possibility for the coming quarter.

Turning to expenses she observed that contractual expenses and other expenses were running within budget for the current year. Within the "Other Costs" category she noted that travel expenses were readjusted downward and Communications, Dues & Subscriptions and Employee Training & Education were adjusted slightly upward. All these categories of expense are under the same state expense code and readjustments are permitted under state budget rules. Overall Other Costs were in line with the budget for the current year.

To conclude she reviewed the current year actuals against the prior year actuals. Revenues were ahead of last year's actuals by $911,638 and expanses also were greater than last year's actuals by $505,115.

Ms. Liggett called for a motion to accept the quarterly financials for the trust funds and the program administration fund as presented to the board. Vice-Chair Desiderio made the motion and Mr. Davis seconded it. The vote to approve the motion was unanimous.

b) Contract Amendments – discussion and possible action

Mr. Miller called the board's attention to the forms of three separate contract amendments.

i) HoganLovells

Mr. Miller asked that the professional services contract for HoganLovells for legal services be amended to extend it for one year in the amount of $250,000 plus any applicable GRT.

Ms. Liggett called for a motion to approve the amended contract. Mr. Desiderio so moved and Mr. Davis seconded the motion. The vote to approve the motion was unanimous.

ii) Esparza

Mr. Miller asked that the professional services contract for Esparza for digital marketing services be amended to extend it for one year in the amount of $800,000 plus any applicable GRT.

Ms. Liggett called for a motion to approve the amended contract. Dr. Garcia made the motion and Mr. Davis seconded it. The vote to approve the motion was unanimous.

iii) Sunny505

Mr. Miller asked that the professional services contract for Sunny505 for traditional media marketing be amended to extend it for one year in the amount of $550,000 plus any applicable GRT.

Ms. Liggett called for a motion to approve the amended contract. Mr. Davis made the motion and Vice-Chair Desiderio seconded it. The vote to approve the motion was unanimous.

9) EVALUATION COMMITTEE RECOMMENDATION FOR INDEPENDENT AUDITOR FOR FY2020

Ms. Liggett asked Mr. Miller to present to the board the Evaluation Committee's recommendation for award of the independent auditor's contract for FY 2020. Mr. Miller referred the board to the Evaluation Committee's written report. He noted that two audit firms had responded to the RFP, and the both proposals merited consideration by the Committee.

He stated that, based upon Committee's review of the two proposals, it was recommending that CliftonLarsonAllen be awarded the contract for the FY2020 audit. He noted that the firm achieved the greatest number of points based upon the scoring criteria in the RFP.

The firm was particularly strong in three areas: experience with large collective trust funds, strength of staff assigned to the audit and strong references from major New Mexico states government departments.

Ms. Atkinson and Ms. Pacheco-Morton both spoke in support of the recommendation as members of the Committee.

Ms. Liggett called for a motion to award the contract to CliftonLarsenAllen subject to the required approvals of OSA and DFA. Dr. Garcia so moved and was seconded by Mr. Davis. The vote to approve the motion was unanimous.

10) ADJOURNMENT

At this point Ms. Liggett called for a motion to adjourn. Vice-Chair Desiderio so moved, seconded by Mr. Davis. The meeting adjourned at 12:35 PM.