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

Meeting Minutes of December 2, 2015
New Mexico Higher Education Department, 5201 Eagle Rock Rd. Suite 1A Albuquerque, NM

APPROVED
Vera Lyons
Board Secretary
3/24/16

Board Members in Attendance
Dr. Barbara Damron - Chair
Robert Desiderio - Vice Chair
Dr. Jose Z. Garcia - Member
David Jansen - Member
Mark Jarmie - Member

Other Individuals in Attendance
Theodore Miller - Executive Director ETB
Vera Lyons - Board Secretary
David Mathews - HED/ETB Attorney
Helen Atkeson - Partner, Hogan Lovells US LLP
Del Esparza - Esparza Advertising
Emily Howard - Esparza Advertising
Lynn Komer - PK Public Relations
Kay Ceserani - Pension Consulting Alliance
Andrea Feirstein - AKF Consulting
Teresa Ward - OppenheimerFunds
Bill Raynor - OppenheimerFunds
Ken Henry - OppenheimerFunds
Chris Werner - OppenheimerFunds
Michele Nelson - Court Reporter
Dori Henry – Member of the public

AGENDA

1) CALL TO ORDER

The Chair called the meeting to order at 1:01 PM. The roll was called and all Board Members were present. Dr. Damron called on the other attendees to introduce themselves as well.

2) PUBLIC COMMENT

Dr. Damron called for public comment. There being none, the Chair moved on to the next agenda item.

3) APPROVAL OF AGENDA

Dr. Damron noted the agenda as presented to the Board and asked if there was any comment on the agenda. There being none, she called for a motion to approve the agenda as presented. Dr. Garcia so moved and Mr. Jarmie seconded the motion. The motion passed unanimously.

4) APPROVAL OF MINUTES

The Chair then turned to the minutes of previous meetings.

a) August 19, 2015

Dr. Damron asked if there was any discussion or comment on the minutes for this meeting. There being none, she called for a motion to approve the minutes of the August 19 meeting as presented. Dr. Garcia so moved. Vice Chair Desiderio seconded the motion. The motion was approved with the abstention of Mr. Jarmie who was not present at the meeting of August 19.

b) September 16, 2015

Dr. Damron then asked if there was any discussion or comment on the minutes of this meeting. There being none, she called for a motion to approve the minutes of the meeting of September 16. Mr. Jarmie so moved. Vice Chair Desiderio seconded the motion. The motion was approved with the abstention of Dr. Garcia who was not present at the meeting of September 16.

5) PROGRAM ADMINISTRATION FUND

Mr. Miller reported that the program administration fund balance at the end of October was slightly in excess of $6 million. He also reported that the fund has been entered in the state's SHARE accounting system. Also, for the first time, the Board's two 529 plans will be entered into the SHARE system. This will assist future independent auditors when performing the annual audit.

Mr. Desiderio noted that a recent state auditor's report on available funds in state government listed the program administration fund as such a fund. Mr. Miller stated that the new characterization of the fund as restricted on SHARE should alleviate that problem going forward.

6) INTRODUCTION OF TERESA WARD AND CHRIS WERNER

Dr. Damron then introduced Teresa Ward and Chris Werner from OppenheimerFunds to the Board. Mr. Miller also noted that the Oppenheimer organizational chart was in the Board's materials. This helps locate the 529 business inside the company, and identifies key executives in the relationship.

Mr. Raynor noted the long tenure of Teresa Ward at OppenheimerFunds and her background in the retirement business. This business has certain similarities with the 529 business. Ms. Ward will head the 529 marketing effort at OppenheimerFunds. Mr. Werner will head the 529 sales team.

Ms. Ward and Mr. Werner spoke briefly about their business backgrounds. Mr. Raynor noted that the changes in management of the 529 business at OppenheimerFunds would allow greater focus on the individual roles of marketing and sales.

7) CLOSED SESSION PURSUANT TO NMSA 10-15-1(H)(6) TO DISCUSS THE COMPETITIVE SEALED PROPOSALS FOR INVESTMENT CONSULTANT AND THE NEGOTIATION PROCESS FOR THE INVESTMENT CONSULTANT CONTRACT

Vice-Chair Desiderio made a motion that the Board go into closed session pursuant to NMSA 10-15-1(H)(6) to discuss the competitive sealed proposals for the investment consultant and the negotiation process for the investment consulting contract.

The motion was seconded by Dr. Garcia. All Board members with the exception of Mr. Jarmie voted to move into closed session. Mr. Jarmie abstained due to the fact that he had known Ms. Feirstein since their attendance at the same law school 30 years ago. Ms. Feirstein is a subcontractor to one of the bidders for the investment consulting contract.

The Board was in closed session from 1:28 Pm to 1:55 PM.

Dr. Damron called for a motion to move out of closed session. Mr. Desiderio so moved. The vote was unanimous to move out of closed session.

8) INVESTMENT CONSULTANT CONTRACT

After the Board moved back into open session Mr. Desiderio made a motion that the contract for investment consulting services be awarded to Pension Consulting Alliance substantially in the form presented to the Board. The motion was seconded by Mr. Jansen. The motion was passed by voice vote of each of the members present, with Mr. Jarmie abstaining.

9) PROPOSED CONTRACT FOR ACCOUNTING SERVICES

Mr. Miller noted that for several years the independent auditor had noted a material weakness with the timely reconcilement of cash balances in the program administration fund. This was due in large part to the lack of trained staff to perform the necessary work. He noted also that on May 23, 2015 a fulltime financial coordinator hired. In order to improve the quality and timeliness of financial oversight and reporting, and to review and make recommendations with regard to appropriate policies and procedures with regard to such accounting, Mr. Miller asked the Board for authority to issue a contract for accounting services. This would be a so-called small contract with a value of $50,000 plus gross receipts tax. This issuance would not require the creation of a request for proposals.

Dr. Damron noted that this type of service was procured from time to time by a number of state agencies. Dr. Damron as for a motion to approve the issuance of such a contract. Mr. Jarmie so moved. Mr. Jansen seconded the motion. The vote to approve the motion was unanimous.

10) ETB MARKETING INITIATIVES UPDATE FOR FY 2016

Mr. Esparza of Esparza Advertising advised the board as to the initiation of the TV, radio, and social media advertising campaigns for FY 2016. He then introduced Lynn Komer of PK Public Relations. Ms. Komer has been subcontracted by Esparza to design and to coordinate a public relations campaign in New Mexico for the 529 program. Ms. Komer outlined some of the efforts that form part of this strategic campaign, including editorial round tables and the placement of articles in publications with wide circulation in New Mexico such as the state employee newspaper and church publications.

Mr. Esparza then asked Ms. Howard to review the metrics associated with the current marketing campaign. She reviewed new account and new asset growth for The Education Plan. She also noted increases in website traffic and website account establishment. She also reviewed the move into social media such as Facebook. This move increases dramatically the number of people who have exposure to the name and message of The Education Plan.

She noted that Cumulus Radio Group had offered to host a discussion of the 529 program in a 15 to 30 minute segment featuring Dr. Damron. This will run on all seven Cumulus Radio stations.

Ms. Howard also discussed the sponsorship by The Education Plan of the Dinosaur Discovery exhibit at The Museum of Natural History.

Mr. Esparza then asked Mr. Miller to outline three additional initiatives designed to promote and grow the 529 program.

Mr. Miller first turned to the concept of an initial and matching grant program. About 10 states offer some form of grant program to encourage the formation and funding of 529 accounts. Mr. Miller noted that Esparza had contracted with the Center for Educational Policy Research at UNM (CEPRS) to conduct a study of existing grant programs, to determine best practices, and to make recommendations as to models that might be a good fit for New Mexico. The study should be complete by the end of January, and the Board would receive recommendations with regard to such a program in FY 2016.

Mr. Jarmie noted that the New Mexico Constitution had an anti-donation clause that could conflict with such a program. Mr. Miller noted that any such program would be based in part on the element of financial need, and that several other states had imposed a need requirement on their programs.

Mr. Miller then turned to a Memorandum of Understanding among the Board and the National Association of Secondary School Principals (NASSP) and OppenheimerFunds.

He noted that OppenheimerFunds and the Board had been approached by the NASSP to be a strategic partner in the awarding of 500 scholarships of $500 each to be awarded nationwide to members of the National Junior Honor Society. These awards would take to form of $500 accounts in The Education Plan.

Dr. Garcia asked why it was necessary to have a Memorandum of Understanding on this matter. Mr. Miller noted that an MOU is a non-binding document, and that NASSP wanted some indication of the commitment of the Board to the scholarship program.

The NASSP intended to have its awards ceremony in Albuquerque, and the association of The Education Plan with the National Honor Society would be beneficial to the Plan. The event will involve high-level New Mexico government officials including, if possible, Governor Martinez.

Mr. Miller observed that the cost of the scholarships would be borne by NASSP and that the primary costs to The Board would be in supporting the event in Albuquerque.

He also noted that, due to the selection methodology, the chances are good that there will be New Mexico award winners.

Mr. Jarmie mode a motion that the Board enter into the Memorandum of Understanding. Mr. Jansen seconded the motion. The motion was approved unanimously.

Finally, Mr. Miller also addressed the creation of a default investment option for The Education Plan.

He noted that many people do not complete the account opening process for the Plan because they are intimidated by the process of selecting investments. This was a perennial problem in 401(k) programs until the defined contribution industry, working with its principal regulator, the Department of Labor, promulgated rules for the creation of Qualified Default Investment Alternatives (QDIA) in defined contribution plans. A QDIA permits the participant in the plan who does not select an investment option to have contributions placed in the QDIA as a default selection.

He also noted that several states had already adopted such an option.

ETB staff, with the assistance of outside ERISA counsel, has been reviewing the creation of an analogous option for The Education Plan. While ERISA does not regulate the activities of 529 programs, it does provide a sort of guide as to how to implement and maintain a default investment option for The Education Plan.

Because the Board is governed by New Mexico law with regard to investments, Mr. Miller also recommended that the Board vote to approve the issuance of a small contract for legal services with a well-qualified expert on New Mexico fiduciary law. Vice Chair Desiderio made a motion to approve the issuance of such a contract. Mr. Jarmie seconded the motion. The vote to approve the motion was unanimous.

At this point the Board took a 10 minute break from 2:40 PM until 2:50 PM.

11) PROGRAM MANAGER'S QUARTERLY REPORT

a) Marketing Report

Mr. Raynor began the marketing report by acknowledging that the board wanted to see the account loss in the ScholarsEdge plan and the slow growth in The Education Plan turned around. He introduced Mr. Werner again and asked him to present his views on marketing the plans, in particular ScholarsEdge.

Mr. Werner began by noting the drop off in accounts, and he expected that the steady 3% drop off in accounts would continue for the next few quarters. He noted the general downward trend in the advisor industry. Fewer people use commission based advisors. More investors are investing directly on their own, including the use of automated services known as "robo-advisors". More investors are turning to exchange traded funds and to index funds for investment.

To overcome these trends requires a strong sales effort. Oppenheimer utilizes a team of four 529 specialists to train advisors about 529 plans. The firm also maintains a staff of 100 telephone sales representatives as well as around 40 529 call representatives.

He noted that one of his primary efforts will be to engage the telephone sales force, many of whom are new since the financial crisis, and to train that sales force in 529. Also he will be working with Ms. Ward to train new Oppenheimer personnel in the basics of 529. Training in 529 will become mandatory for new employees. Videos will be created to assist in the training effort.

A new 529 specialist has been hired to work in Mr. Werner's old territory of the central states as well as the south.

He was optimistic that the wide variety of funds available in ScholarsEdge would be of interest to advisors.

He will be doing more work to understand who the successful 529 advisors are, and to reach out to them more. He will also increase resources for training advisors in 529, including an online video training effort. He will also be gathering more data on the firms that sell the 529 plan and the volume of sales from each firm as well as the advisors at each firm. The analysis will also include data on the regions of the country where the 529 plan is sold. States with no income tax deduction for the home state's plan or states with tax parity for all plans will be targets. In each state the Oppenheimer sales people will also be monitored for their 529 sales efforts. Efforts will be made to reward successful 529 sales people with added compensation.

He noted that more than half of ScholarsEdge new sales result from the "national" telephone sales desk. These people call the smaller broker-dealers. The enhanced individual fund lineup should improve opportunities with this channel. The new funds give the national sales desk a reason to call the broker-dealer and have a useful conversation. This sales group, which consists of younger people, will be given added training on ScholarsEdge. In addition they will be able to handoff a call to a 529 call center representative

Mr. Jarmie asked Mr. Werner when he expected to see results from his new sales plan. Mr. Werner noted that his sales plan first needed to be approved in the early first quarter. Then implementation would begin. He expected results to be noticeable in the third quarter.

At this point Vice Chair Desiderio left the meeting.

At a previous board meeting Mr. Jansen had expressed an interest in seeing how the industry was doing generally. Ms. Feirstein had prepared both an industry update and a fiduciary presentation for the meeting. At this point she was asked to present the industry update.

Ms. Feirstein noted that the 529 industry had seen a change from being primarily advisor-sold to being primarily direct-sold. She also noted that The Education Plan had an average account size that was somewhat above the national average, whereas ScholarsEdge had a well below-average account size by the same comparison. Ms. Feirstein thought that the smaller than average account size in ScholarsEdge was the result of the aging out of the accounts combined with the failure to replace these accounts with new accounts.

She acknowledged that Mr. Werner was on the right track in his suggested marketing plan, but that it requires a long lead time to see results. She did not expect to see results before the third quarter of the year.

Ms. Feirstein noted that a few years ago the 529 market was primarily an advisor-sold market – with 70% of sales through that channel. Today only 47% of sales are through the advisor sold channel. Account growth is now primarily in the direct-sold channel. In the end Ms. Feirstein thought that the controlling factor for the success of a 529 program is to increase the number of accounts - even if those accounts have relatively low account balances. New accounts are likely to have smaller balances, but the new accounts will grow in size.

She noted that over the last several years direct-sold accounts have been growing at a 6.5% pace while advisor-sold accounts have been growing at a 1.6% pace. ScholarsEdge has been losing accounts at over a 3% pace during the same period.

Ms. Feirstein noted that the direct-sold channel is growing substantially faster probably due to increased awareness of the opportunity, lower fees, and more high net worth individuals being willing to control their own investments.

Mr. Jansen asked Mr. Werner whether or not he thought that Oppenheimer could meet the account and new asset goals to which the firm agreed. Mr. Werner said that this was possible.

Ms. Feirstein noted that her firm had the ability to track Oppenheimer's performance in this regard against not only the industry but against a peer group within the industry.

Mr. Jarmie noted that the data provided by Ms. Feirstein indicated that The Education Plan was growing 5% slower than the direct-sold industry average, and that ScholarsEdge was losing an average of 3% of accounts per year while the industry was growing at about2% per year. He noted that Oppenheimer has some work to do.

b) Investment Performance Report

Dr. Damron asked Mr. Henry to give the OppenheimerFunds quarterly performance report. Mr. Henry noted that this was the first quarterly report that included the new investment lineup launched at the end of August. The report began with some new investment performance summary to aid the Board in its review. Mr. Henry provided an explanation of how the new summary was constructed.

Mr. Henry commented on the implementation of a broker-dealer fee reduction for the B and C share classes of the Capital Preservation Portfolio in ScholarsEdge. The Board approved this reduction previously, and the reduction from 1% to ½% in the fee allowed these two share classes to generate positive returns to investors.

He also noted the outstanding performance of the Oppenheimer International Small Company Fund. The fund is changing its name on December 29 to the International Small-Mid Company Fund because of its investment in mid-cap as well as small-cap stocks.

Mr. Henry reminded the Board of the new SEC rules regarding money market funds that take effect in October, 2016. These rules will limit the liquidity and affect the pricing of traditional money market funds. The exception to the new rules will be a money market fund that invests in government securities only. Such a fund will be able to maintain liquidity and a stable $1 per unit value. Oppenheimer will be converting its Institutional Money Market Fund to take advantage of the exception to the new rules.

Mr. Henry noted that the 3rd quarter was a difficult one for the equity markets. The S&P 500 was down 6%. He observed that a number of the Portfolios performed reasonably well against their respective benchmarks, although returns for the Portfolios were negative for the quarter.

At the conclusion of Mr. Henry's remarks Mr. Miller stated that it was his intention to have continued training sessions from the Board's investment consultant on such matters as the construction and use of performance benchmarks, the attribution of returns in the underlying funds that make up the Portfolios, and the use of structured securities or other sophisticated investments, if any, in the underlying funds.

12) INVESTMENT CONSULTANT QUARTERLY REVIEW AND WATCH LIST RECOMMENDATION

Dr. Damron then asked Ms. Ceserani of Pension Consulting Alliance to give the quarterly review and watch list recommendation. Ms. Ceserani noted that there were two new funds in the lineup, the

Oppenheimer International small-Mid Cap Fund and the Oppenheimer Capital Income Fund. Both of these are individual Portfolio options in ScholarsEdge.

She then turned to The Education Plan Portfolios. She noted that there 15 underlying funds in The Education Plan Portfolios, and that overall the watch list status of the funds was predominantly green. The Senior Floating Rate Fund was placed on watch due to organizational changes, and is the only fund with a red status.

With regard to ScholarsEdge there are 27 underlying funds and 5 of them are on watch with a red status. She also noted that one of the new funds, the Capital Income Fund was new to the ScholarsEdge plan and would have qualified for red watch status. It was performing in line with its peers, but below the benchmark. This was probably due to the ability of the Fund to invest in below-investment-grade bonds. As a new standalone fund it did not have much impact on the overall assets of the plan.

She then commented on the Rising Dividends Fund, and its long-time appearance on red watch status. She started that the asset class had been out of favor for a long time, and that the fund was actually performing well for the one-year, three-year and five-year periods compared to a peer group of similar funds. Also when compared to a benchmark that better represented the Fund's investment style (the Dividend Achievers Select Index), the Fund was performing within 20 basis points of that index.

A discussion ensued as to whether the benchmark for the Fund ought to be changed. Mr. Henry noted the mutual fund itself would not be changing its Russell 1000 benchmark. Mr. Miller recommended that the Board not formally change the benchmark away from that employed by the Fund, but that it keep that benchmark and have PCA report on the alternative benchmark for the Board's information.

He asked Ms. Ceserani what other clients were doing. She noted that some were willing to change benchmarks and other kept the original benchmark, but had the alternative benchmark reported to them as addition information.

Mr. Jarmie expressed his concern about keeping a fund on red watch list status for extended periods of time (in this case 27 months). He also agreed with Mr. Miller that the benchmark remain as stated in the Fund's prospectus.

Dr. Garcia noted that there were actually two questions before the Board. The first was whether or not to alter the benchmark for the Fund. The Board was not prepared to do this. The second question was whether or not to remove the Fund from the plan or to continue it on red watch status.

Mr. Henry noted that the Fund had a balance of only about $2 million, and that it might be difficult to select a similar fund to fill the gap. Also, replacing the fund with a better performing fund that was not in the same asset class might cause advisors to move out of the investment, since they had chosen it for exposure to that asset class.

Mr. Miller noted that the peer group of funds was generally not doing well because the investment style was out of favor. The Board would in effect be replacing one red watch status fund with another fund that would quickly go on red watch status.

Mr. Jarmie then made a motion to accept the recommendation of PCA to retain the Rising Dividends Fund, the Commodity Strategies Fund, the Total Return Fund and the Senior Floating Rate fund on watch, and to remove the Discovery Fund and the Dreyfus Research Growth Fund from watch, and finally to add the Capital Income Fund to the watch list.

Mr. Jansen seconded the motion. The motion passed unanimously.

At this point Dr. Garcia left the meeting.

13) INDUSTRY UPDATE AND FIDUCIARY BEST PRACTICES

Dr. Damron then asked Ms. Feirstein to begin her presentation on fiduciary best practices. Ms. Feirstein began by noting that the active discussions held by the Board at the current meeting were a good example of good fiduciary practice. She drew the Board's attention to the sources of fiduciary responsibility in the tax code establishing 529 plans and in state law.

She reviewed the responsibilities of OppenheimerFunds with regard to mutual fund under the Investment Company Act.

She noted that even though the securities issued by 529 plans were not regulated by ERISA or by the Investment Company Act, these statutes were looked to as a guide to fiduciary practice.

She addressed the role of a fiduciary. The principal duties of a fiduciary are a duty of care, a duty of loyalty and a duty of obedience. A duty of care requires the fiduciary to act in good faith and in the best interest of plan participants. The duty of loyalty requires the fiduciary to put the plan's interests ahead of its own. The duty of obedience requires the fiduciary to follow the plan documents and to enlist the aid of professionals when the fiduciary does not possess the requisite expertise. For example, the Board has retained PCA as an investment consultant expert in the field of investments.

She also addressed openness and transparency in Board actions. The public should be made aware of Board meetings and of the Board's agenda. The public should also have access to Board minutes.

She closed her remarks by pointing to the importance of ongoing monitoring of plan providers such as the program manager and the investment managers. She noted that the Board maintains an Investment Policy Statement and has reports from both Oppenheimer and the investment consultant, as well as oversight by Executive Director.

Dr. Damron the addressed the Board's concern that it receive ongoing training with regard to topics related to execution of its duties. Mr. Miller noted that training is scheduled into the Board meetings on an ongoing basis.

Mr. Jarmie asked Ms. Feirstein if in her view there was anything that the Board should be doing that it has not. Ms. Feirstein stated that she thought the Board's actions were appropriate and that there was not anything that the Board should be doing that it was not. The Board should continue to carefully oversee the activities of the plan's service providers, and should continue to ask hard questions about the plan in operation.

ADJOURNMENT

At this point Dr. Damron asked for a motion to adjourn. Mr. Jansen so moved and Mr. Jarmie seconded the motion. The motion to adjourn passed unanimously. The meeting concluded at 5:10 PM.