

# The Education Trust Board of New Mexico



THE HONORABLE SUSANA MARTINEZ  
GOVERNOR OF NEW MEXICO

DR. JOSÉ Z. GARCIA, CABINET SECRETARY  
NEW MEXICO HIGHER EDUCATION DEPARTMENT

BOARD MEMBERS  
DR. JOSÉ Z. GARCIA, CHAIRMAN  
ROBERT J. DESIDERIO, VICE-CHAIR  
ROBBIE HEYMAN, ESQ.  
TREVOR SERRAO

This is the APPROVED August 13, 2013 ETB meeting minutes and are the official minutes.

**Meeting Minutes of August 13, 2013 1:00 p.m.**

New Mexico Higher Education Department  
5201 Eagle Rock NE, Suite 1A  
Albuquerque NM 87113

## Board Members in Attendance

Dr. José Garcia, Chairman  
Robert Desiderio, Vice-Chairman  
Robbie Heyman, Member  
Trevor Serrao, Member

**APPROVED**

## Other Individuals in Attendance

Kevin Deiters - Executive Director  
Angela Gallegos - Board Secretary  
David Mathews - HED Attorney  
Helen Atkeson - Partner, Hogan Lovells US LLP  
Bill Raynor - OppenheimerFunds  
Ken Henry - OppenheimerFunds  
Steve Dombrower - OppenheimerFunds  
Jeremy Thiessen - Pension Consulting Alliance  
Alan Demir, REDW LLC  
Javier Machuca, REDW LLC  
Joseph Goldberg, Freedman Boyd  
John Boyd, Freedman Boyd  
Yvonne Gonzales - Court Reporter

## **AGENDA**

### **1) CALL TO ORDER**

Chairman Garcia called the meeting to order at 1:08 p.m. Board Secretary Angela Gallegos called the roll and announced that four of four members were present and that a quorum existed.

### **2) PUBLIC COMMENT**

Chairman Garcia called for public comment. There was no public comment.

**3) APPROVAL OF AGENDA**

Chairman Garcia called for a motion to amend the order of the agenda to move up Agenda Item #'s 5, 6 and 7 before moving into executive session.

Mr. Heyman made a motion to amend the order of the agenda to move up Agenda Item #'s 5, 6 and 7 before moving into executive session. Mr. Serrao seconded the motion. The amended agenda was approved unanimously.

**4) MEETING MINUTES OF THE MAY 22, 2013 BOARD MEETING**

Chairman Garcia called for a motion to approve the minutes of the May 22, 2013 Board meeting.

Vice-Chairman Desiderio made a motion to approve the minutes of the May 22, 2013 Board meeting. Mr. Serrao seconded the motion. The minutes of the May 22, 2013 Board meeting were approved unanimously.

**5) MEETING MINUTES OF THE JULY 17, 2013 BOARD MEETING**

Chairman Garcia called for a motion to approve the minutes of the July 17, 2013 Board meeting.

Vice-Chairman Desiderio made a motion to approve the minutes of the July 17, 2013 Board meeting. Mr. Heyman seconded the motion. The minutes of the July 17, 2013 Board meeting were approved unanimously.

**6) FINANCIAL AUDIT REPORT – Javier Machuca and Alan Demir, REDW LLC**

Chairman Garcia called on Mr. Machuca to update the Board on the FY13 financial audit.

Mr. Machuca provided an update on the FY13 financial audit and informed the Board that this is the final audit engagement with ETB under the current contract. Mr. Demir provided the Board with an overview of the responsibilities of the auditors and management during the audit. He also stated that ETB management will need to sign a management representation letter asserting the accuracy of the information provided to REDW and assuming responsibility for the internal controls in place in the organization.

Mr. Heyman asked Mr. Machuca to explain who he considered to be management. Mr. Machuca said that it was Mr. Deiters.

Mr. Demir also advised the Board of his intent to submit the FY13 financial audit to the State Auditor's Office before Thanksgiving which is before the State deadline of December 15. REDW will conduct an exit conference and make a formal presentation to the Board as required by the audit.

Vice-Chairman Desiderio asked Mr. Machuca to confirm that the Board will need to go out to bid next year because this is the third audit under the contract. Mr. Machuca agreed that this was the final year of the contract and that the Board would need to rebid the audit contract.

Mr. Deiters reminded the Board that it voted at the May meeting to authorize the staff to issue a request for proposal for an external audit firm.

7) **EXECUTIVE SESSION** – discuss program litigation

Chairman Garcia called for a motion to move into executive session to discuss program litigation.

Mr. Heyman made a motion for the Board to move into executive session to discuss program litigation. Mr. Serrao seconded the motion. A roll call vote was taken and all four members voted unanimously to move into executive session at 1:25 p.m.

Chairman Garcia called for a motion to move back into open session. Vice-Chairman Desiderio made a motion to move back into open session. Mr. Serrao seconded the motion. A roll call vote was taken and all four members voted unanimously to end the executive session.

Chairman Garcia announced that the Board had returned to open session at 2:43 p.m. and that no action was taken in executive session.

8) **INVESTMENT POLICY STATEMENT AND MONITORING GUIDELINES** – discussion and possible action – Helen Atkeson, Hogan Lovells US LLP and Jeremy Thiessen, Pension Consulting Alliance, Inc.

Ms. Atkeson began her presentation by stating that the investment policy statement contemplates periodic review and update by the Board. She advised that most of the changes proposed in the investment policy statement were non-substantive and were intended to clarify the language about the program itself, the purpose of the policy, and to provide a more thorough description of the way that the staff, the Board, the investment consultant, and the plan manager work together and allocate responsibilities of the program.

Ms. Atkeson said that the amended investment policy statement clarified the Board's role in establishing the asset allocations and benchmarks of the investment portfolios and periodically reviewing those allocations and benchmarks. She directed the Board's attention to the appendices that were added to the investment policy statement to detail the asset allocations and underlying investments of each investment portfolio and related benchmarks.

Ms. Atkeson also described a new process for voting proxies as another substantive change for the Board to consider. Under the proposal, the Board delegates its proxy voting responsibility to the executive director, who is required to vote the proxies based upon the recommendation of the investment consultant. The executive director is then responsible for reporting to the Board about the proxy vote at the next quarterly board meeting.

Ms. Atkeson concluded her presentation with a description of the investment performance monitoring guidelines and the process for replacing underlying funds. She counseled the Board that it needs sufficient information from the program manager regarding its recommendation for a replacement fund and from the investment consultant on his evaluation of the program manager's recommendations. She explained that the Board ultimately has to decide to take formal action to approve or not approve such recommendations.

Vice-Chairman Desiderio stated it was his understanding that there were few substantive changes to the policies and he asked Ms. Atkeson to confirm that it was more of an integration of the two documents. Ms. Atkeson agreed with Vice-Chairman Desiderio and she responded that the intent was to clarify the Board's ultimate responsibility in establishing portfolio asset allocations and approving the portfolio benchmarks.

Mr. Thiessen addressed the Board regarding the investment performance monitoring guidelines. He called to the Board's attention the table at the back of the monitoring guidelines that describes how asset classes are organized by either equity securities or fixed income securities. He explained to the Board that the alternative asset classes, like real estate or commodities, are actually equity funds because the underlying funds are actually buying equity securities of companies that either mine these precious metals or equity securities in companies that buy or sell and manage real estate.

Mr. Heyman asked Ms. Atkeson and Mr. Thiessen if, during their review of the investment policy statement and monitoring guidelines, they were able to determine whether the Board was following the investment policy statement and monitoring guidelines. Ms. Atkeson responded that the Board was carrying out its responsibilities.

Mr. Heyman commented that he had seen boards get into trouble for not following their own written policy because they have not paid attention. Mr. Deiters responded that the annual review process for the investment policy statement was intended to give the Board, particularly new members, the opportunity to review and make changes to the policy as needed. Mr. Mathews added that it was a good practice to periodically review policy documents and modify them when needed.

Chairman Garcia asked for comments from Oppenheimer. Mr. Henry pointed out that a few benchmark changes were needed in the monitoring guidelines, but were not reflected in the documents before the Board. In response, Ms. Atkeson acknowledged the need to make additional changes to the document and she asked the Board to delegate authority to the executive director to make non-substantive changes.

Chairman Garcia called for a motion to approve the investment policy statement and monitoring guidelines and to delegate to the executive director the authority to make minor modifications and corrections to the policy as presented.

The motion was made by Mr. Heyman and seconded by Vice-Chairman Desiderio. The motion was approved unanimously.

## 9) PROGRAM MANAGER REPORT

Chairman Garcia called on Messrs. Raynor and Henry to provide a brief overview of the Plans' marketing report and investment performance report for the second quarter of 2013.

### a. Marketing Report – Bill Raynor, OppenheimerFunds

Mr. Raynor summarized account and marketing information from the *OFI Private Investments – New Mexico 529 Quarterly Report for the Period Ending June 30, 2013*.

Mr. Raynor reported sales in The Education Plan remained relatively flat during the quarter while total assets increased by \$4 million. Mr. Raynor pointed out that 53 percent of new assets coming into The Education Plan were directed to the index portfolios.

Mr. Raynor reported a 3 percent decline in Scholar's Edge Plan accounts over the past year while assets increased by 7 percent. He also discussed the efforts of OppenheimerFunds wholesalers to market the Scholar's Edge Plan to Edward Jones and Wells Fargo advisors.

Mr. Raynor commented on Oppenheimer's efforts to implement the state fee rebate for account owners with an address in New Mexico that was adopted by the Board in March 2013. He reported that Oppenheimer's Denver office will use an automated process for issuing the rebates. Mr. Raynor explained that Oppenheimer was going to rebate state fees paid during calendar year 2013 on-or-about January 15, 2014, and thereafter the rebates would be made on a semi-annual basis for fees paid during the previous 6 month period.

Mr. Serrao asked Mr. Raynor to provide the Board with additional details about the email marketing efforts and to discuss who they are targeting. Mr. Raynor explained that they focus their efforts on families with children and on grandparents.

**b. Quarterly Investment Performance Report – Ken Henry, OppenheimerFunds**

Mr. Ken Henry of OppenheimerFunds provided the Board with a summary of the *OFI Private Investments – The Education Plan & Scholar's Edge Portfolio Performance Report for the Period Ending June 30, 2013*.

Mr. Henry began his presentation by discussing the performance of The Education Plan. Portfolio returns ranged between 1.54 percent for the newborn to age 5 portfolio to a negative 0.65 percent for the ages 18 and over portfolio.

He explained that equity returns were strong during the first two months of the quarter until fear struck the fixed income markets after the Federal Reserve made comments regarding the tapering of the bond purchase program.

Mr. Henry began his overview of the underlying funds by discussing the Oppenheimer Capital Appreciation Fund and its underperformance relative to its benchmark of 215 basis points during the quarter. He attributed the underperformance to the funds stock selection.

Mr. Henry described the performance of the Oppenheimer International Growth Fund during the quarter as spectacular because the fund outperformed its benchmark by 327 basis points. He attributed the strong performance to stock selection.

Mr. Henry reported that the Thornburg International Value Fund had another weak quarter as it underperformed relative to its benchmark by 75 basis points. He identified the fund's over exposure to emerging markets and its under exposure to European financial stocks as factors in the underperformance.

Mr. Henry contrasted the performance of the Senior Floating Rate Fund against the performance of the Dreyfus Fund that it replaced in December 2012. Since the reallocation, the Senior Floating Rate Fund outperformed the Dreyfus Fund by 300 basis points.

Mr. Henry identified the Oppenheimer International Bond Fund as another fund with a significant negative variance relative to its benchmark. He reported that the fund underperformed by 206 basis points during

the quarter but that its year-to-date performance had remained positive. Mr. Henry attributed the underperformance to being overweight in longer duration fixed income in the emerging market and to non-dollar currencies.

**10) SHARE CLASS CONVERSION OF CERTAIN UNDERLYING FUNDS – discussion and possible action – Ken Henry, OppenheimerFunds**

Chairman Garcia called on Mr. Henry to give his presentation on the proposed share class conversion for certain Oppenheimer Fund investments.

Mr. Henry advised the Board that OFIPI is proposing to make lower cost Oppenheimer's institutional ("I") shares available to The Education Plan and Scholar's Edge plan.

Messrs. Henry and Dombrower provided an overview of institutional shares and presented a recommendation to the Board to convert the share class of all underlying Oppenheimer funds from Class "Y" to Class "I".

Mr. Henry advised that the investment performance would be the same but the operating expenses would be lower. He pointed out that account owners would see a reduction in the range between two to eight basis points in The Education Plan portfolios and between five to 12 basis points in Scholar's Edge portfolios.

Mr. Heyman asked if Oppenheimer anticipated that lower fees would result in additional participation. Mr. Henry responded by saying that lower fees would improve their relative positioning to other plans.

Ms. Atkeson asked if the different fee structure had any impact on the way the fund was invested and if Oppenheimer was making similar changes to its programs in other states. Mr. Raynor responded that Oppenheimer would roll out the institutional shares to some of their other providers based upon the financial considerations of each plan.

Ms. Atkeson asked Mr. Thiessen if he was seeing the share class conversion in other plans around the country. Mr. Thiessen responded "no" and he commented that New Mexico was ahead of the curve on this issue. He also commended Oppenheimer for bringing the conversion to the Board.

Vice-Chairman Desiderio asked if New Mexican residents would see a reduction in costs from both the resident fee rebate and the lower class share fees. Mr. Raynor agreed.

Chairman Garcia called for a motion to accept the recommendation of the Board's program manager to convert the Oppenheimer underlying funds identified in the presentation from "Y" shares to "I" shares.

The motion was made by Vice-Chairman Desiderio and seconded by Mr. Serrao. The motion was approved unanimously.

**11) ASSET ALLOCATION AND PORTFOLIO ANNUAL REVIEW – discussion and possible action – Ken Henry, OppenheimerFunds and Jeremy Thiessen, Pension Consulting Alliance, Inc.**

Chairman Garcia called on Messrs. Henry and Thiessen to update the Board on the asset allocation and portfolio annual review.

Mr. Henry reported that OppenheimerFunds did not recommend any changes to the plan asset allocations because they were still comfortable with the asset allocations adopted by the Board in August 2012. He reminded the Board that OppenheimerFunds saw significant interest rate risk during their 2012 review and they believed it would remain a long-term strategic situation. Mr. Henry reported he found this year's market conditions to be similar to last year and that additional changes to the asset allocations were not needed.

Mr. Thiessen agreed with OppenheimerFunds recommendation to maintain the asset allocations adopted in 2012. He also commented that other 529 plans were just starting to consider changes like those adopted by the Board in August 2012 to reduce interest rate risk.

Chairman Garcia asked Mr. Henry to explain the Stable Value Fund from New York Life. Mr. Henry responded that it is a guaranteed investment contract that is guaranteed by the full faith and credit of New York Life, which is an "A+" rated company. He reported that the Stable Value Fund yield of 1.83 percent was quite high in comparison to current interest rates and it is locked in for a five-year period using rolling quarters.

Chairman Garcia called for a motion to accept the recommendation of OppenheimerFunds, the Board's program manager, to make no changes to the existing asset allocations and portfolios.

The motion was made by Vice-Chairman Desiderio and seconded by Mr. Serrao. The motion was approved unanimously.

**12) INVESTMENT CONSULTANT QUARTERLY REVIEW – Jeremy Thiessen, Pension Consulting Alliance, Inc.**

Chairman Garcia called on Mr. Thiessen to give his review of investment performance of the underlying funds and the plans for the second quarter of 2013.

Mr. Thiessen provided a review of the capital markets for the second quarter and he summarized returns for fixed income and equity funds. He pointed out that fixed income returns were negative over the last quarter. Mr. Thiessen reminded the Board that although bonds are in the plans to provide some stability versus equity funds that they can still be very volatile.

Mr. Thiessen described equity returns of two to three percent over the last quarter while having very strong returns over the one-year period. Non-U.S. equity funds had negative returns during the quarter but very strong double-digit returns over last one-year period while emerging market returns were only 3.2 percent up over the last one-year period.

Mr. Thiessen began his review of Scholar's Edge fund performance by discussing the Oppenheimer Capital Appreciation Fund. He reported that the fund had underperformed its benchmark by about 275 basis points for quite some time. He pointed out that, although the fund has had positive returns since inception, it is ranked in the 87<sup>th</sup> percentile. Mr. Thiessen advised the Board that the Oppenheimer Capital Appreciation Fund remained on the Watch List and it was the topic of a later agenda item.

Mr. Thiessen then briefed the Board on the other underlying funds on the Watch List. In his discussion of the Oppenheimer Value Fund, Mr. Thiessen pointed out the improvement in performance under the new fund manager. He also reported on the positive performance of the MainStay MAP Fund during the quarter and stated that he expects to recommend its removal from the Watch List if the performance trend continues.

Mr. Thiessen concluded his presentation on underlying fund performance by discussing the under-performance of the Thornburg International Value Fund; Main Street Small - and Mid- Cap Fund; Mainstay High Yield Corporate Bond Fund; and Oppenheimer Rising Dividends Fund. He pointed out that the Oppenheimer Rising Dividends Fund was just added to the Scholar's Edge Plan in December 2012 but that it now had enough data points over the rolling 12 month period to constitute placement on the Watch List.

Ms. Atkeson asked Mr. Thiessen to explain why an underlying fund such as the Oppenheimer Rising Dividends Fund that was just added to the Plan qualifies for "watch." Mr. Thiessen responded that the fund provides solid positive returns and it is a fund that an advisor might use in the design of a portfolio for a client. Mr. Henry agreed with Mr. Thiessen about the fund's performance and he pointed out that the fund underperforms when the market is very hot. Mr. Henry pointed out that the Oppenheimer Rising Dividends Fund has only been added as an individual fund portfolio to Scholar's Edge, not to The Education Plan or to age-based portfolios or custom choice.

Mr. Thiessen then discussed the performance of the Gold and Special Minerals Fund relative to its current benchmark, MSCI World Index. He indicated that this benchmark is not a good benchmark for this Fund, and that he plans to bring back a more appropriate benchmark for evaluation of this Fund to the Board for approval. Mr. Henry explained that initially this broad equity benchmark was selected, but Oppenheimer uses a more specific benchmark that is only mining stock in gold and precious metals for purposes of its risk analysis and quarterly commentary. Mr. Thiessen indicated that the Fund's performance was within 100 basis points of that specific index.

There was discussion about what investors are told regarding the benchmarks and how they are used for purposes of monitoring performance. It was concluded that the prospectus benchmark has been and should be included in the plan documents, with further information indicating any alternative benchmarks the Board uses for purposes of monitoring performance.

**13) WATCH LIST – discussion and possible action – Jeremy Thiessen, Pension Consulting Alliance, Inc.**

Mr. Thiessen provided the Board with an overview of his "*Watch Status*" Update memorandum dated August 8, 2013. He recommended that two of the three funds on the Watch List (Oppenheimer Value Fund and MainStay MAP Fund) should remain on "Watch" and that the Oppenheimer Capital Appreciation Fund should be removed and replaced with a suitable alternative once one has been identified.

Mr. Thiessen recommended adding three funds (Oppenheimer Main Street Small - & Mid-Cap Fund; MainStay High Yield Corporate Bond Fund; Oppenheimer Rising Dividends Fund) to the watch list based on performance of these funds. He advised that a fourth fund (Oppenheimer Gold & Special Minerals Fund)



qualified for the Watch List but that he was not recommending adding the fund to the watch list because he wants to resolve the benchmark issue discussed earlier.

Mr. Heyman stated that he would like to hear Oppenheimer's comments regarding the recommendation to remove and replace the Oppenheimer Capital Appreciation Fund. Mr. Henry responded that he understands the basis for the recommendation.

Chairman Garcia asked whether, aside from the duration of the fund on the Watch List, there was anything positive about the fund that the Board should consider. Mr. Thiessen responded that the fund has been on the Watch List for 15 months and at this point in the process that we are looking for meaningful change to the portfolio. He used the complete "overhaul" of the management and holdings of the Oppenheimer Value Fund as an example of a meaningful change.

Chairman Garcia called for a motion to accept the investment consultant's recommendation to replace the Oppenheimer Capital Appreciation Fund.

Mr. Serrao asked how long it would take to replace the Oppenheimer Capital Appreciation Fund. Mr. Henry advised the Board that it could take up four months to make the change because notice has to be given to account owners and all of the literature and marketing materials changed.

Mr. Serrao moved to accept the investment consultant's recommendation to replace the Oppenheimer Capital Appreciation Fund. The motion was seconded by Mr. Heyman. The motion was approved unanimously.

Chairman Garcia announced for the record that Robert Desiderio left the meeting at 4:12 p.m. and did not vote.

Chairman Garcia called for a second motion directing the plan manager to provide the Board with one or more recommended replacement funds and to direct the investment consultant to provide his opinion of the plan manager's recommendations.

Mr. Heyman made the motion and Mr. Serrao seconded the motion. The motion was approved unanimously.

Chairman Garcia called for a third motion to accept the investment consultant's recommendations to keep the Oppenheimer Value Fund and the MainStay MAP Fund on "Watch" status and to add the Oppenheimer Main Street Small - & Mid-Cap Fund, MainStay High Yield Corporate Bond Fund, and the Oppenheimer Rising Dividends Fund to the Watch List.

Mr. Serrao made the motion and Mr. Heyman seconded the motion. The motion was approved unanimously.

#### 14) EXECUTIVE DIRECTOR'S REPORT – discussion – Kevin Deiters, Executive Director

Chairman Garcia called on Mr. Deiters to give an overview of the Executive Director's report.

Mr. Deiters provided the Board with an overview of his memorandum of August 12, 2013 that summarized the site visit to OppenheimerFunds in New York during July. The executive director also summarized the expenditures from the administrative fund for the fiscal year ended June 30, 2013 and he reported an ending fiscal year balance of \$8,088,724 unaudited.

Mr. Deiters informed the Board that he will make a presentation promoting college savings to an orientation for new board of regents and governing officers that Chairman Garcia and the New Mexico Higher Education Department are hosting.

**15) ADJOURNMENT**

Chairman Garcia called for a motion to adjourn the meeting.

Mr. Serrao moved to adjourn the meeting. Mr. Heyman seconded the motion. The motion was approved unanimously.

Chairman Garcia adjourned the meeting at 4:55 p.m.

*Approved by Education Trust Board*

*December 11* \_\_\_\_\_, 2013 Meeting

*Angela M. Gallegos*  
\_\_\_\_\_  
*Angela M. Gallegos, Board Secretary*