

# 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

Meeting Minutes of August 15, 2012, 1:00 p.m.

New Mexico Higher Education Department  
2048 Galisteo, Santa Fe, NM 87113

## Board Members in Attendance

Dr. José Garcia, Chair  
Robert Desiderio, Vice-Chair  
Trevor Serrao, Student Member  
Robbie Heyman, Member (By Phone)

APPROVED

## Other Individuals in Attendance

Kevin Deiters - Executive Director  
Angela Gallegos - Board Secretary  
David Mathews – HED Attorney  
Helen Atkeson - Partner – Hogan Lovells  
Ross Burkstaller – OppenheimerFunds  
Ken Henry - OppenheimerFunds  
Jeremy Thiessen – Pension Consulting Alliance  
Javier Machuca, REDW, LLC  
Yvonne Gonzales - Court Reporter

## AGENDA

### 1) CALL TO ORDER

Chairman Garcia called the meeting to order at 1:04 p.m. Board Secretary Angela Gallegos called the roll and announced that all 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

Mr. Desiderio made a motion to approve the agenda. Mr. Serrao seconded the motion. The agenda was approved unanimously.

### 4) MEETING MINUTES OF JULY 20, 2012

Mr. Desiderio made a motion to adopt the minutes of July 20, 2012. Mr. Heyman seconded the motion. The minutes of July 20, 2012, were approved with Mr. Serrao abstaining.

**5) EXECUTIVE SESSION**

Mr. Heyman made a motion for the Board to go into Executive Session to discuss the financial audit. The motion was seconded by Mr. Desiderio. A roll call vote was taken and all members voted to adjourn to Executive Session at 1:12 p.m.

Chairman Garcia announced that the Board had returned to open session at 1:46 p.m. and that no action was taken in Executive Session.

**6) FINANCIAL AUDIT UPDATE – Javier Machuca**

Chairman Garcia called upon Javier Machuca to update the Board on the FY 2011 and FY 2012 audits.

Mr. Machuca provided an update on the FY 2011 and FY 2012 audits. He reported their schedule is to complete the FY 2011 audit for the general fund by September and issue the reports for the administrative and fiduciary funds.

Mr. Machuca stated staff is scheduled to perform the FY 2012 audit during October and November and wrap up the report around Thanksgiving weekend and have the exit conference during the beginning of December.

**7) OUTSIDE COUNSEL REPORT – Helen Atkeson**

Chairman Garcia welcomed the Board's new outside counsel, Helen Atkeson with the firm of Hogan Lovells US LLP to the meeting and asked that she provide the Board with an update about her firm.

Ms. Atkeson expressed delight to being there and provided the Board with a brief overview of her professional background, her firm, and the services that she will provide to the Board.

Mr. Heyman welcomed Ms. Atkeson and asked her if there was anything she had to report to the Board in regards to the latest proposal from the Municipal Securities Rulemaking Board (MSRB) concerning 529 plans and disclosure.

Ms. Atkeson reported the MSRB is seeking formal comment on a proposal to collect information on 529 plans. She explained that the MSRB governs the activities of broker dealers and does not formally govern the activities of state plan sponsor. Ms. Atkeson informed the Board that she would keep Mr. Deiters advised.

**8) PROGRAM MANGER REPORT**

**a. Marketing Report – Ross Burkstaller, OFIPI**

Chairman Garcia called on Mr. Burkstaller to update the Board on Marketing Report.

Mr. Burkstaller provided the Board with a summary of the marketing information in the *OFI Private Investments – New Mexico 529 Quarterly Report for the Period Ending June 30, 2012*.

Mr. Burkstaller reported The Education Plan had \$355.68 million in assets with 20,595 accounts at the end of Q2. The assets in The Education Plan increased by 0.2% from the previous quarter and reflected a 6.4%

increase from Q2 2011. The Education Plan had \$8.53 million in sales with \$3.77 million in net flows during Q2 2012, representing a sales increase of about 2% from the previous quarter.

Mr. Burkstaller reported the Scholars Edge ended up with \$1.61 billion in assets with 134,357 accounts. He reported that Scholars Edge assets decreased by 0.4% from the prior quarter and reflected a 3.3% decrease for the year. Scholars Edge had \$30.27 million in sales with \$3.9 million in net flows in Q2 2012 and reflected a 15.2% decrease from the prior quarter.

Mr. Burkstaller stated that according to the Financial Research Corporation, Scholar's Edge still maintains the top ten spot for assets under management out of 35 advisor plans and the 24<sup>th</sup> spot for assets under management out of 94 plans which includes both advisor and direct.

Mr. Burkstaller concluded his presentation with an overview of their marketing efforts and turned to the presentation over to Ken Henry.

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

Mr. Ken Henry of Oppenheimer Funds provided the Board with a summary of his *OFI Private Investments – New Mexico 529 Quarterly Report for the Period Ending June 30, 2012*.

Mr. Henry directed the Board's attention to page 40 of the report to explain the underperformance of the age-based portfolios during the quarter. He stated that the Capital Appreciation Fund and the Value Fund were the primary drivers of the underperformance but that he was confident that the Capital Appreciation Fund would perform better in the future. He stated that Morningstar had recently ranked the fund in the 33<sup>rd</sup> percentile of Large Cap Growth Funds.

Mr. Henry stated that stock selection was the primary driver for the underperformance associated with the Value Fund. He reminded the Board that the Value Fund was outperforming the Russell 1000 as of June 2011.

Mr. Serrao asked Mr. Henry about the Board's exposure to funds tied to LIBOR. Mr. Henry explained how the industry uses LIBOR as a rate setting mechanism and that the recent controversy would not have a material impact on any of the securities owed by the Board. Mr. Thiessen concurred with Mr. Henry's comments and indicated that it would be the fiduciary responsibility of individual fund managers to take action should losses occur due to manipulations of LIBOR ratings.

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

Chairman Garcia called on Mr. Thiessen to give his review of investment performance for the quarter ending June 30, 2012.

Mr. Thiessen provided the Board with an overview of his memorandum of August 1, 2012, detailing investment performance for the quarter ending June 30, 2012. His report provided an overview of economic performance, investment markets, and the performance of the portfolios in the college savings plans.

At the request of Dr. Garcia, Mr. Thiessen provided the Board with a detailed explanation of the metrics behind interest rate risk.

**10) WATCH LIST; discussion and possible action – Jeremy Thiessen, Pension Consulting alliance, Inc.**

Chairman Garcia called upon Mr. Thiessen to present his recommendations for the investment Watch List.

Mr. Thiessen provided the Board with an overview of his *"Watch Status" Update* memorandum dated August 1, 2012. He advised that no new funds qualified for "Watch" status and that he recommended the Board maintain the Capital Appreciation Fund, INVESCO Mid Cap Core Fund, and Oppenheimer Value Fund on the Watch List.

Chairman Garcia called for a motion to adopt the recommendation of the Board's investment consultant to maintain the Watch List without changes.

Mr. Heyman moved to adopt the recommendation of the Board's investment consultant to maintain the Watch List without changes. The motion was seconded by Mr. Serrao. A roll call vote was taken and all four members voted to adopt the motion.

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

Chairman Garcia called upon Messrs. Henry and Thiessen to present their recommendation to the Board regarding changes to the asset allocation and portfolios of the college savings plans.

Mr. Thiessen provided the Board with a brief overview of the annual investment review process that is outlined in the investment policy.

Mr. Henry provided the Board with an overview of his recommendations as reported in *"Annual Investment Review – New Mexico TEP/S.E. 529 Plans"* dated August 15, 2012. He provided an overview of the capital markets and the potential impact of the fiscal cliff.

Mr. Henry advised that the glide path asset allocations were reasonable and in-line with industry averages and that he did not recommended any changes.

Mr. Henry stated that OFI identified an opportunity to improve the overall marketing appeal of the TEP-Blended portfolios by differentiating those portfolios from the TEP-Index portfolios by increasing the allocation of actively managed funds in the TEP-Blended portfolios.

Mr. Henry also proposed changes to both diversify large cap allocations and reduce individual manager risk. Mr. Henry's discussed adding a large cap fund (the Oppenheimer Main Street Fund) and the reallocation of existing large cap holdings across the Oppenheimer Capital Appreciation, Value and Main Street Funds. To address interest rate risk, he recommended reducing the average duration of the portfolio by adding a short-term bond fund (Oppenheimer Senior Floating Rate fund) and by moving a portion of the current allocation to the Dreyfus Bond Market Index fund into the short-term bond fund.

Mr. Henry also recommended two changes to further streamline the plan. He recommended the removal of the Oppenheimer Global Strategic Income Fund from the Age 6-8 Portfolio and the reallocation of its assets across the American Century Diversified Bond Fund, MainStay High Yield Corporate Bond Fund, and Oppenheimer Senior Floating Rate Fund. The other proposal concerned the removal of the Invesco Mid Cap Core Equity Fund and reallocation of current funds equally to the large cap funds and small and mid cap funds.

Mr. Henry concluded his presentation with overview of plan fees.

Mr. Thiessen followed Mr. Henry and indicated his agreement with the comments about interest rate risk and the asset allocation recommendations made by Mr. Henry. He directed the Board's attention to his report *"2012 Annual Review and Recommendations – New Mexico 529 College Savings Plans"* that summarized his analysis of the plan's asset allocation and the proposed changes recommended by Oppenheimer Funds.

Mr. Desiderio asked Mr. Thiessen if there were other pure senior floating rate funds in the universe and why did the proposed fund have lower relative performance. Mr. Thiessen responded that the proposed fund was a pure senior floating rate fund as opposed to many of its peers that use leverage or make investments in high yield funds.

Mr. Henry concurred that the Senior Floating Rate Fund does not use leverage. In response to a question by Mr. Desidario, Mr. Thiessen confirmed that the proposed fund had less risk than those senior floating rate funds using leverage.

Mr. Desiderio asked Mr. Deiters if he had participated in the asset allocation review and if had reviewed the proposal. Mr. Deiters confirmed that he had participated in the asset allocation review and had reviewed the proposal.

Mr. Heyman asked Mr. Thiessen about his chart on page 9 (Estimate of 10-year Treasury Forward-Looking Real Yield) that shows the current yield on 10-year treasuries at historic lows and that the same could have been said about the 10-year yield in 2004.

In response, Mr. Thiessen responded that currently the difference is high duration with a negative real yield. – which suggests the trend must reverse because real yields can't stay negative for very long.

Mr. Heyman also asked about the credit risk associated with the proposed fund and the term of the underlying loans. Mr. Henry stated that it was their opinion that there was incremental increase in credit risk but that the proposed fund was well diversified and actively managed. Regarding the term of the underlying loans, Mr. Henry reported that these are generally mid-term length loans in the three-to-five year range.

Mr. Desiderio made a motion to accept the recommendation of Oppenheimer Funds for changes to asset allocation and underlying funds of the plan. The motion was seconded by Mr. Serrao. A roll call vote was taken and all members voted to approve the motion.

**12) EXECUTIVE DIRECTOR'S REPORT – Kevin Deiters, Executive Director**

Chairman Garcia called on Kevin Deiters to provide the Executive Director's report.

Mr. Deiters provided the Board with an overview of the material presented in the Executive Director's Report of August 15, 2012. He provided an update on administrative expenses, the reserve fund, fee revenues, Core Bond Fund settlement account, and Core Bond Fund Settlement distributions.

Mr. Deiters advised the Board that the State Controller would authorize the Board to pay administrative and marketing fees to Oppenheimer Funds using administrative funds. He advised that we would pay these expenses, pursuant to Board's authority of July 20, 2012, by netting these expenses from the administrative fees paid to the Board.

Mr. Deiters brought to the Board's attention an issue regarding a \$32,164 outstanding balance with the Board's former outside counsel, Patton Boggs, that the Board is unable to pay because certain services were provided during the period between the exhaustion of the original February 2012 contract and the April 3, 2012 effective date of the emergency contract. Mr. Deiters advised the Board that he met with the State Controller in an attempt to change the effective date of the emergency contract; however, the State Controller would not approve the request.

Mr. Heyman asked if we would pay Patton Boggs since the amount owed is covered by the indemnification agreement with Oppenheimer Funds? Mr. Deiters said that he would ask an attorney and would provide the Board with an update.

**13) ADJOURNMENT**

Mr. Heyman made a motion to adjourn the meeting. Mr. Desiderio seconded the motion. The motion was approved unanimously.

Chairman Garcia adjourned the meeting at 4:38 p.m.

*Approved by Education Trust Board*

*December 5*, 2012 Meeting

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