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 September 16, 2015

New Mexico Higher Education Department, 5201 Eagle Rock Rd. Suite 1A Albuquerque, NM

APPROVED
Vera Lyons
Board Secretary 12/2/15

Board Members in Attendance

Robert Desiderio - Vice Chairman
David Jansen -- Member
Mark Jarmie – Member (by telephone)

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
Emily Howard – Esparza Advertising
Kay Ceserani - Pension Consulting Alliance
Eric White - Pension Consulting Alliance (by telephone)
Steve Dombrower - OppenheimerFunds
Bill Raynor - OppenheimerFunds
Ken Henry – OppenheimerFunds
Matt McGee -- OppenheimerFunds
Michele Nelson - Court Reporter

AGENDA

1) **CALL TO ORDER**

Mr. Desiderio called the meeting to order at 2:06 PM. Mr. Miller called the role and announced that three out of five Board members were present and that a quorum existed.

2) **PUBLIC COMMENT**

Vice Chairman Desiderio called for public comment. There was no public comment.

3) APPROVAL OF AGENDA

Vice Chairman Desiderio turned to the agenda and asked if there was any discussion. There being no discussion he called for a motion to approve the agenda. Mr. Jansen so moved. Mr. Jarmie seconded the motion. All present voted to approve the agenda as presented to the meeting.

4) LGIP SIGNATURE AUTHORITY RESOLUTION

Mr. Miller explained that the assets of the Board's program administration fund are invested in the Local Government Investment Pool. Ms. Vera Lyons has joined the Board staff as Financial Coordinator. He explained that it would be appropriate to add Ms. Lyons to the list of those with signature authority for the LGIP account. He noted that although only one signature is required for a deposit, two signatures are required for a withdrawal. Besides Mr. Miller, the other two persons with signature authority are Mr. Mathews and Dr. Damron. Adding Ms. Lyons would add to the availability of authorized signatories, especially when Dr. Damron and Mr. Mathews are not available.

Mr. Desiderio called for a motion to approve the signature authority resolution. Mr. Jarmie so moved and was seconded by Mr. Jansen. The motion was carried unanimously.

5) ETB MARKETING INITIATIVES UPDATE FOR FY2016

Vice Chairman Desiderio then called upon Ms. Howard to provide an update on the Board's FY2016 marketing efforts. Ms. Howard noted that a marketing budget of $700,000 has been established for The Education Plan.

Mr. Miller reminded the Board that under the new Program Manager Agreement, OppenheimerFunds had committed $500,000 for ETB marketing efforts plus an additional $150,000 for grassroots outreach efforts. These funds plus ETB program fees would be used to fund the overall effort.

He noted the low awareness of the public regarding 529 programs. There is a need to increase awareness of the program in New Mexico, and to promote the program in other states where interest in the program has been shown. Mr. Miller noted that the ETB receives no revenue from New Mexico accounts, and must increase its out-of-state presence in order to fund its initiatives.

He also noted that work had begun on New Mexico grassroots outreach efforts, and that he would inform the Board of those efforts in more detail at the December meeting.

Ms. Howard reminded the Board that additional advertising dollars spent in the previous year had increased the number of accounts. She advised the Board that supplemental advertising impressions was a good use of advertising dollars.

Ms. Howard also advised the Board that a public relations strategy was being developed.

Mr. Miller noted that discussions were in progress with education-oriented organizations in the state with a focus on the lower school grades. Experiences of other states were being researched in order to determine best practices for a New Mexico grant program.

Mr. Jarmie asked how the success of the marketing efforts would be measured. Ms. Howard replied that account growth, website visits and website conversion numbers would be metrics. On the public relations side it would be the number of media impressions.

Mr. Miller noted that the principal measures would be new accounts and new assets tied to the results of the marketing efforts.

Mr. Desiderio asked if the scope and design of the pilot program had been outlined yet. Ms. Howard said that it had not. Information was still being gathered on the experiences of other states. Mr. Miller noted that the goal was to start small, to avoid the mistakes of some other state programs, and to see if the pilot effort is working. Only then would substantial funds be expended.

Ms. Atkeson asked if the money allocated for FY2016 was to be spent to make grants or to address administrative costs. Mr. Miller replied that this was to get the pilot program up and running. Additional money for grants would come from the program administration fund. The grants would replace the college level scholarships given in prior years.

Mr. Desiderio and Ms. Atkeson both clarified that the $500,000 for marketing activities this year would be used for promoting The Education Plan, and not for grants or scholarships. Mr. Miller confirmed this.

Ms. Howard then previewed the new TV commercial for The Education Plan. She noted that it was a father/son spot to complement the mother/daughter spot from last year. Both commercials would be run in New Mexico as well as in other states that showed interest in The Education Plan.

6) PROGRAM MANAGER'S QUARTERLY REPORT

a) Marketing Report

Mr. Raynor then gave the quarterly marketing report for the program. He first noted that the re-launch of the program had gone smoothly, with no major glitches. He then introduced Matt McGee, the western regional 529 college savings consultant for OppenheimerFunds.

Mr. McGee noted that, in addition to New Mexico, he spends a lot of his time in California, Texas and Arizona. These states offer no income tax advantage for the in-state plans, so Scholar's Edge is a viable option in them.

Mr. Dombrower asked Mr. McGee how the new Scholar's Edge plan was being received by brokers. Mr. McGee stated that the plan has the broadest investment lineup of any advisor-sold 529 plan. His most frequent competition is the College America Plan managed for the state of Virginia by American Funds.

Mr. McGee opined that the Scholar's Edge product was superior in fees, investment lineup and service. He noted that only OppenheimerFunds has a dedicated 800 number for its 529 business, serviced by knowledgeable phone representatives.

Ms. Atkeson asked how OppenheimerFunds decided between recommending Scholar's Edge or the Illinois advisor-sold plan also managed by OppenheimerFunds.

He noted that in Illinois the firm was obligated to sell only the Illinois Bright Star plan. This same Illinois plan was taken over from Morgan Stanley, so OppenheimerFunds also leads with this plan for Morgan Stanley brokers in all states. He stated that Oppenheimer led with Scholar's Edge for other brokerage relationships.

Mr. Dombrower restated the claim that Scholar's Edge has the broadest investment lineup in the 529 business. He stated that the two new age-based options as well as the fixed income portfolio were good additions to the program. He expected to see the results of the new lineup start to show themselves towards the end of the calendar year. He noted that a couple on mutual fund industry publications had interviewed OppenheimerFunds about the 529 program. He also mentioned the Monetta Young Investor fund as a good addition to the lineup.

Mr. Jansen asked about the size of the 529 industry and its growth. Were other 529 plans adding accounts? Mr. Dombrower noted that college savings plan were growing, but at a slow rate. Most of the asset growth in these plans has been market appreciation in the recovery from the 2008 recession.

Mr. Jansen then asked what account growth was like in the industry, and Mr. Dombrower replied that it was 2% to 3% per year. Mr. Dombrower stated that the target for OppenheimerFunds under the new contract was 5% new account growth per year. This was a target for new accounts only, and not net accounts in the program.

Mr. Raynor acknowledged that OppenheimerFunds had done an extremely poor job in getting new accounts for Scholar's Edge.

Mr. Miller asked what the key resistance factors were in selling Scholar's Edge. Mr. McGee noted the power of American Funds, the knowledge level of the brokers, and convincing brokers to change the 529 plan they are using for their clients.

Vice Chairman Desiderio noted that, if the industry is growing accounts at 2% and Scholar's Edge is losing 3 and ½ % per year, the swing is over 5%. He regarded this as the problem to work on.

Mr. Raynor stated that he would come back to the Board in December with an analysis of the industry data.

Vice Chairman Desiderio asked when the Board could expect to see a turnaround. Mr. Dombrower opined that he expected to be able to report improvement for the 4th quarter of calendar 2015.

Mr. Raynor noted that poor sales performance in the 529 business was not looked upon favorably inside OppenheimerFunds. Mr. Dombrower stated that OppenheimerFunds had rolled out a new advisor website, with space allocated to 529 plans. Oppenheimer is also using social media to promote 529 plans.

Mr. Miller pointed out the rapid growth in both accounts and assets for The Education Plan index options. New account growth at 25.9% and asset growth at 27.7% year over year. Over the next year this part of the program would be reviewed to make sure it was the best possible index offering. There being no further questions, Mr. Desiderio asked Mr. Henry to present the quarterly investment report.

b) Investment Performance Report

Mr. Henry began by noting changes to some of the investment teams – in particular the teams managing the Senior Floating Rate Bank Loan Fund and the Emerging Markets Equity Fund.

Mr. Henry gave some general market commentary for the second quarter of 2015. He noted that domestic equity markets were flat for the quarter, international equity markets up slightly, and fixed income markets down somewhat in anticipation of an interest increase in the United States. High Yield and Bank Loan markets were slightly positive.

He observed that for the second quarter the Value Fund outperformed its benchmark by 90 basis points, year to date by 155 basis points, and one year by one basis point.

Four out of six of the age-based blended portfolios in The Education Plan outperformed their benchmarks.

The Main Street Fund outperformed the benchmark by 42 basis points, and the Main Street Mid-Cap outperformed by 52 basis points. The International Growth Fund outperformed by 215 basis points, and the Global Fund outperformed by 238 basis points.

The index funds performed as expected, in line with their benchmarks less fees.

In Scholar's Edge five out of six of the all active age-based portfolios outperformed their benchmarks. Only the 18+ portfolio lagged its benchmark.

Mr. Henry also noted that savingforcollege.com ranked both Scholar's Edge and The Education Plan quite highly for the one-, three- and five year periods.

There being no further questions Mr. Desiderio turned to Ms. Ceserani from PCA.

7) INVESTMENT CONSULTANT QUARTERLY REVIEW AND WATCH LIST RECOMMENDATION

Ms. Ceserani led off with the derivatives review. As with the last report six months ago the same five fixed income funds had derivatives exposure above the 110% threshold. As with the last report PCA is not concerned about this exposure. The funds all invest in TBA securities related to mortgage contracts.

Mr. Miller then raised the fact that a derivatives review does not cover many of the risks associated with underlying investments in the mutual funds that are used to construct portfolios for the program.

He mentioned several types of securities that had been artificially constructed by the securities industry to appeal to managers who were trying to enhance yields in their fixed income portfolios. These securities generated substantial losses for the managers when the interest rate environment changed.

He noted that even PCA did not have access to the full list of investments for the underlying mutual funds used to construct portfolios. This information is only available every six months in arrears in the mutual fund industry. This means that the Board relies on OppenheimerFunds internal risk controls for suitable oversight of the OppenheimerFunds managers. It also means that outside funds in the program are monitored both by OppenheimerFunds and by PCA on a six month in arrears review process.

Mr. Henry noted that OppenheimerFunds has in place a detailed review process for each outside fund in the program that it sends out on an annual basis. Also OppenheimerFunds only recommends outside funds with good reputations.

Mr. Miller again noted that the Board relies on OppenheimerFunds' internal risk controls for OppenheimerFunds and on OppenheimerFunds' and PCA's reviews of publically available information for outside funds.

Ms. Ceserani then reviewed the watch list process for the benefit of the Board. She noted that PCA looks at rolling one-year and three-year periods versus an appropriate benchmark. Each fund has an allowable threshold of underperformance.

She noted that under the old investment structure prior to the re-launch there were five funds on watch list. Two of those funds are no longer in the program. The remaining three funds are the Oppenheimer Rising Dividend fund, the Oppenheimer Discovery Fund, and the Dreyfus Research Growth Fund. PCA's recommendation is that all three funds remain on the watch list although only the Rising Dividend Fund is currently underperforming.

She noted that against a group of peer dividend funds the fund was actually performing well. It was in the top decile of that peer group. Against the prospectus benchmark, however, the fund has underperformed.

PCA recommended that the other two funds remain on the watch list for a while longer to make sure that their performance improvement continues.

Two new funds are recommended for addition to the watch list -- The Oppenheimer Commodity Strategy Fund and the Oppenheimer Senior Floating Rate Fund. The first fund is recommended for inclusion on the list because of short-term underperformance. The second fund is recommended for inclusion on the list because of recent manager and analyst turnover.

Mr. Desiderio called for a motion to add the Commodity Strategy Fund and the Senior Floating Rate Fund to the watch list. Mr. Jansen so moved, and Mr. Jarmie seconded the motion. The motion was unanimously approved.

Ms. Ceserani then turned to the age-based funds with regard to industry median age-based funds. She also explained how performance is affected both in terms of stock selection and in terms of asset allocation.

She noted that the addition of two additional age-based structures to the program will increase the complexity of the reporting in coming quarters.

8) ADJOURNMENT

There being no further business to come before the Board, Mr. Desiderio called for a motion to adjourn. Mr. Jansen so moved. The motion was seconded by Mr. Jarmie. The vote to adjourn was unanimous. The meeting adjourned at 4:10 PM.