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FISCAL IMPACT REPORT

ORIGINAL DATE 02/10/13

SPONSOR Munoz LAST UPDATED _____ HB _____

SHORT TITLE Education Trust Act Administration SB 119

ANALYST Hartzler-Toon

APPROPRIATION (dollars in thousands)

Appropriation		Recurring or Nonrecurring	Fund Affected
FY13	FY14		
	NFI	N/A	N/A

(Parenthesis () Indicate Expenditure Decreases)

ESTIMATED ADDITIONAL OPERATING BUDGET IMPACT (dollars in thousands)

	FY13	FY14	FY15	3 Year Total Cost	Recurring or Nonrecurring	Fund Affected
Total		\$2,000.0	\$2,000.0	\$4,000.0	Recurring	Education Trust Fund

(Parenthesis () Indicate Expenditure Decreases)

Relates to Appropriation in General Appropriation Act, Higher Education Department

SOURCES OF INFORMATION

LFC Files

LCS Files, Investment and Pension Oversight Committee

Responses Received From

Education Trust Board (ETB)

State Investment Council (SIC)

SUMMARY

Synopsis of Bill

Senate Bill 119 (SB 119) would recompile sections of the Education Trust Act, transferring administrative responsibilities from the Education Trust Board (ETB) to the State Investment Council (SIC), and repeal the section establishing the ETB. The bill would take effect on July 1, 2013.

FISCAL IMPLICATIONS

Base on the ETB's proposed FY14 budget of \$1.6 million, all from other funds, and the SIC's projected operating costs of \$300 thousand, the projected fiscal impact for FY14 is \$2.0 million from revenues in the education trust fund.

Currently, the administrative functions of the ETB in administering the Education Trust Act require 1.5 FTE supporting a four-member board and overseeing \$1.4 million in contracts with investment and fund managers and legal counsel. These functions are paid solely with fees generated from investors in the state's two, college savings plans: The Education Plan and Scholar'sEdge.

The board has provided funds to support the Education Pathways Scholarship program administered by the Higher Education Department (HED). For FY13, this contribution totaled \$500 thousand, and the HED requested and the Executive and LFC recommendations for FY14 included a financial aid contribution at this same level. Should SB 119 be enacted, the SIC would have the discretion on whether to make the \$500 thousand contribution to the state's financial aid program from program fees.

SIGNIFICANT ISSUES

In 1997, the ETB was created pursuant to the Education Trust Act in Section 21-21K-1 through 21-21K-7 NMSA 1978. The ETB administers the education trust fund, which includes all funds received pursuant to college investment agreements as a part of the state's qualified tuition program that is authorized by Internal Revenue Code Section 529. Federally-authorized college savings plans are established to provide a flexible, convenient, and tax-efficient means to save for college costs. Account holdings can be used for tuition, fees, room, books, and supplies. Contributions by a New Mexico tax payer may be deducted from net income for New Mexico individual income tax purposes.

As of December 31, 2012, the ETB manages over \$2 billion in gross assets in two investment plans. The Education Plan has 28,356 accounts and \$376 million in investments. The Scholar'sEdge has 175,322 accounts and \$1.6 billion in investments. Although the majority of accounts and assets belong to out-of-state investors, approximately \$274 million (13 percent) of the plan's assets belong to New Mexico residents.

Within the last number of years, the ETB has experienced significant changes in administration and leadership. Prior to 2012, the board relied more heavily on its contract administrators and investment managers to manage the trust's assets. Market activities and fluctuations during the recession resulted in losses for many college savings plans, but New Mexico's plans were impacted more significantly. The ETB participated in a multi-state lawsuit against Oppenheimer Funds regarding investments in the Oppenheimer Core Bond Fund during 2008-2009. The lawsuit between the ETB and Oppenheimer Funds was settled and a \$67.3 million settlement fund distributed to eligible account holders. One remaining lawsuit, *Ping Lu, et al v. ETB*, stemming from these losses continues against the ETB and possibly the State of New Mexico.

Since 2012, the ETB has made significant progress to address its investment goals and strategies as it has hired a full-time executive director and the board has contracted with firms to guide investment strategies, assess plan weaknesses, and improve performance. Investment returns have improved.

Like SB 246 (50th Legislature, 2nd Session), SB 119 would eliminate the ETB and place administrative functions for the Education Trust Act under the SIC. The council manages investment pools for 17 governmental entities that have limited opportunities to alter allocations or buy/sell assets. The agency noted that it would have to “go outside its current ‘client services’ offerings” to manage the state’s 529 plans and serve the plans’ 200 thousand account holders. The agency reports that it would require at least an additional 3 FTE (a 10 percent increase) in addition to contracting with entities to manage the trust assets.

PERFORMANCE IMPLICATIONS

It is unclear whether changing the administration of the Education Trust Act will result in improved performance of the state’s 529 plans. Both the SIC and ETB noted the changes made by the ETB have expanded investment strategies and options during the last year. Both the SIC and the ETB report that, while concerns have been expressed with Oppenheimer Funds continuing to serve as fund manager, the administrative agency charged with overseeing the trust is unlikely to terminate Oppenheimer’s contract prior to the contract end date in 2015. There appear to be financial and other penalties for terminating the contract earlier.

ADMINISTRATIVE IMPLICATIONS

The SIC states that “with proper resources and personnel it would be able to take on the responsibility of managing the 529 [plans].” However, before assuming such responsibilities, the agency would require “exclusions in the law regarding prior legal liabilities” of the ETB. Under the SIC’s analysis, “any such liabilities associated with [the *Ping Lu* lawsuit] would endanger, at a minimum, SIC resources and budget, or potentially even the permanent funds.”

RELATIONSHIP

SB 119 relates to SB 332, a bill adding an additional governor-appointed board member to the ETB.

TECHNICAL ISSUES

SB 119 allows the SIC to “promulgate rules in order to establish a prepaid higher education tuition program.” This is a carry-over authority from the ETB under Section 21-21K-6 NMSA 1978. Under the ETB and since development of the state’s Legislative Lottery Scholarship Program, New Mexico has terminated its prepaid college tuition plan. Many states that had such plans are re-evaluating the state’s obligations to maintain them or terminate them. Higher education costs have outpaced investment earnings, requiring states to find other revenue sources to compensate for lower than estimated investment earnings and meet obligations to investors. Reviewers of SB 119 may seek to strike this provision from the Act as it does not affect existing 529 plans and maintains the state’s current policy of not sponsoring a prepaid tuition plan.

OTHER SUBSTANTIVE ISSUES

The Legislative Interim Investment and Pension Oversight Committee (IPOC) endorsed legislation to terminate the ETB and transfer administrative responsibilities for the Education Trust Act to the SIC. The IPOC heard from the ETB, its attorneys, and advisors during the 2012 interim. (See IPOC agenda and minutes, Nov. 28, 2012 and Dec. 17, 2012).

WHAT WILL BE THE CONSEQUENCES OF NOT ENACTING THIS BILL

The ETB will continue to function as administrator of the Education Trust Act.

THT/svb:blm