

**STATE OF HAWAII
DEFERRED COMPENSATION PLAN
BOARD OF TRUSTEES**

**OPEN SESSION MINUTES
MEETING # 425**

Date: August 10, 2018

Place: Department of Human Resources Development
14th Floor Merit Appeals Board Conference Room
235 South Beretania Street, State Office Tower
Honolulu, HI 96813

Present: Brian Moto, Chairperson
Ryker Wada, Ex-Officio Member
Ken Kitamura, Ex-Officio Member
Roderick Becker, Employee Member
Kalei Rapoza, Employee Member
Kalbert Young, Employee Member

Others: Krishna Jayaram, Deputy Attorney General
Cynthia Akiyoshi, DHRD Staff
Glenn Ezard, Segal Marco Advisors
Kevin Malmud, Plan Administrator Staff (Prudential)/Honolulu Office
Grace Baracao, Plan Administrator Staff (Prudential)/Honolulu Office
Jeanne Kanai, Plan Administrator Staff (Prudential)/Honolulu Office
Julie Klassen, Prudential Retirement
Carol Blumenthal, Prudential Retirement – via conference phone
Wendy Carter, Segal Marco Advisors – via conference call

Absent: Kenneth Villabrille, Employee Member

Call to Order: There being a quorum present, Chairperson Brian Moto called the meeting to order at 9:03 a.m.

Agenda: The agenda for this meeting was filed with the Office of the Lieutenant Governor, as required by Hawaii Revised Statutes section 92-7.

Chairperson Moto welcomed everyone and introduced the new incoming Board member, Trustee Kalbert Young, who is the Vice President for Budget & Finance at the University of Hawaii System. Trustee Young replaces Trustee Kanoe Margol whose term expired on June 30, 2018. A lei was presented to welcome Trustee Young to the Board. Introductions continued with the other Board members, Prudential staff and attendees participating via the conference line. He

noted that Trustee Villabrille is excused from today's meeting and stated that for the record there are no guests in attendance from the public.

Chairperson Moto moved to Agenda Item no. 1.b.

Agenda

Item # 1:

New Business

a. Introduction of New Incoming Board Trustee

This item was covered in the welcome.

b. Approval of Minutes No. 417-ES, and Minutes Nos. 424 and 424-ES

Chairperson Moto stated that the Minutes No. 424 is for the open session minutes for the June 28, 2018 meeting and Minutes Nos. 417-ES, 424-ES are the Executive Session minutes that were distributed separately.

A motion was made by Trustee Wada and seconded by Trustee Kitamura to adopt Minutes Nos. 417-ES, 424, and 424-ES, as presented. The motion passed unanimously.

Agenda

Item # 2:

Prudential Report on an Incorrect Crediting Rate within the Stable Value Fund Portion of the Nested LifeCycle Funds

Ms. Klassen reported that the Prudential team discovered an error in the crediting rate that was being applied to the Stable Value portion of the custom LifeCycle vintages, and which is in the process of being corrected.

The error on crediting rate impacted the Stable Value Fund portion of the LifeCycle vintages which began in July 2013, at the time of the transition to Prudential. The error was due to administrative reasons in that the crediting rate remained unchanged at 2.89% in the custom LifeCycle vintages since the transition. Most of the affected participants were over credited and these participants will keep the amounts. Prudential has advised INVESCO of the error. There were 269 of the 333 participants who were owed less than \$1.00. Ms. Klassen stated that the information is being reported for information.

Agenda

Item # 3:

Discussion on Proposed Legislative Initiatives and Potential Action Thereon, including but not limited to:

- a. Automatic Enrollment
- b. Roth 457 Option

Mr. Ezard presented an overview of the two initiatives that are being considered to improve the Plan and which would require action by the Legislature. He stated that these initiatives were covered in Segal's deep dive analysis presented at prior meetings and are initiatives that have been discussed by other plans. The goals of the initiatives are to ensure retirees have enough income in retirement. To get there, plans need to look at whether employees are contributing enough and whether the investments are invested properly to ensure sufficient earnings. Other reasons to consider is the long life expectancy in Hawaii and how long the monies will last through retirement.

Mr. Ezard explained the impediments to a secure retirement. He noted that the BEA (U.S. Bureau of Economic Analysis) survey indicates that Hawaii has the highest cost of living relative to other states; and the U.S. Census indicates that Hawaii has the longest life expectancy. These challenges with other factors such as the low interest rates over the past ten years and indecision and procrastination by employees, have been challenges to reaching a secure retirement compared to other states.

Mr. Ezard reviewed the Plan's statistics:

- The Plan's participation rate is 28% which includes the DOE and the UH, so there is room for improvement.
- An average contribution rate within the Plan of 10% is strong and is a good and favorable indicator in comparison to other plans. The average account balance is \$84,641 which compares favorably with other plans. He noted that automatic enrollment would change these statistics.
- 13.3% of the participants are invested through using asset allocation tools (e.g., LifeCycle portfolios and GoalMaker) to get the right risk-adjusted returns.

Mr. Ezard discussed proposed enhancements to help the program:

- The Roth option would allow after tax contributions into the Plan.
- Automatic enrollment would increase participation and bring more employees into the Plan. New employees would be mandatorily enrolled into the Plan with an option to opt out of the Plan.
- The Roth option provides more diversification among tax rate positions; is exempt from required minimum distribution rules and allows assets to be pushed out further; requires a 5-year holding period; requires amendments to the statutes as the law currently is limited to pre-tax deferrals; and is already covered under the TPA agreement with Prudential.

Ms. Carter provided an overview of the Roth option features:

- The reason for increased recognition is due to the millennials who feel that the tax rate could go higher so having an after tax portion would be a more prudent thing to do.
- Seeing more plan sponsors adding this option, as reflected in the NAGDCA survey. 65% of government 457 plans have both options.
- The Roth IRA is an individual personal investment.
- The Roth 457 option is after tax deferrals into the Plan. Individuals are able to withdraw their earnings tax-free, if held for 5 years after the first contributions into the Plan.
- The pros of the option are that the features are attractive to younger employees, including the ability to make higher contributions than with a Roth IRA.
- The cons are the plans have seen only a 5% usage of this option.
- Many plans have limitation problems within their payroll systems.
- In-plan conversions have been rare.
- The maximum limits in the plan are combined; since the Roth 457 limits will be higher, this option would have an advantage over the 403(b) plans since the 403(b) plans do not have a Roth option.

Ms. Klassen added that the current rules for the Roth 457 still state that the RMD requirements still apply, but that changes to this are in process. NAGDCA has been lobbying for the changes. And, for automatic enrollment, Prudential has already anticipated this initiative, but would require an eligible file of all participants if this option is implemented.

Mr. Malmud stated that he has seen a high interest from the younger participants for a Roth option; however, payroll would need to have the capability to identify pre-tax deductions versus after-tax deductions.

DAG Jayaram presented for the Board's review draft amendments to the statute and added that other amendments would also be needed to the Administrative Rules and to the Plan Document.

Mr. Ezard added that he is aware of the appeal by the younger population who feel that the tax rate is going up. Mr. Malmud added that the younger population feel that they are in a lower tax bracket now and most of growth of the investment will be tax-free earnings at the end which is appealing.

Trustee Young noted he is aware that there is a fair amount of interest in the Roth IRA, and therefore escaping the RMD requirements via the Roth 457 would be advantageous. Chairperson Moto added that two participants had submitted written letters encouraging the Board to add a Roth option within the Plan.

DAG Jayaram clarified that the deletion in the drafted amendment would not take away the option to offer pre-tax contributions. The Administrative Rules would provide added specifics on adding the option.

Trustee Becker stated that he suggests that the Board move forward with the legislative bill and suggests adding more prescriptive language to relate the topic to the Roth option for the Deferred Compensation Plan. Trustee Young asked that if the language could even more specific to the Roth option.

A motion was made by Trustee Becker and seconded by Trustee Young to approve the drafted amendments to add a Roth 457 option for inclusion in the legislative packet to be submitted to the Legislature, with noted added language changes. The motion passed unanimously.

There were no objections to sending the updated version through to the Chairperson for submittal to DHRD.

Mr. Ezard provided an overview on automatic enrollment:

- Automatic enrollment would automatically enroll employees into the Plan with ability to opt out;
- Because younger employees do not think about retirement, the provision would remove inertia by employees;
- Some considerations would include:
 - New hires from an effective date; or re-enroll employees.
 - Because the Plan is voluntary, employees would need to make a selection on their investments. Automatic enrollment would need a Qualified Default Investment Alternative option.
 - If there is no defined benefit plan, the contribution rate usually would be between 5-6%.
 - With a defined benefit plan, the rate typically is lower, like a contribution rate of 1%, or at least setting a dollar amount level.
 - The feature would require statute amendments or even through a collective bargaining agreement.
 - Some discussion with affected stakeholders would be needed since pay is impacted.
 - The capabilities are included in the TPA service agreement with Prudential.
 - During the opt out period, the defaulted investments would be held in a cash account or a short term fixed income account until the assets are moved into specific investments, so there is no risk of loss.
 - The con is that the average account balance for this Plan will drop.

Ms. Carter provided additional remarks:

- This feature started with employers whose lower paid employees didn't have retirement savings, so there was an emphasis on the private sector side to start creating retirement savings options for their employees. Now, 60% of private sector 401(k) plans have automatic enrollment.
- Surveys have shown that for plans who have adopted automatic enrollment, those plans have seen 80-90% of the employees accept the automatic contributions.
- Some government plans did not adopt automatic enrollment because of anti-garnishment laws; see some plans, like the city of Los Angeles which is heavily unionized, is putting it through collective bargaining.
- Plans who have adopted automatic enrollment, like the South Dakota plan, has had 94% of those automatically enrolled stay enrolled in the program.
- There are some administrative complexities.

Ms. Klassen provided the following comments:

- The capabilities are already covered in the TPA service agreement.
- Automatic enrollment and auto-escalation generally go hand-in-hand. Auto-escalation generally works better with a percentage contribution rather than on a dollar contribution basis.
- Could see potential impacts from an ERS perspective, since these plans are viewed as supplemental voluntary plans. If it becomes a mandatory contribution, potential questions as to if it complements the defined benefit side or whether it impacts the defined benefit side.
- Possible consideration is to do automatic enrollment on a bargaining unit basis rather than all employees.

Mr. Malmud added that he had a brief discussion with Senator Kalani English during a benefits informational session, and Senator English commented that automatic enrollment was a potentially good idea; however, the idea was not widely accepted because it was a relatively new concept, there were no statistics on utilization by plans, and there were concerns about an auto-escalation feature. Senator English felt that a nominal dollar amount may be more successful in getting a bill passed.

Chairperson Moto remarked that this matter would require some groundwork and talks with stakeholders to determine if there is sufficient support, test the waters and learn what would succeed.

The Board also discussed possible methods on implementing automatic enrollment through statutory changes or through collective bargaining agreements from a management perspective, and potential concerns. Trustee Wada commented that going through collective bargaining might not be good timing because of the recent Supreme Court ruling in the Janus decision. He will check if the Governor is open to discussion and report back at a future meeting.

With regards to enrollment efforts, Mr. Malmud remarked that efforts are being made by Prudential to reach those eligible employees who are not currently participating through an email blast campaign, and the Lunch-n-Learn workshops currently being held. However, although these efforts help, it does not produce the same results as with an automatic enrollment feature. This feature would require having access to the demographic information for all eligible employees and would increase the capability to reach out and educate all employees on the Plan. Trustees Rapoza and Wada explained that when employee information is requested, put together, and then released to one entity to do mailings it becomes a public record and they would have to make the information available to other entities requesting to do the same. Ms. Blumenthal remarked that with corporate plans, most employees who are automatically enrolled stay in the plan due to inertia. It was also observed that employees generally do not increase their deferrals without an auto-escalation feature because of inertia.

Chairperson Moto asked for a revised version of the statutory changes for the addition of a Roth option, which will go through the Board Chairperson to DHRD for transmission to the Governor.

Trustee Young added that if a proposal is introduced, to include him on the roster as a delegated representative of the Board to testify or if there any questions; the Board would submit testimony through the Chairperson.

Agenda

Item # 4:

Discussion on Plan's Budget Report and Proposed Establishment of a New DHRD Staff Position for the Plan and Potential Action Thereon

- a. Sub-Committee Report on the Plan Budget and Expense Account
- b. Proposed Funding for a New Position

Trustee Kitamura reviewed a spreadsheet that has been prepared which reflects a snapshot of the Plan Expense Account budget. The report shows the cash balance amount of \$1.2 million, revenue allocation amounts for the contractual items under Prudential's contract which total \$435,000 per year, month-to-month expenses during FY 2017-2018, the total expenses for the fiscal year, the net carryover balance amount of approximately \$60,000 for the fiscal year. The excess amount could be used to fund other initiatives including the funding of another staff position. The current budget does not reflect the ability to fund a position on an indefinite basis. The recommendation is for the Board to look at creating meaningful line items to track and conducting an annual review of the priority items.

Ms. Akiyoshi explained the purpose of the communications budget which is to promote the Plan, including the communication expenses related to the transition of the TPA, benefits fairs, and written communication materials.

Trustee Kitamura explained that DAG Jayaram conducted a survey of plans on staffing resources based on similar responsibilities. Trustee Kitamura also stated that he has looked at the workload assignments, the types of positions within the Human Resources series, and the corresponding salary schedule. The amount to be budgeted for would depend on the level of the position at recruitment. For example, if the position were to be filled in the same class (e.g., Human Resources Specialist) at a HRS IV entry level, the salary plus fringe would be \$84,729 in continuing costs. The budget could carry the funding for a while; however, the Board would need to look at budget resources thereafter.

Ms. Carter presented information on a survey conducted by California on various plans. The survey provides a breakdown of costs amongst the plans in operating the plan. Hawaii has the highest plan costs but is in the bottom four of the twenty-one plans for internal costs for overseeing the program. In working with plans, the suggestion is for the plan of this size to allocate two FTE positions, and feels this Plan is understaffed.

In discussing the amount of work that is needed for the Plan, Chairperson Moto remarked that the Island Savings Plan is a great Plan; however, there is a lot more work that can be done. The Plan is a mature plan with challenges of a heavy concentration of an older workforce, stagnant workforce and modest pay raises, resulting in participation rate being stagnant. In a few years, many baby boomers will likely start withdrawing monies heavily from the Plan for health care reasons. Administering the Plan takes a lot of time, and therefore, the Plan will need more staff resources to make significant progress.

As an alternative to the Plan funding another position, Trustee Wada remarked that DHRD is looking to go in for additional positions in the next session. He noted that he would look internally at positions that could be made available for support but added that the department is already running pretty lean on positions.

Mr. Malmud commented that on a day-to-day operational basis, this Plan has a lot more manual processes, such as the vacation payout program which has generated additional work for Ms. Akiyoshi.

A motion was made by Trustee Rapoza and seconded by Trustee Wada to seek another FTE position for the Plan.

Discussion: Trustee Becker stated that the justification for the additional position should be well thought through to address the Plan's needs. Trustee Kitamura added that there should not be a negative budget reflected or a show a deficit in

the budget, and there are reasons for the reserves that has accumulated over the years. Funding the position through the Plan and outside the State treasury should be attractive to the Legislature. The reasons should be clear that there is a plan for the allocated resources.

The motion passed unanimously.

Trustee Kitamura stated that in tracking and monitoring the expenditures, the Board would then be able to formulate at budget plan for FY 2020 with the initiatives to support the budget.

Trustee Becker commented that the justification should focus on what the Board expects to accomplish with the additional staffing and its commitments to achieving intended goals, rather than a comparison to other plans.

Agenda

Item # 5: PTS Plan

- a. Approval of Report on Funds Not Deposited in the State/County Treasuries for the Period Ending June 30, 2018
- b. Quarterly Management Report for Period Ending June 30, 2018

Ms. Akiyoshi presented the Report on Funds Not Deposited in the State/County Treasuries for the period ending June 30, 2018, which includes the State and the County of Kauai's contributions, for the Board's action. The report for the Quarterly Management report for this same period has been reconciled against the Report on Funds and is presented for the Board's information.

A motion was made by Trustee Rapoza and seconded by Trustee Becker to accept the Report on Funds for the period ending June 30, 2018, with the noted corrections to the footnote. The motion passed unanimously.

Agenda

Item # 6: Other Business/Announcements

- a. Schedule of Upcoming Board Meetings and Events

Ms. Akiyoshi stated that the next Board meeting is scheduled for September 7, 2018, followed by the Semi-Annual meeting on October 22, 2018 on Maui, and the Benefits Fair on October 23, 2018, on Maui.

- b. Leadership Award Presentation to the Plan at the 2018 NAGDCA Conference

Ms. Akiyoshi reported that NAGDCA sent an email notification that the Board will receive and be presented with an award for one of the categories, Technology and Social Media. The award nomination was submitted for the custom website redesign, which was spearheaded by Trustees Rapoza and Villabrille. The focus was on the use of technology and digital enhancements, such as improving account access, incorporating tablet functionality and the use of a digital morphing program at the Benefits Fair to produce the education for the Plan.

Agenda

Item # 7: Review of How the Plan Procures Investment Product Options for Its Participants

DAG Jayaram provided a review of the Board's decision to move away from the Chapter 103-D process for how the Board procures the investment product options. The Board's instructions were to look at best industry practices and will be looking to gather more information at the upcoming NAGDCA conference by speaking with other government entities before coming up with a proposal on an established competitive bidding process for the Board's consideration.

Chairperson Moto proceeded to Agenda item #8 and stated that the Board will move into Executive Session to confer with our Deputy Attorney General on the Board's powers, duties, privileges, immunities, and liabilities with respect to the Board's options on the extension of the contract agreement with State Street Global Advisors.

A motion was made by Trustee Rapoza and seconded by Trustee Wada to move into Executive Session at 11:23 a.m. to confer with the Plan's legal counsel and to deliberate or make a decision upon a matter that requires the consideration of information that must be kept confidential pursuant to a state or federal law, pursuant to HRS §§ 92-5(a)(8), 103D-105, and 103D-303. The motion passed unanimously.

EXECUTIVE SESSION

All guests were excused, except for Segal Marco Advisors.

Meeting

Reconvened: **A motion was made by Trustee Young and seconded by Trustee Rapoza to move out of Executive Session at 11:37 a.m. The motion passed unanimously.**

All guests rejoined the meeting.

There was no other business. Chairperson Moto thanked everyone for attending today's meeting.

A motion was made by Trustee Becker and seconded by Trustee Rapoza to adjourn the meeting at 11:38 a.m. The motion passed unanimously.

(NOTE: Signed copy on file.)